

# Report of the Board of Directors

## Macroeconomic conditions

### **Moderate growth in the world economy**

The world economy again showed moderate growth in 2016. In the US growth quickened over the year. An improving labour market and more expansionary fiscal policy are likely to contribute to increased private and public demand ahead. In the euro area the moderate upturn is driven by sound growth in domestic demand. Receding growth in employment and higher consumer prices will probably dampen growth somewhat ahead. In Sweden the growth rate edged down in 2016, after high rates of growth in 2014 and 2015. Emerging economies account for a large share of the global growth. Growth is holding up in the Chinese economy, well supported by government measures. Further, developments in India, Brazil and Russia are likely to spur continued sound growth in emerging economies. International interest rates are very low, but expected key policy rates and long-term interest rates have picked up since last autumn.

Overall growth in the world economy is expected to pick up gradually. However, there are many risk factors that could weaken economic growth in the short or longer term. Political uncertainty is unusually large, related among other things to the risk of trade wars and increased protectionism, the UK's exit from the EU and possible election victories for populist parties in Europe. Continued high debt growth among Chinese companies is a further risk factor for global growth.

### **Somewhat brighter prospects for the Norwegian economy, but much uncertainty**

The oil price fall and lower activity in the oil supplier industry have brought lower growth in the Norwegian economy in recent years, particularly in regions closely linked to the oil industry. Economic prospects are somewhat brighter, but uncertainty remains high. The oil price has risen after OPEC's and other countries' decision to curb oil production, and stood at USD 57 p/b at the end of 2016. The key policy interest rate was lowered from 0.75 per cent to 0.50 per cent in March 2016. The krone exchange rate has appreciated over the year.

Economic growth in Norway remains low. Mainland Norway's (non-oil) GDP rose by 0.8 per cent in 2016. Private consumption picked up towards year-end. Residential investments have risen sharply in 2015 and 2016, and are expected to remain high in the immediate future. Petroleum investments have fallen heavily in recent years. The fall in 2016 is estimated at 15 per cent, and a further fall of around 11 per cent is expected in 2017, before investments recover somewhat. Contacts in Norges Bank's (central bank) regional network reported in November that they expected production growth to quicken slightly in the next half-year. Unemployment is expected to remain fairly stable in the immediate future.

Overall, growth in the Norwegian economy is expected to pick up, but the upturn looks set to be a slow one. The negative drag from petroleum investments will gradually abate and growth will be supported by continued expansionary fiscal and monetary policy. However, the high house price and household debt growth is a risk factor for the Norwegian economy. House price growth quickened in 2016, and twelve-month growth in December was 12.8 per cent. Oslo and its surrounding areas are the main contributor to the rapid price growth, with twelve-month growth in Oslo in December 2016 at 23.3 per cent. Both house prices and

the household debt burden are at very high levels in historical terms. This creates a vulnerability which can intensify the effects of a house price fall, income lapse or interest rate hike through a sudden shift in household demand for goods and services and lower residential investment.

### **Trøndelag and Møre og Romsdal faring well**

Growth in house prices has also quickened through 2016, but at a more moderate level. Twelve-month growth in December 2016 was 9.9, 7.3 and 4.8 per cent in Sør-Trøndelag, Nord-Trøndelag and Møre og Romsdal respectively. Unemployment in the region is low. Unemployment rose somewhat in Møre og Romsdal through 2016, but declined in Trøndelag. The region's population is growing, and the towns in particular are on a good trend.

County-by-county forecasts prepared by Menon Economics for SpareBank 1 SMN's economic barometer show that value creation in Sør-Trøndelag will be stable, and somewhat above the national average, in the next couple of years. Growth in exports of fish and high residential investment are sustaining economic growth. In Nord-Trøndelag value creation is expected to be stable. Fish exports and high activity in manufacturing industry are making a positive contribution.

Møre og Romsdal is affected by the reduced activity in the oil-sector. Menon Economics expects virtually zero growth in the county in the current year and that growth will pick up substantially in the longer term. Sentio Research's annual corporate expectations barometer shows increased optimism among business leaders, including in Møre og Romsdal, and a considerable improvement from last year.

## **Annual accounts 2016**

The annual accounts are presented on the going-concern assumption, and the Board of Directors hereby confirms the basis for continued operation.

