

Totens Sparebank Issuer Rating Report



Overview

Scope assigns a first-time Issuer Rating of A- to Totens Sparebank with a Stable Outlook. The rating agency also assigns a first-time rating of BBB+ to senior unsecured debt.

As Norway is part of the EEA, its banks are expected to comply with BRRD, including MREL requirements. In line with our bank rating methodology (May 2018) and when the Norwegian FSA clarifies which debt is MREL-eligible, we expect to rate senior unsecured MREL-eligible debt one notch below the Issuer Rating and senior unsecured non-MREL-eligible debt at the same level as the Issuer Rating.

The Issuer Rating of A- with Stable Outlook also applies to Totens Sparebank Boligkreditt AS, a wholly-owned subsidiary of Totens Sparebank. Totens Sparebank Boligkreditt provides secured funding for its parent, through the issuance of covered bonds.

Highlights

- ✓ Established in 1854, Totens Sparebank (Totens) is a savings bank with a strong market position in its local area in south-east Norway. Macroeconomic conditions in Norway are supportive, with the country recovering from the fall in oil prices in 2014. The bank operates primarily in the Mjos region, an area where agriculture, manufacturing and the public sector are important industries. Over 70% of the bank's loan portfolio is comprised of residential mortgages.
- ✓ With deep local roots and its membership in the Eika Alliance, Totens competes successfully against larger players despite its smaller size. Through the alliance, the bank can provide a full range of products and services and benefits from economies of scale. Further, management is mindful of the need to further develop its digital capabilities to meet evolving customer expectations.
- ✓ Totens generates healthy profits, supported by good cost efficiency and low credit costs.
- ✓ As with other Norwegian banks (and other Nordic banks in general), Totens relies to a non-negligible extent on market funding. The bank, however, has demonstrated its ability to regularly issue in the domestic market and makes use of covered bonds which remain a very stable source of funding.
- ✓ Driven by the desire to remain an important pillar of the local community, management aims to ensure the long-term health and solidity of the bank. This is underpinned by the bank's governance structure, with employees, customers and local government representatives having material influence.

Ratings & Outlook

Issuer Rating	A-
Outlook	Stable
Senior unsecured debt	BBB+
Covered bond ratings (Totens Sparebank Boligkreditt)	AAA
Covered bond outlook	Stable

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Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Savings bank with a strong market position in an economically sound local area of south-east Norway.
- Healthy profitability supported by good cost efficiency and low credit costs.
- Managed reliance on market funding.
- Solid solvency metrics underpinned by savings bank business model.

Rating change drivers



A deterioration in Totens' operating environment which materially impacts profitability. The bank operates in one region of Norway and its performance is dependent on economic conditions in the local area as well as in the country more generally. Macroeconomic conditions currently remain benign, supporting very low loan loss rates.



A loss of services and economies of scale that the bank enjoys from being a member of the Eika Alliance. Without access, the bank would have difficulties meeting the various needs of its customers and would likely be unable to achieve the same levels of cost efficiency.



A change in risk appetite. Over the last several years, the bank has refocused on its core banking business, reduced funding risks and improved its risk management. We would view negatively a change in strategy which increases the risk profile of the bank, e.g. aggressive expansion in new geographic markets or offering products at unprofitable rates to gain market share.



Inability to access market funding at reasonable cost.



Sustainable and profitable growth. The bank sees further growth opportunities in its target markets, particularly outside of Ostre Toten and Vestre Toten. We would view positively managed and sustained profitable growth accompanied by continued sound liquidity and solvency metrics.

Rating drivers (details)

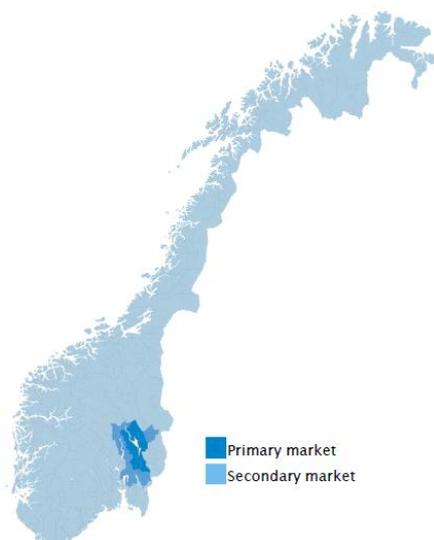
Savings bank with strong market position in an economically sound local area of south-east Norway

