

Totens Sparebank Issuer Rating Report



A-

STABLE

Overview

Scope assigns an Issuer Rating of A- to Totens Sparebank. The rating agency also rates the bank's senior unsecured debt at BBB+. All ratings have a Stable Outlook.

When there is further clarity about the MREL requirements of Norwegian banks, Scope expects to rate senior preferred debt at the same level as the Issuer Rating while non-preferred senior debt or debt meant for MREL will be rated one notch below 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. 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 lending concerns 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. In addition, digital capabilities and ESG matters are areas of management focus due to the evolving expectations of customers and stakeholders.
- ✓ Despite the economic disruption caused by the Covid-19 pandemic, Totens' earnings have remained resilient, supported by good cost efficiency and manageable 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-
Senior unsecured debt rating	BBB+
Outlook	Stable
Covered bond rating	AAA
Covered bond rating outlook	Stable

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Bloomberg: SCOP

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 the operating environment which materially impairs the bank's earnings capabilities. 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. To date, the bank's performance has remained resilient despite the economic disruption caused by the Covid-19 pandemic.



A loss of the benefits and economies of scale that the bank enjoys from being a member of an alliance. Without being part of an alliance, the bank would have challenges meeting the various needs of its customers and would unlikely be able to achieve the same levels of cost efficiency. As well, the covered bond issuing entity of the Eika Alliance provides an additional source of market funding.



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

Leading market shares in Ostre Toten and Vestre Toten

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 about 50% and 25%, respectively.¹ Market shares in neighboring Vestre Toten are 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.

Bank's primary market is Mjos region...

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 2020: 81%). As a savings bank with strong roots in the local area, Totens also seeks to contribute to growth and development in the region. With branches in Lena, Raufoss, Gjovik, Hamar and Raholt, management considers the bank to be sufficiently placed to serve customers and to grow in its focus markets.

which has low exposure to oil and gas sector

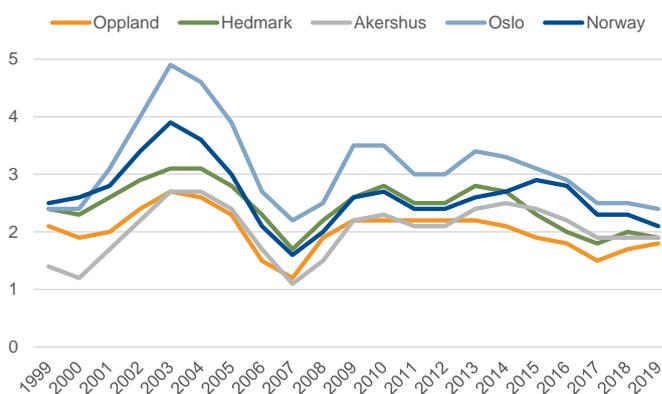
The Mjos region in south-east Norway, with approximately 200,000 residents, has low exposure to the more cyclical and dominant industry in the country, the oil and gas sector. Ostre Toten is one of Norway's largest agricultural municipalities. In Vestre Toten, one of the country's largest industrial 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, tends to have lower and more stable unemployment rates compared to other parts of the country (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.

Focused on residential mortgage lending

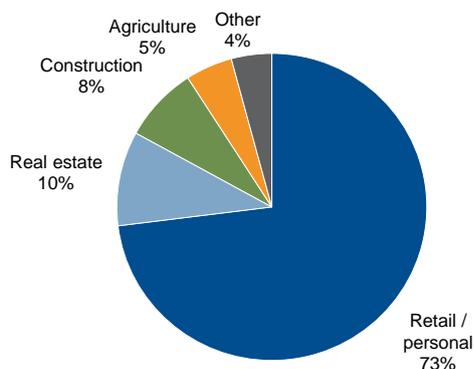
Totens targets mainly personal customers in both its primary and secondary markets as well as business customers in its primary market. Within the secondary market, funding may be offered to existing business customers and companies where the bank already has a customer relationship with key employees. Residential mortgages comprise over 70% of the loan portfolio and there is minimum exposure to unsecured consumer lending (Figure 3).

More moderate house price growth in bank's main markets

Norges Bank continues to note that high household debt and elevated property prices are material vulnerabilities for the country's financial system. Measures have been in place since 2015 to address these risks, including caps on loan-to-value (LTV) and debt-to-income (DTI) ratios, amortization requirements for loans with LTVs above 60%, and a requirement to stress a borrower's ability to withstand a 5% increase in rates.

