SpareBank 1 SMN

Note 5 - Capital adequacy and capital management

The Ministry of Finance adopted on 22 August 2014 amendments to regulations on capital requirements taking effect on 30 September 2014. The amendments bring Norwegian legislation into line with the EU's new capital requirements framework (CRR/CRD IV). This framework is for the present not incorporated into the EEA agreement, although its most important provisions have been incorporated in the Financial Institutions Act and the Securities Trading Act. The adjusted legislation entered into force on 1 July 2013, and requires a gradual increase in minimum requirements on Common Equity Tier 1 (CET1) capital in the period to 1 July 2016.

As of 31 December 2014 the capital conservation buffer requirement is 2.5 per cent and the systemic risk requirement is 3 per cent. The systemic risk buffer rose by 1 percentage point as from 1 July 2014. These requirements are additional to the requirement of 4.5 per cent CET1 capital, so that the overall minimum requirement on CET1 capital is 10 per cent. On 30 June 2015 a countercyclical buffer requirement of 1 percentage point will become effective, bringing the overall minimum CET1 requirement to 11 per cent.

Norwegian authorities have chosen to continue the Basel 1 floor as a floor for risk weighted assets.

SpareBank 1 SMN utilises the Internal Rating Based Approach (IRB) for credit risk. Use of IRB imposes wide-ranging requirements on the Bank's organisational set-up, competence, risk models and risk management systems. In June 2013 the Bank applied for approval to switch to Advanced IRB for those corporation portfolios currently reported under the IRB Foundation Approach.

<u>The most central changes in connection with the new rules</u>:

- Deductions in own funds will primarily reduce CET1 capital, whereas previously CET1 capital and supplementary capital were reduced equally on a 50-50 basis
- Changes in deductions in respect of assets in other financial institutions. A distinction is drawn between significant and non-significant assets, and deductions are to be made in the same asset class as that to which the owned asset belongs. The limit for deductions in respect of assets in other financial institutions is raised from 2 per cent of the other institution's own funds to 10 per cent ownership. The deductions are limited to 10 per cent of own CET1 capital, and all assets below 10 per cent are part of risk weighted assets. The previous capital adequacy reserve no longer applies
- Deferred tax benefit related to temporary differences within 10 per cent own CET1 capital will now not be deductible, but will instead be risk weighted at 250 per cent. Deferred tax benefit above 10 per cent will be deductible from CET1 capital
- The sum of deferred tax benefit and significant assets that are deducted from CET1 capital cannot constitute more than 17.65 per cent of own CET1 capital
- Introduction of Additional Value Adjustments (AVA deductions) – requirement for prudent valuation
- Introduction of Credit Value Adjustments (CVA) for derivative positions
- Changes in rules governing risk weighting of exposures to covered bonds and rated institutions, will now be risk weighted based on the institution's own rating

In connection with changed requirements on conditions governing hybrid capital, hybrid capital not meeting the new requirements over time will not be eligible as other core capital. The bonds will subject to a stepwise reduction of 30 per cent in 2015 and 10 per cent thereafter. As at 31 December 2014 SpareBank 1 SMN held hybrid capital worth NOK 450m that will be subject to stepwise reduction. Finanstilsynet may require the hybrid capital to be written down in proportion to equity capital if the Bank's CET1 capital ratio falls below 5.125 per cent.

As from the second quarter 2013 the measurement of operational risk switched from the Basic Indicator Approach to the Standardised Approach. At group level the Basic Indicator Approach still applies to subsidiaries.

Comparatives have not been restated.

Parent Bank 2013	Parent Bank 2014	(NOK million)	Group 2014	Group 2013
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
2,496	3,122	Dividend equalisation fund	3,122	2,496
3,276	3,619	Savings bank's reserve	3,619	3,276
227	292	Recommended dividends	292	227
124	160	Provision for gifts	160	124
195	139	Unrealised gains reserve	148	206
-	-	Other equity and minority interest	1,620	1,354
-	-	Minority interests	72	67
9,811	**10,824**	**Total book equity**	**12,524**	**11,242**
-447	-447	Deferred taxes, goodwill and other intangible assets	-566	-582
-	-	Part of reserve for unrealised gains, associated companies	120	98
-352	-452	Deduction for allocated dividends and gifts	-452	-361
-401	-	50 % deduction for subordinated capital in other financial institutions	-	-106
-240	-	50 % deduction for expected losses on IRB, net of write-downs	-	-214
-	-	50 % capital adequacy reserve	-	-595
-	-	Minority interests recognised in other equity capital	-72	-
-	-	Minority interests eligible for inclusion in CET1 capital	35	-
-109	-4	Surplus financing of pension obligations	-	-107
-	-31	Value adjustments due to requirements for prudent valuation	-45	-
-	-325	Positive value of adjusted expected loss under IRB Approach	-419	-
-	-	Direct, indirect and synthetic investments in financial sector companies	-451	-
8,262	**9,565**	**Total common equity Tier one**	**10,674**	**9,374**
1,431	1,449	Hybrid capital, core capital	1,716	1,615
-	-	Direct, indirect and synthetic investments in financial sector companies	-9	-
9,693	**11,014**	**Total core capital**	**12,382**	**10,989**
		Supplementary capital in excess of core capital		
-	-	Fund bonds, hybrid capital in excess of 15 %	-	31
1,873	1,906	Subordinated capital	2,598	2,313
-401	-	50 % deduction for subordinated capital in other financial institutions	-	-106
-240	-	50 % deduction for expected losses on IRB, net of write-downs	-	-214
-	-	50 % capital adequacy reserve	-	-595
-	-43	Direct, indirect and synthetic investments in financial sector companies	-43	-
1,231	**1,864**	**Total supplementary capital**	**2,555**	**1,428**
10,924	**12,878**	**Net subordinated capital**	**14,937**	**12,417**
		Minimum requirements subordinated capital		
1,573	1,632	Involvement with spesialised enterprises	1,887	1,573
1,478	1,331	Other corporations exposure	1,371	1,479
363	829	Mass market exposure, property	1,280	628
70	149	Mass market exposure, SMBs	159	74
28	49	Other retail exposure	51	33
1,157	1,111	Equity investments	0	-
4,669	**5,102**	**Total credit risk IRB**	**4,748**	**3,787**
224	397	Debt risk	397	224
8	-	Equity risk	1	10
-	-	Currency risk	0	-
297	292	Operational risk	416	398
560	849	Exposures calculated using the standardised approach	1,971	2,151
-67	-	Deductions	-	-119
-	42	Credit value adjustment risk (CVA)	92	-
-	-	Transitional arrangements	-	316
5,690	**6,682**	**Minimum requirements subordinated capital**	**7,625**	**6,767**
71,130	**83,523**	**Risk weigheted assets (RWA)**	**95,317**	**84,591**

	3,759	Minimum requirement on CET1 capital, 4.5 %	4,289	
		Capital Buffers		
	2,088	Capital conservation buffer, 2.5 %	2,383	
	2,506	Systemic rick buffer, 3.0 %	2,860	
	4,594	**Total buffer requirements on CET1 capital**	**5,242**	
	1,212	**Available CET1 capital after buffer requirements**	**1,143**	
		Capital adequacy		
11.6 %	11.5 %	Common equity Tier one ratio	11.2 %	11.1 %
13.6 %	13.2 %	Core capital ratio	13.0 %	13.0 %
15.4 %	15.4 %	Capital adequacy ratio	15.7 %	14.7 %