

# Report of the Board of Directors

## Macroeconomic conditions

### International

The recovery witnessed in the world economy in 2014 was moderate. Growth picked up sharply over the course of spring and summer. Investments and consumption have picked up, and unemployment has declined. Sweden and the UK show positive developments, but inflation is low. In the euro area high debt and continued high unemployment are holding down consumption and investment. Inflation is low. In China the pace of growth remains high, albeit somewhat dampened compared to previously.

Growth in the world economy is expected to pick up gradually ahead. But uncertainty about the future, especially in the euro area, is substantial. The European Central Bank (ECB) has this year launched quantitative easing measures (bond purchases)

### Norway

The oil price fell sharply in the second half of 2014. At year-end the price was USD 57.5 per barrel, a halving of the level in effect at the end of the first half-year. Market interest rates have fallen, and the Norwegian krone has depreciated.

GDP growth in mainland (non-oil) Norway was 2.3 per cent in 2014 (preliminary figures). Growth in house prices was high throughout the year, after levelling off in autumn 2013. Debt growth was a fairly stable throughout the year. The key policy interest rate was lowered to 1.25 per cent in December 2014. Unemployment has risen somewhat but remains at a relatively low level. The underlying price growth (CPI-JAE – consumer price index adjusted for taxes and energy prices) was 2.4 per cent in 2014. The household debt burden is substantial. This creates a vulnerability which could intensify the impact of a weaker economic trend in Norway.

We must expect increased spillover effects of the oil price fall to the Norwegian economy ahead. Prospects for the Norwegian economy in 2015 are therefore weaker than witnessed in recent years. However, high activity levels among our trading partners and a relatively weak krone exchange rate could dampen the effects of the oil price fall.

### Trøndelag and Nordvestlandet

The number of bankruptcies in Sør-Trøndelag and Møre og Romsdal declined compared with the previous year, while the figure for Nord-Trøndelag showed no change. Population growth in the region remains buoyant. Like the rest of the country, house prices in the region showed a relatively high rate of growth through 2014. Contacts in the central bank's regional network (mid-Norway region) reported in autumn 2014 expectations of somewhat lower production growth ahead.

Measured in corporate turnover, the Trondheim region and Sunnmøre are the most significant areas in the region, accounting for about 60 per cent of the total (Economic Barometer 2014). Retail trade along with manufacturing are the largest industries in the region, accounting for just under 40 per cent of overall turnover. The region's industry structure shows wide geographical variation. In Møre og Romsdal much of the activity is export-oriented, whereas the two Trøndelag counties. Agriculture is largest in Nord-Trøndelag,

shipyards and shipbuilding and the furniture industry are largest in Møre og Romsdal, while wholesale and retail trade and construction are largest in Sør-Trøndelag/Trondheim. In Møre og Romsdal much of the business activity is export-oriented whereas the Trøndelag counties have little exposure to the export industry and are protected by a relatively large public sector.

The region has moderate exposure to the consequence of lower continental shelf investments. The business sector in Nord-Trøndelag is centred around primary industries and trade and commerce. Overall growth prospects for the economy of Sør-Trøndelag shadow the national trend. In Møre og Romsdal overall growth is likely to edge down, after high growth for several years.

## Annual accounts 2014

*Consolidated figures. Figures in parentheses refer to the same period of 2013 unless otherwise stated. The Group accounts are presented on the going-concern assumption, and the Board of Directors hereby confirms the basis for continued operation.*

### Profit of NOK 1,782m after tax

- Profit before tax and assets held for sale: NOK 2,143m (1,758m)
- Net profit: NOK 1,782 m (1,400m)
- Return on equity: 11.2 per cent (11.1 per cent)
- CET1 ratio: 11.2 per cent (11.1 per cent)
- Growth in lending 7.3 per cent (6.8 per cent) and deposits 8.5 per cent (7.3 per cent)
- Loan losses: NOK 89 m (101 m)
- Earnings per equity certificate (EC): NOK 8.82 (6.92)
- Book value per EC: NOK 62.04 (55.69), incl. recommended dividend for 2014
- Recommended dividend: NOK 2.25 per EC. Allocation to non-profit causes: NOK 160m

### Highlights

- Profit improvement of NOK 382m compared with 2013
- Strengthened core business with increased net interest income and limited cost growth
- Low loan losses and low default rate
- Good return on financial investments, mainly from a gain on the disposal of the Bank's stake in Nets Holding
- Excellent results at affiliates, largely thanks to run-off gains in insurance
- CET1 ratio of 11.2 per cent
- Relatively high growth in lending and deposits both to businesses and retail customers

In 2013 SpareBank 1 SMN achieved a post-tax profit of NOK 1,782m (1,400m) and a return on equity of 15.1 per cent (13.3 per cent). Profit before tax and assets held for sale was NOK 2,143m (1,758m).

In 2014 operating income increased by 12 per cent to reach an overall NOK 4,021m (3,580m). Income rose both at the Parent Bank and the subsidiaries.

Return on financial assets was NOK 720m (502m), of which the profit share on owner interests in affiliates was NOK 527m (355m) and the gain on disposal of the Bank's stake in Nets Holding was NOK 165m.

Operating expenses came to NOK 1,789m (1,721m) in 2014, or 3.9 per cent higher than in 2013. Costs for 2014 include NOK 30m set aside at the Parent Bank for reorganisation scheduled for 2015 and 2016.

Net losses on loans and guarantees were NOK 89m (101m).

