MOODY'S INVESTORS SERVICE

CREDIT OPINION
29 April 2022

Update

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RATINGS

Sparebanken Oest

Domicile	Drammen, Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Sparebanken Oest

Update to credit analysis

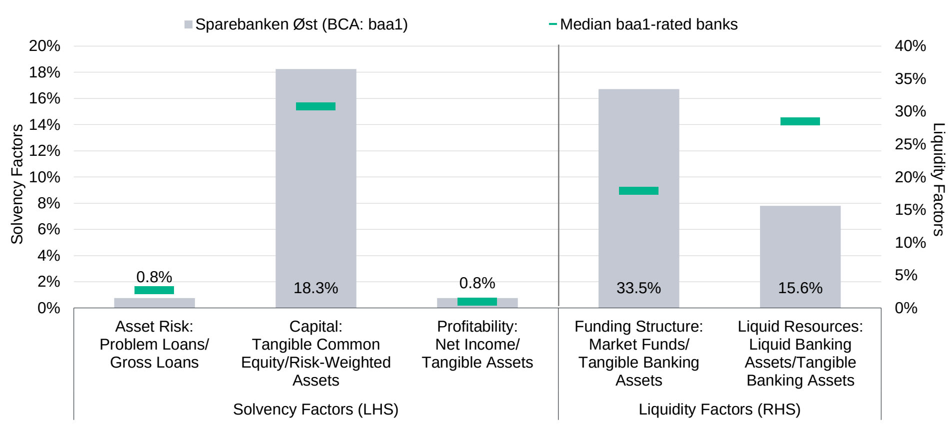
Summary

We assign a baa1 Baseline Credit Assessment (BCA) and A1 long-term deposit and issuer ratings to Sparebanken Oest. Sparebanken Oest's BCA of baa1 primarily reflects its good asset quality with low level of problem loans (0.76% of total loans in December 2021), underpinned by its predominantly mortgage loan book (approximately 89% of total loans in December 2021), as well as the maintenance of its solid capitalization with a tangible common equity (TCE) ratio of 18.3% in December 2021. These features position the bank's credit profile on par with most its local peers.

The bank's BCA is also supported by its strong liquidity, with a liquidity coverage ratio (LCR) of around 250%, combined with a net stable funding ratio (NSFR) of 122% in December 2021. We expect the bank's core profitability performance to remain satisfactory for the foreseeable future, supported by strong loan growth in 2021. The BCA also reflects the bank's relatively high market funding dependence through covered bonds, a common feature for all local banks, and some mortgage margin pressure from strong competition.

The bank's A1 deposit and issuer ratings take into account our Loss Given Failure (LGF) analysis of the bank's large volume of deposits and substantial layers of subordination, resulting in three notches of rating uplift from its BCA. Sparebanken Oest's ratings do not benefit from any government support uplift.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Good asset quality mainly driven by predominant exposure to retail mortgages

» Solid capital buffers, which compare well with those of similarly rated Norwegian savings banks

» Favorable profitability on the back of increasing interest rates and low impairments

» Large volume of deposits and debt, which provide uplift to deposit ratings

Credit challenges

» Sparebanken Oest maintains a high reliance on confidence-sensitive market funding

» Strong competition in retail mortgages exerts some pressure in Sparebanken Oest's market share and franchise

» Relatively low contribution from fees and commissions to the bank's core income

Outlook

The stable outlook assigned to Sparebanken Oest reflects our view that the bank's financials will remain broadly resilient over the next 12-18 months.

Factors that could lead to an upgrade

Upward rating pressure could develop if Sparebanken Oest demonstrates:

» Strong earnings generation without an increase in its risk profile or worsening in its business development

» 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

Factors that could lead to a downgrade

Downward rating pressure would emerge in the future if:

» Sparebanken Oest's credit risk profile worsens through a material increase in its problem loans ratio, or elevated sectoral or borrower concentration

» Any indication that the bank's franchise and market position deteriorates, which will likely lead to earnings erosion

» Funding conditions become more difficult that would challenge the bank's refinancing capacity

» The bank issues a significantly lower volume than expected of junior senior securities

Key indicators

Exhibit 2

Sparebanken Oest (Consolidated Financials) [1]

