CREDIT OPINION
24 January 2023

Update

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Fana Sparebank

Update to credit analysis

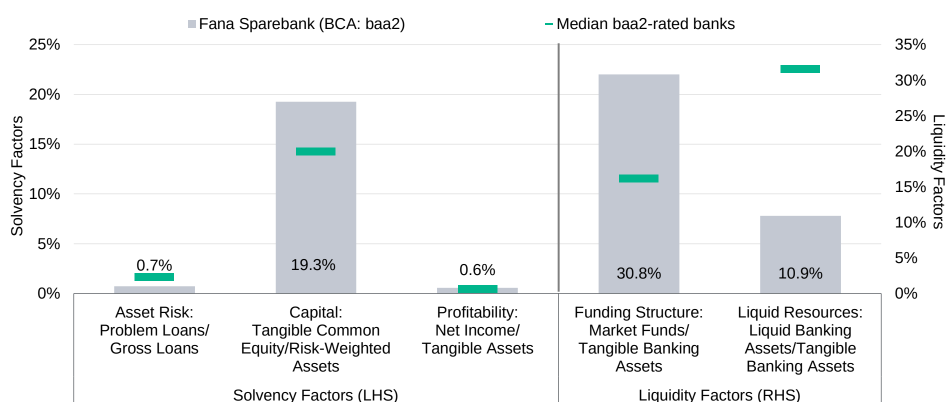
Summary

Fana Sparebank's (FSB) A3 long-term deposit rating incorporates two notches of rating uplift from the bank's baa2 Baseline Credit Assessment (BCA) based on our Advanced Loss Given Failure (LGF) analysis, taking into account the risks faced by the different debt and deposit classes in a bank resolution scenario. The bank's ratings do not incorporate any government support uplift, based on our assessment of a low probability of support.

FSB's standalone BCA of baa2 reflects the generally benign operating environment in Norway and the bank's strong historical asset performance. Problem loans were equivalent to around 0.5% of the bank's gross loans as of September 2022, and credit costs averaged a low 0.04% of gross loans in the past five years, mainly because of its retail banking focus and conservative underwriting policies. The bank's BCA also factors in its strong capitalisation with a tangible common equity (TCE) capital ratio of 19.3% and TCE/tangible banking assets of 9.2% in September 2022.

These credit strengths are balanced against certain single-name and credit concentrations in the county of Vestland and to the cyclical real estate and construction sectors (around 16% of gross loans as of the end of September 2022); the bank's relatively high market funding reliance; and its limited pricing power as a small regional participant in a competitive market.

Exhibit 1
Rating Scorecard - Key financial ratios



These are our Banks Methodology scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average and latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end values.
Source: Moody's Investors Service

RATINGS

Fana Sparebank

Domicile	Norway
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A3
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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Credit strengths

» Robust historical asset performance, characterised by a predominantly mortgage-focused loan book with one of the lowest problem loans ratios among peers

» Strong capital levels well above regulatory requirements

» Deposit ratings benefiting from a very low loss given failure rate because of a large volume of deposits and some junior debt

Credit challenges

» Certain high single-name, geographical and cyclical sectors credit concentrations increase credit risk.

» Small franchise provides limited pricing power.

» High reliance on market funding exposes the bank to potential changes in investor sentiment.

Outlook

The stable outlook on the bank's long-term deposit rating reflects our view that its asset quality will remain broadly stable and capital strong over next 12-18 months. However, the bank's profitability and market funding will remain constrained by its small scale of operations.

Factors that could lead to an upgrade

Upward rating momentum could develop if FSB demonstrates a reduction in credit concentrations, stronger sustained earnings generation without a deterioration in its risk profile, and a reduction in confidence-sensitive market funding. We would also view enhanced access to capital markets and improved ability to raise fresh equity as credit-positive developments.

Factors that could lead to a downgrade

Downward rating pressure would emerge if FSB's problem loan ratio exceeds the average of its similarly rated global peers; its risk profile deteriorates, for example, as a result of increased exposures to more volatile sectors; or the macroeconomic environment deteriorates significantly, leading to a lower macro profile. Also, any reduction in loss-absorbing capacity because of a significant change in the bank's liability structure, could lead to a rating downgrade.

