BN Bank ASA
Issuer Rating Report

A- STABLE

Scope's credit view (summary)

The **A- issuer rating** reflects BN Bank's sound financial profile and ownership by solid member banks of the SpareBank 1 Alliance (SB1 Alliance). Management is successfully executing on a strategy to achieve sustainable returns. This entails growing mortgage lending volume, increasing margins by targeting customers willing to pay for more service, and improving efficiency. For 1H 2021, the reported return on equity was 10.6% with the cost income ratio below 33%.

Strategic decisions such as ceasing unsecured consumer lending activities and restricting the geographic focus of the commercial real estate business support the bank's sound asset quality profile. As of 30 June 2021, non-performing and other doubtful commitments accounted for 0.46% of gross lending. Nevertheless, high household debt and elevated property prices remain risks, particularly in the bank's primary market, the Oslo region.

Incorporating the concerns of external stakeholders, the bank has defined a sustainability strategy focused on two main goals – to actively monitor and reduce the climate footprint of the loan portfolio and to further incorporate sustainability into business operations. Work is being done to integrate ESG risks into the bank's customer onboarding and credit granting processes.

While the bank has actively grown deposits, the use of market funding remains material. BN Banks enjoys regular access to the domestic unsecured debt market as well as to secured funding through the covered bond issuing entities of the SB1 Alliance.

Outlook

The Stable Outlook reflects our expectation that BN Bank's operating performance will continue to be resilient, with credit impairments remaining at levels which can be comfortably absorbed by earnings.

Credit strengths

- Focus on generating sustainable returns underpinned by good cost efficiency and sound asset quality
- Reassuring solvency position
- Owned by solid member banks of SpareBank 1 Alliance

Credit weaknesses

- More exposed to commercial real estate sector than peers
- Majority of loan exposure is to Oslo region where property prices remain elevated
- Reliance on market funding

Positive rating-change drivers

- Sustained and profitable growth without an increase in the bank's risk profile

Negative rating-change drivers

- Decline in operating environment which materially impacts earnings and capitalisation
- Loss of benefits from affiliation with SpareBank 1 Alliance

Ratings & Outlook

Issuer rating	A-
Preferred senior unsecured debt rating	A-
Non-preferred senior unsecured debt rating	BBB+
Outlook	Stable

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Bloomberg: RESP SCOP

Issuer profile

With roots dating back to 1961, BN Bank is primarily a digital bank serving both retail and corporate customers in Norway. Headquartered in Trondheim, the bank has 102,100 retail customers and 6,600 corporate customers. Over the long-term, management aims for a 70% retail / 30% corporate lending mix.

In the retail market, the bank has a nationwide presence and focuses primarily on mortgage lending. In the corporate market, the bank is a specialised commercial real estate lender operating mainly in the Oslo region. This business operates from a branch office in Oslo with a dedicated and experienced team of about 20 employees.

Since December 2008, BN Bank has been wholly owned by member banks of the SpareBank 1 Alliance. Established in 1996, the alliance is comprised of regional and local savings banks cooperating to achieve economies of scale and to provide a full range of competitive financial services and products. Collectively, the alliance is the second largest lender in the country with circa 20% of the retail market and circa 15% of the corporate market.

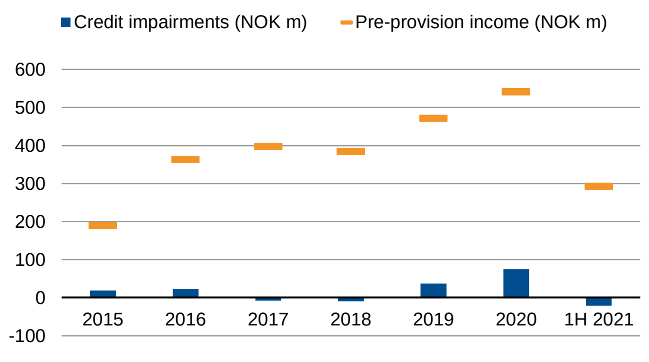
Successfully executing on strategy, with a continued focus on profitability and cost efficiency

BN Bank's strategy is driven by its owners' expectation for the bank to generate sustainable returns in line with their own (generally above 12%). Over time, this has led management to significantly refocus the commercial real estate financing business, sell the unprofitable real estate brokerage business, and cease unsecured consumer lending activities. Efforts in recent years to increase business volumes and improve cost efficiency are giving rise to higher returns.

