

# Report of the Board of Directors

## Macroeconomic conditions

### **Quickening, but not permanent high growth in the global economy**

Growth in the global economy picked up through 2017. The US, the euro zone and many emerging economies provided a positive surprise.

In western countries unemployment has fallen overall and is now lower than normal – and in part very low in many countries. There are signs of quickening wage growth, especially in the US, but price growth remains moderate to low. In the euro zone wage growth is also picking up, but remains low, and price inflation well below target.

Prospects for 2018 are positive, and investment levels are well above the norm in most western countries.

Emerging economies now account for over three-quarters of global economic growth. China and India contribute the most, far more than all wealthy countries in aggregate. Many countries have struggled to adapt to lower commodity prices, but a broad-based turnaround is now in evidence in this part of the global economy. China is likely to be cautiously decelerating, and the risk of an abrupt turnaround is reduced after a substantial decline in investments viewed against overall GDP. A high and still rising debt burden nonetheless poses a risk.

With the fall in unemployment to low levels, central banks have begun to normalise their base rates. The US Federal Reserve raised its base rate four times last year. The European central bank has signalled that bond purchases can be terminated in the third quarter of 2018, but it will probably defer raising the interest rate until 2019.

Although the momentum in the global economy is favourable, there are as always a number of risk factors. The US has adopted a very expansionary fiscal policy, even though the budget deficit is already substantial and unemployment low. This puts more pressure on interest rates. It could also create instability in other sections of the financial market. The US has introduced trade restrictions and threatens more of the same, which could trigger trade wars.

### **Norwegian economy cruising nicely, prospects are good and interest rate due to rise**

Growth in Mainland Norway rose from 1.0 per cent in 2016 to 1.8 per cent in 2017. Employment picked up and unemployment continued to fall. The oil price has more than doubled since bottoming out. Norway is once again witnessing a buoyant upturn. This is reflected in stock markets, including markets for bank shares and equity certificates.

Growth in private consumption and residential investment accelerated last year. At the same time real wage growth remained low. The saving rate consequently fell further and, in as much as residential investments also rose rapidly, households' net borrowing need also rose rapidly. Population growth is also dampened further. In 2018 residential investments will likely fall somewhat, since housing starts were reduced through 2017 due to falling sales of new homes after the decline in house prices. Activity levels in the construction industry, however, remain very high.

House prices fell 2 to 3 per cent from their peak in early spring to year-end. Prices fell by about 10 per cent in Oslo, where they had risen steeply in the two preceding years, whereas a moderate price fall was noted in all the largest towns. At the start of 2017 the government further tightened the lending regulations for residential lending to households by limiting overall debt to five times gross income and imposing tighter requirements on amortisation of large residential mortgages. However, the turnover rate rose over the year and towards year-end the stock of unsold existing homes declined. This indicates that the decline in house prices may now be behind us, in all events this time round. A high and rising debt burden, continued high housing construction and prospects of higher lending rates pose potential threats to housing market stability, in the worst case to general household demand.

Mainland firms' investments rose more than 5 per cent last year and their demand for loans is rising. The level of investment remains low, but is rising, and surveys of firms indicate a further rise this year. Exports rose last year, but the picture were nonetheless mixed. Firms exporting oil-related goods and services continue to struggle, whereas other exports fared better, for one thing because the krone exchange rate is far weaker than it was prior to the oil price fall. Good growth internationally and a lower cost level than previously suggest good prospects for 2018.

Investments in the oil and gas sector fell 35 per cent from their peak in 2013 to the end of last year. This has hit oil-related businesses and regions hard. The situation is now bottoming out. The oil price has recovered well and oil companies will now increase their investments in as much as many development projects have again turned profitable. The order intake to oil-related manufacturing industry has already increased.

Fiscal policy has contributed heavily to maintaining growth in the Norwegian economy in the three preceding years, but since the Oil Fund is not growing as rapidly as previously, it is unreasonable to expect major stimuli in the form of increased transfers from the fund in the years ahead.

The key policy rate was kept unchanged at a record-low 0.5 per cent through 2017. Norges Bank has signalled that it will probably raise its key policy rate in the course of 2018. Unemployment is falling rapidly, price inflation is not far below target, wage growth is likely to increase slightly and demand for credit is good. Probably only a further house price fall or a marked setback in the world economy can prevent a gradual increase on of interest rates in the next few years.