*Consolidated figures. Figures in parentheses refer to the same period of 2015 unless otherwise stated.*

### **Post-tax profit of NOK 1,647m**

- Pre-tax profit: NOK 1,983m (1,776m)
- Post-tax profit: NOK 1,647m (1,406m)
- Return on equity: 11.3 per cent (10.7 per cent)
- CET1 capital ratio: 14.9 per cent (13.6 per cent)
- Growth in lending: 8.0 per cent (5.8 per cent) and in deposits: 4.8 per cent (5.6 per cent)
- Loan losses: NOK 516m (169m)
- Earnings per equity certificate (EC): NOK 7.91 (7.02). Book value per EC, incl. dividend proposed for 2016: NOK 73.26 (67.65)
- Proposed dividend: NOK 3.00 per EC and NOK 220m to be allocated to non-profit causes

## Good profit performance in 2016

### Main points:

- Good profits from banking operations, subsidiaries and product companies alike
- Profit of NOK 241m better than in 2015 as a result of increased operating revenues and very good return on financial investments
- Good cost control. Costs reduced from 2015 to 2016 in real terms thanks to planned zero growth in costs at the parent bank
- Loan losses in keeping with forecast for the year
- Strengthened financial position
- High customer influx and high growth in all product areas

In 2016 SpareBank 1 SMN achieved a pre-tax profit of NOK 1,983m (1,776m). Net profit was NOK 1,647m (1,406m) and return on equity was 11.3 per cent (10.7 per cent).

Overall operating revenues in 2016 come to NOK 3,558m (3,417m), an increase of NOK 140m.

Return on financial assets was NOK 944m (459m), of which the profit share from owner interests in associates and joint ventures accounted for NOK 423m (448m).

Operating expenses came to NOK 2,003m (1,931m) in 2016. The increase refers entirely to the bank's subsidiaries and is attributable to capacity expansion at Eiendomsmegler 1 and company acquisitions by SpareBank 1 Regnskapshuset SMN.

Net losses on loans and guarantees were NOK 516m (169m). These are in all essentials individually assessed loss write-downs in oil-related activity.

In 2016 SpareBank 1 SMN achieved a lending growth of 8.0 per cent (5.8 per cent) and deposit growth of 4.8 per cent (5.6 per cent).

As at 31 December 2016 the CET1 ratio was 14.9 per cent (13.6 per cent). The CET1 target set for end-2016 was 14.5 per cent was duly achieved in keeping with the bank's capital plan.

The market price of the bank's EC at year-end was NOK 64.75 (50.50). In 2016 a cash dividend of NOK 2.25 per EC was paid for the year 2015. This represents a payout ratio of 32 per cent of the consolidated net profit.

Earnings per EC were NOK 7.91 (7.02). The book value per EC was NOK 73.26 (67.65) incl. recommended dividend of NOK 3.00. The recommended dividend represents a payout ratio of 37 per cent.

### 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, associates and joint ventures.

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

<b>Difference between Group - Parent Bank</b>	<b>2016</b>	<b>2015</b>
<b>Profit for the year, Group</b>	<b>1,647</b>	<b>1,406</b>
Profit, subsidiaries	-280	-58
Dividend, subsidiaries	147	103
Profit, associated companies	-423	-448
Dividend, associated companies	591	351
Elimination Group	-27	117
<b>Profit for the year, Parent bank</b>	<b>1,655</b>	<b>1,471</b>
<b>Distribution of profit</b>	<b>2016</b>	<b>2015</b>
Profit for the year, Parent bank	1,655	1,471
Transferred to/from revaluation reserve	95	-66
<b>Profit for distribution</b>	<b>1,750</b>	<b>1,405</b>
Dividends	389	292
Equalisation fund	730	616
Saving Bank's fund	411	457
Gifts	220	40
<b>Total distributed</b>	<b>1,750</b>	<b>1,405</b>

The annual profit for distribution reflects changes of NOK 95m in the revaluation reserve, leaving the total amount for distribution at NOK 1,750m.

The profit is distributed between the ownerless capital and the equity certificate (EC) 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 64.0 per cent of the distributed profit.

The board of directors recommends the supervisory board to set a cash dividend of NOK 3.00 per EC, altogether totalling NOK 389m. This gives the EC holders a payout ratio of 37 per cent of the group profit. The board of directors further recommends the supervisory board to allocate NOK 220m as gifts to non-profit causes, also representing a payout ratio of 37 per cent. Of this amount it is proposed that NOK 160m be transferred to the foundation SpareBank 1 Stiftelsen SMN and NOK 60m as gifts to non-profit causes. NOK 730m and NOK 411m are transferred to the dividend equalisation fund and the ownerless capital respectively.

After distribution of the profit for 2016, the ratio of EC capital to total equity remains 64.0 per cent.

### Stable net interest income

Net interest income came to NOK 1,883m (1,872m). There are changes in the composition of net interest income compared with 2015:

- Increased lending to and deposits from retail and corporate customers
- Increased margins on deposits
- Reduced lending margins

Net interest income on loans sold to SpareBank 1 Boligkreditt (residential mortgage company) and SpareBank 1 Næringskreditt (commercial mortgage company) is recognised as commission income. Commission on loans sold to these two companies in 2016 totalled NOK 282m (334m).

Competition in the home mortgage market is intense, and margins on these loans have fallen by 75 points over the last two years. In the same period deposit rates to retail and corporate customers have been lowered, so that increased deposit margins compensate for some of the margin lapse on home mortgages.