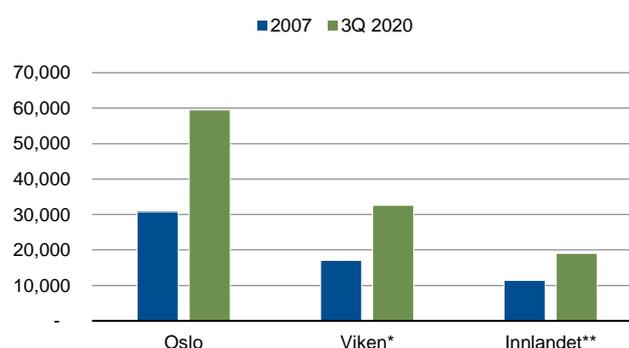
Reassuringly, house prices in the bank's main markets of Oppland and Hedmark are at a lower absolute level and have not increased to the same degree as in the Oslo area (Figure 4).

Figure 3: Breakdown of loan portfolio by sector



Note: Data as of 30 September 2020. Gross loans of NOK 15.6bn, excluding NOK 3bn in loans transferred to Eika Boligkreditt. Source: Company data, Scope Ratings.

Figure 4: Average price per square meter (NOK)



Notes: Average price per square meter for detached houses. *Viken was previously Buskerud, Akershus and Vestfold. **Innlandet was previously Hedmark and Oppland. 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 the bank's membership in the Eika Alliance.² Totens was a founding member and is one of the largest banks within the alliance.

Membership in alliance brings important benefits

The alliance aims to strengthen its member local banks 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 for the bank's ability to remain competitive.

Target cost income ratio below 40%

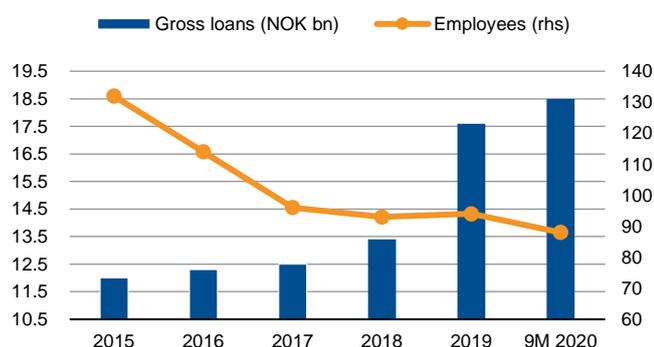
In addition, the bank has taken its own initiatives to reduce costs and boost efficiency. In 2016 and 2017, Totens reduced the number of branches to five from ten and cut the number of staff, incurring NOK 12m in restructuring costs (Figure 5). As well, Totens

² Established by smaller Norwegian savings banks in 1997. There are currently about 55 member banks. Individual banks have assets ranging from NOK 1bn to NOK 30bn.

refocused on its core banking activities, disposing of its real estate brokering business. Over the long-term, management aims for a cost-income ratio below 40%.

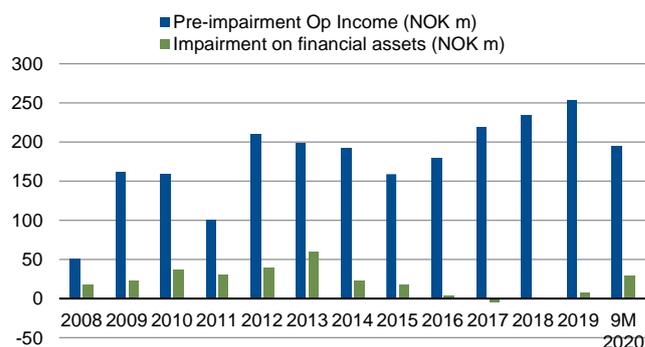
The bank's earnings continue to be sufficiently robust to absorb loan losses even in more difficult circumstances such as in the current downturn caused by the Covid-19 pandemic (Figure 6). For the nine months ending 30 September 2020, NOK 28.5m in provisions have been made, of which NOK 13m has been for Stage 1 and Stage 2 exposures. For 4Q 2020, management does not foresee the need to take provisions beyond normal levels.