### **Positive trend for value creation in Mid-Norway**

SpareBank 1 SMN's economic barometer shows that Trøndelag achieved high and stable value creation in 2017, whereas Møre and Romsdal struggled with readjustments in offshore services and parts of the maritime industry. There are nonetheless signs of improvement in these lines of business in addition to the fact that a weak Norwegian krone and low interest rates continue to have positive effects for a number of industries throughout the region. The aquaculture industry is performing particularly well.

Unemployment in Trøndelag is low at 1.9 per cent of the labour force, down from about 2.2 per cent in 2016. Unemployment also fell in Møre and Romsdal, by 0.7 percentage points to 2.4 per cent in 2017, in keeping with the improvement in manufacturing industry.

In Trøndelag house prices rose by 2.1 per cent in 2017, a far lower figure than in the preceding years, but better than for Norway as a whole, which showed a decline of 1.1 per cent. The housing market in Trøndelag and in Møre and Romsdal shows wide variation with prices rising by 2.4 per cent in Trondheim, while prices in the Ålesund district rose by 1.1 per cent.

Sentio's corporate expectations barometer shows increased optimism among business leaders both in Trøndelag and in Møre and Romsdal. Continued growth and increasing capacity utilisation is expected in manufacturing, along with falling unemployment and moderate growth in house prices.

## Annual accounts 2017

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 2016 unless otherwise stated.)*

As from the fourth quarter of 2017 SpareBank 1 SMN has reclassified two hybrid bonds from debt to equity. The bonds were reclassified since they do not meet the definition of financial liability under IAS 32. The bonds are perpetual, and SpareBank 1 SMN is not required to pay interest to investors. The interest is recognised not as an expense through profit and loss, but as a reduction in equity. The change has brought a reduction in interest expenses totalling NOK 44m in 2017 before tax, NOK 33m after tax. Comparatives for 2016 have been restated. See note 3 for further details.

### Main points for 2017

- Good profits from banking operations, subsidiaries and product companies
- Profit was NOK 1,828m and NOK 147m better than in 2016. The improvement is mainly due to increased operating income, reduced loan losses and sound profit for SpareBank 1 Gruppen
- Strong financial position
- Considerable increase in customers and high growth in all product areas

### Post-tax profit of NOK 1,828m

- Pre-tax profit: NOK 2,279m (2,029m)
- Post-tax profit: NOK 1,828m (1,681m) Return on equity: 11.5 per cent (11.3 per cent)
- CET1 capital ratio: 14.9 per cent (14.9 per cent)
- Growth in lending: 8.2 per cent (8.0 per cent) and in deposits: 13.9 per cent (4.8 per cent)
- Share of lending to the retail market 66 per cent (65 per cent)
- Loan losses: NOK 341m (516m)
- Earnings per equity certificate (EC): NOK 8.71 (7.93). Book value per EC, inclusive dividend proposed for 2017: NOK 78.81 (73.35)
- Proposed dividend: NOK 4.40 per EC and an allocation of NOK 322m to non-profit causes

### Profit NOK 147m better than in 2016

In 2017 SpareBank 1 SMN achieved a pre-tax profit of NOK 2,279m (2,029m). The net profit was NOK 1,828m (1,681m) and return on equity was 11.5 per cent (11.3 per cent).

Overall operating income in 2017 came to NOK 4,229m (3,603m), an increase of NOK 626m from the previous year.

Return on financial assets was NOK 760m (944m), of which the profit share from owner interests in related companies accounted for NOK 437m (423m).

Operating expenses came to NOK 2,369m (2,003m) in 2017. The cost growth refers largely to the bank's subsidiaries and is attributable to EiendomsMegler 1 Midt-Norge's involvement in BN Bolig, capacity expansion at SpareBank 1 Markets and company acquisitions by SpareBank 1 Regnskapshuset SMN.

The Group lost NOK 341m (516m) on loans to customers, mainly in oil-related activity. Sound growth was posted in lending and deposits in 2017. Lending rose by 8.2 per cent (8.0 per cent) and deposits by 13.9 per cent (4.8 per cent).