Home mortgage lending rates are subject to a general increase of up to 20 basis points with effect from 8 January 2017. The background to the increase is a rise in funding costs in the third and fourth quarter of 2016. Loans to corporates have also been repriced.

### Increased commission income

Commission and other operating income totalled NOK 1,674m (1,545m), an increase of NOK 129m.

Income from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt was reduced by NOK 52m due to reduced margins on retail lending. A consistently positive development is seen in other commission income, and overall growth came to NOK 173m, corresponding to 14 per cent. Growth is strongest in income from capital market activities, real estate agency and accounting services along with saving and investment and asset management.

An important element in the bank's strategy is to achieve high number of multi-product customers. The trend in incomes reflects good sales of a broad range of products both to retail and corporate customers.

Commission income (NOKm)	2016	2015	Change
Payment transfers	196	188	9
Creditcard	63	56	6
Saving products	97	82	15
Insurance	159	156	3
Guarantee commission	77	72	6
Real estate agency	391	332	59
Accountancy services	213	183	30
Brokerage income securities	126	64	62
Other commissions	69	78	-9
<b>Commissions ex SB1 Boligkreditt and SB1 Næringskreditt</b>	<b>1,392</b>	<b>1,211</b>	<b>182</b>
Commissions SB1 Boligkreditt	271	326	-55
Commissions SB1 Næringskreditt	12	8	3
<b>Total commissions</b>	<b>1,674</b>	<b>1,545</b>	<b>129</b>

### Financial investments

Overall return on financial investments (excluding the share of the profit/loss of associates and joint ventures) was NOK 521m (10m) in 2016. This breaks down as follows:

- Return on the group's equity portfolios totalled NOK 149m (62m). Of this amount, NOK 65m refers to proceeds of the Visa transaction, while the remainder is mainly gains on equity portfolios at SpareBank 1 SMN Invest.
- Net capital gains on bonds and derivatives came to NOK 236m (loss of 90m) in 2016. This is largely ascribable to reduced credit margins on the liquidity portfolio.
- Income on forex and fixed income transactions was NOK 136m (102m). This is essentially income from SpareBank 1 Markets.

<b>Net return on financial investments (NOKm)</b>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Capital gains/dividends, shares	149	62	87
Bonds and derivatives	236	-90	326
Change in discount factor in fair value model for fixed interest loans	-	-64	64
Income on forex and fixed income	136	102	34
<b>Net return on financial investments</b>	<b>521</b>	<b>10</b>	<b>511</b>
SpareBank 1 Gruppen	317	251	66
SpareBank 1 Boligkreditt	-17	80	-97
SpareBank 1 Næringskreditt	29	30	-1
SpareBank 1 Kredittkort	24	21	3
BN Bank	86	41	45
Companies owned by SpareBank 1 SMN Invest	15	27	-12
SpareBank 1 Mobilbetaling	-27	-	-27
Other companies	-4	-2	-2
<b>Income from investment in associated companies</b>	<b>423</b>	<b>448</b>	<b>-25</b>
<b>Total</b>	<b>944</b>	<b>458</b>	<b>486</b>

### Product companies and other associates

The product companies deliver a broader range of services to the bank's customers and thus commission income. The product companies also provide the banks with good return on invested capital.

### SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit for 2016 was NOK 1,575m (1,316m). SpareBank 1 Forsikring is the main contributor, delivering 90 per cent of the profit. Odin Forvaltning and SpareBank 1 Gruppen Finans contribute in all essentials the remainder. SpareBank 1 SMN's share of the profit for 2016 was NOK 317m (251m). SpareBank 1 Gruppen's profit growth is ascribable to very good financial results in the insurance business and satisfactory growth.

### SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt was established by the banks participating in the SpareBank 1 Alliance to draw benefit from the market for covered bonds. By selling their best secured home mortgage loans to the company, the banks achieve reduced funding costs. As of 31 December 2016 the bank had sold loans totalling NOK 33.1bn (31.9bn) to SpareBank 1 Boligkreditt, corresponding to 37.1 per cent (39.6 per cent) of overall loans to retail borrowers.

The bank's stake in SpareBank 1 Boligkreditt in 2016 was 19.0 per cent, and the bank's share of that company's profit in 2016 was minus NOK 17m (plus 80m). The deficit in 2016 is ascribable to unrealised losses on the company's basis swaps compared with unrealised gains in previous years. The bank's stake reflects the bank's relative share of sold home mortgages. The new stake as of 31 December 2016 is 19.1 per cent.

### SpareBank 1 Næringskreditt

SpareBank 1 Næringskreditt was established along the same lines and with the same administration as SpareBank 1 Boligkreditt. As at 31 December 2016, loans worth NOK 2.1bn (1.5bn) had been sold to SpareBank 1 Næringskreditt.

SpareBank 1 SMN's stake in the company is 36.5 per cent, and the bank's share of the company's profit for 2016 was NOK 29m (30m). The holding reflects the bank's relative share of transferred loans to commercial

property and the bank's stake in BN Bank. Of aggregate loans at SpareBank 1 Næringskreditt, 79.9 per cent have been transferred from BN Bank.

