

Totens Sparebank Issuer Rating Report



Overview

Scope has assigned 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.

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 having recovered 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 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 is able to provide a full range of products and services and benefits from economies of scale. In addition, 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 rating	BBB+
Covered bond ratings (Totens Sparebank Boligkreditt)	AAA
Covered bond outlook	Stable

Lead Analyst

Pauline Lambert
p.lambert@scoperatings.com

Team Leader

Dierk Brandenburg
d.brandenburg@scoperatings.com

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY
Phone +44 203-457 0444

Headquarters

Lennéstraße 5
10785 Berlin
Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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 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 challenges meeting the various needs of its customers and would unlikely be able 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 on unprofitable terms 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

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 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.

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 2019: 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 five 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.

Mjos region has low exposure to oil and gas sector

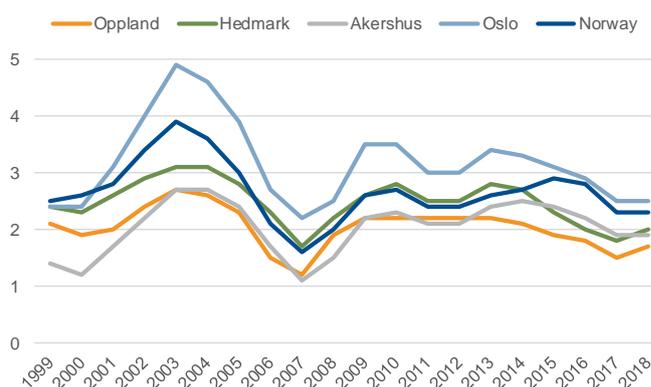
The Mjos region in south-east Norway, with approximately 200,000 residents, has low exposure to the more cyclical and dominant industry in the country, the oil and gas sector. Ostre Toten is one of Norway's largest agricultural municipalities. In Vestre Toten, one of the country's largest industrial 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 than in 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.

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.

Focused on residential mortgage lending

With the expected implementation of CRD IV in Norway later this year, the capital requirements for lending to SMEs will reduce (SME discount). While the bank sees opportunities in this segment, management does not expect the current mix of personal and corporate lending to substantially change. Residential mortgages comprise over 70% of the loan portfolio and there is minimal exposure to unsecured consumer lending.

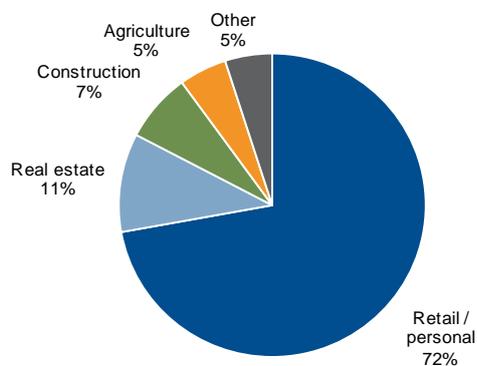
Macroprudential measures in place to address risks

The Norwegian FSA 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. In September, the FSA recommended that existing home mortgage regulations remain in effect while proposing that the cap on DTI and the flexibility for exceptions be reduced. In addition, the recent introduction of a new unsecured debt registry enables banks to better assess borrowers' financial health.

More moderate house price growth in bank's main markets

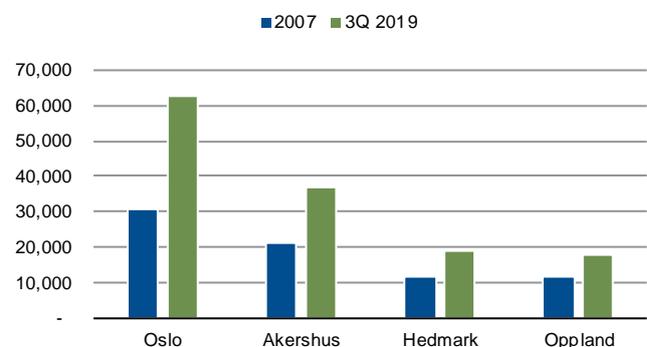
Reassuringly, house prices in the bank's main markets of Oppland and Hedmark are at a lower absolute level and have not increased to the same degree as in the Oslo area (Figure 4).