As at 31 December 2017 the CET1 ratio was 14.9 per cent (14.9 per cent). The CET1 target is set at 15.0 per cent.

The price of the bank's equity certificate (MING) at year-end was NOK 82.25 (64.75). A cash dividend of NOK 3.00 per EC was paid in 2017 for the year 2016.

Earnings per EC were NOK 8.71 (7.93). The book value per EC was NOK 78.81 (73.35) inclusive recommended dividend of NOK 4.40. The recommended dividend represents a payout ratio of 50 per cent (37 per cent) of the Group profit.

### 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, and is corrected for interest expenses on hybrid capital after tax.

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>2017</b>	<b>2016</b>
<b>Profit for the year, Group</b>	<b>1,828</b>	<b>1,681</b>
Profit, subsidiaries	- 196	- 280
Dividend, subsidiaries	364	147
Profit, associates and joint ventures	- 437	- 423
Dividend, associates and joint ventures	410	591
Elimination Group	- 119	- 27
<b>Profit for the year, Parent bank</b>	<b>1,850</b>	<b>1,689</b>
<b>Distribution of profit</b>	<b>2017</b>	<b>2016</b>
Profit for the year, Parent bank	1,850	1,689
Transferred to/from revaluation reserve	- 17	95
Interest Tier 1 capital (after tax)	- 33	- 34
<b>Profit for distribution</b>	<b>1,800</b>	<b>1,750</b>
Dividends	572	389
Equalisation fund	580	730
Ownerless capital	327	411
Gifts	322	220
<b>Total distributed</b>	<b>1,800</b>	<b>1,750</b>

The annual profit for distribution reflects changes of NOK 17m in the unrealised gains reserve.

The total amount for distribution is accordingly NOK 1,800m.

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.

Earnings per equity certificate were NOK 8.71. Of this, the board of directors recommend the bank's supervisory board to set a cash dividend of NOK 4.40, altogether totalling NOK 572m. This gives the EC holders a payout ratio of 50 per cent of the earnings per EC. The board of directors further recommends the supervisory board to allocate NOK 322m as gifts to non-profit causes, also representing a payout ratio of 50 per cent. Of this amount it is proposed that NOK 252m be transferred to the foundation Sparebankstiftelsen SMN and NOK 70m as gifts to non-profit causes. NOK 580m and NOK 327m are transferred to the dividend equalisation fund and the ownerless capital respectively.

After distribution of the profit for 2017, the ratio of EC capital to total equity remains 64.0 per cent.

### **Increased net interest income**

Net interest income rose by NOK 296m to NOK 2,225m (1,929m) in 2017. The strong increase is attributable to:

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

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 2017 totalled NOK 370m (282m).

Risk pricing and attention to the use of regulatory capital have brought improved margins, and work in this respect continues in 2018. The bank's strong growth shows that its prices are in tune with the market.

### **Increased other income**

Commission and other operating income rose by NOK 330m to NOK 2,005m (1,674m) in 2017.

Income from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt rose by NOK 88m as a result of growth and improved margins on residential mortgages.

Strengthening of SpareBank 1 Markets and acquisitions by SpareBank 1 Regnskapshuset SMN have contributed significantly to the increase in other income. A positive development is also noted in income from insurance sales, sales of savings products and payment services.

A high number of multi-product customers is important for the bank. It signifies high customer satisfaction and a diversified income flow for the bank.

Commission income (NOK million)	2017	2016	Change
Payment transfers	207	196	11
Creditcard	59	63	-3
Saving products	117	97	20
Insurance	172	159	13
Guarantee commission	69	77	-8
Real estate agency	365	391	-27
Accountancy services	357	213	144
Markets	214	126	88
Other commissions	75	69	6
<b>Commissions ex SB1 Boligkreditt and SB1 Næringskreditt</b>	<b>1,635</b>	<b>1,392</b>	<b>242</b>
Commissions SB1 Boligkreditt	353	271	83
Commissions SB1 Næringskreditt	17	12	5
<b>Total commissions</b>	<b>2,005</b>	<b>1,674</b>	<b>330</b>

### Good return on financial investments

Overall return on financial investments was NOK 317m (434m). This breaks down as follows:

- A gain of NOK 62m (76m) on the shares of the bank and subsidiaries
- Financial derivatives yielded gains of NOK 148m (280m). This is very largely gains on fixed income instruments
- Other financial instruments measured at fair value include value changes on the bank's portfolio of fixed-interest loans and show a gain of NOK 7m (26m)
- Income of NOK 45m (51m) on forex transactions refers to income from currency trading at SpareBank 1 Markets and to the result of exchange rate fluctuations on the bank's funding in foreign currencies
- Gains on shares and share derivatives at SpareBank 1 Markets totalled NOK 43m (25m)
- The Group's holding of short-term paper and bonds yielded a gain of NOK 58m (-2m) as a result of improved return on the liquidity portfolio
- Prices of financial instruments used by the bank for hedging purposes declined and the bank recognised a net loss of NOK 46m (21m) on hedging instruments

Capital gains/dividends, shares (NOK million)	2017	2016	Change
Capital gains shares	62	76	-14
Gain/(loss) on derivatives	124	280	-156
<i>of which value adjustment on basis swaps</i>	-50	-8	-42
Gain/(loss) on other financial instruments at fair value (FVO)	7	26	-19
Foreign exchange gain / (loss)	45	51	-6
Gain/(Loss) on certificates and bonds	58	-2	60
Gain/(Loss) on equity instruments in SpareBank 1 Markets	43	25	19
Gain/(loss) on financial instruments related to hedging	-22	-21	-1
<b>Net return on financial instruments</b>	<b>317</b>	<b>434</b>	<b>-117</b>

### Product companies and other related companies

Through the product companies, banks have access to a broader product range and hence commission income. The product companies also provide the banks with a good return on invested capital.

### SpareBank 1 Gruppen

SpareBank 1 Gruppen owns 100 per cent of the shares of SpareBank 1 Forsikring, SpareBank 1

Skadeforsikring, ODIN Forvaltning and SpareBank 1 Gruppen Finans. SpareBank 1 SMN's stake in SpareBank 1 Gruppen was unchanged at 19.5 per cent at the end of the fourth quarter of 2017. SpareBank 1 Gruppen's post-tax profit in 2017 was NOK 1,811m (1,575m). SpareBank 1 Forsikring contributes 95 per cent of the profit. The profit growth is explained by:

- A good underlying trend in both the life insurance and non-life insurance business
- High financial earnings
- Positive adjustment of property values

SpareBank 1 SMN's share of the profit for 2017 was NOK 349m (317m), including a correction of minus NOK 4m to the profit for 2016.

### **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. The banks sell well-secured residential mortgages to the company and achieve reduced funding costs.

As of 31 December 2017 the bank had sold loans totalling NOK 34.9bn (33.1bn) to SpareBank 1 Boligkreditt, corresponding to 35.3 per cent (37.1 per cent) of overall loans to retail borrowers.

The bank's stake in SpareBank 1 Boligkreditt in 2017 was 19.1 per cent, and the bank's share of that company's profit in 2017 was minus NOK 41m (minus 17m). The profit share in 2017 was weakened by exchange rate losses of NOK 74m (29m) on the company's basis swaps.

The valuation of the company's basis swaps is linked to currency hedging of the company's borrowings. These are valued quarterly and may produce major profit fluctuations from quarter to quarter. Exchange rate losses arise because the market cost of currency hedging is reduced and the effect of the exchange rate loss will be neutralised over the maturity of the currency hedge.

The new stake as of 31 December 2017 is 19.9 per cent.

### **SpareBank 1 Næringskredit**

SpareBank 1 Næringskredit was established along the same lines and with the same administration as SpareBank 1 Boligkreditt. As at 31 December 2017, loans worth NOK 1.8bn (2.1bn) had been sold to SpareBank 1 Næringskredit.

SpareBank 1 SMN's stake in the company in 2017 was 36.5 per cent, and the bank's share of the company's profit for 2017 was NOK 19m (29m). The holding reflects the bank's relative share of sold loans to commercial property and the bank's stake in BN Bank. Of aggregate loans at SpareBank 1 Næringskredit, 42 per cent have been transferred from BN Bank. The new holding as at 31 December 2017 is 33.5 per cent.