### **SpareBank 1 Kredittkort**

Profit for 2016 was NOK 128m (112m). SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 18.4 per cent. SpareBank 1 SMN's share of the profit for 2016 was NOK 24m, and the bank's share of the portfolio is NOK 829m (792m).

### **BN Bank**

SpareBank 1 SMN owns 33.0 per cent of BN Bank as of 31 December 2016.

BN Bank recorded a profit of NOK 261m (125m) in 2016. SpareBank 1 SMN's share of the profit of BN Bank was NOK 86m (41m) providing a return on equity of 7.3 per cent (3.5 per cent). The profit growth is largely related to increased margins on loans to corporates, reduced operating expenses and good return on financial assets.

The board of directors of BN Bank decided in 2015 to wind down the focus on lending to commercial property and to carry out a reduction of the portfolio. As at 31 December 2016 the corporate portfolio has been reduced by NOK 16.6bn or 52 per cent since 30 June 2015. This has helped to improve SpareBank 1 SMN's financial position and to enhance the profitability of the remaining corporate portfolio of BN Bank.

BN Bank's main focus is on the personal market, as reflected in the strong growth of 13.4 per cent in home mortgage lending in 2016.

BN Bank has in 2016 resolved to strengthen its product platform through a cautious focus on consumer loans. In addition the company has, in collaboration with Eiendomsmegler 1 Midt-Norge established the company BN Bolig, in which BN Bank holds a 50 per cent stake. The focus on estate agency in the Oslo market is intended to strengthen home mortgage lending for BN Bank in this market. To support the focus on estate agency, the bank's board of directors have also adopted a new focus on funding of housing projects. This will involve a controlled, gradual build-up of the portfolio.

### **SpareBank 1 Mobilbetaling (mCASH)**

SpareBank 1 Mobilbetaling is SpareBank 1's project to strengthen the SpareBank 1 banks' position in the mobile device field. mCASH has grown from a team of eight individuals into a business with an 18-strong staff along with advisers and sales organisation in the banks. As of 31 December 2016, 5,538 user sites are registered, of which 2,155 are clubs and associations, and close to 600,000 have downloaded the app. mCASH has a turnover totaling NOK 63 million. mCASH has achieved broad-based exposure and growth in the transport field, including Norwegian State Railways and the public transport company Ruter.

The company recorded a deficit of NOK 135m for 2016 of which SpareBank 1 SMN's share is NOK 27m. The deficit is a consequence of start-up costs and marketing and further development of mCASH. The company is owned by the SpareBank 1 banks, and SpareBank 1 SMN's stake is 19.7 per cent.

On 13 February 2017 it was announced that SpareBank 1 SMN is to join 105 other banks in adopting Vipps as a mobile payment solution.

Vipps has so far been a part of the DNB Group, but will now be placed in an independent company whose largest owner will be DNB with about 52 per cent of the shares. The SpareBank 1 Alliance will own 25 per



cent, the independent savings banks 12 per cent, the Eika Alliance 10 per cent and Sparebanken Møre 1 per cent. The mCASH brand will accordingly be removed from the market in the course of 2017. The new company will build further on SpareBank 1 Mobilbetaling, with new owners in keeping with the owner stakes outlined.

The new Vipps will be a strong Norwegian company and will be well placed in the competition with large Nordic and international actors in the mobile payments sphere. The company will develop and deliver simple, secure services at the lowest possible cost. Assembling competence and technology in a single Norwegian company will be of benefit to our customers.

SpareBank 1's 530,000 mCASH customers will be invited to the new company, where payment solutions developed by the respective banks will be taken on board. The customers will retain the same facilities they enjoyed as users of mCASH. The technology is being transferred to the new company, which will itself decide how to make the best use of that technology ahead.

### **Reduced operating expenses at the parent bank**

Overall operating expenses came to NOK 2,003m (1,931m) in 2016. Of the increase of NOK 72m, NOK 59m is ascribable to SpareBank 1 Markets' consolidation as a subsidiary as from the second quarter of 2015.

Parent bank costs are reduced by NOK 66m to NOK 1,151m from 2015 to 2016. Parts of the change are explained by:

- The expensing of NOK 50m in reorganisation costs connected to downsizing in 2016 and 2017.
- The termination in the fourth quarter of 2016 of the defined benefit pension scheme for employees of the parent bank and subsidiaries and the transfer of all Group employees to a defined contribution scheme. New contribution rates were concurrently introduced for defined contribution pensions. The termination resulted in a settlement gain of NOK 90m, of which NOK 74m is in the parent bank and NOK 16m in the subsidiaries.