Figure 3: Breakdown of loan portfolio by sector



Note: Data as of 3Q 2019. Gross loans of NOK 14.4bn, excluding NOK 3.2bn in loans transferred to Eika Boligkreditt.
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 are able to 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. The alliance holds a 30% ownership stake in SDC, a technology company used by 120 financial institutions in five Nordic countries. Norway is at the forefront of digital adoption with over 90% of the population using the internet and online banking services.³

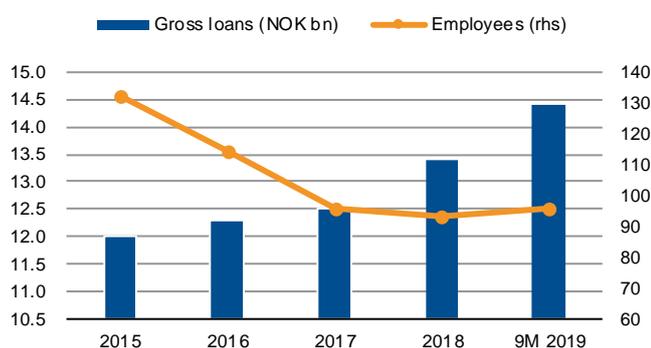
In addition, the bank has taken its own initiatives to reduce costs and boost efficiency. In 2016 and 2017, Totens reduced the number of branches to five from ten and cut the number of staff, incurring NOK 12m in restructuring costs (Figure 5). As well, Totens refocused on its core banking activities, disposing of its real estate brokering business. Over the long-term, management aims for a cost-income ratio below 40% (Q3 2019: 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.

Membership in Eika Alliance brings important benefits

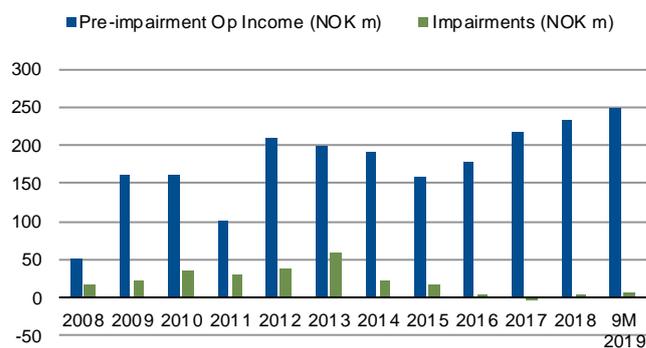
Continued attention to improving efficiency

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

² Established by smaller Norwegian savings banks in 1997. There are currently about 65 member banks although in 2022 the number will reduce as 11 banks have given notice to exit the alliance. Individual banks have assets ranging from NOK 1bn to NOK 27bn.

³ Source: International Telecommunications Union, Statista

Regular issuer in domestic capital markets ...

with access to two covered bond issuing vehicles

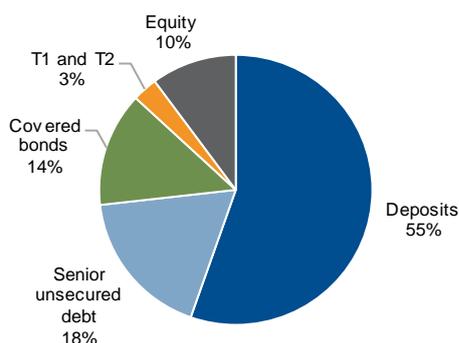
Managed reliance on market funding

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. Deposits as of 3Q 2019 funded over 65% of loans, up from levels of around 50% in 2011. Including loans transferred to covered bond vehicles, Totens targets a minimum deposit-to-loan ratio of 47% (3Q 2019: 52%). 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 2019, NOK 3.2bn in loans had been transferred to Eika Boligkreditt.