	12-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	48.1	44.1	42.4	42.0	37.0	6.8[4]
Tangible Common Equity (NOK Billion)	3.9	3.7	3.5	3.3	3.2	5.0[4]
Problem Loans / Gross Loans (%)	0.8	0.6	0.6	0.6	0.6	0.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.3	17.9	17.8	16.6	17.7	17.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.5	5.3	6.0	5.9	5.3	6.0[5]
Net Interest Margin (%)	1.3	1.4	1.5	1.4	1.6	1.4[5]
PPI / Average RWA (%)	2.1	2.8	2.2	2.4	2.3	2.4[6]
Net Income / Tangible Assets (%)	0.8	1.0	0.8	0.8	0.8	0.8[5]
Cost / Income Ratio (%)	40.0	34.5	38.5	39.1	40.0	38.4[5]
Market Funds / Tangible Banking Assets (%)	33.4	36.5	37.5	38.8	37.2	36.7[5]
Liquid Banking Assets / Tangible Banking Assets (%)	15.6	18.2	18.2	15.2	14.5	16.3[5]
Gross Loans / Due to Customers (%)	223.2	237.2	229.3	234.1	222.4	229.2[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Sparebanken Oest is a savings bank based in Drammen with a good market positioning in southeastern Norway. Traditional banking services including deposit accounts, mortgage loans and money-transfer services are provided to retail customers and small and medium-size enterprises (SMEs). Through agreements with external suppliers, the bank also distributes pension insurance, life and general insurance, and asset management services. As of 31 December 2021, the bank reported total consolidated assets of NOK48.1 billion (approximately €4.8 billion).

Recent developments

Russia-Ukraine crisis injects new risks into global economic outlook. Russia's invasion of Ukraine (Caa2 RUR-) and the economic sanctions that the US (Aaa stable), European governments and other allies have subsequently imposed on Russia have increased risks to the global economic outlook. In particular, further escalation of the Russia-Ukraine conflict would put Europe's economic recovery at risk. Heightened geopolitical risks are unambiguously negative for economic activity. The magnitude of the effects will depend on the length and severity of the crisis.

Norway's trade flows with Russia are very limited as they export the same type of goods with the production of oil and gas among the most significant to the Norwegian economy. As European countries are looking to reduce imports from Russia, Norway is likely to be positively affected by increased demand in Europe.

Norges Bank increased the reference rate by 25 bps in March 2022, resulting in a reference rate of 0.75% as of end-March 2022, while indicated that further rate hikes will occur in 2022 and that it expects the reference rate to reach 1.7% by year-end 2024. The counter cyclical buffer (CCyB) requirement has been increased from 1% currently to 1.5% in end June 2022, 2.0% by the end of December 2022 and to 2.5% effective from 31 March 2023.

Detailed credit consideration

Norway's 'Very Strong-' Macro Profile remains supportive towards the bank's stand alone credit profile

Sparebanken Oest operates only in Norway and thus its operating environment is reflected through the 'Very Strong -' Macro Profile we assign for Norway. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as a very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the last weakening in the oil sector in 2014-15.

The main risks to the banking system stem from the high level of household debt, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with the total size of the economy.

Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to expand by 3.8% in 2022, up from 3.3% in 2021. Unemployment rose to around 10.6% in March 2020, but falling back to 2.0% as of 31 March 2022, below the pre-pandemic level.

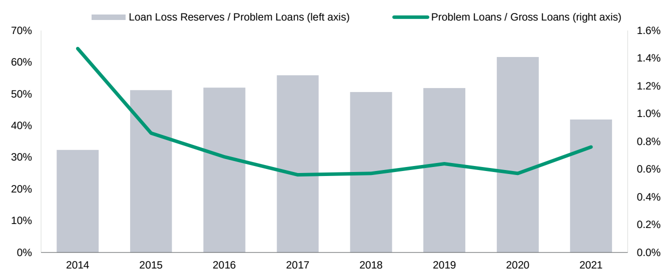
Good asset quality mainly driven by predominant exposure to retail mortgage

We expect Sparebanken Oest's problem loans to remain low, reflecting its focus on mortgage lending and limited lending to business customers. The bank's corporate loans declined to 11.4% in December 2021 from a peak of around 24% of gross loans back in 2011, while its top 20 exposures amount to less than 6% of total loans, improving the granularity of its loan book.

As of December 2021, the bank's problem loan ratio (measured as impaired loans as a percentage of total loans) stood at 0.76% (0.57% as of year-end 2020) with the bulk of the nonperforming loans related to car loans to individuals. At this low level, it compares favorably to rated domestic peers, with the increase from 2020 being attributable to updated definitions of default implemented in 2021. Sparebanken Oest's coverage of problem loans improved to 42% as of December 2021 (see Exhibits 3-4).