Totens Sparebank (Totens) enjoys strong market positions in its local area in south-east Norway. Established in 1854, the bank has grown organically and is headquartered in the municipality of Ostre Toten where its retail and corporate market shares are more than 50% and 25%, respectively.¹ Market shares in neighboring Vestre Toten are also at similar levels. Meanwhile, in other municipalities where the bank has a shorter history, market shares are lower – up to 15% in retail and up to 10% in corporates. Key competitors include other local savings banks, the regional bank Sparebank 1 Ostlandet, DNB and Nordea.

Management has defined the Mjos region as the bank’s primary market and the areas immediately adjacent as its secondary market. Per bank policy, at least 70% of lending should be within the primary market (3Q 2018: 79%). As a savings bank with strong roots in the local area, Totens also seeks to contribute to growth and development in the region. With five branches in Lena, Raufoss, Gjovik, Hamar and Raholt, management currently considers the bank to be sufficiently placed to serve customers and to grow in its focus markets.

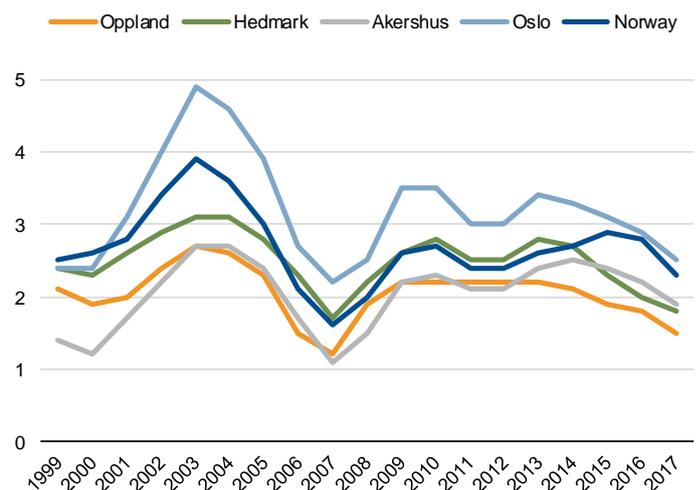
The Mjos region in south-east Norway, with approximately 200,000 residents, has low exposure to the more cyclical and dominant industry in the country, the oil and gas sector. Ostre Toten is one of Norway’s largest agricultural municipalities. In Vestre Toten, one of the country’s largest industrial areas, the construction, manufacturing and research sectors are important employers. In addition, the region is home to the Norwegian University of Science and Technology with over 3,000 students. The Mjos region, which is part of Oppland, Hedmark and Akershus counties, has experienced lower and more stable unemployment rates than in other parts of Norway (Figure 2).

Figure 1: Focused market in south-east Norway



Source: Company data

Figure 2: Unemployment rates (%)



Note: Toten’s main markets are in Oppland and Hedmark.
Source: Statistics Norway

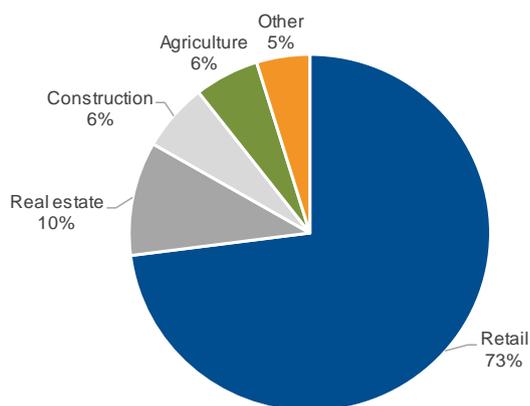
¹ Defined as proportion of residents and companies which are customers of the bank. Data assembled by Eika, Statistics Norway and the National Register of Companies.

Totens targets mainly personal customers in both its primary and secondary markets as well as business customers in its primary market. Within the secondary market, funding may be offered to existing business customers and companies where the bank already has a customer relationship with key employees. Going forward, management expects the mix of retail and corporate lending to remain unchanged.