In the retail market, the bank targets less price sensitive customers willing to pay for more service and aims to develop more enduring client relationships. Distribution channels have also been expanded beyond the internet to include mortgage brokers, a partnership with the real estate group, Krogsveen, and open banking initiatives.

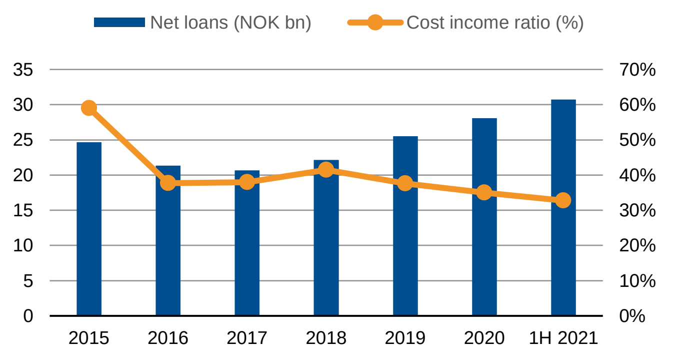
In the corporate market, BN Bank is a recognised niche player in financing traditional commercial property. By pursuing smaller parts of larger commercial property portfolios, the focus is on higher margin business. In addition, the bank has a construction loan portfolio which is limited to 15% of the total corporate loan book (12.8% as of 30 June 2021).

Figure 1: Pre-provision income and impairments (NOK m)



Source: Bank, Scope Ratings.

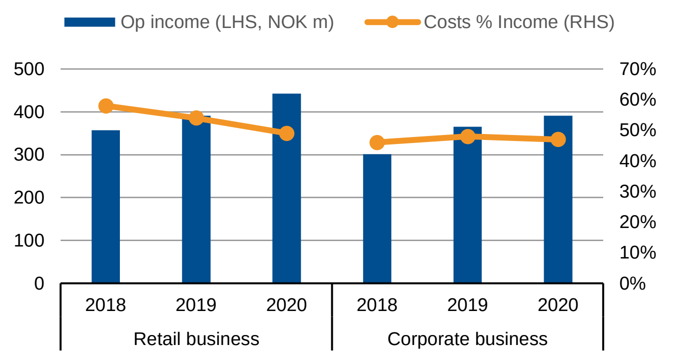
Figure 2: Loans (NOK bn) and cost income ratio (%)



Source: Bank, Scope Ratings.

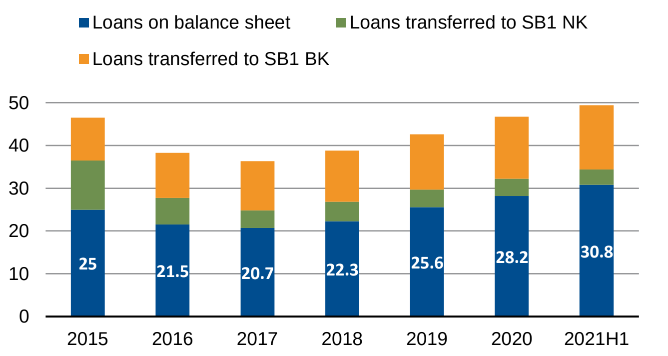
Over the long-term, management aims for a 70% retail / 30% corporate lending mix. The proportion of retail lending which is comprised almost entirely of residential mortgages has gradually increased and stood at 63% as of 30 June 2021.

Figure 3: Development of retail and corporate businesses



Source: Bank, Scope Ratings.

Figure 4: Total loan origination (NOK bn)



Notes: SB1 NK = SpareBank 1 Naeringskreditt; SB1 BK = SpareBank 1 Boligkreditt. Source: Bank, Scope Ratings.

