

# BN Bank ASA

## Issuer Rating Report



A<sup>STABLE</sup>-

### 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 implementation of the 2017/2399/EU Directive in Norway establishing the ability of banks to issue non-preferred senior debt for MREL purposes, Scope intends to adjust its senior unsecured debt ratings on Norwegian banks. In accordance with our rating methodology, Scope will 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 an online 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. While retail lending accounted for nearly 65% of the loan book as of 1Q 2019, the goal is to have a 70% retail / 30% corporate 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 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 a 20% share of the retail market.
- ✓ BN Bank operates in a prudent manner, generating sustainable earnings and dividends for its owners. Recent strategic changes such as the decision to limit the consumer unsecured lending business and to restrict the geographic focus of the commercial real estate business should further support the bank's sound asset quality profile. In addition, BN Bank is supervised and regulated like other Norwegian banks and is thus, subject to relatively rigorous prudential requirements.
- ✓ High household debt and elevated property prices remain concerns, particularly in the bank's primary market, the Oslo region. Meanwhile, the macro environment is expected to remain supportive with Norway benefitting from solid economic growth, low unemployment and high wealth levels.
- ✓ Although the bank has actively grown deposits, the use of market funding remains material. BN Bank 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-
Outlook	Stable
Senior unsecured debt rating	BBB+

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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. Loss of these benefits would be considered negatively.

 **Decline in operating environment which materially impacts earnings.** Over 70% of the bank's balance sheet lending exposure is to the Oslo region, where property prices remain elevated by historical standards.

 **Material negative outcome from an outstanding legal issue.** A former client has filed a claim against the bank and other involved parties, seeking compensation for losses allegedly suffered. The trial has recently concluded and a judgement, which could be appealed, is expected later this year. To date, based on legal opinions, the bank has not made provisions for this matter.

 **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 is 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 the corporate loan portfolio 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.

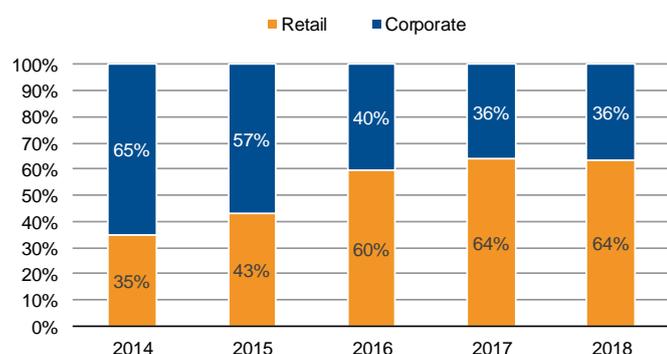
The bank has since decided to further develop the remaining profitable business and to moderately increase the proportion of construction loans to support its mortgage brokerage business. As of YE 2018, construction loans accounted for about 8% of the corporate loan portfolio.

Recognised for its expertise and efficiency, BN Bank successfully targets smaller projects within larger commercial property portfolios. Management has recently decided to limit 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.

At the same time, BN Bank continues to grow its retail business, targeting a 70% retail / 30% corporate mix (Figure 1). The bank had previously focused on serving clients seeking low prices and basic banking services. Since 2018, the strategy has been to target less price sensitive segments of the retail market and to develop more enduring client relationships. The bank intends to raise brand awareness by diversifying its distribution channels, including through partners operating in traditional branches and mortgage brokers.

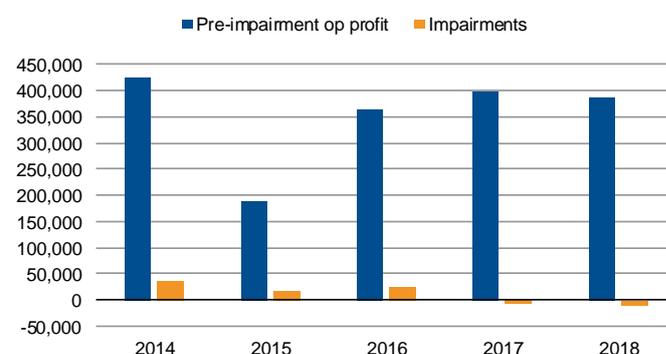
#### Clear shift in focus to retail customers

Figure 1: Breakdown of lending



Source: Company data, Scope Ratings

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



Source: Company data, Scope Ratings

BN Bank has materially strengthened its capabilities in the retail market. The CEO, who joined in November 2018, led the retail business of SpareBank 1 SMN for more than five years. 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.