Key indicators

Exhibit 2
Fana Sparebank (Consolidated Financials) [1]

	09-22[2]	12-21[2]	12-20[2]	12-19[2]	12-18[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	29.8	30.0	29.3	26.2	25.2	4.6[4]
Tangible Common Equity (NOK Billion)	2.7	2.6	2.5	2.4	2.3	4.9[4]
Problem Loans / Gross Loans (%)	0.5	0.8	0.6	1.1	0.8	0.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	19.3	17.8	17.0	18.8	17.9	18.2[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	4.2	7.9	5.6	10.1	7.3	7.0[5]
Net Interest Margin (%)	1.4	1.2	1.2	1.4	1.4	1.3[5]
PPI / Average RWA (%)	1.7	1.2	1.3	1.7	2.0	1.6[6]
Net Income / Tangible Assets (%)	0.7	0.4	0.4	0.7	0.7	0.6[5]
Cost / Income Ratio (%)	49.9	58.9	59.2	54.1	48.5	54.1[5]
Market Funds / Tangible Banking Assets (%)	28.6	30.8	33.2	31.0	30.9	30.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	11.9	10.9	11.7	9.5	12.0	11.2[5]
Gross Loans / Due to Customers (%)	198.2	209.7	213.3	206.7	199.6	205.5[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

Fana Sparebank is a savings bank with a well-established market position in Western Norway, which provides traditional banking services to retail and corporate customers online and through its three branches in the greater Bergen region. These include deposit accounts, loans and money-transfer services. Through agreements with external suppliers, the bank also distributes insurance and other financial services. As of 30 September 2022, the bank reported consolidated assets of around NOK30 billion (€2.9 billion).

Recent developments

Russia's military invasion of Ukraine (Caa3 negative) and the economic sanctions that the United States (Aaa stable), European governments and other allies have subsequently imposed on Russia have weakened the global economic outlook. 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 the two countries 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 benefit from the increased demand in Europe.

To curb rising inflation, Norges Bank has been gradually increasing its reference rate since September 2021, resulting in a reference rate of 2.75% as of December 2022. Norges Bank expects the policy rate to be around 3% in 2023.

Detailed credit considerations

Norway's "Very Strong -" macro profile continues to support the bank's standalone credit profile

The Norwegian banking system benefits from the government's generally strong fiscal flexibility and countercyclical buffers available through its sovereign oil fund to respond to economic shocks. Unemployment peaked in March 2020 to 10.6% according to the Norwegian Labour and Welfare Administration, although it has since declined to 1.6% in November 2022.

FSB operates only in Norway and, thus, its operating environment is reflected in the "Very Strong -" macro profile we assigned to Norway. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the weakening in the oil sector in 2014-15 as well as in 2020.

The main risks to the banking sector stem from its extensive use of market funding, and from Norway's high household indebtedness and elevated real estate prices. However, the household sector's strong debt servicing ability, the Norwegian government's wellcoordinated monetary and regulatory policies, and the country's sizeable sovereign wealth fund, which supports the economy during crises, mitigate these risks.

Strong asset performance, but exposed to credit risk from high sector and credit concentrations