Ownership by SpareBank 1 Alliance banks brings significant benefits, including strong governance

The bank's ownership is dominated by two large regional banks each holding stakes of about 35% (Figure 5). Over time, the ownership structure has become more concentrated as smaller banks in the SB1 Alliance have terminated their ownership or have merged.

With five senior executives from the owner banks being represented on its board, the owners have significant influence on the bank's strategic direction. The owners consider BN Bank a solid investment and have expressed their intention to further strengthen the bank's development. BN Bank not only provides a platform for trying new business ideas but also access to the Oslo region. The two owners with the largest stakes, SpareBank 1 SMN and SpareBank 1 SR-Bank, are based in Trondheim and Stavanger, respectively.

BN Bank enjoys significant benefits from its relationship with the SB1 Alliance. These include the use of common IT systems, access to credit models based on data from alliance customers, and the exchange of expertise on topics such as market and liquidity risks and regulatory developments.

Further, BN Bank uses the covered bond issuing entities of the SB1 Alliance for its funding needs (Figure 4). In recent years, the bank has pursued a more balanced growth strategy focusing on both loans and deposits, but market funding remains important. The access to covered bond funding is highly beneficial as this market has proven to be relatively stable and liquid. BN Bank aims to transfer 50% of mortgages and 40% of commercial real estate loans to the alliance's covered bond issuing companies.

Figure 5: Selected data on BN Bank's owners

	Stake in BN Bank (%)	Assets (NOK bn)	Return on Avg Assets (%)	Return on Avg Equity (%)	Costs % Income	NPLs % Gross loans	CET1 capital ratio (%)
SpareBank 1 SMN	35.02%	200.4	1.6	14.0	44.2	2.5	18.3
SpareBank 1 SR-Bank	35.02%	299.9	1.1	11.8	39.1	1.7	17.9
SpareBank 1 Nord-Norge	9.99%	124.0	1.7	13.7	39.1	0.5	18.0
SpareBank 1 Østlandet	9.99%	155.2	1.3	11.0	45.2	0.3	17.8
SpareBank 1 Sørøst-Norge	7.46%	73.8	1.5	11.3	39.9	0.5	20.0
SpareBank 1 Østfold Akershus	2.52%	27.1	1.8	12.2	39.0	0.6	18.2

Notes: Data as of 30 June 2021. In September 2021, SpareBank 1 Modum signed a letter of intent to merge with SpareBank 1 Sorost-Norge.
Source: SNL, Scope Ratings.

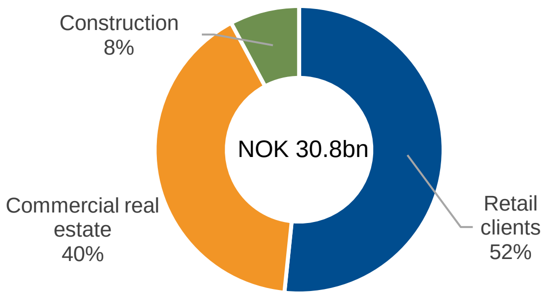
The bank's focus on the Oslo region is a risk considering elevated property prices

While a nationwide provider of mortgages, over 85% of the bank's exposure is in south-eastern Norway. The bank performs operations from its base in Trondheim and thus, prudently restricts lending to well-functioning markets with good market data. As of 30 June 2021, nearly 77% of the mortgage portfolio had LTVs below 70% while another 21% had LTVs between 70% and 85%. Just over 11% of mortgages are greater than NOK 5m in size.

Compared to peers, BN Bank has greater exposure to the commercial real estate sector but has demonstrated the ability to manage these risks well. Over the last three years, the risk profile of the corporate loan portfolio has remained relatively stable. The bank finances commercial properties with multi-year leases and high occupancy rates. The portfolio is diversified across various types of commercial property, with lower exposure to retail and hotels as these are more cyclical industries. Management has restricted the business to Oslo and the Ostlandet region based on their expertise and low loss experience in this geographic area.