### **SpareBank 1 Kredittkort**

Profit for 2017 was NOK 84m (128m). SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 17.9 per cent. SpareBank 1 SMN's share of the profit for 2017 was NOK 15m, and the bank's share of the portfolio is NOK 845m (829m).



SpareBank 1 SMN Kredittkort has since 1 January 2017 managed the credit card programme LOfavør. This agreement expands the business relationship between the Norwegian Confederation of Trade Unions (LO) and the SpareBank 1 Alliance.

In 2017 work on the LOfavør portfolio reflected start-up and one-time costs, but the portfolio will make a positive contribution to the SpareBank 1 Alliance as early as in 2018. At year-end the portfolio consisted of 45,250 accounts overall of which 6,250 were assigned to SpareBank 1 SMN.

On behalf of the alliance, SpareBank 1 Kredittkort was commissioned to deliver credit products to Vipps, a Norwegian mobile payment application. The agreement will be implemented in the course of 2018.

### **BN Bank**

SpareBank 1 SMN owns 33.0 per cent of BN Bank as of 31 December 2017.

BN Bank recorded a profit of NOK 298m (261m) in 2017 providing a return on equity of 8.3 per cent (7.3 per cent). SpareBank 1 SMN's share of the profit of BN Bank was NOK 98m (86m) adjusted for the profit share in BN Bolig and interest on hybrid capital.

After the decision to wind down the focus on financing of commercial property, the corporate portfolio has been reduced by NOK 18.7bn or 59 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 is to be developed into a digital bank serving the retail market.

BN Bank has resolved to strengthen its product platform through a cautious focus on consumer lending. 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 residential mortgage lending for BN Bank. 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 Betaling (Vipps)**

In autumn 2017 the SpareBank 1 Alliance's mobile payments service mCASH was amalgamated with Vipps. Several Norwegian bank groupings joined the company on the owner side, and all Norwegian banks have Vipps as their mobile payments service. BankID and BankAxept are to merge with Vipps to compete in the arena for payment solutions for the future. Vipps aims to take its place as the Nordic region's leading financial technology company, and SpareBank 1 SMN's stake in, and close collaboration with, Vipps will be important with a view to retaining customer relationships after the introduction of PSD2 (Revised Payment Services Directive). In the course of 2018 Vipps will launch a number of services designed to simplify bank customers' everyday life, and its integration of accounts will ensure that costs are kept down.

### **Operating expenses**

Overall Group operating expenses rose by NOK 366m in 2017 to total NOK 2,369m (2,003).

Parent bank costs increased by NOK 58m to NOK 1,209m from 2016 to 2017. The change is explained by:

- Improved efficiency and effectiveness have brought lower staffing and reduced costs. Since 31 December 2014 the number of FTEs at the parent bank has been reduced by 90 to 595 FTEs at the end of 2017



- In 2016 the bank expensed NOK 50m in reorganisation costs related to downstaffing
- The defined benefit pension scheme for employees of the parent bank and subsidiaries was terminated in 2016 and all Group employees were transferred to a defined contribution scheme. The termination brought a gain of NOK 74m at the parent bank
- The introduction of a new tax on financial institutions in 2017 has increased costs by NOK 25m
- Changing customer behaviour and new technology will set the stage for increased efficiency gains in the period ahead
- The focus on new technology has increased costs by NOK 30m.
- The target of zero growth in the parent bank's operating expenses is retained for 2018

Total costs among the subsidiaries came to NOK 1,159m having risen by NOK 308m in 2017. NOK 140m refers to SpareBank 1 Regnskapshuset SMN's acquisitions in Møre and Romsdal, about NOK 130m to the build-up of SpareBank 1 Markets and NOK 45m to costs connected to EiendomsMegler 1 Midt-Norge's investment in BN Bolig. Costs in 2016 were positively affected by one-time effects of NOK 16m related to the termination of the defined benefit pension scheme.

The acquisition of SpareBank 1 Regnskapshuset SMN has provided substantial income growth and profit growth in the company. Increased capacity through new appointments has enabled strong income growth at SpareBank 1 Markets and the potential for further growth is high. The result for BN Bolig reflects start-up costs and is in keeping with plan. Improved results are expected in 2018.

The cost-income ratio was 47 per cent (44 per cent) for the Group, 32 per cent (31 per cent) for the parent bank.

