Note 5 - Capital adequacy and capital management

SpareBank 1 SMN has used IRB (Internal Rating Approach – Foundation) to calculate charges for credit risk since January 2007. Using IRB imposes wide-ranging requirements on the bank's organisation, competence, risk models and risk management systems. In June 2013 the bank applied for permission to switch to Advanced IRB for enterprise portfolios currently reported using the foundation approach. The effect of the risk weights under IRB is limited due to transitional rules set out in regulations issued by Finanstilsynet.

As from Q2 2013 the measurement method for operational risk was changed from the basic approach to the standardised approach at the Parent Bank. At the Group level, subsidiaries are still measured using the basic approach.

As from 1 July 2013 new buffer requirements have been introduced; see the Financial Institutions Act section 2-9e. As of 31 December 2013 the capital conservation buffer requirement is 2.5 per cent and the systemic risk buffer requirement is 2 per cent. These requirements are in addition to the requirement that own funds should constitute at least 4.5 per cent common equity tier 1 (CET1) capital, bringing the overall minimum CET1 requirement to 9 per cent.

Over the course of 2014 the systemic risk buffer requirement will increase by a further 1 percentage point, bringing the overall CET1 requirement as of 30 June 2014 to 10 per cent. As of 1 July 2015, a countercyclical buffer requirement of 1 percentage point will be applicable.

Hybrid capital denotes bonds with a nominal interest rate, but the bank is not obliged to pay interest in a period where dividends are not paid, and neither is the investor subsequently entitled to interest that has not been paid, i.e. interest does not accumulate. Hybrid capital characterised by moderate repayment incentives is approved as an element of tier 1 capital up to limit of 15 per cent of aggregate tier 1 capital. If, on the other hand, hybrid capital has no fixed term to maturity and has no repayment incentives, it may be included as an element of core capital up to limit of 35 per cent of aggregate core capital.

Finanstilsynet (Norway's FSA) can require hybrid capital to be written down in proportion with equity capital should the bank's tier 1 capital adequacy fall below 5 per cent or total capital adequacy falls below 8 per cent. Written-down amounts on hybrid capital must be written up before dividends can be paid to shareholders or before equity capital is written up. Hybrid capital is recognised as other long-term debt at amortised cost.

In connection with change requirements regarding the conditions for hybrid capital, hybrid capital that does not satisfy the new requirements over time will not be eligible for inclusion in other core capital. Such hybrid capital will be reduced by 20 per cent in 2014 and 10 per cent thereafter. As of 31 December 2013, SpareBank 1 SMN held NOK 450m in hybrid capital which will be subject to reduction.

Subordinated debt ranks behind all other liabilities. Dated subordinated loans cannot constitute more than 50 per cent of tier 1 capital for capital adequacy purposes, while perpetual subordinated loans cannot constitute more than 100 per cent of tier 1 capital. Subordinated loans are classified as a liability in the balance sheet and are measured at amortised cost in the same way as other long-term loans.

For detailed information regarding subordinated detbt and hybrid captial, see note 38 Subordinated debt and hybrid equity issue.

Parent Bank			Group	
2012	2013	(NOK million)	2013	2012
2,597	2,597	Equity capital certificates	2,597	2,597
-0	-0	- Own holding of ECCs	-0	-0
895	895	Premium fund	895	895
1,889	2,496	Dividend equalisation fund	2,496	1,889
2,944	3,276	Savings bank's reserve	3,276	2,944
195	227	Recommended dividends	227	195
30	124	Provision for gifts	124	30
106	195	Unrealised gains reserve	206	123
0	-	Other equity and minority interest	1,421	1,370
8,656	**9,811**	**Total book equity**	**11,242**	**10,042**
-447	-447	Deferred taxes, goodwill and other intangible assets	-582	-674
-	-	Part of reserve for unrealised gains, associated companies	98	57
-225	-352	Deduction for allocated dividends and gifts	-361	-238
-448	-401	50 % deduction for subordinated capital in other financial institutions	-106	-2
-165	-240	50 % deduction for expected losses on IRB, net of write-downs	-214	-179
-	-	50 % capital adequacy reserve	-595	-703
-55	-109	Surplus financing of pension obligations	-107	-49
7,316	**8,262**	**Total common equity Tier one**	**9,374**	**8,254**
918	1,431	Hybrid capital, core capital	1,615	1,103
8,234	**9,693**	**Total core capital**	**10,989**	**9,357**
		Supplementary capital in excess of core capital		
-	-	Tier 2 capital - excees of 15 per cent additional Tier 1 capital	31	31
312	304	Perpetual subordinated capital	363	312
1,810	1,569	Non-perpetual subordinated capital	1,950	2,127
-448	-401	50 % deduction for subordinated capital in other financial institutions	-106	-2
-165	-240	50 % deduction for expected losses on IRB, net of write-downs	-214	-179
-	-	50 % capital adequacy reserve	-595	-703
1,509	**1,231**	**Total supplementary capital**	**1,428**	**1,586**
9,742	**10,924**	**Net subordinated capital**	**12,417**	**10,943**
		Minimum requirements subordinated capital, Basel II		
1,654	1,573	Involvement with spesialised enterprises	1,573	1,654
1,470	1,478	Other corporations exposure	1,479	1,470
39	70	SME exposure	74	42
316	363	Retail morgage exposure	628	560
28	28	Other retail exposure	33	30
1,118	1,157	Equity investments	-	-
4,625	**4,669**	**Total credit risk IRB**	**3,787**	**3,756**
205	224	Debt risk	224	205
14	8	Equity risk	10	15
-	-	Currency risk	-	-
315	297	Operational risk	398	420
553	560	Exposures calculated using the standardised approach	2,151	2,074
-75	-67	Deductions	-119	-120
-	-	Transitional arrangements	316	246
5,637	**5,690**	**Minimum requirements subordinated capital**	**6,767**	**6,596**
70,468	**71,130**	**Risk weigheted assets (RWA)**	**84,591**	**82,446**
		Capital adequacy		
10.4 %	11.6 %	Common equity Tier one ratio	11.1 %	10.0 %
11.7 %	13.6 %	Core capital ratio	13.0 %	11.3 %
13.8 %	15.4 %	Capital adequacy ratio	14.7 %	13.3 %