Figure 5: Gross loans vs. number of employees



Source: Company data, Scope Ratings

Figure 6: Pre-impairment operating income vs impairments



Source: Company data, Scope Ratings

Regular issuer in domestic capital markets ...

with access to two covered bond issuing vehicles

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. At group level, deposits as of 3Q 2020 funded over 62% of loans, up from levels of around 50% in 2011. Excluding loans transferred to covered bond vehicles, Totens targets a minimum deposit-to-loan ratio of 70% (3Q 2020: 82%).

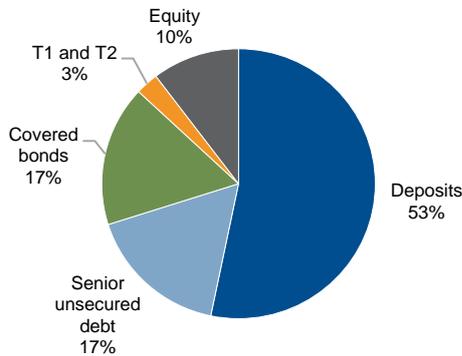
The bank also focuses on retail deposits rather than larger corporate deposits which may be less stable. At the same time, management does not intend to greatly increase the proportion of deposit funding as it would like to maintain an active presence in capital markets by issuing regularly in sufficient 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 (Figure 7). Over time, management intends to increasingly use the bank's own covered bond vehicle rather than that of the alliance. As of 3Q 2020, NOK 3bn in loans had been transferred to Eika Boligkreditt.

Management anticipates that the bank will be subject to MREL requirements when they are finalised. Consequently, in the future the bank expects 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.

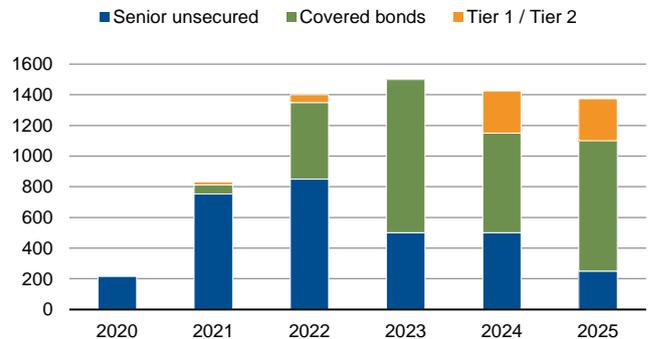
Mitigating risks related to the use of market funding, Totens maintains a high-quality liquidity portfolio (primarily government and covered bonds). As of 30 September 2020, the portfolio amounted to NOK 2.4bn, equivalent to more than two times the amount of wholesale funding due within the next twelve months (Figure 8). Meanwhile, the LCR was above 160% and the NSFR was nearly 140%.

Figure 7: Funding profile



Note: Data as of 30 September 2020. Total = NOK 18.4bn.
Source: Company data, Scope Ratings

Figure 8: Funding maturity profile (NOK 000)



Note: Data as of 30 September 2020.
Source: Company data, Scope Ratings

Solid solvency metrics underpinned by savings bank business model

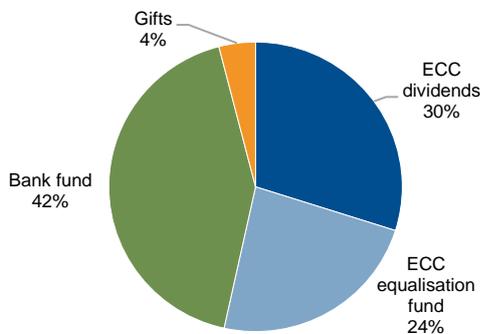
Historically, Totens was a mutually owned foundation and its equity was comprised primarily of retained profits. In 1995, the bank issued equity capital certificates (ECC) for the first time and became listed on the Oslo Stock Exchange. Further rights issues in 1997, 2003 and 2008 were all fully subscribed. As of 30 September 2019, 52% of the bank was owned by ECC-holders.

Governance structure ensures accountability to numerous stakeholders

While ECCs are similar to 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 (Figure 9).