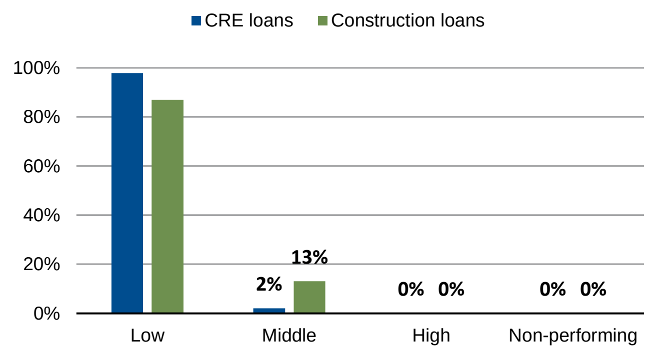
As of 30 June 2021, the average LTV of the commercial real estate portfolio was less than 70%, while the proportion of loans with LTVs in excess of 80% was less than 15%. To date, there has not been a material impact from the economic disruption caused by the Covid-19 pandemic. After incurring NOK 55m in credit provisions for the corporate book in 2020, there has been NOK 21m in reversals for 1H 2021.

Figure 6: Loans on balance sheet (30 June 2021)



Source: Bank, Scope Ratings.

Figure 7: Risk profile of corporate portfolio (30 June 2021)



Source: Bank, Scope Ratings.

For some time, Norges Bank has highlighted elevated retail and commercial property prices as a key vulnerability for the Norwegian financial system. While commercial real estate prices declined in the first half of 2020, they currently stand about 10% higher than pre-pandemic levels. The pandemic has had little impact on sectors such as law, consulting, and finance that normally rent prime office space. In its September monetary policy report, Norges Bank stated that CRE losses are expected to be limited going forward due to the ongoing economic recovery.

The housing market has also remained strong, with prices up nearly 9% in 2020.[1] Norges Bank expects growth to modereate as interest rates rise and household consumption patterns normalise. In Oslo, house price inflation slowed during the first three months of 2021. The stock of existing homes is increasing, and price inflation has migrated to regions surrounding Oslo where prices increased more during the pandemic compared to larger cities in Norway.

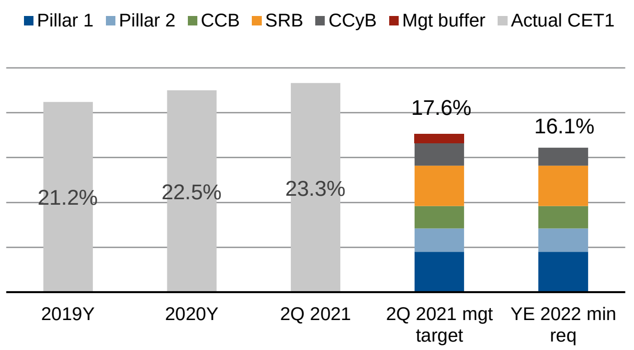
Reassuring solvency and liquidity positions

As of 30 June 2021, BN Bank's CET1 capital ratio was 23.3%, well above regulatory requirements. The current CET1 requirement is 15.1%, which includes a Pillar 2 requirement of 2.6%, a systemic risk buffer of 4.5% and a countercyclical buffer of 1%. Management has set an internal CET1 target of 17.6% which includes a 1% management buffer and anticipates the eventual return of the countercyclical buffer to 2.5% (Figure 8).

As part of the response to the Covid-19 pandemic, the countercyclical buffer was lowered to 1% from 2.5% in March 2020. With effect from 30 June 2022, the countercyclical buffer rate will be increased to 1.5%. And from 31 December 2022, the countercyclical buffer will be further raised to 2%.