Residential mortgages comprise over 70% of the loan portfolio and there is minimal exposure to unsecured consumer lending. The Norwegian FSA continues to note that high household debt and elevated property prices are significant vulnerabilities for the country's financial system. Measures in place since 2015 to address these risks include a five times cap on debt-to-income, caps on loan-to-value (LTV) ratios, amortization requirements for loans with LTVs above 60% and a requirement to stress a customer's ability to withstand a 5% increase in interest rates.

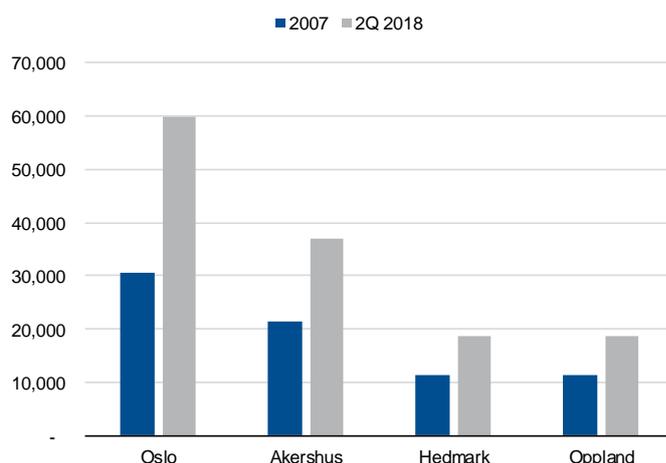
Reassuringly, house prices in the bank's main markets of Oppland and Hedmark are at a lower absolute level and have not increased to the same degree as in the Oslo area (Figure 4).

Figure 3: Breakdown of loan portfolio by sector



Note: Data as of 3Q 2018. Gross loans of NOK 13.1bn includes loans transferred to covered bond entities.
Source: Company data, Scope Ratings.

Figure 4: Average price per square meter (NOK)



Note: Average price per square meter for detached houses.
Source: Statistics Norway, Scope Ratings

Healthy profitability supported by good cost efficiency and low credit costs

Totens aims to be an independent and profitable bank offering customers competitive financial products and services. Key to its ability to meet customer needs is Toten's membership in the Eika Alliance.² Totens was a founding member and is one of the largest banks in the alliance.

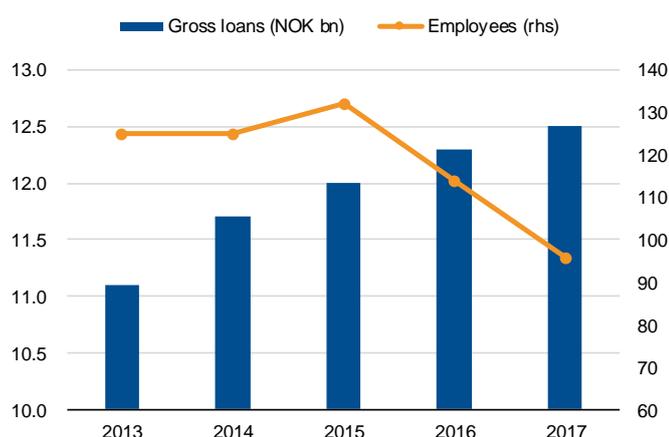
Eika's aims to strengthen the local banks in the alliance which together represent the third largest banking group in the country. Through jointly owned product companies, member banks can offer products such as insurance, credit cards and mutual funds to their customers. In addition, the alliance provides a means to achieve economies of scale regarding banking operations, IT infrastructure and the fulfilment of legal requirements (e.g. AML and GDPR).

Scope considers Totens' membership in the alliance as being critically important in the bank's ability to remain competitive. Totens relies on IT development in the Eika Alliance to ensure that its digital offering is on par with competitors. Norway is at the forefront of digital adoption with over 90% of the population using the internet and online banking services.³ Between 2013 and 2017, the bank's costs excluding IT declined by 14% while IT spend increased by 12%.

In addition, the bank has taken its own initiatives to reduce costs and boost efficiency. In 2016 and 2017, Totens reduced the number of branches to five from ten and cut the number of staff, incurring NOK 12m in restructuring costs (Figure 5). In addition, Totens refocused on its core banking activities, disposing of its real estate brokering business. Management targets a cost-income ratio below 50% (9M 2018: 40%).