#### No new unsecured consumer loans to be granted

Meanwhile, in March 2019, BN Bank announced that it would no longer offer new unsecured consumer loans as the level of risk was beyond the bank's risk appetite and expectations. The bank will now only refinance loans for existing customers capable of servicing them. BN Bank started offering unsecured consumer loans in 2016 and as of YE 2018, the outstanding balance was NOK 430m, accounting for less than 2% of the loan portfolio.

### 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 six 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.

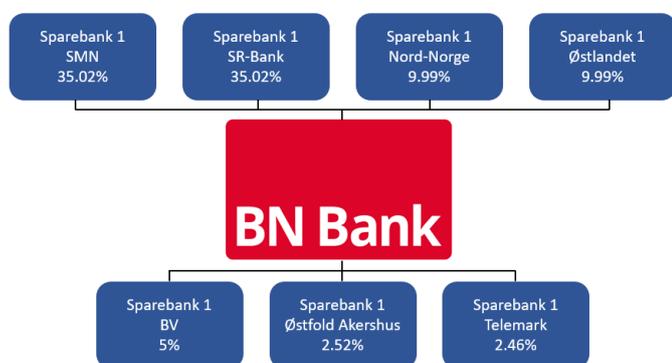
In terms of returns, the owner banks expect BN Bank to generate earnings at a level on par with their own (currently in excess of 10%). When evaluating the bank's profitability, the board also considers the amount of capital that has been allocated by the owner banks. Hence, reported return figures are not used for performance management. As of 1Q 2019, the reported return on equity was 7.4% or 10.1% based on required capital.

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

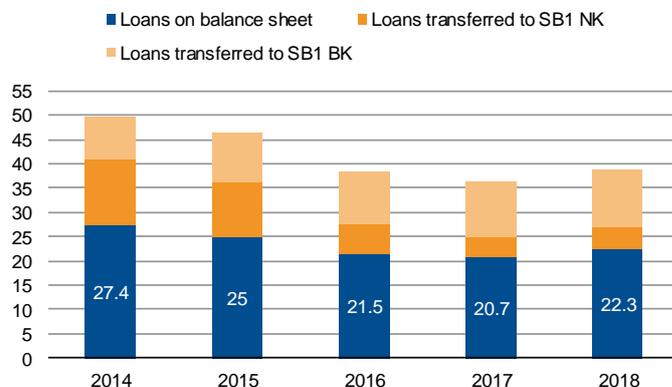
Further, BN Bank uses the covered bond issuing entities of the SB1 Alliance for its funding needs. In recent years, the bank has pursued a more balanced growth strategy focusing on both loans and deposits, but market funding remains important. The access to covered bond funding is highly beneficial as 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 Næringskreditt. SB1 BK = SpareBank 1 Boligkreditt. Source: Company data, Scope Ratings

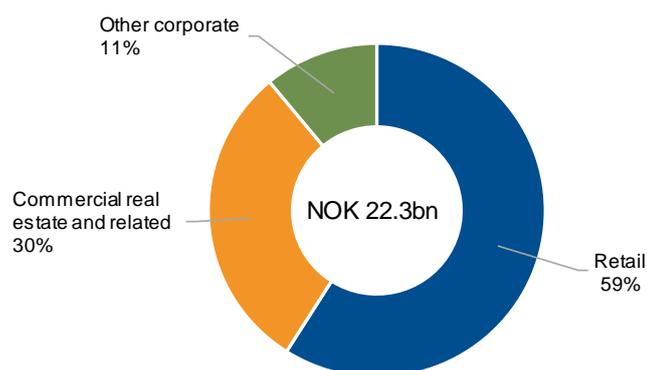
**The bank's focus on the Oslo area is a risk considering particularly elevated property prices in the region**

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. Along with stricter limits to address the higher risks in Oslo, these measures have led to some price growth moderation. In its June 2019 assessment, the IMF notes that house prices are rising at a more sustainable level of around 2.5%, compared to over 10% year-over-year at the peak in 2017. House prices in Oslo have also slowed to around 5% year-over-year in recent months.

