# BN Bank ASA
# Issuer Rating Report

STABLE
A-

## Overview

Scope assigns an Issuer Rating of A- to BN Bank ASA with a Stable Outlook. The rating agency also assigns a rating of BBB+ with a Stable Outlook to senior unsecured debt.

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.

## Highlights

- BN Bank is a digital bank serving both retail and corporate customers in Norway. In the retail market, the bank has a nationwide presence and focuses primarily on mortgage lending. The bank is also a specialised commercial real estate lender operating mainly in the Oslo region. The bank aims for a 70% retail / 30% corporate lending mix.
- Since December 2008, BN Bank has been wholly owned by member banks of the SpareBank 1 Alliance (SB1 Alliance). Established in 1996, the alliance is comprised of regional and local banks who cooperate 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% share of the retail market and circa 15% of the corporate market.
- BN Bank operates in a prudent manner, generating sustainable earnings and dividends for its owners. 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. The loan portfolio has remained resilient throughout the economic disruption caused by the Covid-19 pandemic.
- High household debt and elevated property prices remain concerns, particularly in the bank's primary market, the Oslo region.
- Although 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. Mindful of past experiences during the 2007-2008 global financial crisis, the bank is keenly aware of the need for sound liquidity management.

### Ratings & Outlook

| | |
|---|---|
| Issuer rating | A- |
| Senior unsecured debt rating | BBB+ |
| Outlook | Stable |


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## Rating drivers (summary)

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

- Proven ability to adapt the bank's strategy and business to ensure the generation of sustainable earnings.
- Ownership by member banks of the SpareBank 1 Alliance brings significant benefits, including strong governance and access to the alliance's resources.
- The bank's focus on the Oslo area is a risk considering particularly elevated property prices in the region.
- Reassuring prudential metrics guided by regulatory requirements as well as the bank's experience during the global financial crisis.

## Rating-change drivers

**Loss of benefits from being affiliated with the SB1 Alliance.** BN Bank benefits significantly from having access to the alliance's resources, such as covered bond funding, common IT systems, and a broad range of financial products and services. A loss of these benefits would be considered negatively.

**Decline in operating environment which materially impacts earnings and capitalisation.** Nearly 90% of lending exposure is to the Oslo region, where property prices remain elevated by historical standards. In economic downturns, commercial real estate exposures tend to be more vulnerable.

**Sustained and profitable growth without an increase in the bank's risk profile.** Over the next few years, BN Bank aims to further grow its retail business, with a greater emphasis on customer retention. Meanwhile, the focus for the corporate business remains profitability. A material strengthening of the bank's market position is likely to take many years.

## Rating drivers (details)

**Proven ability to adapt the bank's strategy and business to ensure the generation of sustainable earnings**

Historically, BN Bank's corporate business was focused on financing commercial property in urban areas. However, with increasing regulatory capital requirements, management concluded that this would no longer be sufficiently profitable and reduced its exposure. From 2015 to 2017, the corporate loan book decreased by half to NOK 13.2bn. The remaining profitable business has since been further developed and a small construction portfolio has been added. As of 30 September 2020, construction loans accounted for about 15% of the corporate loan portfolio.

Recognised for its expertise and efficiency, BN Bank successfully targets smaller projects within larger commercial property portfolios. In recent years, management has limited operations to the Oslo area as this is where the bank's proficiency lies, and losses have been low in the region. The bank has had a branch office in Oslo since 1983.

Clear shift in focus to retail customers

At the same time, BN Bank continues to grow its retail business, targeting a 70% retail / 30% corporate mix (Figure 1). The bank has materially strengthened its retail capabilities in recent years. The CEO, who joined in November 2018, led the retail business of SpareBank 1 SMN for more than five years and the head of the retail business, who joined in January 2019, is a well-known market commentator. Further, the bank has added experienced staff from SpareBank 1 Ostlandet.