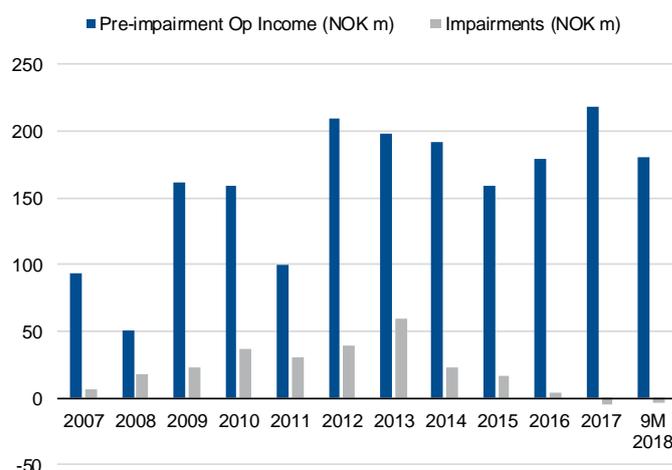
The bank's earnings have been sufficiently robust to absorb loan losses even in more difficult environments such as the 2007-2008 financial crisis and the 2014-2015 downturn in oil prices (Figure 6). Since 2016, as part of the decision to refocus on core banking activities, the bank materially reduced its securities portfolio; holdings of high yield bonds and shares had been a source of earnings volatility.

Figure 5: Gross loans vs. number of employees



Source: Company data, Scope Ratings

Figure 6: Pre-impairment operating income vs impairments (NOK 000)



Source: Company data, Scope Ratings

² Established by smaller Norwegian savings banks in 1997. There are currently about 70 member banks, with assets ranging from NOK 1bn to NOK 27bn.

³ Source: International Telecommunications Union, Statista

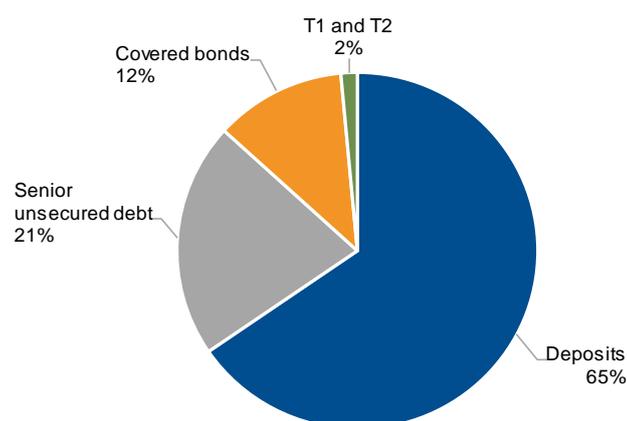
Managed reliance on market funding

Over the last several years, Totens has reduced its funding risk profile by increasing deposits, managing the use of short-term funding and by issuing covered bonds. Deposits as of 3Q 2018 funded nearly 70% of loans, up from levels of around 50% in 2011. Totens targets a minimum deposit-to-loan ratio of 70% and focuses on retail deposits rather than larger corporate deposits which may be less stable. At the same time, management does not intend to greatly increase the proportion of deposit funding because it would like to ensure that Totens maintains an active presence in capital markets by regularly issuing in sufficient size.

Covered bonds are an important source of funding and Totens has access to two covered bond vehicles – Eika Boligkreditt, the issuing entity for the Eika Alliance and Totens Sparebank Boligkreditt, its own.