Size of mortgages are relatively modest considering focus on Oslo region

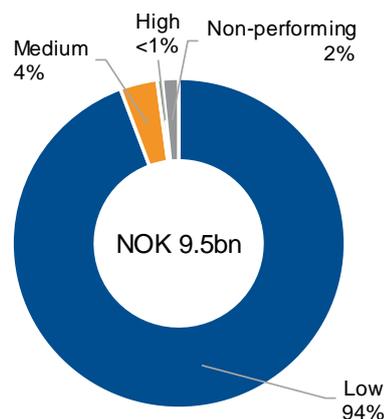
While a nationwide provider of mortgages, nearly 80% of the bank's exposure is in south-eastern Norway which includes Oslo. The bank performs all operations from its base in Trondheim and thus, prudently restricts its lending to well-functioning markets with good market data. As of YE 2018, the average LTV on the bank's mortgage portfolio was about 59%, with less than 10% of mortgages having LTVs above 80%. As well, fewer than 20% of mortgages are greater than NOK 5m in size.

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



Notes: Data as of YE 2018. Loan portfolio excluding transferred loans. Source: Company data, Scope Ratings

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



Notes: Data as of YE 2018. Loan portfolio excluding transferred loans. Bank's risk classification. Source: Company data, Scope Ratings

CRE price growth expected to moderate due to new supply

Partly as a response to rising commercial real estate (CRE) risks, the countercyclical buffer in Norway will be increasing to 2.5% from 2% at year-end. In the same report mentioned above, the IMF highlights that CRE risks are well-acknowledged and that there is a strong supervisory focus on banks' risk management practices. Prudential measures include Pillar 2 capital add-ons for banks with concentrated exposures and higher risk weights.

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 exposure is diversified across various types of commercial property, with a lower weight towards retail and hotels as these are more cyclical industries. As of YE 2018, the average LTV was less than 70%, while the proportion of loans with LTVs in excess of 80% was less than 15%.

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

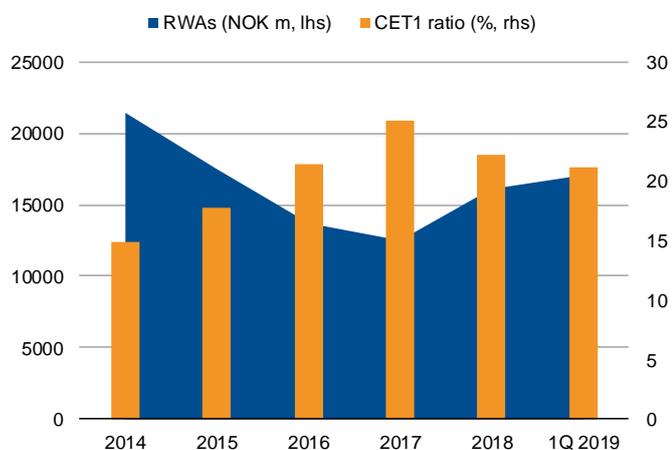
As of 1Q 2019, BN Bank's CET1 capital ratio was 21.2%, well in excess of regulatory requirements. The current minimum CET1 requirement is 14.5%, which includes a Pillar 2 requirement of 2.5%, a systemic risk buffer of 3% and a countercyclical buffer of 2%. Management's present policy is to maintain a buffer of at least 0.5% on top of Pillar 1 and Pillar 2 requirements.

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

With pending regulatory developments, management believes that the bank's capital requirements are likely to increase. As CRD IV/CRR is fully implemented in Norway, the capital requirement for SME loans will be reduced and the Basel 1 floor for banks using internal ratings-based models will be removed. Consequently, with lower RWAs, capital ratios will rise. The Norwegian FSA, however, would like to mitigate these effects to ensure that the capitalisation of banks remains unchanged. Due to the proportional consolidation of their stakes in BN Bank, increases in capital requirements for the owner banks are likely to be reflected at the level of the bank.

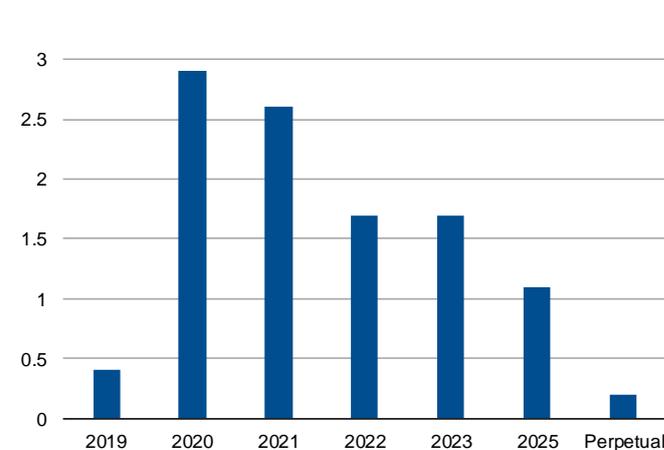
BN Bank has been using advanced internal rating-based (A-IRB) models since 2014 for its corporate portfolio and since 2015 for its retail portfolio. The bank believes that using A-IRB models enhances risk and performance management. BN Bank is the smallest bank in Norway to be granted approval by the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