Lending growth was 7.3 per cent (6.8 per cent) and deposit growth was 8.5 per cent (7.3 per cent).

Capital adequacy is measured under the new Capital Requirements Directive (CRD IV), described more fully in note 5 on capital Adequacy and capital management. CET1 capital adequacy at 31 December 2014 was 11.2 per cent (11.1 per cent).

SpareBank 1 SMN is planning for a CET1 ratio of 13.5 per cent by 30 June 2016. SpareBank 1 SMN's capital plan is further described in the section on financial strength.

At year-end the Bank's EC was priced at NOK 58.50 (55.00). A cash dividend of NOK 1.75 per EC was paid in 2014 for the year 2013.

Earnings per EC were NOK 8.82 (6.92). Book value was NOK 62.04 (55.69) per EC included recommended dividend of NOK 2.25.

### Proposed distribution of profit

Distribution of the profit for the year is done on the basis of the Parent Bank's accounts. The Parent Bank's profit includes dividends from subsidiaries, affiliates and joint ventures.

Subsidiaries are fully consolidated in the Group accounts, whereas profit shares from affiliates and joint ventures are consolidated using the equity method. Dividends are accordingly not included in the Group results.

Difference between Group - Parent Bank (NOKm)	2014	2013
<b>Profit for the year, Group</b>	<b>1,782</b>	<b>1,400</b>
Profit, subsidiaries	-92	-112
Dividend, subsidiaries	117	111
Profit, associated companies	-527	-355
Dividend, associated companies	182	328
Elimination subsidiaries and associated companies	-15	-24
<b>Profit for the year, Parent Bank</b>	<b>1,447</b>	<b>1,348</b>

Annual profit for distribution reflects changes of a positive NOK 57m in the revaluation reserve, leaving the total amount for distribution at NOK 1,503m.

The profit is distributed between the ownerless capital and the equity certificate capital in proportion to their relative shares of the Bank's total equity, such that dividends and the allocation to the dividend equalisation fund constitute 64.6 per cent of the distributed profit.

In keeping with the Bank's capital plan, the Board of Directors has opted to recommend a lower payout ratio than allowed for by the dividend policy.

The Board of Directors recommends the Supervisory Board to set a cash dividend of NOK 2.25 per equity certificate, altogether totalling NOK 292m. This gives a payout ratio of 25.4 per cent of the Group profit. The Board of Directors further recommends the Supervisory Board to allocate NOK 160m as gifts to non-profit causes, i.e. the same payout ratio as to the EC-holders. Of this sum, NOK 40m will be allocated to non-profit

causes and NOK 120m donated to the foundation Sparebankstiftelsen SMN. NOK 679m and NOK 372m are added to the dividend equalisation fund and the ownerless capital respectively. The level of dividend and gifts is anchored in the Bank's capital plan and reflects the need to increase the Bank's core capital through continuation of a relatively low dividend payout ratio.

After distribution of the profit for 2014 the EC-holder ratio (EC-holders' share of total equity) remains 64.6 per cent.

Distribution of profit (NOKm)	2014	2013
Profit for the year, Parent Bank	1,447	1,348
Transferred to/from revaluation reserve	57	-89
<b>Profit for distribution</b>	<b>1,503</b>	<b>1,259</b>
Dividends	292	227
Equalisation fund	679	587
Saving Bank's fund	372	321
Gifts	160	124
<b>Total distributed</b>	<b>1,503</b>	<b>1,259</b>

### Strengthened net interest income

Net interest income in 2014 came to NOK 1,790m (1,616m). The improvement is ascribable to interest rate increases on loans to retail and corporate customers alike in the first half of 2013 as a result of higher capital requirements and relatively high growth in lending and deposits in 2014. Margins on loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt are recorded as commission income, and commissions on loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt totalled NOK 427m (422m) as of the fourth quarter of 2014.

Two general interest rate cuts on loans to retail customers were carried out in 2014 (June and December), and the Bank has thereby adjusted its mortgage lending rates to the competitive situation. Over the year there have been several repricings of deposits both to retail and corporate clients, while the costs of money market funding were also reduced over the year.

### Increased commission income

Commission income and other operating income rose to NOK 1,512m (1,463m) in 2014, an increase of NOK 49m or 3.4 per cent. The growth in income is mainly ascribable to a positive trend in incomes from accounting services, insurance and payments.

Commission income (NOKm)	2014	2013	Change
Payment transfers	239	233	6
Savings	48	50	-2
Insurance	138	124	14
Guarantee commission	57	56	1
Real estate agency	315	319	-4
Accountancy services	172	125	47
Active management	20	30	-10
Rent	45	45	0
Other commissions	50	59	-9
<b>Commissions ex SB1 Boligkreditt and SB1 Næringskreditt</b>	<b>1,084</b>	<b>1,041</b>	<b>44</b>
Commissions SB1 Boligkreditt and SB1 Næringskreditt	427	422	6
<b>Total commissions</b>	<b>1,512</b>	<b>1,463</b>	<b>49</b>

## Financial investments

Overall return on financial investments (excluding the Bank's share of the profit/loss of affiliates and joint ventures) was NOK 193m (147m) in 2014. Overall return breaks down as follows:

