

SpareBank 1 Østfold Akershus

Rating Update

**NCR REVISES OUTLOOK ON SPAREBANK 1 ØSTFOLD
AKERSHUS TO NEGATIVE; 'A' LONG-TERM RATING AFFIRMED**

Today Nordic Credit Rating (NCR) affirmed its 'A' long-term issuer rating on SpareBank 1 Østfold Akershus (Østfold Akershus) and revised its outlook on the rating to negative from stable. NCR also affirmed its 'N-1+' short-term rating on the bank.

MACROECONOMIC UNCERTAINTY IS VERY HIGH

NCR has lowered its assessment of the Norwegian banking sector to 'a-' from 'a' due to the economic effects of the COVID-19 pandemic. In addition, NCR views the outlook for the domestic operating environment as negative given the abrupt reduction in economic activity and the uncertain prospects and timeline for an economic recovery. We note that many companies have elected to furlough employees using a government-supported programme which reduces costs for employers and maintains up to 80% of employees' wages. However, there was a significant rise in unemployment during the last weeks of March and we believe there will be long-term challenges for many sectors given varying degrees of economic shut down for Norway's neighbours and global trading partners and lower oil prices. Initially, the government's efforts to support the severe macroeconomic disruption could be effective, however, we believe that maintaining stability, especially in terms of bank earnings and credit losses, will become increasingly difficult the longer economic activity remains subdued.

We have also lowered our assessment of Østfold Akershus's operating region, which relies heavily on industrial jobs and logistics, by one notch to 'a-' from 'a'. Industrial activity in the region is likely to be negatively impacted by the pandemic. However, activity levels in the oil sector are less likely to have a negative effect and weaker NOK means lower trade leak to Sweden, which has been a problem for retailers in the region.

We believe that the competitive position of Norway's savings banks has improved and that the current crisis will help boost their market shares at the expense of larger Nordic banks. Last year, we cut the competitive position subfactor score in our rating on Østfold Akershus due to loss of market share to Danske Bank, but we believe that the situation has now been reversed. We note that the bank's capital situation significantly improved from the third to the fourth quarter of 2019, and that the board of directors has reduced the 2019 dividend. In view of a lower countercyclical buffer requirement, we think it prudent to increase Østfold Akershus's capital assessment by one notch.

Østfold Akershus is mainly funded by deposits and has one bond maturity in 2020 (13 May) with NOK 132m remaining due. In general, we believe that the Norwegian banking sector will have ample funding, with the help of short-term credit from the central bank and long-term funding support from the Norwegian government's bond fund.

Our main concerns are increased credit risk and loan losses, particularly in the corporate sector. On the basis of experience from the domestic banking crisis in the early 1990s and the more recent global financial crisis, we see low risk for large losses from mortgage loans despite increasing unemployment. Mortgage loans account for close to three-quarters of Østfold Akershus's loan book and the bank has no direct or indirect exposure to the oil industry. However, 15% of the loan book is to commercial real estate and 5% to the construction sector, which historically have been high risk sectors in major recessions. While we expect government support packages to have substantial effects, we still see a one-notch reduction in the bank's score for loan losses as prudent.

LONG-TERM RATING

A

OUTLOOK

Negative

SHORT-TERM RATING

N-1+

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We will continue to monitor Østfold Akershus's interest margins. A decline of 15 bps in its net interest margin would bring profitability below the threshold for an 'aa' score which could trigger a downgrade of the bank.

NEGATIVE OUTLOOK

The negative outlook reflects our view that Østfold Akershus and its Norwegian banking peers face an uncertain future on many fronts which could primarily affect our view of the bank's operating environment, earnings potential, and longer-term loss performance. In a severe economic downturn, loss reserves could even put pressure on the bank's capital position, collateral coverage, and other aspects of its operations. The outlook could be revised to stable if the government's efforts to support the economy are effective and there are clear signs of an economic recovery.

Our full analysis of SpareBank 1 Østfold Akershus, published 11 Nov. 2019, is available at:

<https://nordiccreditrating.com/issuer/sparebank-1-ostfold-akershus>

POTENTIAL POSITIVE RATING DRIVERS

- An upgrade is unlikely at this time given the current state of the regional economy and uncertain timeline for returning to normal operating conditions.

POTENTIAL NEGATIVE RATING DRIVERS

- Long-term economic recession in the region, affecting economic activity and employment.
- Lower asset quality metrics and credit losses impacting capitalisation
- Margin pressure due to lower spreads and higher level of non-performing loans

Figure 1. Scoring summary sheet

Subfactors	Impact	Score
National factors	10.0%	a-
Regional, cross border, sector	10.0%	a-
Operating environment	20.0%	a-
Capital	17.5%	a+
Funding and liquidity	15.0%	a
Risk governance	5.0%	a-
Credit risk	10.0%	bbb+
Market risk	-	-
Other risks	2.5%	a
Risk appetite	50.0%	a
Market position	15.0%	bbb+
Earnings	7.5%	aa
Loss performance	7.5%	a
Performance indicators	15.0%	a+
Indicative credit assessment		a
Peer comparisons		Neutral
Transitions		Neutral
Borderline assessments		Neutral
Stand-alone credit assessment		a
Support analysis		Neutral
Material credit enhancement		Neutral
Rating caps		Neutral
Issuer rating		A
Outlook		Negative
Short-term rating		N-1+

Figure 2: Capital structure ratings

Seniority	Rating
Senior unsecured	A
Senior non-preferred	A
Tier 2	A-
Additional Tier 1	BBB

Type of credit rating:	Long-term issuer credit rating Short-term issuer credit rating Issue credit rating
Publication date:	The rating was first published on 28 Nov. 2018.
Office responsible for the credit rating:	Nordic Credit Rating AS (NCR), Oslo, Norway. NCR is a registered credit rating agency under Regulation (EC) No 1060/2009.
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Methodology used when determining the credit rating:	NCR's Financial Institutions Rating Methodology published on 14 Aug. 2018 NCR's Rating Principles published on 16 Sep. 2019 The methodology and principles documents provide analytical guidance to NCR's rating activities including but not limited to, assumptions, parameters, cash flow analysis, and stress-testing. NCR's methodologies and principles can be found on our website nordiccreditrating.com/governance/policies . The historical default rates of entities and securities rated by NCR will be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA) .
Materials used when determining the credit rating:	Annual- and quarterly reports of the rated entity, Data provided by external data providers, External market reports, Press reports/public information, Website of rated entity
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Ancillary services provided:	No ancillary services were provided.
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