When corrected for the above factors, parent bank costs are reduced by NOK 28m or 2.3 per cent from 2015 to 2016. Wide-ranging efficiency improvement measures have been initiated at the bank. Since 31 December 2014 the number of FTEs at the parent bank has been reduced by 90 from 720 to 630. The bank has accordingly achieved its target of zero growth in the period 2014 to 2016. Changing customer behaviour and new technology will set the stage for increasing efficiency in the period ahead, and the target of zero growth is retained for 2017.

When corrected for SpareBank 1 Markets and the pension settlement gain, cost growth among the subsidiaries was NOK 91m. The cost growth refers to Eiendomsmegler 1 (estate agency services) and SpareBank 1 Regnskapshuset SMN (accounting services). Eiendomsmegler 1 intensified its market drive through 2016 and SpareBank 1 Regnskapshuset SMN acquired businesses again in 2016, thereby increasing the cost base.

The Group cost-income ratio was 44 per cent (50 per cent).

### **Increased losses but low payment- defaults**

Net loan losses totalled NOK 516m (169m) for 2016. Net loan losses measure 0.39 per cent of total outstanding loans (0.14 per cent). Net losses in the fourth quarter in isolation were NOK 99m (56m).



A net loss of NOK 495m (151m) was recorded on loans to corporates for 2016. Of this amount, NOK 464m refers to four exposures in the offshore segment.

A net loss of NOK 21m (18m) was recorded in the retail banking portfolio in 2016.

Individually assessed write-downs on loans and guarantees totalled NOK 638m (184m) at 31 December 2016.

Total problem loans (defaulted and doubtful) come to NOK 1,688m (604m), or 1.23 per cent (0.47 per cent) of gross outstanding loans, including loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

Defaults in excess of 90 days totalled NOK 214m (205m), measuring 0.16 per cent (0.16 per cent) of gross lending. Of the overall default volume, NOK 39m (26m) is loss provisioned, corresponding to 18 per cent (13 per cent).

Defaults break down to NOK 38m (50m) on corporates and NOK 176m (155m) on retail borrowers.

Other doubtful exposures totalled NOK 1,474m (399m), i.e. 1.07 per cent (0.31 per cent) of gross outstanding loans. NOK 599m (158m) or 41 per cent (40 per cent) is written down.

Other doubtful exposures break down to NOK 1,455m (350m) on corporates and NOK 19m (49m) on retail borrowers.

### **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 after granting of loans)
- 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).

Collectively assessed impairment write-downs were increased by NOK 150m in the first quarter of 2016. This was done on the basis that increased probability of default and reduced ship values entailed a greater likelihood of loss in oil-related activity due to a challenging market situation. An increase in individually assessed impairment write-downs as from the second quarter of 2016 connected to this sector provided a basis for reducing the provision for collectively assessed write-downs, and the write-downs were reduced by NOK 188m in this period.

Overall collectively assessed loss write-downs thus total NOK 339m (376m), measuring 0.25 per cent (0.30 per cent) of total loans. Collectively assessed write-downs break down to NOK 100m on retail exposures and NOK 239m on corporates. Of the overall provision of NOK 239m on the corporate portfolio, the provision related to oil-related activity accounts for NOK 60m. The remaining collectively assessed write-downs of NOK 179m on the corporate portfolio are fairly evenly spread across other sectors.

### **Total assets of NOK 138bn**

The bank's assets totalled NOK 138bn at 31 December 2016 (132bn), having risen by NOK 6bn or 4.7 per cent. The increase in total assets is a consequence of increased lending.

As at 31 December 2016 home mortgage loans worth a total of NOK 35bn (33bn) had been sold from SpareBank 1 SMN to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. These loans do not figure as loans in the bank's balance sheet. The comments covering lending growth do however include loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

### High growth in home mortgage lending

Total outstanding loans have risen by NOK 10.2bn (6.9bn) or 8 per cent (5.8 per cent) in 2016 to reach NOK 137.5bn (127.4bn) at year-end.

Loans to retail borrowers rose in 2016 by NOK 8.7bn (6.6bn) to reach NOK 89.4bn (80.7bn), equivalent to an increase of 10.7 per cent (9.0 per cent).

Growth in lending to corporates in 2016 was NOK 1.5bn (0.3bn) or 3.2 per cent (0.7 per cent). Overall lending to corporates was NOK 48.1bn (46.7bn) as at 31 December 2016. Loans to retail accounted for 65 per cent (63 per cent) of ordinary loans to customers as at end-2016.

(For distribution by sector, see note 8).

### Deposits

Customer deposits rose by NOK 3.1bn (3.4bn) in 2016 to reach NOK 67.2bn (64.1bn) as at 31 December 2016. This represents a growth of 4.8 per cent (5.6 per cent).

Retail deposits rose by NOK 1.4bn (1.8bn) or 5.1 per cent (6.9 per cent) to reach NOK 29.7bn, while corporate deposits rose by NOK 1.6bn (1.6bn) or 4.6 per cent (4.6 per cent) to NOK 36.6bn.

The deposit-to-loan ratio at SpareBank 1 SMN was 66 per cent at 31 December 2016 (68 per cent).