- Return on the Group's share portfolios totalled NOK 202m (114m), of which the gain on the disposal of and dividend on the Bank's stake in Nets Holding accounted for NOK 165m
- Net capital loss on bonds and derivatives of NOK 66m in 2014 (40m). Of this amount, the booking of negative value related to an interest rate swap at SpareBank 1 SMN Kvartalet accounts for NOK 26m after tax. The interest rate swap was originally connected to the construction of the Bank's head office in Søndre gate no. 4
- Capital gains on forex and fixed income trading at SpareBank 1 SMN Markets came to NOK 57m (73m)

Capital gains/dividends, shares (NOKm)	2014	2013	Change
Capital gains/dividends, shares	202	114	87
Bonds and derivatives	-66	-40	-26
SpareBank 1 SMN Markets	57	73	-16
<b>Net return on financial investments</b>	<b>193</b>	<b>147</b>	<b>46</b>
SpareBank 1 Gruppen	358	210	148
SpareBank 1 Markets	-32	-1	-30
SpareBank 1 Boligkreditt	38	40	-3
SpareBank 1 Næringskreditt	41	8	33
SpareBank 1 Kredittkort	2	-	2
BN Bank	93	91	2
Companies owned by SpareBank 1 SMN Invest	31	14	17
Other companies including held for sale	-3	23	26
<b>Income from investment in related companies</b>	<b>527</b>	<b>384</b>	<b>143</b>
<b>Total</b>	<b>720</b>	<b>531</b>	<b>189</b>

## Excellent result for SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit for 2014 was NOK 1,849m (1,110m). The main contributor to the profit performance is the insurance business. The profit performance by the non-life arm is particularly creditable due to reduced claims payments and revenue recognition of run-off gains. SpareBank 1 SMN's share of the profit in 2014 was NOK 358m (210m).

## SpareBank 1 Markets

SpareBank 1 SMN has a stake of 27.3 per cent in SpareBank 1 Markets. The company recorded a deficit of NOK 120m in 2014, of which SpareBank 1 SMN's share was minus NOK 32m.

SpareBank 1 SMN has undergone a restructuring. The company has carried out extensive enhancement measures resulting in a halving of the cost level since 2012-13, while adjustments to the business model have brought lower market risk. SpareBank 1 SMN will integrate its capital market activities with SpareBank 1 SMN Markets by agreement with the remaining owners, after which SpareBank 1 SMN's stake will stand at 73.3 per cent. The other owners are SpareBank 1 Nord-Norge (10.0 per cent), SamSpar, i.e.

Samarbeidende Sparebanker (10.0 per cent), SpareBanken Hedmark (6.1 per cent) and the Norwegian Confederation of Trade Unions and employee shareholders (0.6 per cent). This is described in further detail in Note 40 – Business acquisitions/business combinations.

## SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt AS was established by the banks participating in the SpareBank 1 Alliance to take advantage of the market for covered bonds. The banks sell their best secured home mortgage loans to the

company, giving them reduced funding costs. As of 31 December 2014 the Bank had sold loans worth a total of NOK 28.4bn (30.5bn) to SpareBank 1 Boligkreditt, corresponding to 38 per cent (44 per cent) of overall loans to the retail market.

The Bank's stake in SpareBank 1 Boligkreditt AS at 31 December 2014 was 17.67 per cent, and the Bank's share of that company's profit in 2014 was NOK 38m (40m). The bank's holding reflects the Bank's relative share of home mortgage loans sold.

The Board of Directors of SpareBank 1 SMN has, like that of the other alliance banks, decided to apply for a licence for a wholly owned residential mortgage company. This entity will be a supplement to SpareBank 1 Boligkreditt, which will remain the alliance banks' main tool for raising loans through covered bonds. The residential mortgage company will be able to make use of loans outside the scope of SpareBank 1 Boligkreditt's credit policy. Moreover, the establishment of a wholly owned residential mortgage company will eliminate issue posed by the regulations governing large exposures which regulate the maximum permitted intercompany balance between SpareBank 1 SMN and SpareBank 1 Boligkreditt.

### **SpareBank 1 Næringskreditt**

SpareBank 1 Næringskreditt was established along the same lines, and with the same administration, as SpareBank 1 Boligkreditt. As of 31 December 2014, loans worth NOK 1.5bn (1.2bn) had been sold to SpareBank 1 Næringskreditt.

SpareBank 1 SMN owns 33.62 per cent of the company, and the bank's share of the company's profit in 2014 was NOK 41m (8m). The Bank's stake reflects its relative share of commercial property loans sold and its stake in BN Bank. The profit growth is ascribable to the change in the interest rate applied between SpareBank 1 Næringskreditt and BN Bank. This rate reflects the capital cost for BN Bank's loans sold to SpareBank 1 Næringskreditt.

### **SpareBank 1 Kredittkort**

The company was in ordinary operation from 1 July 2014, and achieved a net profit of NOK 12m for the year. SpareBank 1 SMN share of the profit was NOK 2m. SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 18.36 per cent. In June SpareBank 1 Kredittkort carried out a successful conversion of the SpareBank 1 banks' credit card portfolio from Entercard. SpareBank 1 SMN's share of the portfolio is NOK 715m.

### **BN Bank**

SpareBank 1 SMN had a 33 per cent stake in BN Bank as of 31 December 2014.

SpareBank 1 SMN's share of the profit of BN Bank for 2014 was NOK 93m (91m), yielding a return on equity of 7.8 per cent. The result is affected by the change in the interest rate mentioned in the section on SpareBank 1 Næringskreditt.