Note: Data as of 31 July 2019. Source: Company data, Scope Ratings

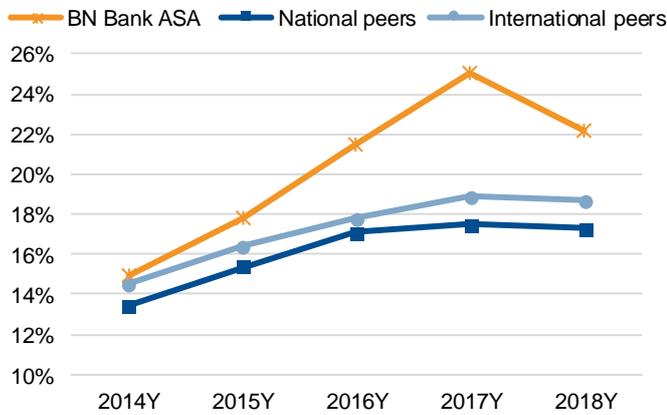
### Deposits are primarily from retail customers

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. We note positively the renewed focus on deposits, with deposits increasing by more than 9% in 2018.

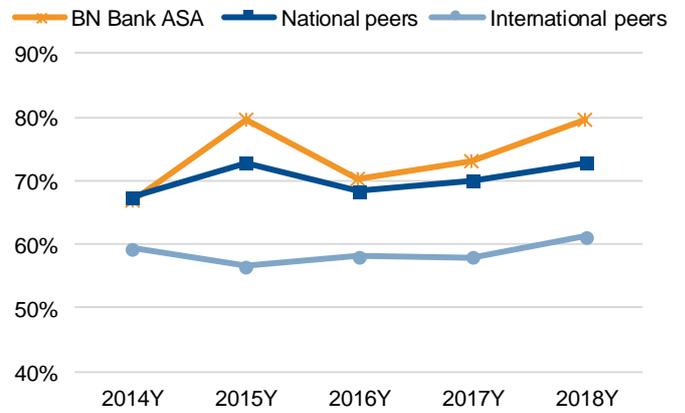
In addition to covered bond funding via the SB1 Alliance, BN Bank relies on the domestic unsecured debt market which can be more volatile and less accessible. Nevertheless, the bank aims to maintain enough liquidity and reserves so that it does not need access to wholesale markets for at least one year. As of 1Q 2019, the bank had a NOK 5.3bn 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

**CET1 ratio (% transitional)\***

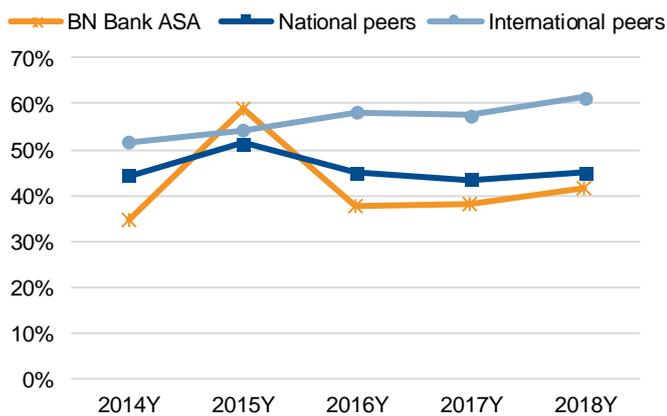


**Net interest income % Operating income**

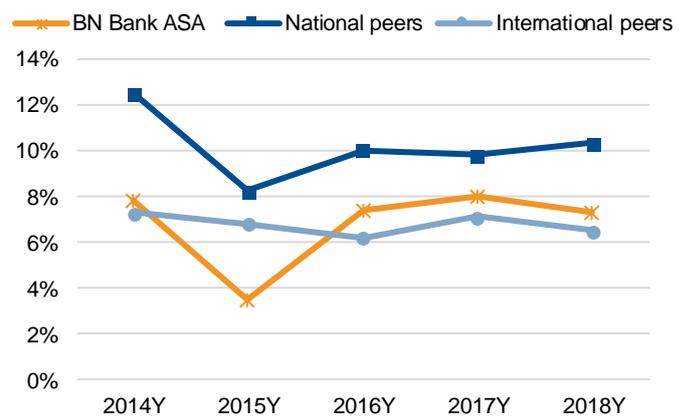


\* The decline in BN Bank's CET1 ratio from 2017 to 2018 was due primarily to new consolidation rules for financial stakes.