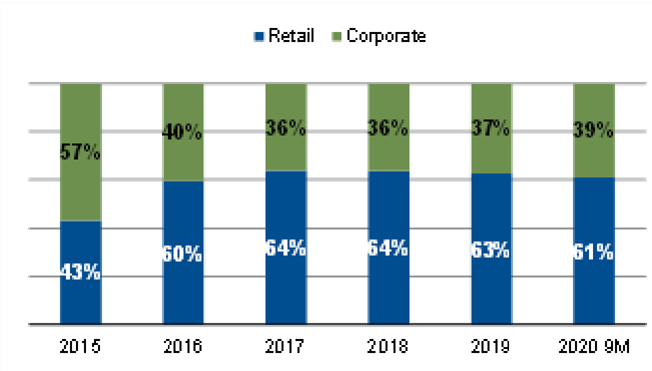
Since 2018, the strategy has been to target less price sensitive segments of the retail market and to develop more enduring client relationships. Previously, the bank had focused on serving clients seeking low prices and basic banking services.

The bank continues to diversify its distribution channels, adding mortgage brokers and developing new open banking initiatives. In December 2019, the bank sold its unprofitable real estate brokerage business and entered into a distribution agreement with a larger real estate group, Eiendomsmegler Krogsveen.

Exiting unsecured consumer lending business

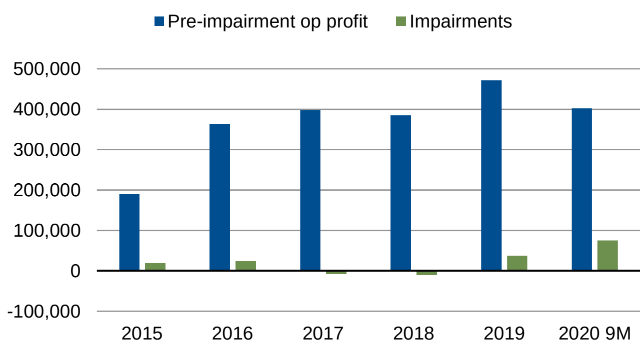
Meanwhile, following a decision in March 2019 to no longer offer new secured consumer loans, the bank is now exiting the business. In September 2020, the bank sold the bulk of its portfolio, with NOK 51m remaining (accounts for less than 0.4% of the retail portfolio).

**Figure 1: Breakdown of total lending**




Source: Company data, Scope Ratings

**Figure 2: Evolution of earnings and impairments (NOK m)**




Source: Company data, Scope Ratings

**Ownership by member banks of the SpareBank 1 Alliance brings significant benefits, including strong governance and access to the alliance's resources**

During the 2008 financial crisis, a consortium of SpareBank 1 banks acquired the bank from its troubled Icelandic owner for NOK 300m. Initially established as a credit institution in 1961, the bank was owned by Islandsbanki (Glitnir) from 2004 to 2008.

Owners are primarily large regional banks

In May 2019, a new ownership structure was agreed upon as smaller banks in the SB1 Alliance wanted to reduce or terminate their ownership. The current ownership structure is shown in Figure 3. The bank's board consists of five senior executives from the owner banks, two employee representatives and two independent members.

The owner banks 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.

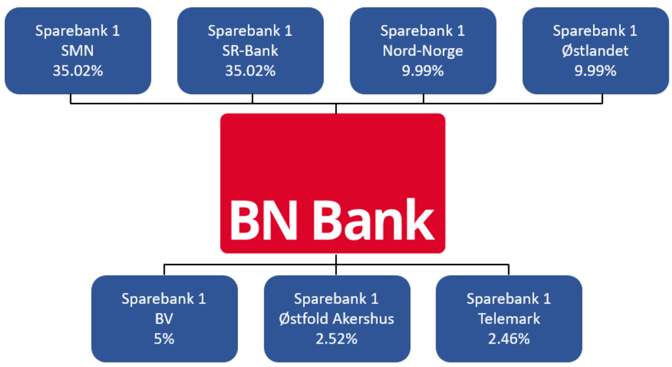
The owner banks expect BN Bank to generate earnings at a level on par with their own (generally above 10%). When evaluating the bank's profitability, the amount of capital allocated by the owner banks is considered. Hence, reported return figures are not used for performance measurement. As of 3Q 2020, the reported return on equity was 7.8%.

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 concerning topics such as market and liquidity risks and regulatory developments. Access to the alliance's product companies which include insurance, funds and credit cards also means that BN Bank has the possibility to offer a broad product range to its clients.