(For distribution by sector, see note 35).

### Investment products

The customer portfolio of off-balance sheet investment products totalled NOK 10.2bn (9.4bn) at 31 December 2016. Active asset management has shown strong growth both as a result of value increases and good sales.

Saving products, customer portfolio (NOKm)	2016	2015	Change
Equity funds	6,612	6,540	72
Pension products	762	683	79
Active management	2,780	2,197	583
<b>Total</b>	<b>10,154</b>	<b>9,420</b>	<b>734</b>

### Insurance

The bank's insurance portfolio showed growth of 5.6 per cent in the last 12 months. Growth has been strongest for personal insurance, at 12.6 per cent.

Insurance, premium volume (NOKm)	2016	2015	Change
Non-life insurance	738	724	14
Personal insurance	303	269	34
Occupational pensions	214	195	19
<b>Total</b>	<b>1,255</b>	<b>1,188</b>	<b>67</b>

**Retail Banking**

Operating income totalled NOK 1,633m (1,663m) of which net interest income accounted for NOK 953m (948m) and commission income for NOK 679m (715m). Operating income has increased due to increased lending and improved deposit margins along with increased commission income from payments, savings and investment and insurance. At the same time reduced lending margins have in isolation reduced incomes, and overall income fell by NOK 30m. Return on capital employed in the retail banking segment was 13.8 per cent (15.8 per cent). Regulatory capital of 14.5 per cent is used as capital employed, corresponding to the Group's targeted CET1 capital ratio.

The lending margin for 2016 was 1.72 per cent (2.07 per cent), while the deposit margin was 0.27 per cent (minus 0.14 per cent) (measured against three-month NIBOR). The average three-month NIBOR has fallen by about 30 basis points since the start of 2015.

In the last 12 months retail lending and retail deposits grew by 10.3 per cent (8.4 per cent) and 3.9 per cent (6.2 per cent) respectively.

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

**Corporate Banking**

Operating income totalled NOK 1,205m (1,164m) in 2016. Net interest income was NOK 1,000m (971m), while commission income totalled NOK 205m (193m). Operating income in the corporate segment has increased due very largely to increased deposit margins and increased guarantee commissions.

Overall net losses recorded in the Corporate Banking Division were NOK 490m (151m). The losses are in all essentials related to the challenges faced in the oil and offshore segment.

Return on capital employed for the corporate banking segment in 2016 was 6.9 per cent (12.4 per cent). Regulatory capital of 14.5 per cent is used as capital employed, corresponding to the Group's targeted CET1 capital ratio.

The lending margin was 2.66 per cent (2.68 per cent) and the deposit margin was minus 0.14 per cent (minus 0.29 per cent) as at end-December 2016.

Lending grew by 0.7 per cent (0.9 per cent) and deposits by 6.7 per cent (6.9 per cent) in 2016.

## Subsidiaries

The subsidiaries posted an overall profit of NOK 326.8m (130.7m) before tax. The results below are from the respective company accounts.

Pre-tax profit (NOKm)	2016	2015	Change
EiendomsMegler 1 Midt-Norge	66.7	47.0	19.7
SpareBank 1 Finans Midt-Norge	103.4	83.1	20.4
SpareBank 1 Regnskapshuset SMN	42.9	34.8	8.1
Allegro Kapitalforvaltning	9.8	1.4	8.4
SpareBank 1 SMN Invest	73.7	38.6	35.2
Sparebank 1 Markets (from second quarter 2015)	9.9	-84.1	93.9
Other companies	20.4	9.8	10.6
<b>Total</b>	<b>326.8</b>	<b>130.7</b>	<b>196.2</b>

**Eiendomsmegler 1 Midt-Norge** leads the field in Trøndelag and in Møre og Romsdal with a market share of 40 per cent, and in Trondheim of about 50 per cent. The company's pre-tax profit of NOK 66.7m (47.0m) for 2016 is very good. Dwellings sold in 2016 totalled 7,439 compared with 6,612 in 2015.

**SpareBank 1 Finans Midt-Norge** also delivered a very good pre-tax profit of NOK 103.4m in 2016 (83.1m). Good sales of car loans in particular made a positive contribution, with growth of 35 per cent. The company's business areas are mainly car loans to retail customers and leasing to the SMB market. Car loans account for NOK 2.7bn and leasing for NOK 2.3bn. The company also offers consumer loans, and at year-end this portfolio was worth NOK 132m.

The SamSpar banks in SpareBank 1 hold a 27.9 per cent stake in SpareBank 1 Finans Midt-Norge. Sparebanken Sogn og Fjordane joined as co-owner in January 2016 with a stake of 7.5 per cent, thereby further strengthening the company's distributive power. SpareBank 1 SMN owns 64.6 per cent of the shares of SpareBank 1 Finans Midt-Norge.