Exhibit 3

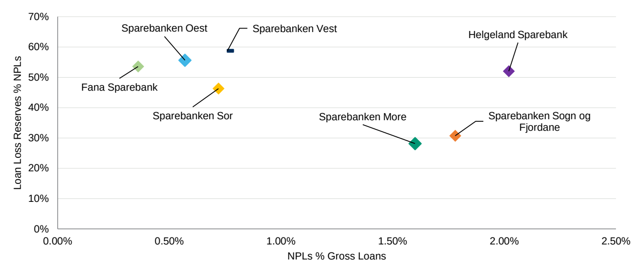
Sparebanken Oest's asset quality has held up in recent years...



Source: Moody's Banking Financial Metrics

Exhibit 4

... and compares well with its Norwegian peers



Source: Moody's Banking Financial Metrics (September 2021)

Although Sparebanken Oest's concentration level in the commercial real estate (CRE) sector has declined, it remains significant. Loans to the real estate and construction sector accounted for around 8.9% of its gross loans as of December 2021. The exposure to the CRE sector makes its asset quality vulnerable in case the sector faces difficulties, particularly given that many of the bank's large customers are active in this sector. However, Sparebanken Oest's CRE portfolio has been decreasing since 2011, while both residential and commercial real estate prices have illustrated growth, particularly in the Oslo metropolitan area. Growth in real estate prices has also been sustained in 2021, following strong growth in 2020.

As of December 2021 gross lending increased by 11% year-on-year. Lending to retail customers increased by 14.8% year-on-year while the bank's gross lending to corporate customers decreased by 11.2% over the same period. The overall increase in lending came as a result of the Bank's 'Nybygger.no' campaign, which is the bank's digital mortgage platform, as well as increased economic activity following easing of restrictions and a rebound in the economy.

The bulk of Sparebanken Oest's lending is in retail loans, mostly in the form of mortgages with very low average LTVs (the average LTV within the security pool was around 45% at the end of 2021), accounting for around 89% of total loans as of December 2021. Sparebanken Oest is based in Drammen, which is located on the outskirts of Oslo and where residential property prices have increased significantly over the past several years, which pose some downside risks for the bank. Nonetheless, we expect the bank to maintain its high asset quality within its portfolio over the medium term, even if competition would challenge its positioning in the market.

Solid capital buffers, which compare favorably with similarly rated Norwegian savings banks

Sparebanken Oest's capital buffers are solid with a Common Equity Tier 1 capital (CET1) ratio of 18.2% in December 2021, a slight increase from 18.0% as of year-end 2020. Concurrently, the bank had a Tier 1 ratio of 19.9% and a total capital adequacy ratio of

21.8% as of December 2021, combined with a leverage ratio of 8.6% indicating the ample room it has for credit growth and loss absorption buffer. We expect that the bank will continue to easily meet its capital regulatory requirements.

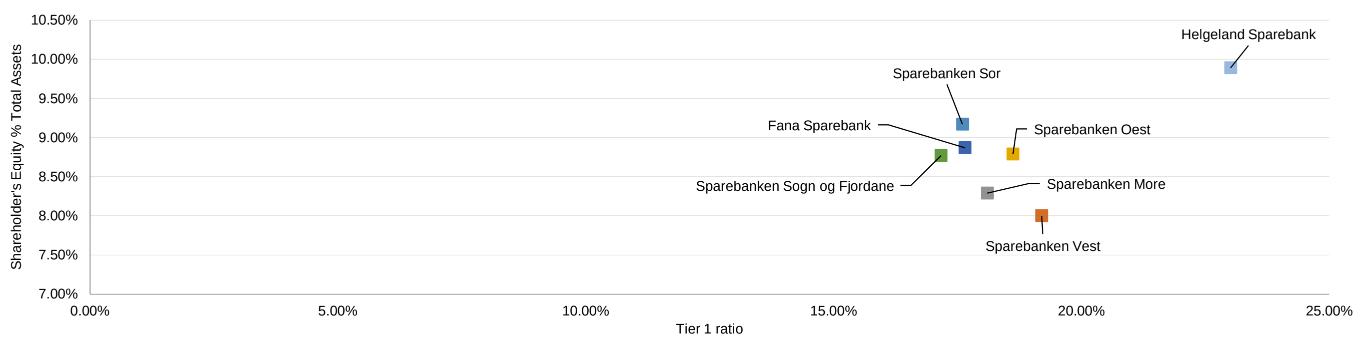
The bank's capital levels compare favorably with other Norwegian savings banks (see Exhibit below) and exceed both the current regulatory requirement of 12.8% (including a Pillar 2 requirement of 1.8% for Sparebanken Oest) and the bank's increased internal target of 14.8%.