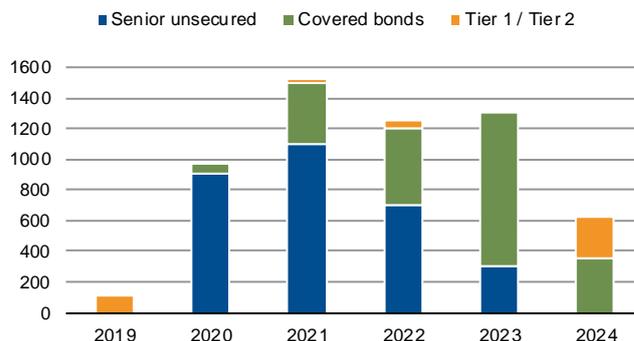
Management anticipates that the bank will be subject to MREL requirements when they are finalised. Consequently, in the future the bank expects to partially replace maturing senior unsecured debt with non-preferred senior debt eligible for MREL. As well, the bank foresees further issuance of AT1 and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

Figure 7: Funding profile



Note: Data as of 30 September 2019. Total = NOK 16.8bn.
Source: Company data, Scope Ratings

Figure 8: Funding maturity profile (NOK 000)



Note: Data as of 30 September 2019.
Source: Company data, Scope Ratings

Liquidity portfolio helps to mitigate risks related to the use of market funding

As of 3Q 2019, Totens held a NOK 2.4bn 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 was 153% as of 30 September 2019.

Solid solvency metrics underpinned by savings bank business model

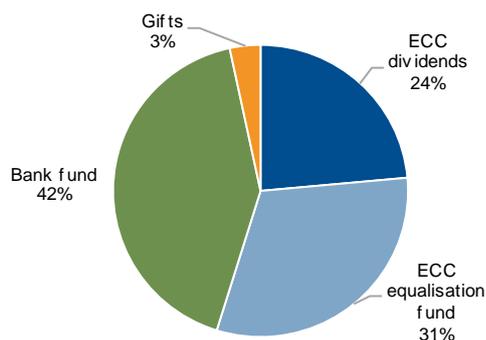
Historically, Totens was a mutually owned foundation and its equity was comprised primarily of retained profits. In 1995, the bank issued equity capital certificates (ECC) for the first time and became listed on the Oslo Stock Exchange. Further rights issues in 1997, 2003 and 2008 were all fully subscribed. As of 30 September 2019, 53% 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.

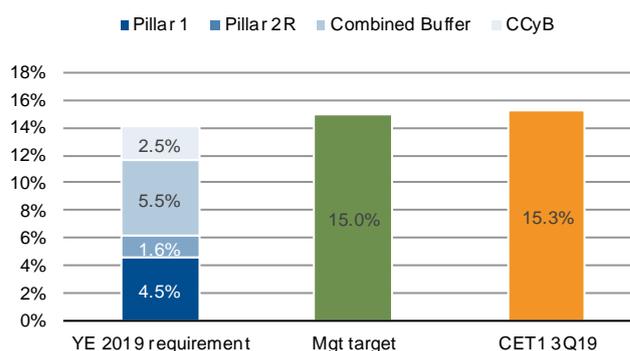
In Totens' general meetings, there are 20 elected members: seven ECC-holders, five customers, five employees, and three members appointed by the municipalities in which the bank operates. As part of their responsibilities, the elected members appoint the board of the bank. Consequently, customers, employees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

Figure 9: Allocation of profit (2018)



Note: The above refers to the allocation of NOK 208m 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 2019 includes profit after tax not expected to be distributed to ECC-holders or as gifts.
Source: Company data, Scope Ratings