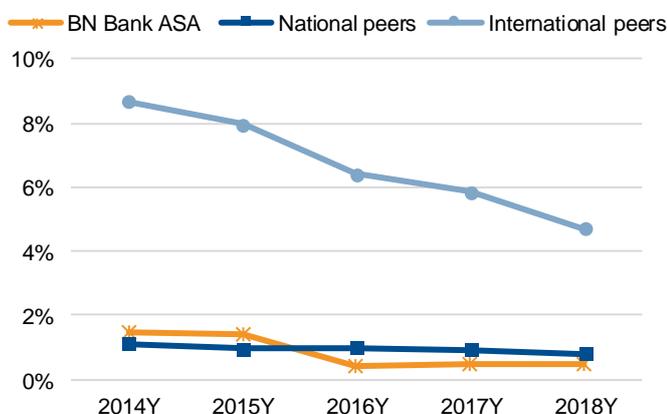
**Costs % Income**



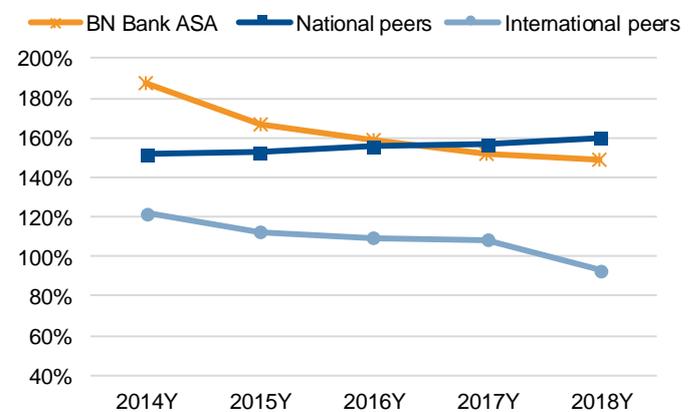
**Return on average equity (%)**



**Problem loans % Gross customer loans**



**Net loans % Deposits**



National peers: BN Bank, DNB, Landkredit Bank, Sandnes Sparebank, Totens Sparebank, SpareBank 1 SMN, SpareBank 1 SR-Bank, SpareBank 1 Ostlandet, Sbanken ASA  
 International peers: BN Bank, Hypo-Bank Burgenland AG, Coventry Building Society, Banco Popolare di Sondrio, Credito Emiliano SpA, Kutxabank, Unicaja

Source: SNL



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

	2015Y	2016Y	2017Y	2018Y	2019Q1
<b>Balance sheet summary (NOK m)</b>					
<b>Assets</b>					
Cash and interbank assets	593	42	519	964	758
Total securities	7,259	6,277	4,825	5,789	6,168
of which, derivatives	576	471	276	113	109
Net loans to customers	24,681	21,338	20,687	22,157	22,186
Other assets	116	140	137	111	208
<b>Total assets</b>	<b>32,649</b>	<b>27,797</b>	<b>26,168</b>	<b>29,021</b>	<b>29,320</b>
<b>Liabilities</b>					
Interbank liabilities	5	318	36	19	95
Senior debt	12,531	8,695	7,731	9,027	9,240
Derivatives	404	344	198	96	65
Deposits from customers	14,771	13,411	13,637	14,909	15,106
Subordinated debt	1,202	1,202	500	501	501
Other liabilities	NA	NA	NA	NA	NA
<b>Total liabilities</b>	<b>29,135</b>	<b>24,201</b>	<b>22,285</b>	<b>24,739</b>	<b>25,266</b>
Ordinary equity	3,514	3,596	3,483	3,758	3,828
Equity hybrids	0	0	400	524	226
Minority interests	0	0	0	0	0
<b>Total liabilities and equity</b>	<b>32,649</b>	<b>27,797</b>	<b>26,168</b>	<b>29,021</b>	<b>29,320</b>
<i>Core tier 1/Common equity tier 1 capital</i>	3,124	2,947	3,144	3,572	3,609
<b>Income statement summary (NOK m)</b>					
Net interest income	369	411	470	524	142
Net fee & commission income	152	121	146	131	33
Net trading income	-70	47	29	10	0
Other income	12	5	-3	-7	-3
<b>Operating income</b>	<b>463</b>	<b>584</b>	<b>642</b>	<b>658</b>	<b>172</b>
Operating expense	273	220	244	273	69
<b>Pre-provision income</b>	<b>190</b>	<b>364</b>	<b>398</b>	<b>385</b>	<b>103</b>
Credit and other financial impairments	19	23	-8	-10	3
Other impairments	0	0	0	0	0
Non-recurring items	0	0	11	0	0
<b>Pre-tax profit</b>	<b>171</b>	<b>348</b>	<b>395</b>	<b>395</b>	<b>100</b>
Discontinued operations	-3	-2	4	0	0
Other after-tax items	0	0	0	0	0
Income tax expense	43	85	101	101	26
Net profit attributable to minority interests	0	0	0	0	0
<b>Net profit attributable to parent</b>	<b>125</b>	<b>261</b>	<b>298</b>	<b>294</b>	<b>74</b>