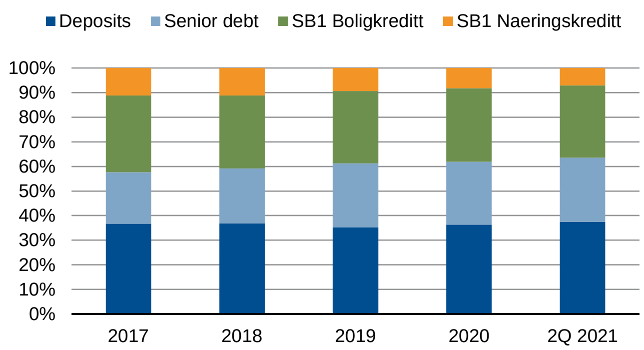
Currently, management does not foresee material changes to its capital requirements stemming from regulatory changes – some such as adjustments to IRB models will drive the amount of required capital higher while others such as the SME discount will provide an offset. BN Bank has been using advanced internal rating-based (A-IRB) models since 2014 for its corporate portfolio and since 2015 for its retail portfolio. The bank believes that using A-IRB models enhances risk and performance management.

Figure 8: Capital position vs target and requirements (%)



Source: Bank, Scope Ratings.

Figure 9: Funding profile



Source: Bank, Scope Ratings.

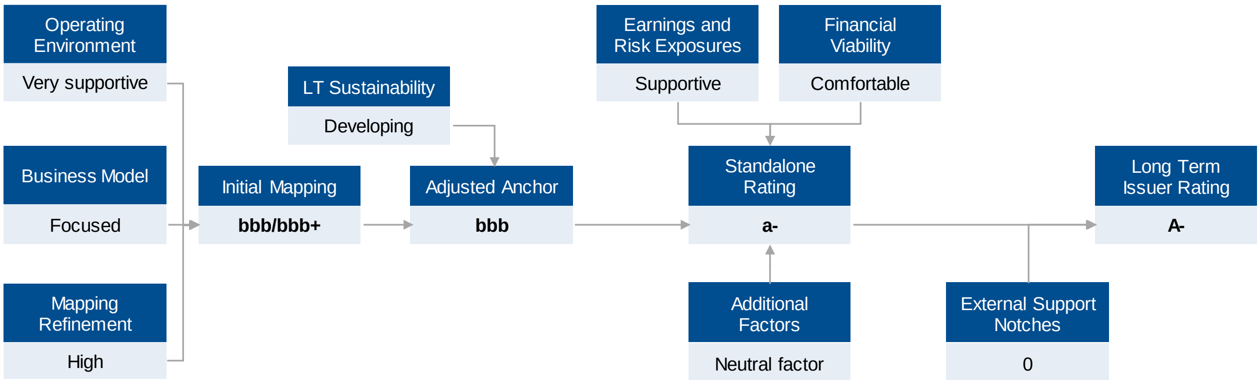
[1] Eiendomsverdi.

During the financial crisis, when it was under Icelandic ownership, the bank suffered material deposit outflows, particularly with larger deposits not covered by the guarantee scheme. From this experience, management is keenly aware of the need to maintain a sound liquidity profile and to have contingency measures in place.

In addition to covered bond funding via the SB1 Alliance, BN Bank relies on the domestic unsecured debt market which can be more volatile and less accessible. Nevertheless, the bank aims to maintain enough liquidity and reserves so that it does not need access to wholesale markets for at least one year. As of 30 June 2021, the bank had only NOK 0.3bn of debt maturing within 12 months.

At the same time, the bank held a NOK 5.7bn liquidity portfolio comprised primarily of high-quality government and municipal securities and covered bonds. Further, the bank has various targets and limits in place such as a minimum duration for outstanding market funding and a maximum amount for debt maturing each year.

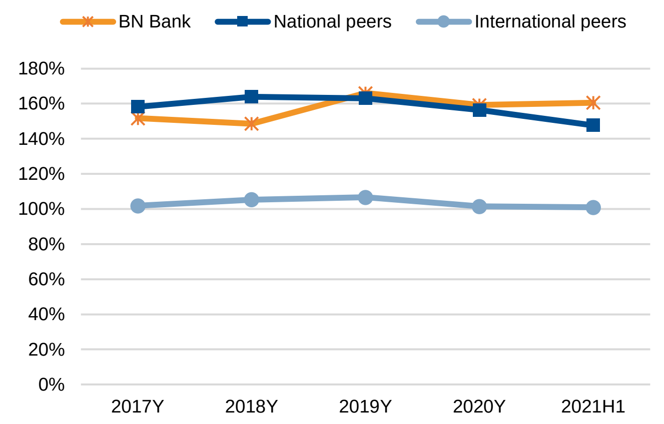
I. Appendix: Overview of the rating process