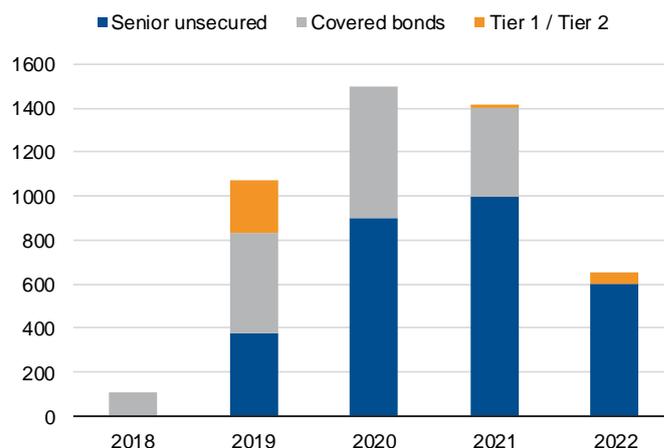
While MREL requirements for Norwegian banks are still being finalised, management anticipates that Totens will be subject to them. Consequently, the bank expects in the future to partially replace maturing senior unsecured debt with non-preferred senior debt eligible for MREL. As well, the bank foresees further issuance of AT1 and Tier 2 securities to optimise funding costs.

Figure 7: Funding profile



Note: Data as of 30 September 2018. Total = NOK 13.6bn.
Source: Company data, Scope Ratings

Figure 8: Funding maturity profile (NOK 000)



Note: Data as of 30 September 2018.
Source: Company data, Scope Ratings

As of 3Q 2018, Totens held a NOK 2.1bn liquidity portfolio (primarily government and covered bonds), equivalent to more than two times the amount of wholesale funding due within the next twelve months. The LCR and NSFR were 151% and 137%, respectively as of 30 September 2018.

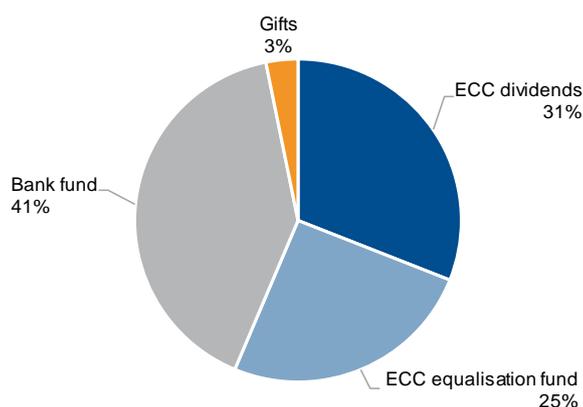
Solid solvency metrics underpinned by savings bank business model

Historically, Totens was a mutually owned foundation and its equity was comprised primarily of retained profits. In 1995, the bank issued equity capital certificates (ECC) for the first time and became listed on the Oslo Stock Exchange. Further rights issues in 1997, 2003 and 2008 were all fully subscribed. As of 30 September 2018, 55% of the bank was owned by ECC-holders.

While ECCs are like shares, they do not give holders full ownership rights to the bank's assets. In addition, there are rules concerning the governing bodies of Norwegian savings banks. These specificities help to ensure that savings banks support their local communities, by offering reliable banking services and by using a portion of earnings to finance local activities.

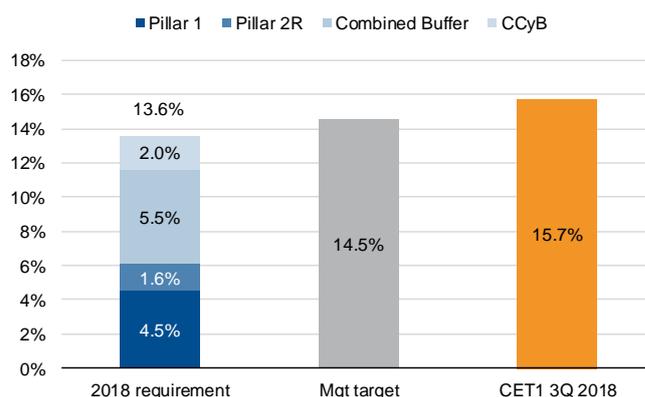
In Totens' general meetings, there are 20 elected members: seven ECC-holders, five customers, five employees, and three members appointed by the municipalities in which the bank operates. As part of their responsibilities, the elected members appoint the board of the bank. Consequently, customers, employees and community stakeholders play an important role in the governance of Totens.