BN Bank's focus is on implementing profitability-enhancing measures, and it achieved increased income and reduced losses in 2014. Work continues on further internal measures with a view to profitability enhancement. BN Bank received approval to apply the advanced IRB approach to its corporate portfolio in April 2014. This resulted in a CET1 ratio of 14.9 per cent at end-2014.

**Affiliates of SpareBank 1 SMN Invest**

The overall profit for 2014 came to NOK 31m (14m). These companies are mainly engaged in the construction and sale of dwellings and commercial property in Sør-Trøndelag.

**Assets held for sale**

A profit of NOK 0.2m (29.5m) was recorded on assets held for sale in 2014.

**Limited cost growth**

Overall costs came to NOK 1,789m (1,721m) in 2014. Group expenses have thus risen by NOK 68m or 3.9 per cent.

Parent Bank cost growth rose by NOK 68m. This includes a provision of NOK 30m for reorganisation. Excluding this provision, Parent Bank costs grew NOK 38m or 3.1 per cent in 2014, in keeping with the Bank's objective.

As a result of changing customer behaviour involving far greater use of self-service solutions, the Board of Directors has adopted a goal of unchanged costs up to 2017. The number of FTEs will be reduced by up to 100 in the period to end-2016 by means of efficiency improvements at the Parent Bank. The cost of reorganisation reflects restructuring costs.

Operating expenses measured 1.52 per cent (1.54 per cent) of average total assets. The Group's cost-income ratio was 44 per cent (48 per cent).

**Low losses and low defaults**

Net loan losses came to NOK 89m (101m) for 2014. This represents 0.08 per cent of total loans (0.09 per cent).

Net losses of NOK 83m (95m) were recorded on loans to the Group's corporate customers, including losses of 6m (20m) at SpareBank 1 Finans Midt-Norge. The retail portfolio saw a net loss of NOK 6m (7m) in 2014.

Total individually assessed loan impairment write-downs came to NOK 172m (173m) as at 31 December 2014.

Total problem loans (defaulted and doubtful) came to NOK 486m (544m), or 0.40 per cent (0.49 per cent) of gross loans, including loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

Defaults in excess of 90 days totalled NOK 270m (387m), measuring 0.22 per cent (0.35 per cent) of gross lending. Of total defaults, NOK 67m (87m) are loss provisioned, corresponding to 25 per cent (23 per cent).

Defaults break down to NOK 136m (246m) on corporate customers and NOK 134m (140m) on retail customers.

Other doubtful exposures totalled NOK 216m (157m), i.e. 0.18 per cent (0.14 per cent) of gross outstanding loans. NOK 105m (86m) or 48 per cent (55 per cent) are loss provisioned.

Other doubtful exposures break down to NOK 201m (139m) to corporate customers and NOK 15m (18m) to retail customers.

**Collectively assessed impairment write-downs**

Collective assessment of impairment write-downs is based on two factors:

- events that have affected the Bank's portfolio (causing migration between risk categories)
- events that have not yet affected the portfolio since the Bank's credit risk models do not capture the effects rapidly enough (e.g. macroeconomic factors)

For 2014 no basis is found for any change in collectively assessed impairment write-downs. The aggregate volume of such write-downs is NOK 295m (295m). Collectively assessed impairment write-downs break down to NOK 90m on retail customers, NOK 188m on corporate customers and NOK 16m on SpareBank 1 Finans Midt-Norge.

**Total assets of NOK 126bn**

The Bank's assets totalled NOK 126bn (115bn) at 31 December 2014, having risen by NOK 9bn or 9.3 per cent over the year. The rise in total assets is a consequence of increased lending.

As of 31 December 2014 loans worth a total of 30bn (32bn) had been sold from SpareBank 1 SMN to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. These loans do not figure as lending in the Bank's balance sheet. The comments covering lending growth do however include loans transferred to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

**Lending**

In the last 12 months, total outstanding loans rose by NOK 8.1bn (7.1bn) or 7.3 per cent (6.8 per cent) to reach NOK 120.2bn (112.0m) as of 31 December 2014.

Lending to retail customers rose by NOK 5.5bn (5.9bn) or 8.0 per cent (9.5 per cent) to reach NOK 74.0bn in 2014.

Growth in lending to corporates in 2014 was NOK 2.7bn (1.2bn) or 6.1 per cent (2.8 per cent). Overall loans to corporates totalled NOK 46.2bn (43.5bn) as of 31 December 2014. This growth is slightly above the figure allowed for by the capital plan, and lending to corporates will reflect thus in 2015.

Loans to retail customers accounted for 62 per cent (61 per cent) of ordinary loans to customers at the end of 2014.

(For distribution by sector, see Note 8 on loans and advances to customers).

**Deposits**

Customer deposits rose in 2014 by NOK 4.8bn (3.8bn) to reach NOK 62.2bn (56.1m) at 31 December 2014. This represents a growth of 8.5 per cent (7.3 per cent).

Retail customer deposits rose by NOK 2.6bn (1.6bn) or 11.0 per cent (9.5 per cent) to reach NOK 26.5bn, while deposits from corporates rose by NOK 2.2bn (2.2bn) or 6.8 per cent (7.5 per cent) to NOK 34.2bn.

The deposit-to-loan ratio at SpareBank 1 SMN was 69 per cent as of 31 December 2014 (70 per cent).

(For distribution by sector, see Note 35 on deposits from and liabilities to customers).



### Portfolio of investment products

The customer portfolio of off-balance sheet investment products totalled NOK 6.2bn (5.2bn) at 31 December 2014. Compared with the previous year, there are higher values on equity funds and active management, largely due to increased stock exchange values and good sales.