Actual lending volume is not reflected on the balance sheet

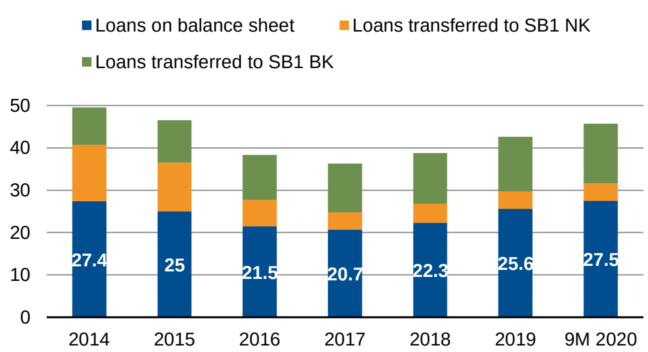
Further, BN Bank uses the covered bond issuing entities of the SB1 Alliance for its funding needs. In recent years, the bank has pursued a more balanced growth strategy focusing on both loans and deposits, but market funding remains important. The access to covered bond funding is highly beneficial as 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 4).

**Figure 3: BN Bank's ownership structure**




Source: Company data, Scope Ratings

**Figure 4: Total loan origination (NOK bn)**




Notes: SB1 NK = SpareBank 1 Naeringskreditt. SB1 BK = SpareBank 1 Boligkreditt. Source: Company data, Scope Ratings

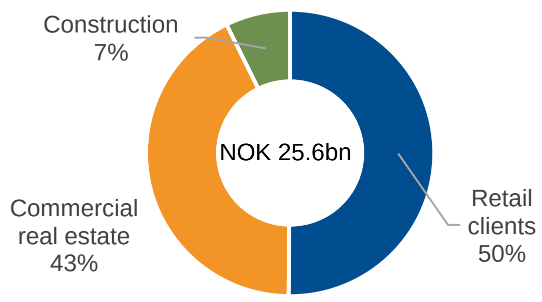
**The bank's focus on the Oslo area is a risk considering particularly elevated property prices in the region**

In its November 2020 financial stability report, Norges Bank notes that high residential and commercial property prices remain key vulnerabilities. While house prices fell in March and April because of the Covid-19 pandemic, they have risen markedly since. Residential mortgage regulations, consisting of both capital and borrower-based measures such as maximum LTVs of 85% and maximum debt to income of 5x, have been in place since 2015. As well, there are stricter limits to address the higher risks in Oslo.

**Size of mortgages are relatively modest considering focus on Oslo region**

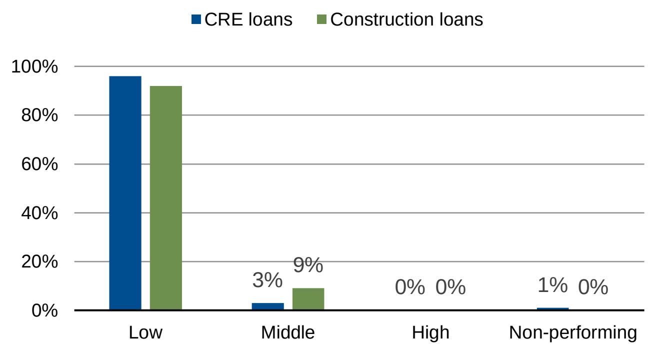
While a nationwide provider of mortgages, over 85% of the bank's exposure is in south-eastern Norway which includes Oslo. The bank performs operations from its base in Trondheim and thus, prudently restricts lending to well-functioning markets with good market data. As of 30 September 2020, nearly 78% of the mortgage portfolio had LTVs below 70% while another 21% had LTVs between 70% and 85%. Just over 20% of mortgages are greater than NOK 5m in size.

**Figure 5: Breakdown of loans on balance sheet**




Notes: Data as of 30 September 2020. Loan portfolio excluding transferred loans. Source: Company data, Scope Ratings

**Figure 6: Risk profile of corporate portfolio**




Notes. Data as of 30 September 2020. Loan portfolio including transferred loans. Bank's risk classification. Source: Company data, Scope Ratings

BN Bank's CRE activities are originated solely from its branch office in Oslo, which has a specialist team of about 20 employees. 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.

The risk profile of the corporate loan portfolio has remained relatively stable over the last three years. As of 30 September 2020, the average LTV 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. For the nine months ending 30 September 2020, credit provisions of NOK 58m have been taken for the corporate book, of which NOK 36m has been for Stage 1 and Stage 2 exposures.