Minimum CET1 requirement of 12.5% for all Norwegian banks

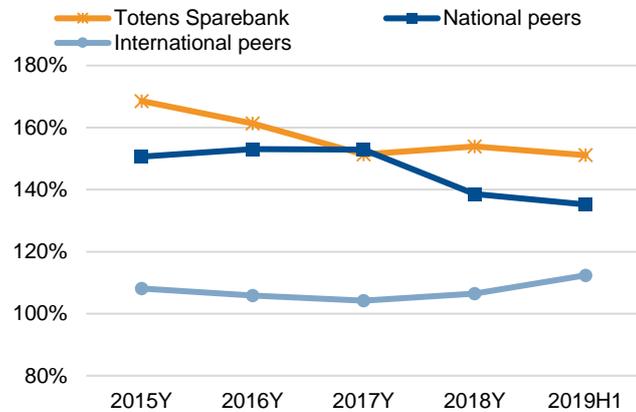
Solvency requirements for Norwegian banks are relatively stringent, with even the smallest savings banks being subject to a minimum CET1 requirement of 12.5%; comprised of the Pillar 1 minimum of 4.5%, a capital conservation buffer of 2.5%, a systemic risk buffer of 3% and a countercyclical buffer of 2.5%⁴. 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 14.1% CET1 requirement, targeting a CET1 capital ratio of 15% (Figure 10).

Management estimates that the introduction of the SME discount will benefit the CET1 capital ratio by about 1% based on the bank's current loan portfolio. This would provide a meaningful offset to the FSA's proposed 1.5% increase to the systemic risk buffer (phased-in over a three-year period) for banks using the standardised approach for credit risk like Totens.

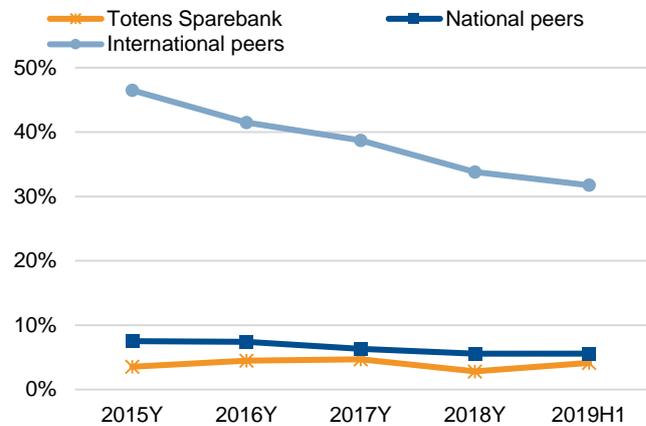
⁴ Countercyclical buffer rate is currently 2% but will increase to 2.5% as of 31 December 2019.

I. Appendix: Peer comparison

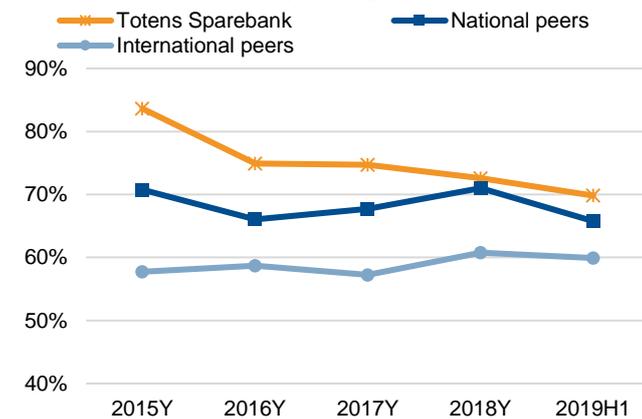
Net loans % Deposits



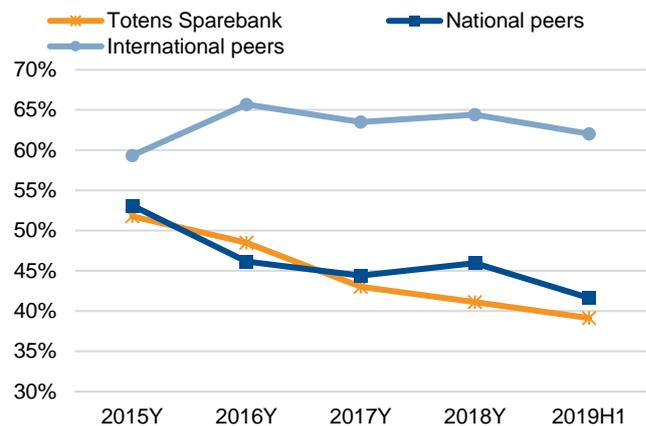
Problem loans % Tangible equity and reserves



