

Credit Opinion: Sparebanken Nord-Norge

Sparebanken Nord-Norge

Tromsø, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aa3/P-1
Bank Financial Strength	C+
Senior Unsecured	Aa3
Subordinate	A1
Jr Subordinate MTN	A1
Preferred Stock	A2

Contacts

Analyst	Phone
Kimmo Rama/London	44.20.7772.5454
Janne Thomsen/London	
Adel Satel/London	

Key Indicators

Sparebanken Nord-Norge

	[1]2007	2006	2005	2004	2003	5-Year Avg.
Total assets (NOK billion)	58.46	54.90	48.63	42.26	40.89	[2]9.25
Total assets (EUR billion)	7.33	6.69	6.09	5.13	4.87	--
Total capital (NOK billion)	5.05	4.76	4.24	3.71	3.86	[2]8.78
Return on average assets	1.28	1.45	1.23	0.97	0.54	0.87
Recurring earnings power [3]	1.65	1.46	1.55	1.70	1.52	1.55
Net interest margin	2.19	2.29	2.49	2.74	2.72	2.64
Cost/income ratio (%)	50.11	54.20	55.44	53.00	57.65	55.73
Problem loans % gross loans	1.33	1.22	2.27	2.60	3.11	2.48
Tier 1 ratio (%)	9.27	10.10	9.60	9.96	9.03	9.31

[1] As of June 30. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a Bank Financial Strength Rating (BFSR) of C+ to Sparebanken Nord-Norge (SNN), which translates into a Baseline Risk Assessment of A2. The BFSR reflects SNN's (i) leading position in both corporate and retail banking in its operating region in northern Norway; (ii) improving financial fundamentals; and (iii) the benefits of being part of the SpareBank 1 Alliance. Its competitive advantages consist of extensive local knowledge and a good product range.

SNN benefits from being part of the SpareBank 1 Alliance, created in 1996, which has provided member banks with a stronger brand, more sophisticated products provided by SpareBank 1 Group and cost synergies. Although the member banks have retained their local brandings, they continue to learn from each other's best practices. The successful restructuring of the SpareBank 1 Alliance has become a strong positive contributor to its owners' financials.

The Aa3 Global Local Currency Deposit Rating of SNN incorporate three elements: (1) the bank's BFSR of C+

(Baseline Risk Assessment of A2), (2) low support and high dependence from SpareBank 1 Alliance (3) Moody's assessment of a very high probability of systemic support from Norway. Consequently, SNN benefit from a two notch uplift from its Baseline Risk Assessment.

Credit Strengths

- Strong regional market position and brand recognition in northern Norway
- Strategic alliance with other Norwegian savings banks aids efficiency, product offering, staff and management quality and IT through shared operations and active benchmarking
- Comprehensive and improving risk management practices and systems, which have lowered the risk profile
- Sound capitalisation provides support for growth targets

Credit Challenges

- Future top-line profit growth given intense competition and pressure on net interest margins
- Liquidity remains tight by international standards

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Given the recent upgrade (April 2007), a further positive rating action on the BFSR is unlikely in the short term. In the medium term an upgrade of the financial strength rating would likely require an improvement in the bank's risk profile, in particular a reduction of loan concentration, and/or further improvement of the bank's asset quality.

SNN's Global Local Currency Rating may be upgraded if a) the bank's BFSR is upgraded, b) the support coming from the coop group is substantially increased, and/or c) systemic support is increased.

What Could Change the Rating - Down

SNN's BFSR could be negatively affected by any deterioration in the liquidity level or risk profile at the bank or product companies, although such a development is unlikely given current strategy.

SNN's Global Local Currency Deposit Rating would be downgraded in case that a) the BFSR is downgraded, and/or b) in the unlikely case of a decline in Moody's view of the probability of systemic support for the bank.

Recent Results and Developments

Sparebanken Nord-Norge's core banking operations continued solid performance in Q3 2007. Net interest income increased by 5% from Q2 2007 due to higher lending volumes whereas the interest margin has remained rather stable so far this year. Net fee and commission income developed also favourably by increasing 8% from Q2 2007. Due to unrealised losses in securities holdings net profit deteriorated from the previous quarter as well as from Q3 2006 and was NOK137 million. The contribution of SpareBank 1 Group continues to be positive representing over 10% of the bank's operating profit in Q3 2007. Due to lower income the cost-to-income ratio rose to 52%. Despite over 10% lending growth in recent times, the asset quality so far has remained good. The bank's Tier 1 ratio was 8.0%. Economic environment in Norway has developed favourably which has supported the banking sector. The economic growth is however expected to slow down and near-term domestic risks are linked to shortage of labour which could feed into inflation and higher interest rates. We also note that competition in financial services remains intense.

DETAILED RATING CONSIDERATIONS

Detailed considerations for SNN currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a C+ Bank Financial Strength Rating to Sparebanken Nord-Norge. We believe that C+ is an appropriate measure of the bank's current financial strength given the trends of the past three years. The key positive drivers behind the assigned rating are the benign regulatory and operating environments in Norway. The key negative drivers behind SNN's assigned rating are quantitative factors, particularly the modest asset quality

ratios. The assigned rating is in line with Moody's bank financial strength scorecard.