**Reassuring prudential metrics guided by regulatory requirements as well as the bank's experience during the financial crisis**

As of 30 September 2020, BN Bank's CET1 capital ratio was 21.9%, well above regulatory requirements. The current CET1 requirement is 13.6%, which includes a Pillar 2 requirement of 2.6%, a systemic risk buffer of 3% and a countercyclical buffer of 1%. During 2Q 2020, the bank received an updated Pillar 2 requirement of 2.6%, practically unchanged from the previous level of 2.5%. As part of the measures in response to the Covid-19 pandemic, the countercyclical buffer was lowered to 1% from 2.5% in March 2020.

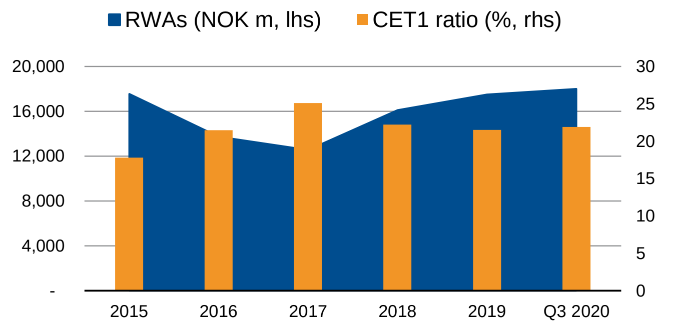
However, as previously announced, the systemic risk buffer will be increasing to 4.5% from the current 3% at year-end. This stems from the Norwegian FSA's aim to mitigate the effects of the removal of the Basel 1 floor for banks using internal models and the introduction of the SME discount.

Consequently, the bank's CET1 requirement will increase to 15.1% at year-end. Management's present policy is to maintain a buffer of at least 1.6% above Pillar 1 and Pillar 2 requirements.

**Bank is well positioned to meet potential future requirements**

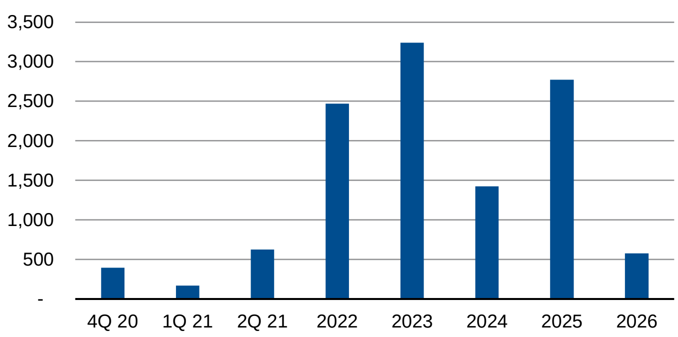
BN Bank has been using advanced internal rating-based (A-IRB) models since 2014 for its corporate portfolio and since 2015 for its retail portfolio. The bank believes that using A-IRB models enhances risk and performance management. BN Bank is the smallest bank in Norway to be granted approval by the Norwegian FSA to use the A-IRB approach.

**Figure 7: Development of RWAs and CET1 ratio**




Source: Company data, Scope Ratings

**Figure 8: Debt maturity profile (NOK m)**




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

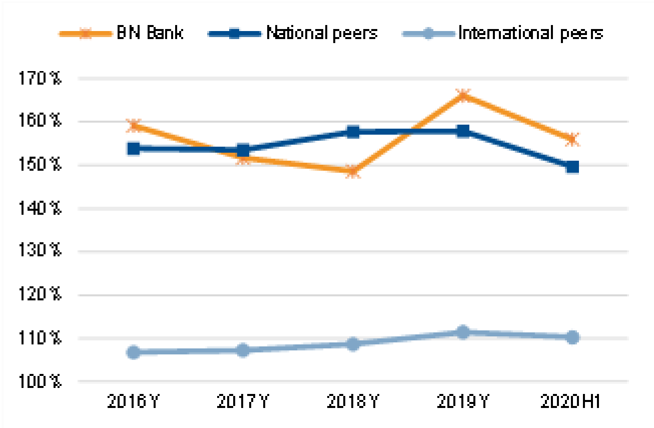
**Deposits are primarily from retail customers**

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. With this experience, management is keenly aware of the need to maintain a sound liquidity profile and to have contingency measures in place.