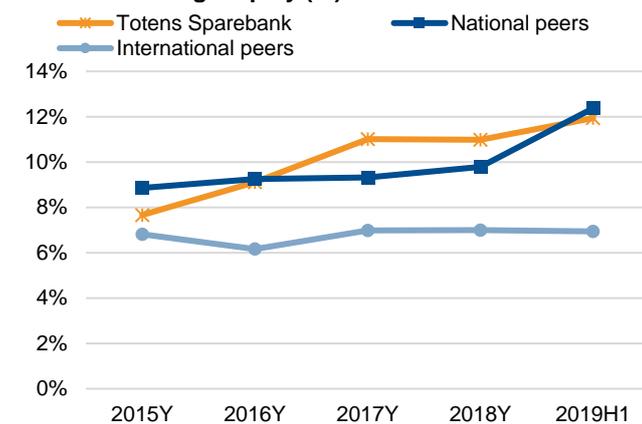
Net interest income % Operating income



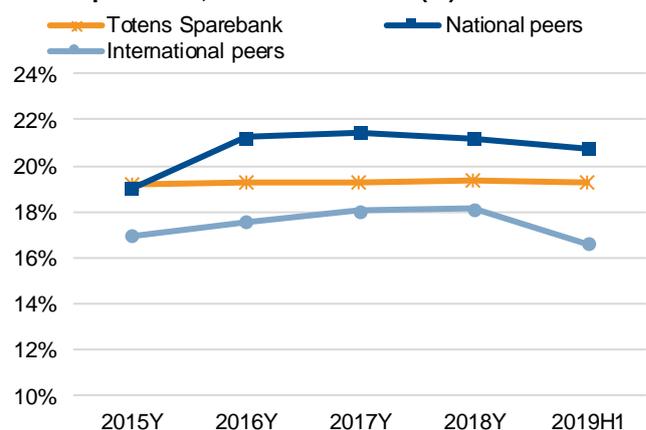
Costs % Income



Return on average equity (%)



Total capital ratio, transitional basis (%)



National peers: Totens Sparebank, DNB, Landkreditt Bank, SpareBank 1 SMN, SpareBank 1 SR-Bank, Sparebank 1 Ostlandet, Jaeren Sparebank, Sandnes Sparebank, BN Bank ASA.

International peers: Totens Sparebank, Hypo-Bank Burgenland, Bausparkasse Wustenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Principality Building Society.

Note: 1H 2019 data is not available for Hypo-Bank Burgenland and Bausparkasse Wustenrot.
Source: SNL



Totens Sparebank

Issuer Rating Report

II. Appendix: Selected Financial Information – Totens Sparebank group

	2015Y	2016Y	2017Y	2018Y	9M 2019
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	144	220	169	89	139
Total securities	1,480	1,569	1,982	2,208	2,422
of which, derivatives	84	57	42	26	17
Net loans to customers	11,882	12,242	12,366	13,330	14,304
Other assets	110	105	102	81	121
Total assets	13,615	14,136	14,619	15,708	16,986
Liabilities					
Interbank liabilities	0	0	0	2	6
Senior debt	4,787	4,672	4,523	4,986	5,369
Derivatives	33	14	11	7	8
Deposits from customers	7,049	7,590	8,171	8,664	9,325
Subordinated debt	179	180	180	181	262
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	12,177	12,586	13,011	13,945	15,102
Ordinary equity	1,260	1,372	1,481	1,635	1,695
Equity hybrids	178	178	128	128	189
Minority interests	0	0	0	0	0
Total liabilities and equity	13,615	14,136	14,619	15,708	16,986
<i>Core tier 1/Common equity tier 1 capital</i>	1,174	1,238	1,280	1,344	1,316
Income statement summary (NOK m)					
Net interest income	275	261	286	288	235
Net fee & commission income	60	61	68	71	55
Net trading income	-31	6	9	16	2
Other income	25	21	20	21	31
Operating income	329	348	383	397	321
Operating expense	170	169	165	163	126
Pre-provision income	159	179	218	234	195
Credit and other financial impairments	17	1	-5	0	2
Other impairments	0	0	0	0	0
Non-recurring items	0	12	0	0	0
Pre-tax profit	142	169	223	234	193
Discontinued operations	0	0	0	0	0
Other after-tax items	0	0	0	0	0
Income tax expense	35	35	51	52	40
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	107	134	173	182	152