Figure 9: Allocation of profit (2017)



Note: The above refers to the allocation of NOK 158m in profit for the bank and not the group. The Bank fund and ECC equalization fund are considered part of Totens' equity. With approval from the general meeting, the ECC equalization fund may be used to pay dividends or be transformed into new ECCs.
Source: Company data, Scope Ratings

Figure 10: Actual CET1 vs management target and requirements



Notes: Combined buffer comprises 2.5% capital conservation buffer and a 3% systemic risk buffer. CCyB = countercyclical capital buffer. CET1 as of 3Q 2018 includes profit after tax not expected to be distributed to ECC-holders or gifts.
Source: Company data, Scope Ratings

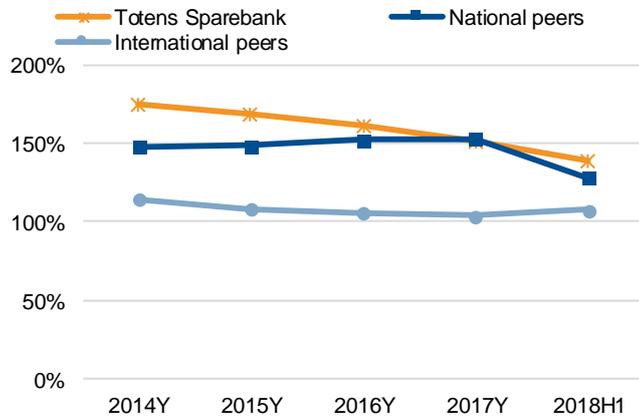
Solvency requirements for Norwegian banks are relatively stringent with even the smallest savings banks being subject to minimum CET1 requirements of 12%; comprised of the Pillar 1 minimum of 4.5%, a capital conservation buffer of 2.5%, a systemic risk buffer of 3% and a countercyclical buffer of 2%. In addition, Totens is subject to a Pillar 2 requirement of 1.6%, one of the lowest for Norwegian banks and below the average of 2.5%.

Totens intends to maintain a management buffer above its 13.6% CET1 requirement. The bank's minimum CET1 target is 14.5% which provides flexibility to cover fluctuations in growth and losses as well as regulatory uncertainties (Figure 10). Nevertheless, in its budgeting, management works towards a CET1 ratio of 15% as this is the level of peers.

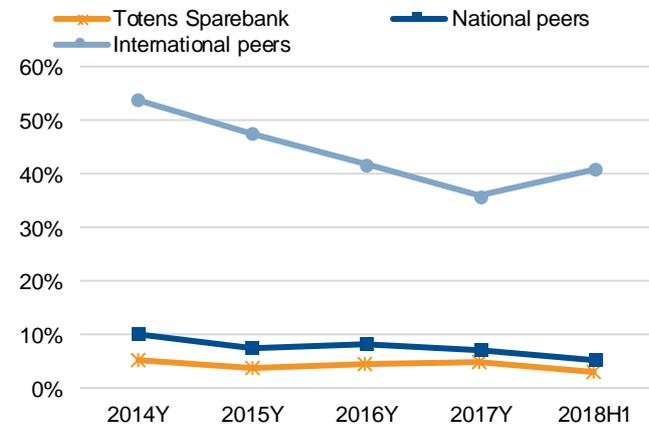
As of 30 September 2018, Totens' leverage ratio was 8.4%, comfortably above the 5% minimum required.