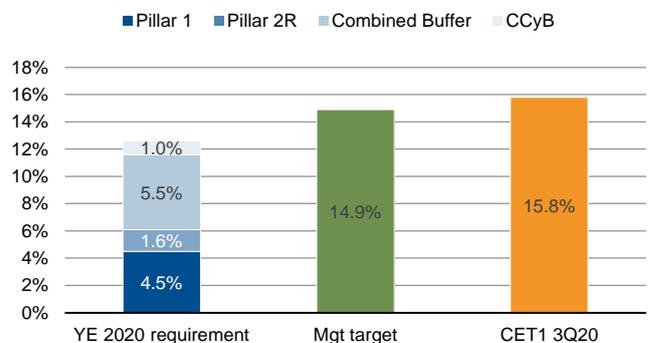
In Totens' general meeting, there are 20 elected members: seven ECC-holder representatives, five customer representatives, five employee representatives, and three members appointed by the municipalities in which the bank operates. As part of their responsibilities, the elected members appoint the board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

Figure 9: Allocation of profit (2019)



Note: The above refers to the allocation of NOK 175m 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 2020 includes profit after tax not expected to be distributed to ECC-holders or as gifts.
Source: Company data, Scope Ratings



Totens Sparebank

Issuer Rating Report

**Management buffer of 2.3%
above minimum CET1
requirement**

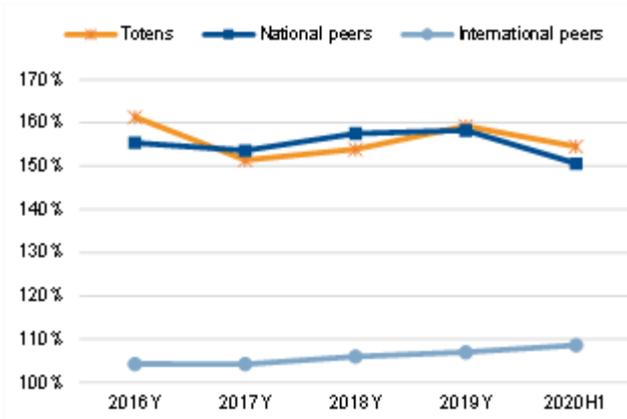
Solvency requirements for Norwegian banks are relatively stringent, with even the smallest savings banks being subject to a minimum CET1 requirement of 11%; comprised of the Pillar 1 minimum of 4.5%, a capital conservation buffer of 2.5%, a systemic risk buffer of 3% and a countercyclical buffer of 1%³. In addition, Totens is subject to a Pillar 2 requirement of 1.6%, one of the lowest for Norwegian banks. Totens intends to maintain a management buffer above its 12.6% CET1 requirement, targeting a CET1 capital ratio of 14.9% (Figure 10).

CRD IV / CRR entered into force in Norway on 31 December 2019. Consequently, the SME discount was introduced and has had a beneficial impact on the bank's CET1 capital ratio. With the additional provisions related to the SME discount under CRD V as well as regulatory changes relating to retail exposures, management estimates that these will largely offset the upcoming increase in the systemic risk buffer requirement to 4.5% from the current 3%. For banks like Totens using the standardised approach for credit risk the requirement is being phased-in until end-2022.

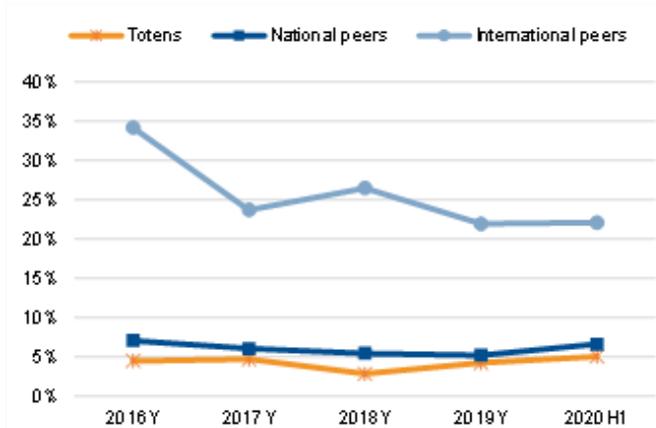
³ Countercyclical buffer rate was reduced from 2.5% to 1% on the 13 March 2020.