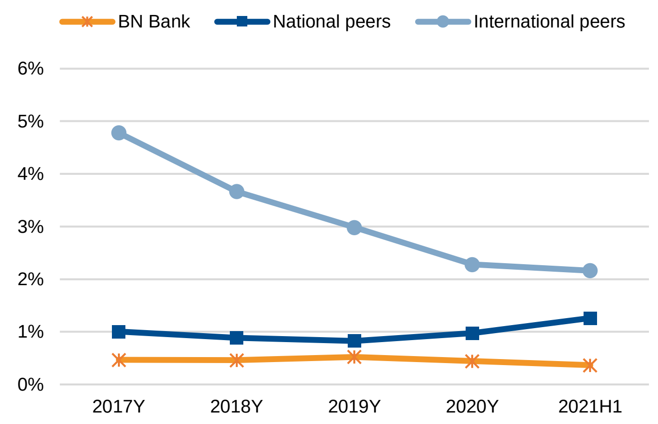
Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive	• Wealthy economy with well-developed capital markets and a solid track record of economic resilience • Supportive competitive environment • Relatively stringent and active financial regulator
		Supportive	
		Moderately supportive	
		Constraining	
		Very constraining	
	Business model	Very resilient	• Activities concentrated in central-eastern Norway • Material commercial real estate exposure balanced by residential mortgage business • Affiliation with an alliance brings significant benefits
		Resilient	
		Consistent	
		Focused	
		Narrow	
	Mapping refinement	High	• Benefits from ownership by solid member banks of SpareBank 1 Alliance
		Low	
	Initial mapping	**bbb/bbb+**	
	Long-term sustainability	Best in class	• Actively embracing ESG developments, including incorporating the concerns of external stakeholders • In process of integrating ESG risks in loan origination and credit processes
		Advanced	
		Developing	
		Lagging	
	Adjusted anchor	**bbb**	
STEP 2	Earnings capacity & risk exposures	Very supportive	• From a solid base, executing on strategy to reach level of returns targeted by owners • Good cost efficiency underpinned by digital business model • Sound asset quality and low credit losses
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Comfortably meets regulatory requirements • Reliance on market funding, including more stable covered bonds through issuing vehicles of SpareBank 1 Alliance
		Comfortable	
		Adequate	
		Limited	
		Stretched	
		At risk	
	Additional factors	Significant support factor	• No further considerations
		Material support factor	
		Neutral	
		Material downside factor	
		Significant downside factor	
	Standalone	**a-**	
STEP 3	External support	Not applicable	
Issuer rating		**A-**	