I. Appendix: Peer comparison

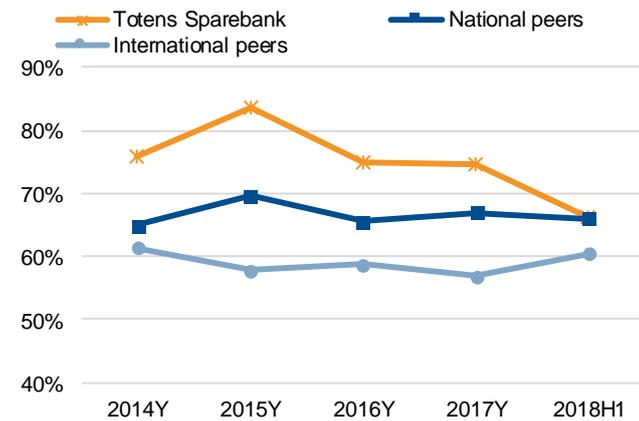
Amortised loans % Deposits



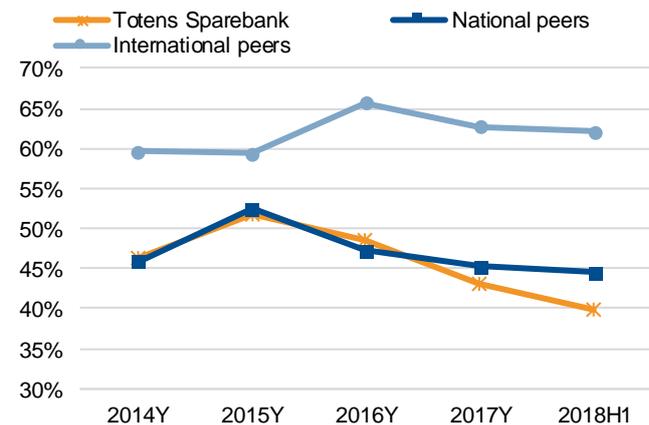
Impaired loans % Tangible equity and reserves



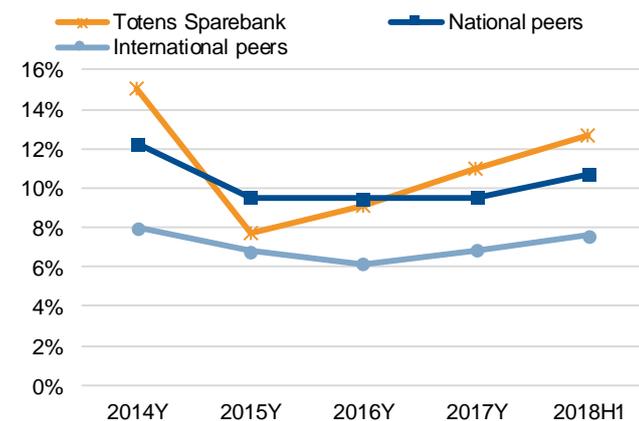
Net interest income % Operating income



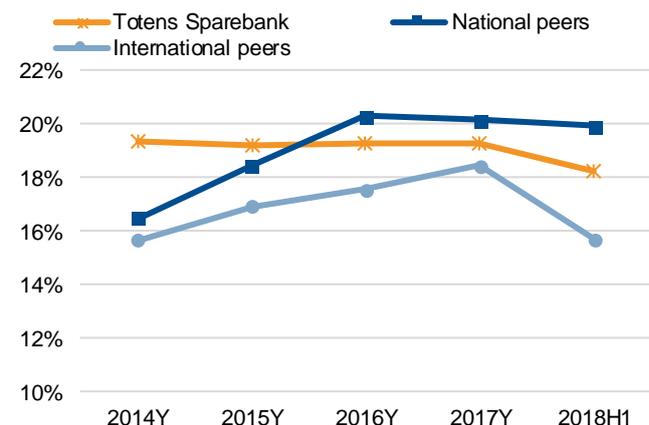
Costs % Income



Return on average equity (%)



Total capital ratio (transitional) (%)



National peers: Totens Sparebank, DNB, Landkreditt Bank, SpareBank 1 SMN, SpareBank 1 SR-Bank, Sparebank 1 Ostlandet, Jaeren Sparebank, Sandnes Sparebank.
 International peers: Totens Sparebank, Hypo-Bank Burgenland, Bausparkasse Wuestenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Principality Building Society.
 Source: SNL