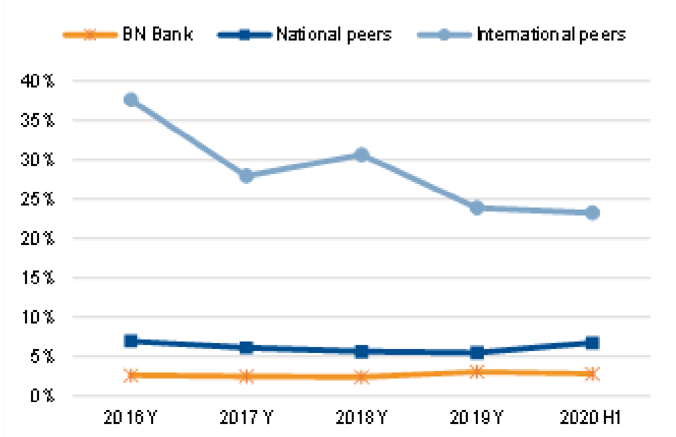
In addition to covered bond funding via the SB1 Alliance, BN Bank relies on the domestic unsecured debt market which can be more volatile and less accessible. Nevertheless, the bank aims to maintain enough liquidity and reserves so that it does not need access to wholesale markets for at least one year. As of 3Q 2020, the bank had a NOK 6.1bn 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: Peer comparison