#### **Reduced losses and low defaults**

Net loan losses totalled NOK 341m (516m) in 2017. Net loan losses measure 0.23 per cent of total outstanding loans (0.39 per cent).

A net loss of NOK 323m (495m) was recorded on loans to corporates for 2017, in all essentials related to offshore exposures.

A net loss of NOK 18m (21m) was recorded in the retail banking portfolio in 2017.

Individually assessed write-downs on loans and guarantees totalled NOK 769m (638m) at 31 December 2017.

Total problem loans (defaulted and doubtful) come to NOK 1,468m (1,688m), or 0.99 per cent (1.23 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 284m (214m), measuring 0.19 per cent (0.16 per cent) of gross outstanding loans. Of the overall default volume, NOK 55m (39m) is loss provisioned, corresponding to 20 per cent (18 per cent).

Defaults break down to NOK 75m (38m) on corporates and NOK 209m (176m) on retail borrowers.

Other doubtful exposures totalled NOK 1,184m (1,474m), i.e. 0.80 per cent (1.07 per cent) of gross outstanding loans. NOK 714m (599m) or 60 per cent (41 per cent) is written down.

Other doubtful exposures break down to NOK 1,164m (1,455m) on corporates and NOK 21m (19m) on retail borrowers.

Credit quality in the loan portfolio is good. A very large share of the year's loan losses refers to oil-related activity, but the trend is positive in this part of the portfolio too.

### **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. significant shifts in macroeconomic factors)

Collectively assessed impairment write-downs increased by NOK 9m in 2017. Overall collectively assessed loss write-downs thus total NOK 347m (339m), measuring 0.23 per cent (0.25 per cent) of total loans. Collectively assessed write-downs break down to NOK 104m on retail exposures and NOK 243m on corporates. Of the overall provision of NOK 243m on the corporate portfolio, the provision related to oil-related activity accounts for NOK 60m. The remaining collectively assessed write-downs of NOK 173m on the corporate portfolio are fairly evenly spread across other sectors.

### **IFRS 9**

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement as from 1 January 2018. IFRS 9 deals with the recognition, classification, measurement and derecognition of financial assets and liabilities along with hedge accounting. In collaboration with other SpareBank 1 banks, SpareBank 1 SMN has worked on models and clarifications with regard to valuation and classification in the past two years or so. Our calculations show an increased need for loss provisioning as at 1 January 2018 of NOK 17m for the parent bank, and NOK 20m the Group. See note 2 and note 45 of the Annual Accounts for 2017 for further details.

### **Total assets of NOK 153bn**

The bank's assets totalled NOK 153bn at 31 December 2017 (138bn), having risen by NOK 15bn or 11.0 per cent over the year. The increase in total assets is a consequence of increased lending and a larger liquidity holding.

As at 31 December 2017 loans worth a total of NOK 37bn (35bn) 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 residential mortgage lending**

Total outstanding loans have risen by NOK 11.2bn (10.2bn) or 8.2 per cent (8.0 per cent) in 2017 to reach NOK 148.8bn (137.5bn) at year-end.

- Loans to personal borrowers rose in 2017 by NOK 9.3bn (8.7bn) to reach NOK 98.7bn (89.4bn). Growth of 10.4 per cent (10.7 per cent)
- Loans to corporates rose in 2017 by NOK 1.9bn (1.5bn) to reach NOK 50.1bn (49.1bn). Growth of 4.1 per cent (3.2 per cent)

- Loans to personal borrowers accounted for 66 per cent (65 per cent) of total loans to customers as at end-2017

The growth in residential mortgage lending is high and the bank's market shares are growing. There are no indications of higher loss and default levels in the bank's residential mortgage portfolio and the quality of this portfolio is excellent.

New loans to corporate borrowers are mainly to small businesses and are prioritised on the basis of capital limitations and profitability requirements.

SpareBank 1 SMN has over the course of recent years increased the share of its loans going to personal borrowers, and at 31 December 2017 personal borrowers accounted for 66 per cent (65 per cent) of total loans.

(For distribution by sector, see note 5).

### Deposits

Customer deposits rose by NOK 9.3bn (3.1bn) in 2017 to reach NOK 76.5bn (67.2bn) as at 31 December 2017. This represents a growth of 13.9 per cent (5.6 per cent).