II. Appendix: Selected Financial Information – Totens Sparebank

	2014Y	2015Y	2016Y	2017Y	9M 2018
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	347	144	220	169	110
Total securities	1,897	1,480	1,569	1,982	2,174
of which, derivatives	112	84	57	42	24
Net loans to customers	11,658	11,882	12,242	12,366	12,998
Other assets	125	110	105	102	107
Total assets	14,028	13,615	14,136	14,619	15,389
Liabilities					
Interbank liabilities	100	0	0	0	0
Senior debt	5,397	4,787	4,672	4,523	4,485
Derivatives	43	33	14	11	12
Deposits from customers	6,662	7,049	7,590	8,171	8,881
Subordinated debt	310	179	180	180	181
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	12,659	12,177	12,586	13,011	13,695
Ordinary equity	1,190	1,260	1,372	1,481	1,563
Equity hybrids	178	178	178	128	132
Minority interests	0	0	0	0	0
Total liabilities and equity	14,028	13,615	14,136	14,619	15,389
<i>Core tier 1/Common equity tier 1 capital</i>	1,064	1,174	1,238	1,280	1,220
Income statement summary (NOK m)					
Net interest income	271	275	261	286	212
Net fee & commission income	65	60	61	68	54
Net trading income	0	-31	6	9	15
Other income	22	25	21	20	21
Operating income	357	329	348	383	302
Operating expense	166	170	169	165	122
Pre-provision income	192	159	179	218	180
Credit and other financial impairments	-14	17	1	-5	-4
Other impairments	0	0	0	0	0
Non-recurring items	0	0	12	0	0
Pre-tax profit	206	142	169	223	184
Discontinued operations	0	0	0	0	0
Other after-tax items	0	0	0	0	0
Income tax expense	40	35	35	51	40
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	166	107	134	173	145

Source: SNL



III. Appendix: Ratios – Totens Sparebank

	2014Y	2015Y	2016Y	2017Y	9M 2018
Funding and liquidity					
Net loans/deposits (%)	175.0%	168.6%	161.3%	151.3%	146.4%
Liquidity coverage ratio (%)	NA	119.0%	142.0%	168.0%	151.0%
Net stable funding ratio (%)	NA	134.0%	130.0%	136.0%	137.0%
Asset mix, quality and growth					
Net loans/assets (%)	83.1%	87.3%	86.6%	84.6%	84.5%
NPLs/net loans (%)	0.6%	0.5%	0.6%	0.6%	0.4%
Loan-loss reserves/NPLs (%)	122.0%	177.5%	131.8%	114.0%	135.0%
Net loan growth (%)	5.3%	1.9%	3.0%	1.0%	6.8%
NPLs/tangible equity and reserves (%)	5.0%	3.5%	4.5%	4.7%	2.8%
Asset growth (%)	6.5%	-2.9%	3.8%	3.4%	7.0%
Earnings and profitability					
Net interest margin (%)	2.0%	2.0%	1.9%	2.0%	1.9%
Net interest income/average RWAs (%)	3.5%	3.6%	3.3%	3.6%	3.4%
Net interest income/operating income (%)	75.8%	83.6%	74.9%	74.7%	70.1%
Net fees & commissions/operating income (%)	18.0%	18.3%	17.4%	17.7%	17.8%
Cost/income ratio (%)	46.4%	51.8%	48.5%	43.0%	40.3%
Operating expenses/average RWAs (%)	2.1%	2.2%	2.2%	2.1%	2.0%
Pre-impairment operating profit/average RWAs (%)	2.5%	2.0%	2.3%	2.7%	2.9%
Impairment on financial assets /pre-impairment income (%)	-7.4%	10.5%	0.6%	-2.2%	-2.0%
Loan-loss provision charges/net loans (%)	0.2%	0.1%	0.0%	0.0%	0.0%
Pre-tax profit/average RWAs (%)	2.7%	1.8%	2.2%	2.8%	3.0%
Return on average assets (%)	1.2%	0.8%	1.0%	1.2%	1.3%
Return on average RWAs (%)	2.1%	1.4%	1.7%	2.1%	2.3%
Return on average equity (%)	15.1%	7.7%	9.1%	11.0%	11.8%
Capital and risk protection					
Common equity tier 1 ratio (% , fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (% , transitional)	13.7%	15.5%	15.5%	15.9%	14.5%
Tier 1 capital ratio (% , transitional)	17.4%	17.4%	17.4%	17.3%	16.0%
Total capital ratio (% , transitional)	19.3%	19.2%	19.3%	19.3%	18.2%
Leverage ratio (%)	NA	8.7%	9.3%	9.1%	8.4%
Asset risk intensity (RWAs/total assets, %)	55.4%	55.4%	56.4%	55.1%	54.6%
Market indicators					
Price/book (x)	0.7x	0.7x	0.8x	0.9x	0.9x
Price/tangible book (x)	0.3x	0.5x	0.5x	0.5x	NA
Dividend payout ratio (%)	34.1%	52.9%	50.5%	52.3%	NA

Source: Company data, SNL



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