Saving products, customer portfolio (NOKm)	2014	2013	Change
Equity funds	4,002	3,367	635
Pension products	597	555	42
Active management	1,611	1,240	371
<b>Total</b>	<b>6,210</b>	<b>5,162</b>	<b>1,048</b>

### Insurance

The Bank's insurance portfolio showed growth of 2.4 per cent in 2014. Non-life insurance delivered 1.6 per cent growth, personal insurance 10.4 per cent while growth in the occupational pensions portfolio declined by 4.4 per cent.

Insurance, premium volume (NOKm)	2014	2013	Change
Non-life insurance	706	695	11
Personal insurance	245	222	23
Occupational pensions	174	182	-8
<b>Total</b>	<b>1,125</b>	<b>1,099</b>	<b>26</b>

### Retail banking segment and corporate banking segment, Parent Bank

As from 2014 an organisational adjustment was carried through. The retail banking segment now covers agricultural customers, associations etc and sole proprietorships. In 2013 these customers were part of the SMB segment. Other customers in the SMB segment are as from 2014 included in the corporate banking segment. Historical data for the retail segment and the corporate segment are therefore incomplete and no comparison is made with the previous year's figures. Economic capital is used to calculate return on capital employed from and including the third quarter of 2014.

Results (NOKm)	Retail Market	Corporate Market
Net interest	873	840
Interest from allocated capital	40	67
<b>Total interest income</b>	<b>913</b>	<b>906</b>
Commission income and other income	762	159
Net return on financial investments	1	29
<b>Total income</b>	<b>1,675</b>	<b>1,095</b>
Total operating expenses	809	318
<b>Ordinary operating profit</b>	<b>867</b>	<b>777</b>
Loss on loans, guarantees etc.	6	77
<b>Result before tax including held for sale</b>	<b>861</b>	<b>699</b>
<b>Post-tax return on equity</b>	<b>19.2 %</b>	<b>10.0 %</b>

### Retail Banking

Operating income has increased due to increased margins on home loans and growth in lending and deposits, and totalled NOK 1,675m in 2014. Net interest income came to NOK 913m and commission income to NOK 762m. Return on capital employed in the private banking segment was 19.2 per cent. Economic capital of 13.5 per cent is used as capital employed, corresponding to the CET1 target the Group intends to reach by 30 June 2016.

The lending margin in 2014 was 2.38 per cent (2.32 per cent), while the deposit-to-loan ratio was -0.55 per cent (-0.52 per cent) measured against three-month NIBOR.

In 2014 lending to retail customers rose by 7.5 per cent and deposits from the same segment by 8.5 per cent.

Lending to retail borrowers generally carries low risk, as reflected in continued very low losses. There are no indications of a higher loss and default levels in the Bank's home mortgage loan portfolio. The loan portfolio is secured on residential properties, and the trend in house prices has been satisfactory across the market area as a whole.

### Corporate Banking

Operating income totalled NOK 1,095m in 2014. Net interest income was NOK 906m, while other income totalled NOK 188m.

Return on capital employed for the corporate banking segment was 10.0 per cent for 2014. Regulatory capital of 13.5 per cent is used as capital employed, corresponding to the CET1 target the Group intends to reach by 30 June 2016.

The lending margin was 2.90 per cent (2.94 per cent) and the deposit margin was -0.55 per cent (-0.52 per cent) in 2014.

Growth in loans and deposits respectively in 2014 was 6.3 per cent and 8.8 per cent.

### Incomes SpareBank 1 SMN Markets

SpareBank 1 Markets delivers a complete range of capital market products and is an integral part of SMN's Parent Bank operation.

SpareBank 1 Markets posted total income of NOK 68.0m (103.0m) in 2014. Issuer services income and other income in 2013 include income from the corporate business which was transferred to SpareBank 1 Markets as from the fourth quarter of 2013.

Markets (NOKm)	2014	2013	Change
Currency trading	75.8	68.3	7.5
Securities, brokerage commission	0.9	21.6	-20.7
SpareBank 1 Markets	-14.8	3.1	-17.9
VPS and other income	4.0	17.4	-13.4
Investments	2.1	-7.4	9.5
<b>Total income</b>	<b>68.0</b>	<b>103.0</b>	<b>-35.0</b>

*Of gross income of NOK 68m, a total of NOK 29m is transferred to Corporate Banking and NOK 1m to Retail Banking. These amounts are the respective entities' share of income on forex and fixed income business derived from their own customers.*

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### Subsidiaries

The subsidiaries posted an aggregate pre-tax profit of NOK 124.6m (157.3m) in 2014. The results are from the companies' financial statements.

Pre-tax profit (NOKm)	2014	2013	Change
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EiendomsMegler 1 Midt-Norge	50.9	60.7	-9.8
SpareBank 1 Finans Midt-Norge	67.9	50.7	17.3
SpareBank 1 Regnskapshuset SMN	40.5	14.4	26.1
Allegro Kapitalforvaltning	2.6	9.3	-6.7
SpareBank 1 SMN Invest	1.7	46.6	-45.0
Other companies	-39.0	-24.4	-14.6
<b>Total</b>	<b>124.6</b>	<b>157.3</b>	<b>-32.7</b>

**EiendomsMegler 1 Midt-Norge** leads the field in its catchment area with a market share of about 40 per cent. The company recorded a sound profit in 2014, but a slower market at the start of the year and increased price competition contributed to a weaker pre-tax profit than in 2013. The profit was NOK 50.9m (60.7m). The company arranged the sale of 6,383 dwellings in 2014 compared with 6,229 the previous year.