I. Appendix: Peer comparison

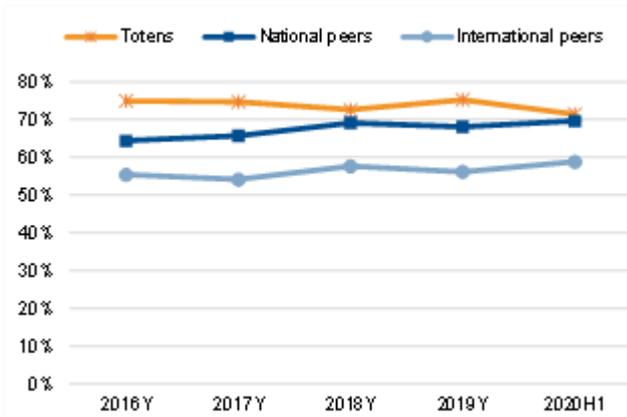
Net loans % Deposits



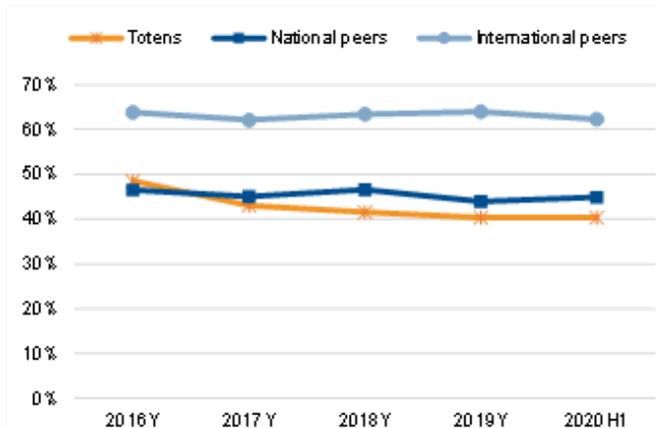
Problem loans % Tangible equity and reserves



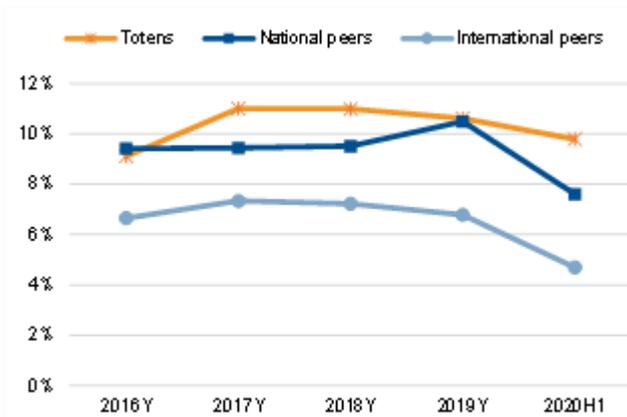
Net interest income % Operating income



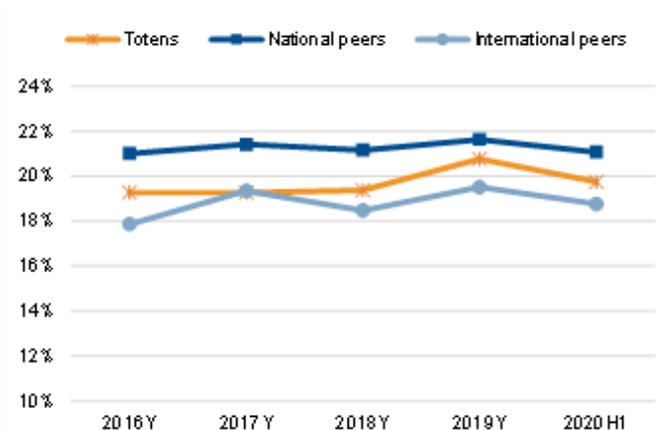
Costs % Income



Return on average equity (%)



Total capital ratio (%)



National peers: Totens Sparebank, Sandnes Sparebank, SpareBank 1 Nordvest, Landkreditt Bank, BN Bank, SpareBank 1 SMN, SpareBank 1 SR-Bank, SpareBank 1 Ostlandet, Jaeren Sparebank.
 International peers: Totens Sparebank, Hypo-Bank Burgenland, Bausparkasse Wustenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Principality Building Society, Credit Mutuel Arkea, Sparebanken Sjuharad.
 Source: SNL, Scope Ratings.