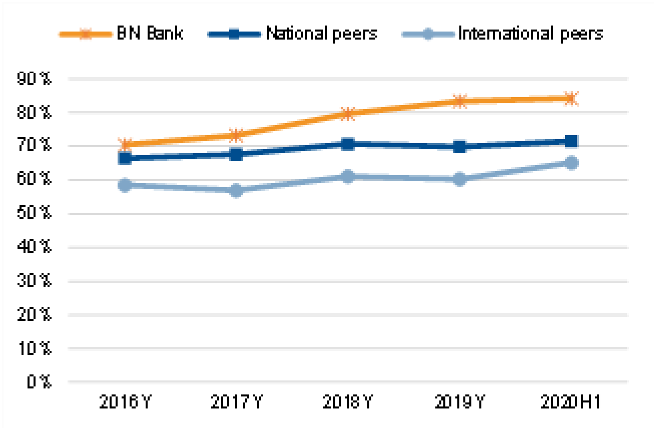
### Net loans % Deposits



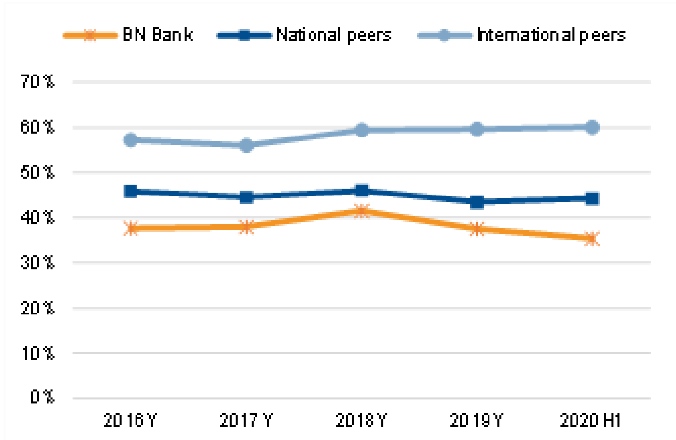

### Problem loans % Tangible equity and reserves



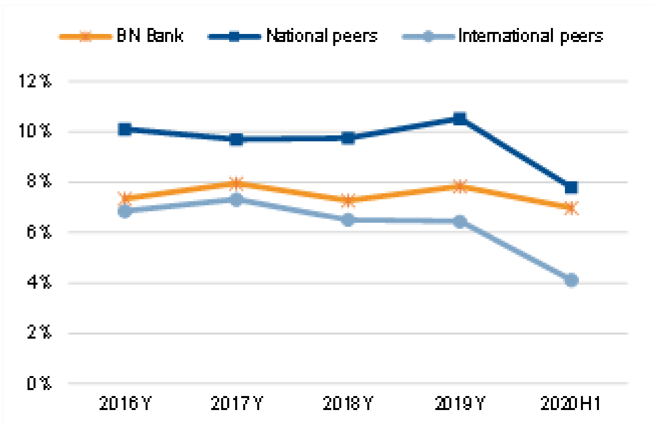

### Net interest income % Operating income



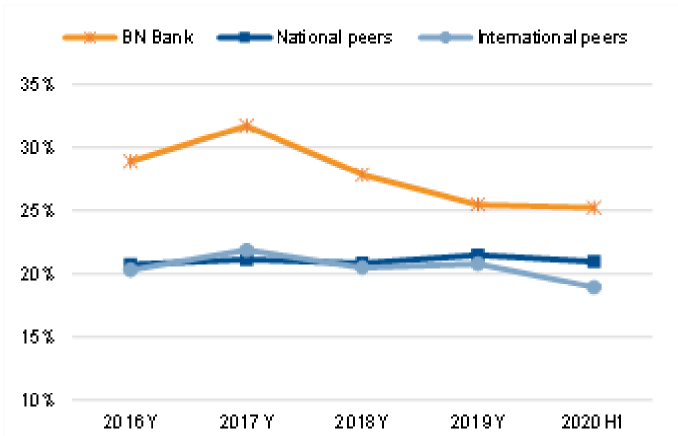

### Costs % Income




### Return on average equity (%)




### Total capital ratio (%)




National peers: BN Bank, Totens Sparebank, Sandnes Sparebank, SpareBank 1 Nordvest, Landkreditt Bank, SpareBank 1 SMN, SpareBank 1 SR-Bank, SpareBank 1 Ostlandet, SBanken.

International peers: BN Bank, Hypo-Bank Burgenland, Oberbank, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Coventry Building Society, Sparebanken Sjuharad.

Note: 1H 2020 data is unavailable for Hypo-Bank Burgenland.
Source: SNL

## II. Appendix: Selected Financial Information – BN Bank ASA

| | 2016Y | 2017Y | 2018Y | 2019Y | 9M 2020 |
|---|---|---|---|---|---|
| **Balance sheet summary (NOK m)** | | | | | |
| **Assets** | | | | | |
| Cash and interbank assets | 42 | 519 | 964 | 1,010 | 171 |
| Total securities | 6,277 | 4,825 | 5,789 | 5,261 | 7,247 |
| of which, derivatives | 471 | 276 | 113 | 77 | 299 |
| Net loans to customers | 21,338 | 20,687 | 22,157 | 25,503 | 27,360 |
| Other assets | 140 | 137 | 111 | 143 | 93 |
| **Total assets** | **27,797** | **26,168** | **29,021** | **31,917** | **34,871** |
| **Liabilities** | | | | | |
| Interbank liabilities | 318 | 36 | 19 | 7 | 879 |
| Senior debt | 8,695 | 7,731 | 9,027 | 11,414 | 11,425 |
| Derivatives | 344 | 198 | 96 | 89 | 104 |
| Deposits from customers | 13,411 | 13,637 | 14,909 | 15,360 | 17,334 |
| Subordinated debt | 1,202 | 500 | 501 | 439 | 300 |
| Other liabilities | 231 | 183 | 187 | 311 | 385 |
| **Total liabilities** | **24,201** | **22,285** | **24,739** | **27,620** | **30,427** |
| Ordinary equity | 3,596 | 3,483 | 3,758 | 4,072 | 4,218 |
| Equity hybrids | 0 | 400 | 524 | 225 | 226 |
| Minority interests | 0 | 0 | 0 | 0 | 0 |
| **Total liabilities and equity** | **27,797** | **26,168** | **29,021** | **31,917** | **34,871** |
| *Core tier 1/ common equity tier 1 capital* | *2,947* | *3,144* | *3,572* | *3,756* | *3,943* |
| **Income statement summary (NOK m)** | | | | | |
| Net interest income | 411 | 470 | 524 | 630 | 501 |
| Net fee & commission income | 121 | 146 | 131 | 135 | 103 |
| Net trading income | 47 | 29 | 10 | 3 | 3 |
| Other income | 5 | -3 | -7 | -12 | 6 |
| **Operating income** | **584** | **642** | **658** | **756** | **613** |
| Operating expenses | 220 | 244 | 273 | 284 | 211 |
| **Pre-provision income** | **364** | **398** | **385** | **472** | **402** |
| Credit and other financial impairments | 23 | -8 | -10 | 37 | 75 |
| Other impairments | 0 | 0 | 0 | 0 | 0 |
| Non-recurring income | 7 | 0 | 0 | 0 | 0 |
| Non-recurring expense | 0 | 11 | 0 | 0 | 0 |
| **Pre-tax profit** | **348** | **395** | **395** | **435** | **327** |
| Income from discontinued operations | -2 | 4 | 0 | 0 | 0 |
| Income tax expense | 85 | 101 | 101 | 108 | 78 |
| 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** | **261** | **298** | **294** | **327** | **249** |