Qualitative Factors (50% weighting)

Factor 1: Franchise Value

Trend: Neutral

SNN has a solid, defensible footprint in northern Norway, characterised by a loyal customer base, high market shares and stable earnings. We believe that SNN will be able to maintain a leading position in the region due to close client contact, a good product offering and its ability to respond to the specific demands of the market. Nevertheless, the bank operates in a limited geographic area, which brings the score for franchise to a C+.

Factor 2: Risk Positioning

Trend: Improving

The management practices and systems in SNN provide a comprehensive basis for measured risk-taking, a conservative framework which has permeated the organisation. However, operating in - and being supportive to - its small operating region means that the bank has relatively large customer exposures when compared to its European peers. This pushes the overall score on risk positioning down to a C. Moody's notes that a significant portion of these exposures are of very good quality.

Factor 3: Regulatory Environment

Trend: Neutral

All Norwegian banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. The regulatory environment for Norway is solid as the country, despite not being part of EU, complies with all EU practices. The supervisor actively benchmarks the Norwegian banks.

Factor 4: Operating Environment

Trend: Improving

The adjusted score for Norway's operating environment is A-. In our opinion mainland GDP should be a better proxy for economic stability because of the segregation of oil income from the public finances that has been in place for the last decade. Regarding the time horizon, we also think that the last 5 year standard deviation would be a better indicator due to the material changes in economic policies after the crisis of the early 1990's. These two factors considered together lead to an A- adjusted operating environment score.

Quantitative Factors (50% weighting)

Factor 5: Profitability

Trend: Improving

In our final ratings, we have taken into account the improving profitability of Sparebanken Nord-Norge. We expect SNN will be able to sustain the current level of profitability going forward due to cost containment, focus on cross-selling, good asset quality and the contribution from SpareBank 1 Group. The C+ profitability score is based on a three-year average.

Factor 6: Liquidity

Trend: Improving

We note that liquidity is structurally tight in Norway but is to a degree balanced by good liquidity management. In addition, we note that SNN intends to issue covered bonds jointly with other members of the SpareBank 1 Alliance. This should have a positive effect on the liquidity score even in the short term, which we have taken into account in the adjustments. The D+ score in liquidity is broadly in line with other Norwegian banks.

Factor 7: Capital Adequacy

Trend: Neutral

SNN's solid capital adequacy compares well to its peer group and remains a positive ratings factor, which is reflected in the B+ score.

Factor 8: Efficiency

Trend: Neutral

In a competitive market such as Norway, we continue to see efficiency as key for the financial flexibility of the institution. The bank's efficiency score is B, which we perceive to be a reflection of SNN's focus on the ongoing cost effective programmes.

Factor 9: Asset Quality

Trend: Improving

The asset quality ratios of SNN are improving which can be attributed to the thriving Norwegian economy. With risk management now improved, we regard the positive trend to be reflective of the bank's situation.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency deposit rating of Aa3 for Sparebanken Nord-Norge. The rating is supported by SNN's A2 Baseline Risk Assessment and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of SNN'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, SNN also benefits from a low probability of support from the SpareBank 1 Alliance. Finally, the dependence between SNN and SpareBank 1 Alliance is high due to the substantial degree of integration and shared business lines between the two.

Notching Considerations

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

Foreign Currency Deposit Rating

Foreign Currency ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken Nord-Norge's foreign currency deposit rating is Aa3.

Foreign Currency Debt Rating

Foreign Currency ratings are unconstrained given that Norway has a country ceiling of Aaa. Sparebanken Nord-Norge's senior unsecured foreign currency debt rating is Aa3.

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 Risk 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

Sparebanken Nord-Norge

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C+	
Factor 1: Franchise Value (20%)						C+	Neutral
Market Share and Sustainability	x						
Geographical Diversification					x		
Earnings Stability		x					
Earnings Diversification [2]							
Factor 2: Risk Positioning (20%)						C	Improving
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 3: Regulatory Environment (5%)	-	-	-	-	-	-	Neutral
Factor 4: Operating Environment (5%)						B+	Improving
Economic Stability			x				
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C	
Factor 5: Profitability (7.9%)						C+	Improving
PPP % Avg RWA			2.34%				
Net Income % Avg RWA		1.81%					
Factor 6: Liquidity (7.9%)						D+	Improving
(Mkt funds-Liquid Assets) % Total Assets					27.99%		
Liquidity Management			x				
Factor 7: Capital Adequacy (7.9%)						B+	Neutral
Tier 1 ratio (%)		9.89%					
Tangible Common Equity % RWA	9.28%						
Factor 8: Efficiency (3.5%)						B	Neutral
Cost/income ratio		54.21%					
Factor 9: Asset Quality (7.9%)						C	Improving
Problem Loans % Gross Loans			2.03%				
Problem Loans % (Equity + LLR)			24.57%				
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						Neutral	
Total Scorecard Implied BFSR						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

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