II. Appendix: Selected Financial Information – Totens Sparebank group

	2016Y	2017Y	2018Y	2019Y	9M 2020
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	220	169	89	101	109
Total securities	1,569	1,982	2,208	2,398	2,679
of which, derivatives	57	42	26	11	24
Net loans to customers	12,242	12,366	13,330	14,468	15,478
Other assets	105	102	81	98	121
Total assets	14,136	14,619	15,708	17,065	18,387
Liabilities					
Interbank liabilities	0	0	2	21	203
Senior debt	4,672	4,523	4,986	5,752	6,183
Derivatives	14	11	7	8	7
Deposits from customers	7,590	8,171	8,664	9,085	9,714
Subordinated debt	180	180	181	200	200
Other liabilities	130	126	106	98	133
Total liabilities	12,586	13,011	13,945	15,165	16,440
Ordinary equity	1,372	1,481	1,635	1,757	1,804
Equity hybrids	178	128	128	143	143
Minority interests	0	0	0	0	0
Total liabilities and equity	14,136	14,619	15,708	17,065	18,387
<i>Core tier 1/ common equity tier 1 capital</i>	1,238	1,280	1,344	1,443	1,448
Income statement summary (NOK m)					
Net interest income	261	286	288	320	240
Net fee & commission income	61	68	71	74	58
Net trading income	6	9	16	1	-7
Other income	21	20	21	31	32
Operating income	348	383	397	425	323
Operating expenses	169	165	165	171	128
Pre-provision income	179	218	232	254	195
Credit and other financial impairments	1	-5	0	7	29
Other impairments	0	0	0	0	0
Non-recurring income	3	0	0	0	0
Non-recurring expense	12	0	0	0	0
Pre-tax profit	169	223	232	246	167
Income from discontinued operations	0	0	0	0	0
Income tax expense	35	51	50	53	32
Other after-tax items	0	0	0	0	0
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	134	173	182	193	135

Source: SNL



III. Appendix: Selected Financial Information – Totens Sparebank group

	2016Y	2017Y	2018Y	2019Y	9M2020
Funding and liquidity					
Net loans/ deposits (%)	161%	151%	154%	159%	159%
Liquidity coverage ratio (%)	142%	168%	174%	192%	164%
Net stable funding ratio (%)	130%	136%	139%	138%	NA
Asset mix, quality and growth					
Net loans/ assets (%)	86.6%	84.6%	84.9%	84.8%	84.2%
Problem loans/ gross customer loans (%)	0.6%	0.6%	0.4%	0.6%	0.7%
Loan loss reserves/ problem loans (%)	131.8%	114.0%	137.0%	94.5%	88.3%
Net loan growth (%)	3.0%	1.0%	7.8%	8.5%	9.3%
Problem loans/ tangible equity & reserves (%)	4.5%	4.7%	2.8%	4.2%	5.5%
Asset growth (%)	3.8%	3.4%	7.4%	8.6%	10.3%
Earnings and profitability					
Net interest margin (%)	1.9%	2.0%	1.9%	1.9%	1.8%
Net interest income/ average RWAs (%)	3.3%	3.6%	3.5%	3.6%	3.6%
Net interest income/ operating income (%)	74.9%	74.7%	72.6%	75.3%	74.2%
Net fees & commissions/ operating income (%)	17.4%	17.7%	17.9%	17.3%	17.9%
Cost/ income ratio (%)	48.5%	43.0%	41.5%	40.3%	39.6%
Operating expenses/ average RWAs (%)	2.2%	2.1%	2.0%	1.9%	1.9%
Pre-impairment operating profit/ average RWAs (%)	2.3%	2.7%	2.8%	2.8%	2.9%
Impairment on financial assets / pre-impairment income (%)	0.6%	-2.2%	0.1%	2.9%	14.6%
Loan loss provision/ average gross loans (%)	0.0%	0.0%	0.0%	0.1%	0.3%
Pre-tax profit/ average RWAs (%)	2.2%	2.8%	2.8%	2.8%	2.5%
Return on average assets (%)	1.0%	1.2%	1.2%	1.2%	1.0%
Return on average RWAs (%)	1.7%	2.1%	2.2%	2.2%	2.0%
Return on average equity (%)	9.1%	11.0%	11.0%	10.6%	9.5%
Capital and risk protection					
Common equity tier 1 ratio (% , fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (% , transitional)	15.5%	15.9%	15.8%	16.8%	15.8%
Tier 1 capital ratio (% , transitional)	17.4%	17.3%	17.3%	18.4%	17.4%
Total capital ratio (% , transitional)	19.3%	19.3%	19.4%	20.8%	19.6%
Leverage ratio (%)	9.3%	9.1%	9.1%	9.0%	8.4%
Asset risk intensity (RWAs/ total assets, %)	56.4%	55.1%	54.3%	50.4%	49.8%

Source: SNL



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