In response to the global coronavirus outbreak and resulting economic stress banks' capital requirements were revised. However, the requirements are now set to increase to above pre-pandemic levels. The systemic risk buffer will increase by 1.5% to 4.5% from 31 December 2022. The countercyclical capital buffer will be increased by 0.5% to 1.5% from 30 June 2022, and again in December 2022, and by a further 0.5% to 2.5% in end-March 2023. Provided the Pillar 2 requirement stays the same the CET1 capital requirement will increase to 15.8% by the end of the first quarter in 2023.

Following the implementation of finalised EU bank capital rules (which have yet to be fully agreed) it is likely that the bank's risk-weighted assets (RWAs) could reduce, with lower requirements being applied to SME exposures and a more risk-sensitive approach to retail mortgages. However, the implementation has been delayed from 2023 to 2025. It should be noted that Oest remains on the standardised model in calculating its RWAs and has no intention to start an internal ratings based (IRB) process.

Our capital score for the bank reflect comfortable capital metrics a strong leverage ratio and the negative adjustment reflects our view that raising fresh equity in case of need could prove challenging given its only 29.6% equity certificate ownership of its capital.

Exhibit 5
Sparebanken Oest's capital levels compare favorably with that of peers



Source: Banks reports, Moody's Investors Service (September 2021)

Favourable profitability on the back of low impairments although with relatively low contribution from fees and commissions

Sparebanken Oest's return on assets, as adjusted and calculated by Moody's, reached 0.76% in 2021. Net income decreased in 2021 compared with 2020, due to one off income in 2020. Excluding the one-off income was stable. Recent rate increases by Norges Bank have translated to increased mortgage rates, while deposit rates have remained mostly flat. This is expected to boost the bank's profitability going forward, although a competitive market environment will continue to be a challenge for the bank going forward.

Net interest income from lending operations still constitutes the main income line for Sparebanken Oest with majority of loans being predominantly retail — representing a stable source of income. We note that there is also some margin pressure due to intense competition in the bank's core markets and increased focus on retail mortgages, with net interest income as a percentage of average total assets slightly down to 1.34% in December 2021, from 1.46% as of December 2020. Overall, net interest income represented around 83% of the bank's net revenue in 2021, while fees and commissions remained a relatively low contributor to the bank's revenues comprising only around 4% of its total net income in 2021. Income from product companies that the owns jointly was strong in 2021, contributing 17% of total income.

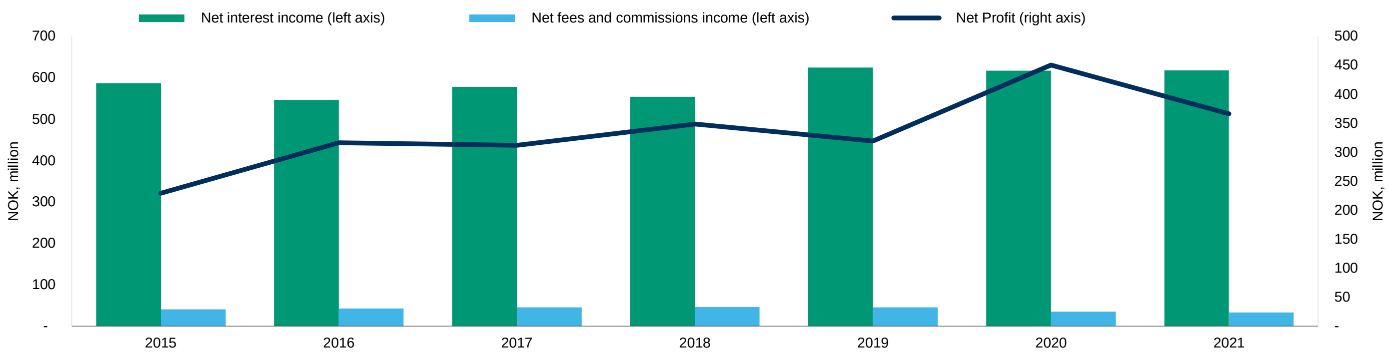
The bank managed to keep good control of its costs with operational efficiency remaining sound and continuing to compare well with that of its domestic peers, with a cost-to-income ratio of just 38% as of December 2021. The revision of salaries combined with its digitalisation transformation have also helped contain its cost base and be one of the most efficient Norwegian banks, despite a significant IT investment cost in the last two years.