**SpareBank 1 Finans Midt-Norge** posted a profit of NOK 67.9m (50.7m) in 2014. The profit growth is ascribable to increased income from car loans and reduced losses in the leasing business. At year-end the company managed leases and car loan agreements worth a total of NOK 3.6bn of which leases accounted for NOK 1.9bn and car loans for NOK 1.7bn.

**SpareBank 1 Regnskapshuset SMN** posted a pre-tax profit of NOK 40.5m (14.4m) excluding income of NOK -0.5m from affiliates. Of this, NOK 7m comprises a gain on the sale of a 40 per cent stake in SpareBank 1 Regnskapshuset Østlandet.

SpareBank 1 SMN Regnskapshuset SMN has a growth strategy based on the acquisition of small accounting firms. This represents a consolidation of a fragmented accounting industry. A further four accounting firms were acquired in 2014.

**Allegro Kapitalforvaltning** is an active management company that manages portfolios for clients primarily in SpareBank 1 SMN and the SamSpar banks. These banks are Allegro's distribution channel. The company posted a profit of NOK 2.6m in 2014 (9.3m).

**Sparebanken SMN Invest's** mission is to invest in shares, mainly in regional businesses. The company posted a pre-tax profit of NOK 1.7m in 2014 (profit of 46.6m). This profit is a consequence of value changes and realisation of losses or gains on the company's overall shareholding, and is the profit shown in the company's financial statements. In addition the company recorded profits totalling NOK 31m (14m) from owner interests in the property companies Grilstad Marina and Homelvik Sjøside in 2014.

**Other companies** have an overall deficit of NOK 39.0m (deficit of 24.4m). These are mainly property companies that lease premises to SpareBank 1 SMN and other tenants.

### Satisfactory funding and good liquidity

The Bank has a conservative liquidity strategy. The strategy attaches importance to maintaining liquidity reserves that ensure the bank's ability to survive 12 months of ordinary operation without need of fresh external funding.

The Bank has liquidity reserves of NOK 19bn and thus has the funding needed for 24 months of ordinary operation without fresh external finance.

The Bank's funding sources and products are amply diversified. At year-end the proportion of money market funding in excess of 1 year was 87 per cent (72 per cent).

SpareBank 1 Boligkreditt is the Bank's chief source of funding, and as of 31 December 2014 loans totalling NOK 28bn had been sold to SpareBank 1 Boligkreditt.

### Rating

SpareBank 1 SMN has a rating of A2 (negative outlook) with Moody's and a rating of A- (stable outlook) with Fitch Ratings. The Bank was placed on negative outlook by Moody's in May 2014, as were a number of other Norwegian and European banks.

### Financial position

After distribution of the profit for 2014, the CET1 capital ratio is 11.2 per cent (11.1 per cent) as at 31 December 2014. Through 2014 the CET1 ratio strengthened thanks to a good profit performance, but concurrently weakened by an increase in risk weighted assets.

The minimum requirement on CET1 capital as of 31 December 2014 was 10 per cent, of which aggregate buffer requirements made up 5.5 per cent. CET1 capital is core capital excluding hybrid capital.

(NOKm)	2014	2013
Tier 1 capital	10,674	9,374
Hybrid capital	1,707	1,615
Subordinated loan	2,555	1,428
<b>Capital base</b>	<b>14,937</b>	<b>12,417</b>
Required subordinated debt	7,625	6,767
<b>Risk weighted assets</b>	<b>95,317</b>	<b>84,591</b>
Tier 1 capital ratio	11.2 %	11.1 %
Core capital ratio	13.0 %	13.0 %
Capital adequacy ratio	15.7 %	14.7 %

Increased home loan weights brought a substantial increase in risk weighted assets in the first quarter of 2014. In addition, further new capital requirements have been introduced in connection with CRD IV which have adversely affected the Group's risk weighted assets. The Group has shifted lending growth from Corporate Banking over to Retail Banking to counteract these effects.

A countercyclical buffer of 1 per cent will be introduced at the end of the second quarter of 2015. The Ministry of Finance decided in December that no change would be made to the countercyclical buffer. The normal period of notification for an increase is 12 months.

The Board of Directors of SpareBank 1 SMN continually assesses the capital situation and future capital requirements. The Board considers it important for the Group to be sufficiently capitalised to fulfil all regulatory requirements, as well as market expectations. The practical consequence is that the Bank's CET1 capital target remained unchanged, even though SMN was not defined as a SIFI. The Board of directors is planning for a CET1 ratio of 13.5 per cent including a countercyclical buffer of 1 per cent plus a reserve of 0.5 per cent.

SpareBank 1 SMN applied in June 2013 for permission to apply the advanced IRB approach to its corporate portfolio. Finanstilsynet (Norway's FSA) had yet to issue a decision regarding approval at the end of the fourth quarter of 2014. The net effect of such approval will be curbed by the transitional rules (the "floor").

The following are the most important measures in the Group's capital plan:

- Continued sound banking operation through efficiency enhancements and prioritisation of profitable segments.
- The dividend policy to entail an effective payout ratio of 25–35 per cent of the Group profit.
- Moderate growth in the Bank's asset-intensive activities, including priority given to lending to the retail and corporate segments in the Bank's catchment area

The Group's capital plan presupposes that SpareBank 1 SMN's application for permission to apply the advanced IRB approach receives approval.