**SpareBank 1 Regnskapshuset SMN** posted a pre-tax profit of NOK 42.9m (34.8m) in 2016. SpareBank 1 Regnskapshuset SMN has a growth strategy based on the acquisition of small accounting firms. In 2016 the company acquired three businesses in Sunnmøre which were consolidated into the company at year-end.

The company caters to the SMB segment with a technologically modern distribution model and a broad range of services. In order to be better equipped to implement a major digital project and to modernise its accounting services, the company acquired the IT consultancy Areto Solutions in the third quarter. This company has 20 employees and offices in Trondheim.

SpareBank 1 Regnskapshuset SMN has in addition acquired all shares of Økonomisenteret Kunderegnskap in Molde along with about 110 employees with effect from 1 January 2017. SpareBank 1 Regnskapshuset SMN will now have 360 employees and an annual turnover of NOK 360m.

**Allegro Kapitalforvaltning** manages portfolios for clients primarily in SpareBank 1 SMN and the SamSpar banks. These banks are the company's distribution channel. The company posted a pre-tax profit of NOK 9.8m in 2016 (1.4m). The company manages a portfolio worth NOK 6.5bn.

**Sparebanken SMN Invest** invests in shares, mainly in regional businesses. The company posted a net profit of NOK 73.7m (38.6m) as per the fourth quarter of 2016.

Value changes and realisation of losses or gains on the company's overall holding of shares represent NOK 58.7m of the company's total income. The company has in addition ownership interests in the property company Grilstad Marina and its share of the latter's profit in 2016 was NOK 15.0m.

**SpareBank 1 Markets** is a subsidiary of SpareBank 1 SMN with a stake of 73.5 per cent. The company is headquartered in Oslo and has offices in Trondheim and Ålesund. It has a staff of 105.

SpareBank 1 Markets is an investment firm offering a complete product range. The company's aspires to being a profitable capital market unit able to deliver all capital market services in collaboration with its parent banks.

The company's pre-tax profit for 2016 was NOK 9.9m compared with minus NOK 84.1m in 2015. Results across all the company's business lines have been satisfactory. Underlying operations for these business lines are sound, with a solid customer base.

The company is the leading capital market unit in SpareBank 1 SMN's market area. SpareBank 1 Markets' main focus is on clients where the company is in a strong competitive position alone or in collaboration with its parent banks.

#### **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 22bn and has the funding needed for 25 months of ordinary operation without fresh external finance.

The Ministry of Finance requires all credit institutions to maintain sufficient liquidity buffers to withstand periods of limited access to market funding. The liquidity coverage ratio (LCR) measures the size of banks' liquid assets relative to net liquidity outflow 30 days ahead in time given a stressed situation.

The LCR is calculated at 129 per cent as at 31 December 2016.

In the second quarter the bank raised a new loan of EUR 500m in the Euromarket with a five-year term.

The bank's funding sources and products are amply diversified. At year-end the proportion of the bank's overall money market funding in excess of 1 year was 88 per cent (86 per cent).

#### **Rating**

SpareBank 1 SMN has a rating of A1 (outlook stable) with Moody's and a rating of A- (outlook stable) with Fitch Ratings.

#### **Financial position**

The CET1 capital ratio at 31 December 2016 was 14.9 per cent (13.6 per cent). The change over the last 12 months is ascribable to:

- An increase of NOK 1.1bn, or 9 per cent, in CET1 capital. This is in all essentials retained profit.

- Overall capital needs are reduced by NOK 0.7bn corresponding to 0.8 per cent over the last 12 months. The reduced need for capital is largely due to a reduction in lending to commercial property at BN Bank and a reduced need for capital related to transitional arrangements. In addition, lending growth has focused on home mortgages while growth in lending to corporates has been low.

SpareBank 1 SMN goal was to attain a CET1 capital ratio of at least 14.5 per cent by 31 December 2016. The Group has attained this target with launching a stock issue. The most important measures have been:

- Profit retention and a reduced level of dividend payouts
- Sound banking operations through efficiency enhancement and increased prioritisation of profitable segments
- Moderate growth in the bank's asset-intensive activities, with priority given to lending to households
- Wind-down of the commercial property portfolio of BN Bank. By the end of 2016 the portfolio had been reduced by 52 per cent since 30 June 2015.

As at 31 December 2016 the regulatory requirement on CET1 capital is 11.5 per cent, including combined buffer requirements.

Finanstilsynet's (Norway's FSA) final assessment of the add-on for risks not adequately covered under Pillar 1 was set at 2.1 per cent, down from 2.3 per cent in the preliminary assessment. The add-on is mainly related to owner risk, market risk and credit concentration risk. On 15 December the Ministry of Finance decided that the countercyclical buffer should be increased by a further 0.5 per cent, to 2.0 per cent. The increase will be effective as from 31 December 2017. The board of directors has therefore decided to raise the capital target to 15 per cent by the end of 2017 to ensure a sufficient management buffer. The capital build-up will take place without a stock issue.

The board of directors of SpareBank 1 SMN continually assesses the capital situation and future capital requirements.