Loan losses have decreased significantly to NOK0.5 million in December 2021 from NOK15.1 million a year earlier, indicating credit loss ratio (loss provisions as a % gross loans) of 0.32%, compared to 0.35% the year before. Sparebanken Oest's low credit loss ratio in 2021 was one of the lowest among Norwegian banks, supporting its bottom line performance.

Over the next 12-18 months we do not expect any major deviation in the bank's profitability metrics, and will likely remain satisfactory. The bank has good recurring pre-provision income, and higher interest rates will support its profitability. However, the strong competition the bank faces in the greater Oslo and Akershus area where it also operates, mainly from bigger commercial and digital banks with strong pricing power, could pressure margin and constrain its long-term profitability trajectory.

Exhibit 6

Sparebanken Oest's profitability evolution



Source: Banks reports, Moody's Investors Service

Sparebanken Oest maintains a sizable reliance on market funding...

Sparebanken Oest remains more reliant on market funds than its domestic peers, as its Moody's-adjusted market funds ratio comprised around 33% of the bank's tangible banking assets as of December 2021. Accordingly, we believe that the bank remains sensitive to fluctuations in investor sentiment, which we view as a potential credit challenge.

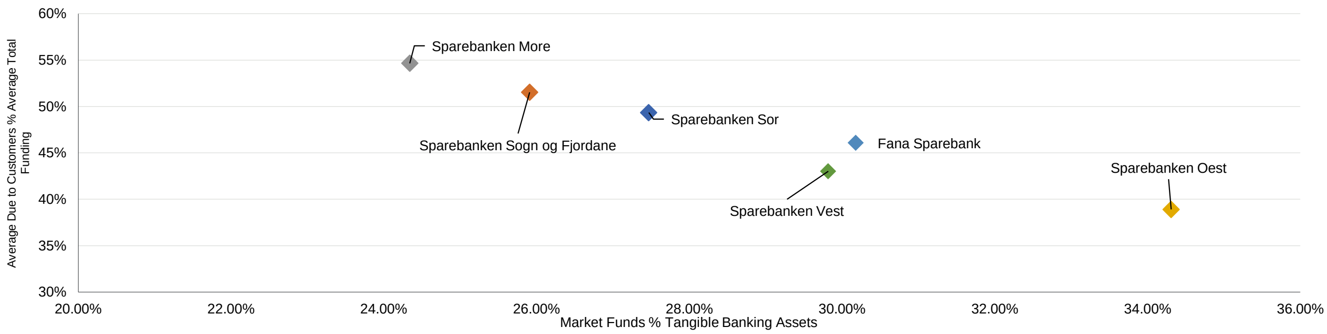
A relatively large part of Sparebanken Oest's market funding consists of covered bonds issued via Sparebanken Oest Boligkreditt, with this source of funding representing around 71% of Sparebanken Oest's unadjusted market funds as of December 2021. We view the benefits from diversification and the typically longer maturity of these funding instruments positively, particularly because recent larger issuances are eligible liquid assets under the liquidity coverage ratio (LCR) rules. The bank also had a comfortable net stable funding ratio (NSFR) at 122% at the end of December 2021.

We expect that the bank will continue to refinance part of its senior preferred debt with senior non-preferred (SNP) debt. This is based on the bank's minimum requirement for own funds and eligible liabilities (MREL).

Deposits accounted for about 44% of Sparebanken Oest's non-equity funding as of December 2021 — at the lower end of the range of similarly rated Norwegian savings banks. The 18.4% increase in total deposits as of December 2021 from a year earlier was largely driven by the deposits from the retail sector increasing by 35.6%.

Exhibit 7

A relatively large part of Sparebanken Oest's market funding consists of covered bonds



Source: Banks reports, Moody's Investors Service (September 2021)

...although mitigated by high liquidity buffers

Mitigating its high reliance on market funds, Sparebanken Oest holds a relatively large liquidity buffer. As of December 2021, liquid assets stood at NOK7.5 billion or 15.6% (18.2% as of December 2020) of total assets and consisted mainly of cash, as well as government-related bonds and covered bonds. Furthermore, according to the bank, liquid assets should be sufficient enough to cover its funding needs for at least the next 12 months without the need for external financing, and its LCR was 250% in December 2021.

Environmental, social and governance (ESG) considerations

In line with our general view for the banking sector, Sparebanken Oest has a low exposure to Environmental risks. See our Environmental risk heatmap for further information.