SpareBank 1 SMN currently has no plans to issue equity capital, and the Board of Directors is of the view that other measures are sufficient to attain the goal of a CET1 ratio of 13.5 per cent by 30 June 2016.

The Bank is IRB approved and uses the IRB foundation approach to compute capital charges for credit risk.

### **The Bank's equity certificate (MING)**

The book value of the Bank's EC as of 31 December 2014 including a recommended dividend of NOK 2.25 was NOK 62.04 (55.69), and earnings per EC were NOK 8.82 (6.92).

The Price / Income ratio was 6.63 (7.95), and the Price / Book ratio was 0.94 (0.99).

At year-end the EC was priced at NOK 58.50, and dividend of NOK 1.75 per EC was paid in 2014 for the year 2013.

SpareBank 1 SMN's articles of association do not impose trading restrictions on its EC holders.

With regard to placings with employees, the latter are invited to participate under given guidelines. In placings where discounts are granted, a lock-in period applies before sale can take place. The rights to ECs issued in placings with employees cannot be transferred.

SpareBank 1 SMN is not aware of any agreements between EC holders that limit the opportunity to trade ECs or to exercise voting rights attached to ECs.

See also the chapter Corporate Governance.

### **Risk factors**

In the second half of 2014 the oil price fell substantially, and firms' expectations are weaker than previously. This is so far not reflected in the Group's loss and default levels, which remain low. The directors consider the credit quality of the Bank's loan portfolio to be satisfactory.

The Bank expects low oil prices to affect various industries differently, and export-oriented industries will stand to benefit from a weakened krone exchange rate in relation to the most important export markets. Cyclical developments are uncertain, and the directors expect that the economic climate may be somewhat weaker than previously assumed. This is down to moderate activity growth due to very weak international growth impulses. The region's industry structure has little direct exposure to oil-related activities.

The Bank has limited credit exposure to oil service related activity (about 4 per cent of aggregate lending), an industry that is seeing weaker demand. No basis has been found for individually assessed impairment

write-downs on exposures to this sector. The directors also consider contract coverage and LTV values in the portfolio to be of such quality that at the end of 2014 no need has been found to increase collectively assessed impairment write-downs either. This assessment could change should oil prices remain low for a protracted period.

Unemployment in Norway is expected to remain at a low level, but employment growth is expected to be somewhat lower ahead. A continued low interest rate level is anticipated, and the Bank accordingly expects the risk of loss in the retail banking portfolio to remain low. Credit demand from Norwegian households continues to outstrip wage growth, which could provide a basis for increased risk in the longer term. The Bank reviews its credit policy on a continuous basis to ensure no increase in the level of risk.

Steadily rising capital requirements combined with uncertainty particularly in relation to the handling of the countercyclical buffer, suggest that Norwegian banks will pursue a more conservative credit policy towards business and industry.

The Bank's results are affected directly and indirectly by the fluctuations in the securities markets. The indirect effect relates above all to the Bank's stake in SpareBank 1 Gruppen, where both the insurance business and fund management activities are affected by the fluctuations.

The Bank is also exposed to risk related to access to external funding. This is reflected in the Bank's conservative liquidity strategy (see the above section on funding and liquidity).

### **Corporate social responsibility**

The Bank aims to contribute to society's value creation by assuring profitable and sound banking, prudent capital allocation and sustainable management of inputs. Healthy growth provides the 'lift' that enables the Bank to attract good customers and skilled staff and to contribute to the further development of the region of which we are a part.

SpareBank 1 SMN aims to balance financial growth against the need for rational use of inputs and resources consumed by the Bank. Consideration for society is integrated in all aspects and at all levels of our business, extending to matters touched on in the Accounting Act section 3-3c which deals with human rights, employee rights, social conditions, external environment and the combating of corruption. This ensures that ethics, the environment and important social issues are on the agenda throughout.

SpareBank 1 SMN has established a strategy for its corporate social responsibility that brings together three themes: finance, social responsibility and environment. Under each main theme, important areas are defined and clear targets are set for the Bank's contribution to responsible development.

This is further described in the chapter Corporate Social Responsibility in this annual report, which includes meeting the requirements of the Accounting Act section 3-3c.

### **HR and competence**

SpareBank 1 SMN is a competence-intensive business. This means that the individual staff member's, department's and the organisation's combined competence are key inputs for securing sound value creation at all levels. The Bank's advisers are the core of the business and the most important competitive advantage in combination with the values 'close at hand' and 'capable'.

**Knowledge, skills and mindsets**

SpareBank 1 SMN makes heavy demands on its advisers to ensure that customers experience the best the market has to offer in terms of personal financial and corporate financial advice. The Bank has developed good training arenas for its advisers and has a continual focus on professional development, improvement of customer processes and a high standard of ethics among all members of staff. The SpareBank 1 Alliance has jointly developed a comprehensive certification programme for advisers and is thus well placed to adapt to new industry requirements. At the end of 2014 all the Bank's advisers were approved non-life insurance advisers, and all advisers have completed or are undergoing authorisation as financial advisers. Twenty-nine advisers became authorised financial advisers in the course of 2014, and annual updating of previously authorised advisers was carried out.