II. Appendix: Peer comparison

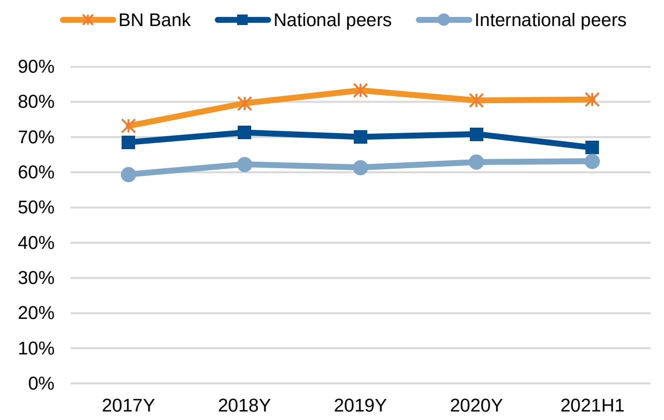
Net customer loans % Deposits



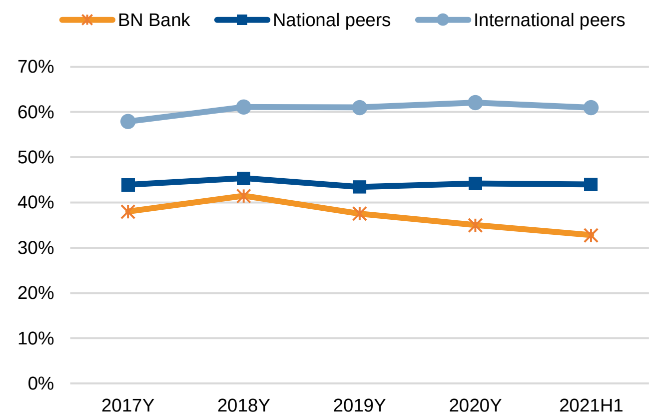
Problem loans % Gross customer loans



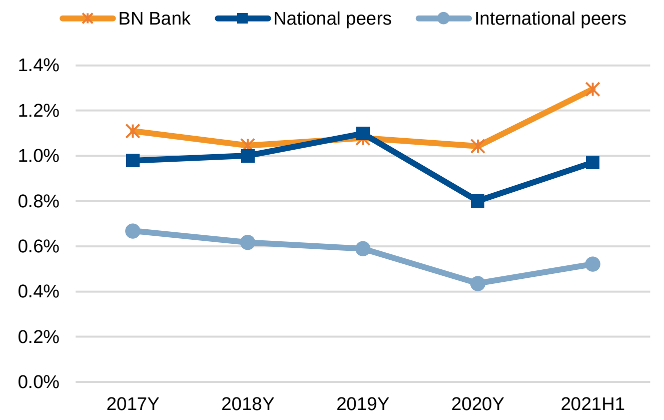
Net interest income % Operating income



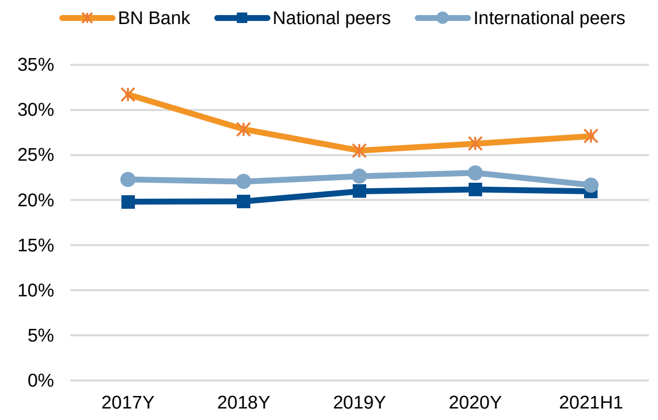
Costs % Income



Return on average assets (%)



Total capital ratio (%, transitional)



National peers: Landkreditt Bank, Sandnes Sparebank, Totens Sparebank, SpareBank 1 Nordmore, SpareBank 1 SR-Bank, SpareBank 1 SMN, DNB, Sbanken.
International peers: Hypo-Bank Burgenland AG, Oberbank AG, Banca Popolare di Sondrio SCpa, Credito Emiliano SpA, Kutxabank SA, Unicaja Banco SA, Coventry Building Society, Sparbanken Sjuharad AB, de Volksbank NV.
Note: 1H 2021 data is unavailable for Hypo-Bank Burgenland AG.
Source: SNL.