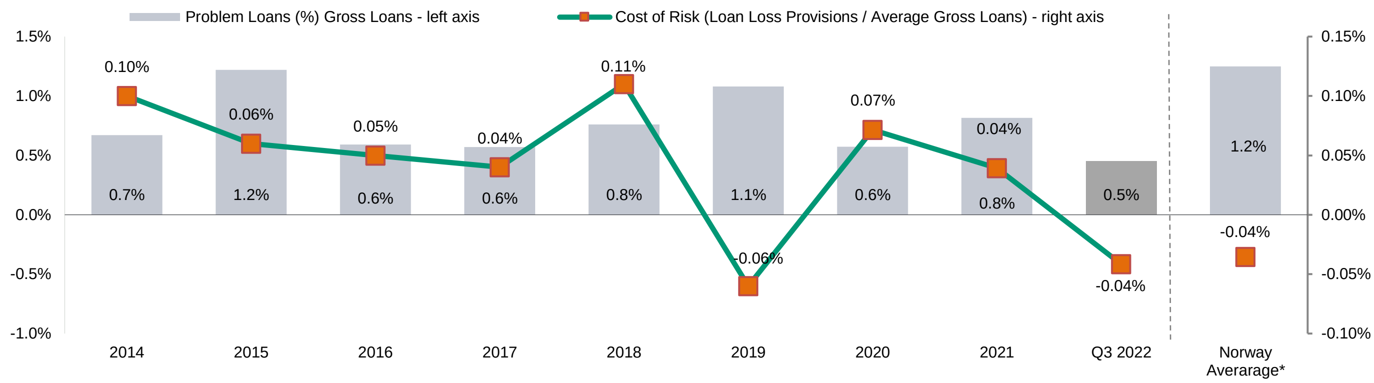
FSB's problem loan ratio (impaired and other doubtful loans as a percentage of gross loans) was relatively low at 0.5% as of September 2022 (year-end 2021: 0.8%; see Exhibit 3) and lower than that of its Norwegian peers. Furthermore, its loan-loss provision expenses as a percentage of gross loans averaged just 0.04% in the past five years, and was -4.0 bps as of September 2022, despite peaking to 0.32% in Q1 2020, at the beginning of the pandemic.

The bank's strong asset performance reflects its retail banking focus, with retail loans, mainly in the form of mortgages, making up around 80% of the bank's total loan book as of September 2022. Residential mortgages have performed well in the past, reflecting conservative underwriting policies, and we expect asset quality of this segment to remain resilient despite the long-term risks from the high level of household indebtedness and the recently increased interest rate burden. We expect Norway's households to continue to be able to service their debt as unemployment remains low and inflationary pressures manageable.

Exhibit 3

FSB's asset-quality evolution

Historical asset-quality performance has been robust and problem loan levels remain relatively low



Source: Moody's Financial Metrics™

Our assessment of FSB's asset risk also takes into account the elevated risks from its exposure to the cyclical real estate and construction sectors, which was around 16% of gross loans as of September 2022 and accounted for a substantial portion of the bank's credit losses in the past. In addition, similar to other small local savings banks, the bank is exposed to high geographical and single-name concentrations, which could exacerbate the extent and pace of any deterioration in asset quality. Around 84% of the bank's lending exposures were in the county of Vestland, while its top 20 borrowers, mainly in the property management business reflecting the bank's historical focus on property, accounted for around 13% of its total loans.

We expect the bank's problem loan ratio to remain low, with defaults and loan losses remaining within the bank's risk appetite. The bank has no oil and gas exposure, and insignificant exposure to hotels or other sectors that have historically caused significant loan losses for Norwegian banks. However, the bank's relatively high exposure to real estate and construction sectors can hurt loan quality in the current operating environment.

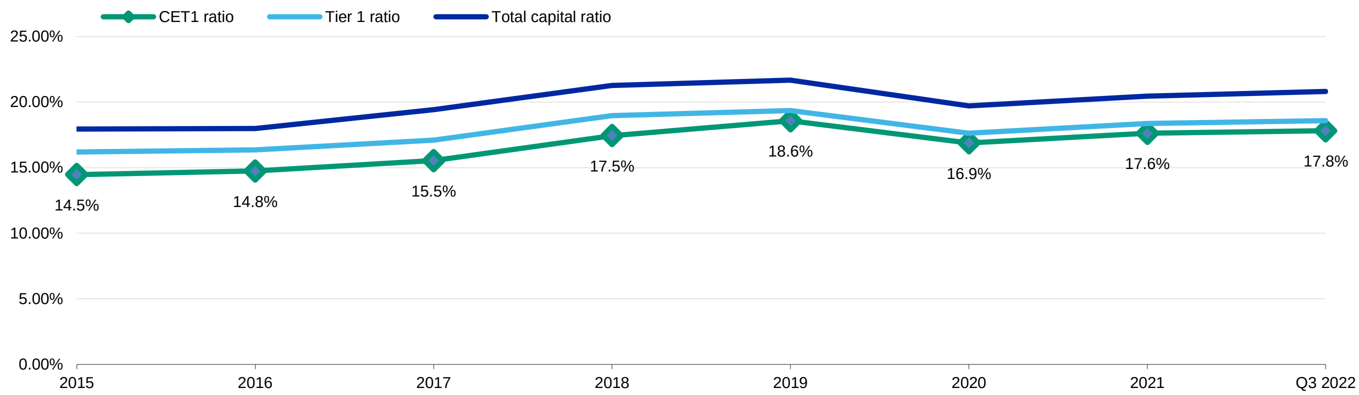
Strong capital levels provide a good loss absorption buffer