Source: SNL



III. Appendix: Ratios – Totens Sparebank group

	2015Y	2016Y	2017Y	2018Y	9M 2019
Funding and liquidity					
Net loans/ deposits (%)	168.6%	161.3%	151.3%	153.9%	153.4%
Liquidity coverage ratio (%)	119.0%	142.0%	168.0%	174.0%	153.0%
Net stable funding ratio (%)	134.0%	130.0%	136.0%	139.0%	NA
Asset mix, quality and growth					
Net loans/ assets (%)	87.3%	86.6%	84.6%	84.9%	84.2%
Problem loans/ gross customer loans (%)	0.5%	0.6%	0.6%	0.4%	0.6%
Loan loss reserves/ problem loans (%)	177.5%	131.8%	114.0%	137.0%	89.2%
Net loan growth (%)	1.9%	3.0%	1.0%	7.8%	9.7%
Problem loans/ tangible equity & reserves (%)	3.5%	4.5%	4.7%	2.8%	4.2%
Asset growth (%)	-2.9%	3.8%	3.4%	7.4%	10.8%
Earnings and profitability					
Net interest margin (%)	2.0%	1.9%	2.0%	1.9%	1.9%
Net interest income/ average RWAs (%)	3.6%	3.3%	3.6%	3.5%	3.5%
Net interest income/ operating income (%)	83.6%	74.9%	74.7%	72.6%	73.0%
Net fees & commissions/ operating income (%)	18.3%	17.4%	17.7%	17.9%	17.0%
Cost/ income ratio (%)	51.8%	48.5%	43.0%	41.1%	39.3%
Operating expenses/ average RWAs (%)	2.2%	2.2%	2.1%	2.0%	1.9%
Pre-impairment operating profit/ average RWAs (%)	2.0%	2.3%	2.7%	2.8%	2.9%
Impairment on financial assets / pre-impairment income (%)	10.5%	0.6%	-2.2%	0.1%	1.2%
Loan loss provision/ average gross loans (%)	0.1%	0.0%	0.0%	0.0%	0.0%
Pre-tax profit/ average RWAs (%)	1.8%	2.2%	2.8%	2.8%	2.9%
Return on average assets (%)	0.8%	1.0%	1.2%	1.2%	1.3%
Return on average RWAs (%)	1.4%	1.7%	2.1%	2.2%	2.3%
Return on average equity (%)	7.7%	9.1%	11.0%	11.0%	11.3%
Capital and risk protection					
Common equity tier 1 ratio (% , fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (% , transitional)	15.5%	15.5%	15.9%	15.8%	14.3%
Tier 1 capital ratio (% , transitional)	17.4%	17.4%	17.3%	17.3%	15.9%
Total capital ratio (% , transitional)	19.2%	19.3%	19.3%	19.4%	18.1%
Leverage ratio (%)	8.7%	9.3%	9.1%	9.1%	8.3%
Asset risk intensity (RWAs/ total assets, %)	55.4%	56.4%	55.1%	54.3%	54.1%
Market indicators					
Price/ book (x)	0.7x	0.8x	0.9x	0.9x	0.9x
Price/ tangible book (x)	0.5x	0.5x	0.5x	NA	NA
Dividend payout ratio (%)	52.9%	50.5%	52.3%	NA	NA

Source: Company data, SNL



Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin
Phone +49 30 27891 0

London

Suite 301
2 Angel Square
London EC1V 1NY
Phone +44 20 3457 0444

Oslo

Haakon VII's gate 6
N-0161 Oslo
Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main
Phone +49 69 66 77 389 0

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid
Phone +34 914 186 973

Paris

1 Cour du Havre
F-75008 Paris
Phone +33 1 8288 5557

Milan

Via Paleocapa 7
IT-20121 Milan
Phone +39 02 30315 814

info@scoperatings.com
www.scoperatings.com

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