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

The book value of the bank's EC as at 31 December 2016, including a recommended dividend of NOK 3.00, was NOK 73.26 (67.65), and earnings per EC were NOK 7.91 (7.02).

The Price / Income ratio was 8.19 (7.19) and the Price / Book ratio was 0.88 (0.74).

As at 31 December 2016 the EC was priced at NOK 64.75 and dividend of NOK 2.25 per EC was paid in 2016 for the year 2015.

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 any 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**

Losses and problem loans related to the offshore industry remain at a high level at the end of 2016. The increase in individually assessed write-downs and collectively assessed write-downs is in all essentials ascribable to customers in this market segment, as confirmed by reporting from Norges Bank's (Norway's

central bank) Regional Network. The bank sees little evidence of contagion effects to the remainder of the loan portfolio. Credit quality in the rest of the portfolio is satisfactory, and loss and default levels in other portfolios are low.

The bank expects a continued low rate of GDP growth as a result of declining oil investment. The Norwegian krone has appreciated, thereby reducing some of the positive impact enjoyed by export industries, and will partially offset some of these effects. The bank also expects moderate growth in credit demand from mid-Norway's business sector ahead as a result of the continued low level of investment.

The bank expects unemployment to remain relatively low, and, given continued low interest rates, the bank considers that the risk of loss in the bank's retail banking portfolio will remain low.

Growth in credit demand from Norwegian households remains higher than wage growth and will be heavily affected by the trend in house prices. The Ministry of Finance has decided to increase the countercyclical buffer from 1.5 per cent to 2.0 per cent, with effect from 31 December 2017. In the bank's assessment, this increase will have only a marginal effect on households' credit demand and on the trend in house prices. If house prices stagnate, or fall, there is a risk that households' saving rate will quicken, which will result in reduced turnover for parts of Norwegian business and industry.

The bank's results are affected directly and indirectly by fluctuations in the securities markets. The indirect effect is due 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**

SpareBank 1 SMN wishes to contribute to society's value creation through responsibly-minded banking operations that instil confidence in the populace.

Healthy growth provides the 'lift' that enables the Group to attract good customers and skilled staff and to contribute to the further development of the region of which the Group is a part.

SpareBank 1 SMN has established a corporate social responsibility (CSR) strategy comprising three main themes: financial, social and environmental. Under each theme we have defined key areas and set clear-cut goals for how the bank should contribute to responsible development.

This is described in greater detail in a separate chapter in the annual report, Corporate social responsibility (CSR), including compliance with the requirements of the Accounting Act section 3-3(c).

### **The people**

Technological development and changing customer behaviour mean that the bank needs to adapt to a new everyday life and to rig up for the future. This has also impacted the work done on organisation and management in 2016.

Reorganisation, employee development and recruiting new competence in order to build a bank for the future were given high priority in the year behind us. The work on a new vision and a new set of values was



also very much in focus, and will play its part in building a culture in which it is good to work and good to be a customer. Read more about this and the work environment, gender equality and other staff-related content in the chapter The people and in note 22 Personnel expenses.

This is described in greater detail in a separate chapter in the annual report, Corporate social responsibility (CSR), including compliance with the requirements of the Accounting Act section 3-3(c).

## Outlook

SpareBank 1 SMN has, again in 2016, shown a satisfactory development with a strengthened market position and a strong profit performance.

The bank's distribution strategy involves a comprehensive focus on digitalisation of working processes and customer processes in combination with competent advisory services present across 48 localities in the market area. A wide-ranging effort to reduce costs related to the bank's branches was launched in 2016. This work continues and is being reinforced in 2017.

The bank has taken an active part in the work on restructuring businesses in the oil and offshore segment in 2016. Impairment write-downs have been made in this sector in keeping with the forecasts announced early in the year. How this sector will develop in 2017 remains uncertain. The board of directors expect the losses to continue, but at a lower level in 2017 than in 2016. The board is pleased that there is no noticeable spread of contagion effects from the problems in the oil and offshore segment to business and industry in general in the market area.

The bank's plan for zero cost growth at the parent bank has been carried through. The directors expect and assume that changing customer behaviour and new technology will pave the way for further efficiency gains ahead.

The board is pleased that the CET1 capital ratio has strengthened to 14.9 per cent. The Group's target of a CET1 ratio of 14.5 per cent by 31 December 2016 has been achieved and a new capital target of 15.0 per cent has been set.

The board is pleased with the Group's achievements and results for 2016.

Trondheim, 7. mars 2017  
The Board of Directors of SpareBank 1 SMN

Kjell Bjordal  
(chair)

Bård Benum  
(deputy chair)

Paul E. Hjelm-Hansen

Aud Skrudland

Morten Loktu

Janne Thyø Thomsen

Arnhild Holstad

Erik Gunnes  
(employee rep.)

Oddny Lysberg  
(employee rep.)

Finn Haugan  
(Group CEO)