As of September 2022, FSB had a TCE ratio of 19.3%, which we consider as strong capital level compared with the bank's risk profile and in line with that of its domestic peers, providing a good loss absorption buffer. We also expect the bank's capitalisation to continue to comfortably exceed the regulatory requirements.

FSB reported a CET1 ratio of 17.8% at the end of September 2022, including a Pillar 2 requirement of 2.3%. The reported figure significantly exceeds the regulatory requirement of 13.8% as of September 2022 and a higher requirement of 16.3%, which will be effective in Q4 2023 when the systemic risk buffer will be increased. The bank's Tier 1 ratio and overall capital adequacy ratio (CAR) were strong at 18.6% and 20.8%, respectively, in September 2022, combined with a leverage ratio of 8.3%, comparing well with its rated Norwegian peers.

Since 2015, the bank has gradually increased its CET1 ratio (see Exhibit 4) by changing its credit strategy towards less-capital intensive exposures and reducing its corporate exposure towards commercial real estate. Our Capital score of aa3 reflects this strength, but also takes into account the fact that the bank's capital is not listed/traded, thus limiting its capacity to raise fresh equity if needed.

Exhibit 4
FSB's capital metric



Source: FSB's Q3 2022 results

Stable long-term profitability, although low compared with that of its larger peers

In the second half of 2021, to curb rising inflation, Norges Bank started gradually increasing its reference rate, resulting in a base rate of 2.75% as of December 2022. Norges Bank expects the policy rate to be around 3% in 2023. The initial rate hikes have largely translated into higher mortgage rates, while deposit rates remained stable, improving most Norwegian banks', including FSB's, net interest income in 2022.

FSB's profitability has historically been resilient and relatively stable, as net interest income from retail operations (and some lending to small and medium-sized enterprises) drive the bulk of the bank's revenue, although it has been weaker than that of its larger domestic rated peers.

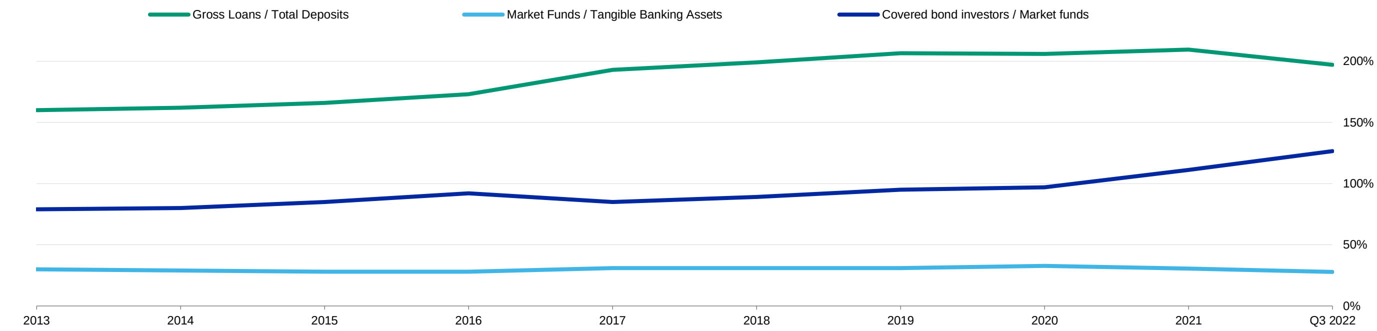
Since 2019, the bank's profitability has declined because of several factors. The bank's ambition to grow, which has been achieved through competitive pricing combined with the rate cuts from Norges Bank in 2020, reduced its net interest margin. Additionally, the higher cost of credit in 2020 during the pandemic constrained its profitability. Once Norges Bank started increasing interest rates, FSB's profitability improved. The bank's (annualised) net income/tangible assets as of September 2022 was 0.7%, higher than the 0.4% in 2021 and 2020, although still marginally lower than the average of 0.8% for Norwegian banks.