We believe banks face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. In addition, we regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. See our Social risk heatmap for further information.

Governance is highly relevant for Sparebanken Oest, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Sparebanken Oest we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure and additional nothing

The European Union's BRRD has been transposed into Norwegian law, applicable from 1 January 2019, which confirmed our current assumptions regarding the LGF analysis. We assume a residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred over senior unsecured debt. These metrics are in line with our standard assumptions. BRRD2 will formally enter into effect in June 2022 but current requirements set by the Norwegian FSA already reflect the new regulation.

For Sparebanken Oest's short-term and long-term deposit ratings, we consider the likely impact of loss-given-failure, reflecting the combination of debt and deposit volumes and the amount of debt subordinated to them. We also take into consideration the expected level of MREL eligible debt issuance until the end of 2023. This has resulted in a Preliminary Rating Assessment of three notches above the BCA for the bank's deposit and senior unsecured ratings, reflecting very low loss-given-failure.

Government Support considerations

Given the implementation of the BRRD law in Norway on 1 January 2019 we reconsidered the probability that government support would benefit certain creditors.

Sparebanken Oest benefits from a well-established market position in the lower Buskerud County of southeastern Norway. While its market share in this county is material (we estimate it at around 6% on terms of loans), it falls to around 1.4% if we include the greater Oslo and Akershus areas, in which Sparebanken Oest also operates. We also note that the proximity of the bank's home region to Oslo means that a number of other Norwegian banks are operational in the area. Therefore, we take into consideration the probability of government support for debt and deposits as low, resulting in no rating uplift. Sparebanken Oest's market share in loans on a national basis is around 0.7%.

Counterparty Risk Assessment

Sparebanken Oest's CR Assessment is A1(cr)/P-1(cr)

Sparebanken Oest's CR Assessment is A1(cr)/P-1(cr), three notches above the bank's Adjusted BCA of baa1, based on the buffer against default provided by junior deposits, senior unsecured, subordinated debts and preference shares. The bank's CR Assessment does not benefit from any government support, in line with deposits and senior unsecured debt ratings.

Counterparty Risk Ratings (CRRs)

Sparebanken Oest's CRR is A1/P-1

The CRR is three notches above the Adjusted BCA of baa1 and at the same level as the CR Assessment, reflecting the buffer against default provided by more junior instruments to the CRR liabilities.

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 methodology and scorecard factors

Exhibit 8

Sparebanken Oest

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					
Factor		**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency							
Asset Risk							
Problem Loans / Gross Loans		0.8%	aa2	↑	baa1	Geographical concentration	Sector concentration
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		18.3%	aa1	↔	aa2	Access to capital	
Profitability							
Net Income / Tangible Assets		0.8%	baa1	↔	baa2	Earnings quality	
Combined Solvency Score			aa3		a2		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		33.4%	baa3	↓	ba2	Expected trend	
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		15.6%	baa2	↔	baa2	Stock of liquid assets	
Combined Liquidity Score			baa3		ba1		
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		
BCA Scorecard-indicated Outcome - Range					a3 - baa2		
Assigned BCA					baa1		
Affiliate Support notching					0		
Adjusted BCA					baa1		

Balance Sheet	**in-scope (NOK Million)**	**% in-scope**	**at-failure (NOK Million)**	**% at-failure**
Other liabilities	21,557	44.8%	23,350	48.5%
Deposits	17,579	36.5%	15,786	32.8%
Preferred deposits	13,008	27.0%	12,358	25.7%
Junior deposits	4,571	9.5%	3,428	7.1%
Senior unsecured bank debt	6,398	13.3%	6,398	13.3%
Junior senior unsecured bank debt	400	0.8%	400	0.8%
Dated subordinated bank debt	400	0.8%	400	0.8%
Preference shares (bank)	350	0.7%	350	0.7%
Equity	1,444	3.0%	1,444	3.0%
Total Tangible Banking Assets	48,128	100.0%	48,128	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	25.8%	25.8%	25.8%	25.8%	3	3	3	3	0	a1
Counterparty Risk Assessment	25.8%	25.8%	25.8%	25.8%	3	3	3	3	0	a1 (cr)
Deposits	25.8%	5.4%	25.8%	18.7%	2	3	2	3	0	a1
Senior unsecured bank debt	25.8%	5.4%	18.7%	5.4%	2	2	2	3	0	a1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0	A1	A1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 9

Category	Moody's Rating
SPAREBANKEN OEST	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1

Source: Moody's Investors Service

REPORT NUMBER 1317156

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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