

Rating Action: Moody's upgrades Sparebanken Oest's long-term deposit ratings to A2 from A3

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London, 04 October 2017 -- Moody's Investors Service, ("Moody's") has today upgraded Sparebanken Oest's long-term deposit and issuer ratings to A2 from A3. Moody's also upgraded the bank's long-term counterparty risk assessment (CRA) to A1(cr) from A2(cr) and maintained the stable outlook on all ratings. The rating upgrades are driven by an upgrade in the bank's standalone baseline credit assessment (BCA) and adjusted BCA to baa1 from baa2, reflecting the bank's strengthened asset quality, increased coverage of problem loans as well as its better than peers capital buffers.

The full list of the affected ratings can be found at the end of this press release

RATINGS RATIONALE

-UPGRADE OF THE BCA

The upgrade of Sparebanken Oest's BCA to baa1 from baa2 reflects its strengthened asset quality, increased coverage of problem loans in line with similar rated peers as well as its significantly better than peers capitalization, despite the challenging economic conditions in Norway over the last two years. The rating action also takes into account Moody's expectation that Sparebanken Oest's asset quality and profitability will remain resilient in the foreseeable future with comfortable capital buffers benefiting from a gradually recovering operating environment.

Moody's expect Sparebanken Oest's asset quality to remain strong in the next twelve months, supported by the increased granularity in the bank's loan book and decreased single name concentrations stemming from its high allocation to mortgages, a market segment with low delinquencies and losses historically. Over the past years Sparebanken Oest has actively focused on retail lending and reduced considerably the size of its corporate book to 13% at end June 2017 from 24% of gross loans in December 2011. The bank's problem loans as a percentage of gross loans declined to 0.6% at end-June 2017 from 1.5% at end-2014, and compares favorably to similar rated Norwegian peers, while its problem loan coverage ratio increased to 62% at end-June from below 30% in 2013.

Moody's expects the bank to use excess capital to finance future growth, while maintaining a strong capital position. The bank's capital buffers have improved over the past years and compare favorably with domestic peers. As of June 2017 Sparebanken Oest's Common Equity Tier 1 capital (CET1) ratio was at 17.6% already above the regulatory requirement of 13.8%, which includes a bank specific Pillar 2 requirement of 2.3%. The bank's leverage ratio stands at a high 9.3%.

RATIONALE FOR THE UPGRADE OF DEPOSIT AND ISSUER RATINGS

The upgrade of Sparebanken Oest's long-term deposit and issuer ratings to A2 from A3 reflects the upgrade of the BCA and Adjusted BCA to baa1 from baa2 previously as well as the unchanged assumptions on Moody's Advanced Loss Given Failure (LGF) analysis.

Taking account of the group's consolidated balance sheet structure at end-June 2017 and its near-term funding plan, Moody's Advanced LGF analysis indicates that Sparebanken Oest's deposits are likely to face very low loss-given-failure, due to the loss absorption provided by subordinated debt and, potentially, by senior unsecured debt should deposits be treated preferentially in a resolution, as well as the substantial volume of deposits and senior debt themselves. This results in two notches uplift.

Moody's assumption of a low probability of government support for Sparebanken Oest's issuer and deposits ratings provide no further uplift, leading to long-term deposit ratings of A2 and long-term issuer ratings of A2.

RATIONALE FOR THE CR ASSESSMENT

As part of today's action, Moody's also upgraded Sparebanken Oest's long-term CR Assessment to A1(cr)

from A2(cr), and affirmed the short-term CR Assessment at P-1(cr). The CR Assessment is driven by the banks' standalone assessment based on the substantial cushion against default provided to the senior obligations represented by subordinated instruments, accounting for three notches of uplift relative to the BCA.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Upward rating pressure could develop from significant improvements in the bank's financial performance, including: (1) strong earnings generation without an increase in its risk profile or worsening in its business development (2) sustained good asset quality in its retail and corporate books and a decline in sector/single borrower concentration while maintaining adequate cash coverage of problem loans (3) continued access to the debt markets without significant changes in pricing;

Downward rating pressure could arise from: (1) Sparebanken Oest's risk profile increases as a result of increased concentration, for example if construction and real-estate concentration or top-20 client concentration as a percent of Core Tier 1 Capital exceeds 150% or if the problem loan ratio increases above market system wide expectation of approximately 2%; (2) any indication that the improvements achieved in recent years are not sustainable; (3) financing conditions become more difficult

LIST OF AFFECTED RATINGS

Issuer: Sparebanken Oest

Upgrades:

...LT Issuer Ratings, Upgraded to A2 from A3, Outlook Remains Stable

...LT Bank Deposits, Upgraded to A2 from A3, Outlook Remains Stable

...ST Bank Deposits, Upgraded to P-1 from P-2

...Adjusted Baseline Credit Assessment, Upgraded to baa1 from baa2

...Baseline Credit Assessment, Upgraded to baa1 from baa2

...LT Counterparty Risk Assessment, Upgraded to A1(cr) from A2(cr)

Affirmations:

...ST Counterparty Risk Assessment, Affirmed P-1(cr)

Outlook Actions:

...Outlook, Remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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