Accordingly, the bank reported a cost-to-income ratio of 44.4% in Q3 2022, down from 53.9% in Q3 2021. Increased digitalisation and online banking solutions and services are likely to improve the bank's productivity in loan processing and support a high efficiency levels. The bank's small size and agility to introduce innovation through its “Himla” digital platform should also help improve its customer experience and attract more business, boosting its revenue and profitability over time.

A good retail deposit base, but high reliance on market funding renders the bank vulnerable to changes in investor sentiment

FSB's funding profile is mainly underpinned by customer deposits, which represented around 48% of non-equity funding as of September 2022 (46% as of December 2021), of which around 80% pertains to retail customers. However, the bank continues to have a high reliance on wholesale funding, as deposit growth has lagged lending growth in nominal terms, rendering it vulnerable to changes in investor sentiment. Covered bond funding has increased significantly since 2009, when Fana Sparebank Boligkreditt AS (the bank's wholly owned covered bond company) was established. As of September 2022, covered bonds accounted for 37% the bank's total non-equity liabilities.

Exhibit 5
FSB's funding metrics
Increasing reliance on covered bonds



Source: Moody's Financial Metrics™

Based on our Banks Methodology, we reflect the stability of covered bonds compared with unsecured market funding through an adjustment (50%) to our market funds/tangible assets, and our adjusted ratio for the bank was roughly 28.6% as of September 2022, lower than the 30.8% as of the year-end 2021. However, we do not expect FSB to have the capacity to make large benchmark issuances, ultimately restricting its potential investor base and increasing its refinancing risk. As such, we reverse this adjustment for the bank (similar to other small Norwegian savings banks) by assigning a Funding score based on the bank's higher unadjusted market funds/tangible assets of 45.4% as of September 2022 (47.6% as of December 2021). The bank's funding score of ba3 reflects funding risk that remains a relative credit weakness comparing to peers.

We consider the bank's liquidity adequate with liquid banking assets, mainly comprising domestic government securities and investments in other local banks' covered bonds (increasing to some degree the vulnerability of the financial system) representing 11.9% of tangible banking assets as of September 2022. FSB also reported a high liquidity coverage ratio (LCR) of 282% on a consolidated basis (including its covered bond company) and 219% on a parent bank-only basis as of September 2022.

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank. Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions, published on 9 August 2018.

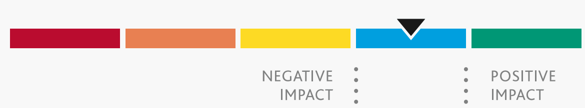
ESG considerations

Fana Sparebank's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 6
ESG Credit Impact Score

CIS-2

Neutral-to-Low



For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Fana Sparebank's ESG Credit Impact Score is neutral-to-low (**CIS-2**). This reflects the limited credit impact of environmental and social risk factors on the rating to date, and neutral-to-low governance risks.

Exhibit 7
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-3	G-2
Neutral-to-Low	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

Fana Sparebank faces low environmental risks, specifically in relation to carbon transition risks. This is because of the structure of its loan book, predominantly mortgages and property management and negligible exposure to other corporate lending, which typically carry high carbon transition risk.