III. Appendix: Selected financial information – BN Bank ASA

	2017Y	2018Y	2019Y	2020Y	2021H1
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	519	895	1,010	437	627
Total securities	4,825	5,789	5,261	7,155	6,745
of which, derivatives	276	113	77	238	117
Net loans to customers	20,687	22,157	25,503	28,069	30,728
Other assets	137	180	143	106	102
Total assets	**26,168**	**29,021**	**31,917**	**35,767**	**38,202**
Liabilities					
Interbank liabilities	36	19	7	414	323
Senior debt	7,731	9,027	11,414	12,455	18,287
Derivatives	198	96	89	80	58
Deposits from customers	13,637	14,909	15,360	17,627	19,140
Subordinated debt	500	501	439	300	300
Other liabilities	183	187	311	341	312
Total liabilities	**22,285**	**24,739**	**27,620**	**31,218**	**33,420**
Ordinary equity	3,483	3,758	4,070	4,323	4,556
Equity hybrids	400	524	227	226	226
Minority interests	0	0	0	0	0
Total liabilities and equity	**26,168**	**29,021**	**31,917**	**35,767**	**38,202**
Core tier 1/ common equity tier 1 capital	*3,144*	*3,572*	*3,756*	*4,170*	*4,270*
Income statement summary (NOK m)					
Net interest income	470	524	630	671	352
Net fee & commission income	146	131	135	152	82
Net trading income	29	10	3	1	-6
Other income	-3	-7	-12	10	8
Operating income	**642**	**658**	**756**	**834**	**436**
Operating expenses	255	273	284	292	143
Pre-provision income	**387**	**385**	**472**	**542**	**293**
Credit and other financial impairments	-8	-10	37	75	-21
Other impairments	0	0	0	0	0
Non-recurring income	0	0	0	0	0
Non-recurring expense	0	0	0	0	0
Pre-tax profit	**395**	**395**	**435**	**467**	**314**
Income from discontinued operations	4	0	0	0	0
Income tax expense	101	101	108	113	75
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	**298**	**294**	**327**	**354**	**239**

Source: SNL

IV. Appendix: Selected financial information – BN Bank ASA

	2017Y	2018Y	2019Y	2020Y	2021H1
Funding and liquidity					
Net loans/ deposits (%)	152%	149%	166%	159%	161%
Liquidity coverage ratio (%)	140%	169%	163%	150%	170%
Net stable funding ratio (%)	129%	160%	148%	165%	168%
Asset mix, quality and growth					
Net loans/ assets (%)	79.1%	76.3%	79.9%	78.5%	80.4%
Problem loans/ gross customer loans (%)	0.5%	0.5%	0.5%	0.4%	0.4%
Loan loss reserves/ problem loans (%)	110.3%	108.7%	92.5%	156.0%	139.8%
Net loan growth (%)	-3.1%	7.1%	15.1%	10.1%	18.9%
Problem loans/ tangible equity & reserves (%)	2.4%	2.4%	3.0%	2.6%	2.3%
Asset growth (%)	-5.9%	10.9%	10.0%	12.1%	13.6%
Earnings and profitability					
Net interest margin (%)	1.8%	1.9%	2.1%	2.0%	1.9%
Net interest income/ average RWAs (%)	3.8%	3.5%	3.7%	3.7%	3.9%
Net interest income/ operating income (%)	73.2%	79.6%	83.3%	80.5%	80.7%
Net fees & commissions/ operating income (%)	22.7%	19.9%	17.9%	18.2%	18.8%
Cost/ income ratio (%)	38.0%	41.5%	37.6%	35.0%	32.8%
Operating expenses/ average RWAs (%)	2.0%	1.8%	1.7%	1.6%	1.6%
Pre-impairment operating profit/ average RWAs (%)	3.2%	2.6%	2.8%	3.0%	3.2%
Impairment on financial assets / pre-impairment income (%)	-2.0%	-2.6%	7.8%	13.8%	-7.2%
Loan loss provision/ average gross loans (%)	0.0%	0.0%	0.2%	0.3%	-0.1%
Pre-tax profit/ average RWAs (%)	3.2%	2.6%	2.6%	2.6%	3.5%
Return on average assets (%)	1.1%	1.0%	1.1%	1.0%	1.3%
Return on average RWAs (%)	2.4%	2.0%	1.9%	2.0%	2.6%
Return on average equity (%)	8.0%	7.3%	7.8%	8.1%	10.2%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	25.1%	22.2%	21.5%	22.5%	23.3%
Tier 1 capital ratio (%, transitional)	28.0%	24.1%	23.2%	24.1%	24.9%
Total capital ratio (%, transitional)	31.7%	27.8%	25.5%	26.3%	27.1%
Leverage ratio (%)	12.8%	8.5%	8.4%	8.2%	8.0%
Asset risk intensity (RWAs/ total assets, %)	47.9%	55.4%	54.8%	51.7%	47.9%

Source: SNL

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