Source: SNL

## III. Appendix: Selected Financial Information – BN Bank ASA

| | 2016Y | 2017Y | 2018Y | 2019Y | 9M 2020 |
|---|---|---|---|---|---|
| **Funding and liquidity** | | | | | |
| Net loans/ deposits (%) | 159% | 152% | 149% | 166% | 158% |
| Liquidity coverage ratio (%) | 339% | 140% | 169% | 207% | 152% |
| Net stable funding ratio (%) | 143% | 129% | 160% | 148% | NA |
| **Asset mix, quality and growth** | | | | | |
| Net loans/ assets (%) | 76.8% | 79.1% | 76.3% | 79.9% | 78.5% |
| Problem loans/ gross customer loans (%) | 0.4% | 0.5% | 0.5% | 0.5% | 0.4% |
| Loan loss reserves/ problem loans (%) | 106.3% | 110.3% | 108.7% | 92.5% | 176.6% |
| Net loan growth (%) | -13.5% | -3.1% | 7.1% | 15.1% | 9.7% |
| Problem loans/ tangible equity & reserves (%) | 2.6% | 2.4% | 2.4% | 3.0% | 2.4% |
| Asset growth (%) | -14.9% | -5.9% | 10.9% | 10.0% | 12.3% |
| **Earnings and profitability** | | | | | |
| Net interest margin (%) | 1.4% | 1.8% | 1.9% | 2.1% | 2.0% |
| Net interest income/ average RWAs (%) | 2.7% | 3.8% | 3.5% | 3.7% | 3.7% |
| Net interest income/ operating income (%) | 70.4% | 73.2% | 79.6% | 83.3% | 81.7% |
| Net fees & commissions/ operating income (%) | 20.7% | 22.7% | 19.9% | 17.9% | 16.8% |
| Cost/ income ratio (%) | 37.7% | 38.0% | 41.5% | 37.6% | 34.4% |
| Operating expenses/ average RWAs (%) | 1.5% | 2.0% | 1.8% | 1.7% | 1.6% |
| Pre-impairment operating profit/ average RWAs (%) | 2.4% | 3.2% | 2.6% | 2.8% | 3.0% |
| Impairment on financial assets / pre-impairment income (%) | 6.3% | -2.0% | -2.6% | 7.8% | 18.7% |
| Loan loss provision/ average gross loans (%) | 0.1% | 0.0% | 0.0% | 0.2% | 0.4% |
| Pre-tax profit/ average RWAs (%) | 2.3% | 3.2% | 2.6% | 2.6% | 2.4% |
| Return on average assets (%) | 0.9% | 1.1% | 1.0% | 1.1% | 1.0% |
| Return on average RWAs (%) | 1.7% | 2.4% | 2.0% | 1.9% | 1.8% |
| Return on average equity (%) | 7.4% | 8.0% | 7.3% | 8.0% | 7.8% |
| **Capital and risk protection** | | | | | |
| Common equity tier 1 ratio (%, fully loaded) | NA | NA | NA | NA | NA |
| Common equity tier 1 ratio (%, transitional) | 21.5% | 25.1% | 22.2% | 21.5% | 21.9% |
| Tier 1 capital ratio (%, transitional) | 23.9% | 28.0% | 24.1% | 23.2% | 23.5% |
| Total capital ratio (%, transitional) | 28.9% | 31.7% | 27.8% | 25.5% | 25.7% |
| Leverage ratio (%) | 11.7% | 12.8% | 8.5% | 8.4% | 8.1% |
| Asset risk intensity (RWAs/ total assets, %) | 49.4% | 47.9% | 55.4% | 54.8% | 51.6% |

Source: SNL

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