**Attractive employer**

Vacancy announcements have attracted many applicants and keen interest is shown in the Bank's company presentations, and recruitment agencies report unequivocally that the Bank has a positive reputation in the labour market. The Bank is continuously engaged in developing and improving its appointment policy to ensure the recruitment of staff with the right knowledge, skills and mindsets and to come across as an attractive employer in the labour market.

The Bank collaborates with relevant educational institutions in our market area and participates both in company presentations and as a mentor enterprise for certain lines of study.

**The Group's internal labour market**

Job changes are facilitated across business areas and subsidiaries to stimulate circulation of competencies and experience in the organisation, and career development for our staff. Twenty-one staff members went to new jobs within the Group in 2014.

Internal career models have been established for the various business areas. This lends clarity to requirements and expectations in various roles and indicates possibilities for professional career development.

The overarching objective of the internal recruiting processes is to get the right person into the right job and to offer interesting development opportunities for our staff. Inherent in this objective is a clear-cut aim of a good gender balance at all levels of the organisation. A healthy gender equality perspective is a precept of the Bank's HR policy.

**Staff turnover at the Bank**

The Bank's staff turnover rate in 2014 was 4.9 per cent. This is excluding staff that have retired. In the Bank's view, a balanced replacement of staff adds new competencies and experience. It also indicates that the Bank's staff are attractive and competitive in the labour market.

**Sickness absence**

The Bank's overall sickness absence was 4.1 per cent in 2013 compared with 4.6 per cent in 2012. The Bank makes an active effort to keep sickness absence as low as possible. Initiatives at various levels have been important and are viewed as key explanations for our relatively moderate rate of sickness absence.

## Corporate initiatives

- 'Better Shape' workout/activities programme
- close cooperation with the corporate health service
- targeted health follow-up (ergonomics, work environment, health)
- organisation analysis

## Individual initiatives

- more and more staff turning to healthful leisure activities
- substantial support for company sports activities
- close follow-up of staff on sick leave

Main figures, Parent Bank	2014	2013
No. of FTEs 31/12	753	757
No. of staff 31/12	789	805
Turnover	4.9 %	8.4 %
Share of female managers	32.0 %	31.6 %
New staff	53	38
Average age	46 yrs	46 yrs
Sickness absence rate	3.2 %	4.1 %

*Demographic data for the Parent Bank.*

**Non-discrimination**

SpareBank 1 SMN works to prevent discrimination in spheres including recruitment, pay and employment conditions, promotion, career development, and protection against harassment. SpareBank 1 SMN aims to reflect the population structure in its catchment area.

**The Group's remuneration policy**

All remuneration arrangements at SpareBank 1 SMN are formulated in accordance with the Financial Institutions Act, and with the Securities Trading Act with associated Regulations on Remuneration Arrangements at Financial Institutions, Investment Firms and Fund Management Companies.

The Group's guidelines for variable remuneration are designed to assure that employees, groups and the business as a whole are compliant with the risk management strategies, processes and tools that the Group has put in place to protect assets and values. The remuneration arrangements are formulated in such a way as to ensure that neither individuals nor the organisation will take unacceptable risk in order to maximise the variable remuneration.

For further information, see note 23 on personnel expenses and emoluments to senior employees and elected officers.

**Prospects**

The directors are highly pleased with the performance for 2014. The core business has achieved good income growth while at the same time cost growth is moderate and losses are being kept to very low levels. The directors are highly satisfied with the employees' achievement in 2014.

The Bank strengthened its market position in the retail segment in 2014, and shows sound growth in all business areas.



Growth in lending to business and industry was higher in 2014 than allowed for in the capital plan, and lending to this segment in 2015 will reflect this. The intention is to attain the CET1 target of 13.5 per cent in 2016 by moderate lending growth, profit retention and without carrying out an ordinary equity capital issue. On February 24th 2015 the Financial Supervisory Authority of Norway informed SpareBank 1 SMN that the Bank was given permission to use the advanced IRB approach, effective from 1st quarter 2015.

The falling oil price and a somewhat more negative economic situation have focused greater attention on Banks' loan exposure. Defaults at SpareBank 1 SMN are at a very low level, and no basis has been found for increasing individually or collectively assessed impairment write-downs.

The Board of Directors expect another good performance in 2015.

Changing customer behaviour with increasing use of digital channels and fewer visits to bank branches create a need for a new design of distribution of the Bank's products and services. The Bank will optimise resource use between the channels and will continuously adjust the distribution model to fit the Bank's distribution to customer behaviour and customers' use of the channels. An efficient and effective branch structure staffed by competent advisers, combined with a customer-oriented direct bank and good self-service solutions will help to ensure that customers can meet their needs in their preferred manner.

SpareBank 1 SMN has through the SpareBank 1 Alliance a good platform on which to implement the system adjustments needed in a cost-efficient manner.

Necessary investments will be made in technology in tandem with efficiency enhancements at the Bank.

The board of directors has established a new target for the Parent Bank's cost trend which requires unchanged costs in the period to 2017.

Through the project SMN 2020, new service concepts are being developed and the cost level adapted to ensure that SpareBank 1 SMN is seen to be best for customer experience, thereby maintaining its competitive power.

Trondheim, 3 March 2015  
The Board of Directors of SpareBank 1 SMN

Kjell Bjordal  
Board chair

Bård Benum

Paul E. Hjelm-Hansen

Arnhild Holstad

Aud Skrudland

Janne Thyø Thomsen

Morten Loktu

Venche Johnsen  
Employee representative

Finn Haugan  
Group CEO