Source: SNL



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

	2015Y	2016Y	2017Y	2018Y	2019Q1
<b>Funding and liquidity</b>					
Net loans/ Deposits (%)	167.1%	159.1%	151.7%	148.6%	146.9%
Liquidity coverage ratio (%)	475.0%	339.0%	140.0%	169.0%	196.0%
Net stable funding ratio (%)	149.0%	143.0%	129.0%	160.0%	NA
<b>Asset mix, quality and growth</b>					
Net loans/ Assets (%)	75.6%	76.8%	79.1%	76.3%	75.7%
Problem Loans/ Gross Customer Loans (%)	1.4%	0.4%	0.5%	0.5%	0.4%
Loan Loss Reserves/ Problem Loans (%)	60.6%	106.3%	110.3%	108.7%	127.3%
Net loan growth (%)	-9.1%	-13.5%	-3.1%	7.1%	0.5%
Problem Loans/ Tangible Equity & Reserves (%)	9.5%	2.6%	2.4%	2.4%	2.1%
Asset growth (%)	-8.8%	-14.9%	-5.9%	10.9%	4.1%
<b>Earnings and profitability</b>					
Net interest margin (%)	1.1%	1.4%	1.8%	1.9%	2.0%
Net interest income/ Average RWAs (%)	1.8%	2.7%	3.8%	3.5%	3.4%
Net interest income/ Operating income (%)	79.7%	70.4%	73.2%	79.6%	82.6%
Net fees & commissions/ Operating income (%)	32.8%	20.7%	22.7%	19.9%	19.2%
Cost/ Income ratio (%)	59.0%	37.7%	38.0%	41.5%	40.1%
Operating expenses/ Average RWAs (%)	1.3%	1.5%	2.0%	1.8%	1.7%
Pre-impairment operating profit/ Average RWAs (%)	0.9%	2.4%	3.2%	2.6%	2.5%
Impairment on financial assets / Pre-impairment income (%)	0.1%	0.1%	0.0%	0.0%	0.0%
Loan Loss Provision/ Avg Gross Loans (%)	0.1%	0.1%	0.0%	0.0%	0.1%
Pre-tax profit/ Average RWAs (%)	0.8%	2.3%	3.2%	2.6%	2.4%
Return on average assets (%)	0.4%	0.9%	1.1%	1.0%	1.0%
Return on average RWAs (%)	0.6%	1.7%	2.4%	2.0%	1.8%
Return on average equity (%)	3.5%	7.4%	8.0%	7.3%	7.1%
<b>Capital and risk protection</b>					
Common equity tier 1 ratio (% , fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (% , transitional)	17.8%	21.5%	25.1%	22.2%	21.2%
Tier 1 capital ratio (% , transitional)	19.6%	23.9%	28.0%	24.1%	22.9%
Total capital ratio (% , transitional)	23.5%	28.9%	31.7%	27.8%	26.4%
Leverage ratio (%)	9.2%	11.5%	12.8%	8.5%	8.3%
Asset risk intensity (RWAs/ Total assets, %)	53.8%	49.4%	47.9%	55.4%	58.2%

Source: SNL



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