Social

Fana Sparebank faces moderate social risks related to customer relations and associated regulatory and litigation risks, requiring high compliance standards. The exposure to customer relation risks is lower than its international peers, given the bank's untarnished customer conduct track record supported by the social mandate of the Savings Bank's model. Data security and customer privacy are critical for banks because they access large amounts of personal data. These areas are becoming increasingly important as banks' online businesses expand and regulatory standards tighten. Sizeable investments in technology and banks' long track record of handling sensitive customer data, as well as appropriate culture and governance and compliance functions that ensure adherence to regulatory standards, help to mitigate the associated credit risk.

Governance

Fana Sparebank faces low governance risks and its risk management, policies and procedures are in line with industry best practices. Despite sectoral and geographical concentrations, due to its limited reach, the bank benefits from strong underwriting standards which mitigate some of these concerns. The bank has a track record of sound capital and liquidity management and earnings stability while losses have been low, even at times of market turbulence. Being a local savings bank, the bank's Supervisory Board comprises representatives of the bank's customers and employees, and in addition, one representative from the municipality. Related governance risks are however mitigated by Norway's developed institutional framework.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

The EU Bank Recovery and Resolution Directive (BRRD) entered into force as of 1 January 2019 in Norway. In accordance with our methodology, we apply our Advanced LGF analysis, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution.

In our LGF analysis for the bank, we use our standard assumptions and assume residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits, and a 5% run-off in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt.

Under these assumptions, FSB's deposits are likely to face very low loss given failure because of the volume of the deposits and senior debt themselves, and the amount of debt subordinated to them. This results in a Preliminary Rating Assessment two notches above the bank's BCA.

Government support considerations

We do not incorporate any government support uplift into FSB's deposit ratings as a result of the expected implementation of resolution legislation in Norway. FSB is a local savings bank with a well-established market position in Bergen (a municipality in the county of Vestland), especially in the borough of Fana. However, the bank's regional position in the county of Vestland is more modest with a single-digit market share. Therefore, we consider the likelihood of government support for FSB's debt and deposits as low (similar to other Norwegian local savings banks that we rate), resulting in no rating uplift.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

FSB's CRRs are placed at A2/P-1

The CRRs are positioned three notches above the Adjusted BCA of baa2 and at the same level as the CR Assessment, reflecting the buffer against default provided by more junior instruments to the CRR liabilities.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

FSB's CR Assessment is A2(cr)/P-1(cr)

FSB's CR Assessment is A2(cr)/Prime-1(cr), three notches above the bank's Adjusted BCA of baa2.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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

Fana Sparebank

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	0.7%	aa1	↑	baa1	Geographical concentration	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	19.3%	aa1	↓	aa3	Access to capital	Expected trend
Profitability						
Net Income / Tangible Assets	0.6%	baa2	↔	baa3	Earnings quality	
Combined Solvency Score		aa3		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	30.8%	baa3	↔	ba3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	10.9%	baa3	↔	baa3		
Combined Liquidity Score		baa3		ba2		
Financial Profile				baa2		
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				baa1 - baa3		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Balance Sheet	in-scope (NOK Million)	% in-scope	at-failure (NOK Million)	% at-failure
Other liabilities	12 135	40.7%	13 459	45.1%
Deposits	12 982	43.5%	11 658	39.1%
Preferred deposits	9 607	32.2%	9 126	30.6%
Junior deposits	3 375	11.3%	2 532	8.5%
Senior unsecured bank debt	3 402	11.4%	3 402	11.4%
Dated subordinated bank debt	300	1.0%	300	1.0%
Preference shares (bank)	100	0.3%	100	0.3%
Equity	894	3.0%	894	3.0%
Total Tangible Banking Assets	29 814	100.0%	29 814	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	24.2%	24.2%	24.2%	24.2%	3	3	3	3	0	a2
Counterparty Risk Assessment	24.2%	24.2%	24.2%	24.2%	3	3	3	3	0	a2 (cr)
Deposits	24.2%	4.3%	24.2%	15.8%	2	3	2	2	0	a3

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	a2	0	A2	A2
Counterparty Risk Assessment	3	0	a2 (cr)	0	A2(cr)	
Deposits	2	0	a3	0	A3	A3

[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
FANA SPAREBANK	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Source: Moody's Investors Service

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