- Personal customer deposits rose by NOK 2.0bn (1.8bn) or 6.8 per cent (6.9 per cent) to reach NOK 31.8bn
- Corporate deposits rose by NOK 7.3bn (1.6bn) or 19.5 per cent (4.6 per cent) to NOK 44.7bn. The growth in corporate customer deposits has been very high, and is explained by high growth in the majority of segments. As expected, total deposits are somewhat lower at the end of January 2018
- The deposit-to-loan ratio at SpareBank 1 SMN was 68 per cent (66 per cent) at 31 December 2017

The growth in deposits at the bank was highly satisfactory in 2017, from personal and corporate customers alike.

(For distribution by sector, see note 9).

### Investment products

The customer portfolio of off-balance sheet investment products totalled NOK 11.7bn (10.2bn) at 31 December 2017. The increase of NOK 1.5bn is a result of good sales and value increases, especially as regards equity funds and active asset management.

Saving products, customer portfolio (NOK million)	2017	2016	Change
Equity funds	7,870	6,612	1,258
Pension products	840	762	78
Active management	2,989	2,780	209
<b>Total</b>	<b>11,699</b>	<b>10,154</b>	<b>1,545</b>

### Insurance

The bank's insurance portfolio showed growth of 5.8 per cent in 2017. Growth was strongest for personal insurance, which grew by 7.9 per cent.

Insurance, premium volume (NOK million)	2017	2016	Change
Non-life insurance	769	738	31
Personal insurance	327	303	24
Occupational pensions	232	214	18
<b>Total</b>	<b>1,328</b>	<b>1,255</b>	<b>73</b>

### Retail Banking

Outstanding loans to retail borrowers total NOK 103bn and deposits total NOK 37bn as at 31 December. These are loans to and deposits from wage earners, agricultural customers and sole proprietorships.

Operating income totalled NOK 1,926m (1,663m) in 2017 of which net interest income accounted for NOK 1,137m (953m) and commission income for NOK 789m (679m). Operating income has increased mainly due to increased lending and improved lending margins along with increased commission income from other funding income, investment products, payments and insurance. Overall income rose by NOK 293m. Return on capital employed in the retail banking segment was 16.6 per cent (13.8 per cent). Regulatory capital of 15.0 per cent is used as capital employed, corresponding to the Group's targeted CET1 capital ratio.

The lending margin for 2017 was 1.93 per cent (1.75 per cent), while the deposit margin was 0.11 per cent (0.25 per cent) measured against three-month NIBOR. The average three-month NIBOR fell by about 0.30 percentage points over the course of 2017.

In 2017 retail lending and retail deposits grew by 10.0 per cent (10.3 per cent) and 6.7 per cent (3.9 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 residential mortgage portfolio. The portfolio is secured on residential property.

### Corporate Banking

Outstanding loans to corporates total NOK 39bn and deposits total NOK 39bn as at 31 December 2017. This is a diversified portfolio of loans to and deposits from corporate customers in Trøndelag and Møre and Romsdal.

Operating income totalled NOK 1,315m (1,205m) in 2017. Net interest income was NOK 1,108m (1,000m), while commission income and return on financial investments totalled NOK 207m (205m). Operating income in the corporate segment has increased due very largely to increased lending and improved lending margins.

Overall net losses recorded in the corporate banking segment have declined and amounted to NOK 318m (490m) in 2017. The losses are in all essentials related to the challenges faced in oil-related activity.

Return on capital employed for the corporate banking segment in 2017 was 10.5 per cent (6.9 per cent). Regulatory capital of 15.0 per cent is used as capital employed, corresponding to the Group's targeted CET1 capital ratio.

The lending margin was 2.69 per cent (2.51 per cent) and the deposit margin was minus 0.10 per cent (minus 0.08 per cent) as at end-December 2017.

Lending grew by 1.5 per cent (0.7 per cent) and deposits by 19.5 per cent (6.9 per cent) in 2017.

## Subsidiaries

The subsidiaries posted an overall profit of NOK 242.7m (326.8m) before tax.

Pre-tax profit (NOK million)	2017	2016	Change
EiendomsMegler 1 Midt-Norge	2.6	66.7	-64.0
SpareBank 1 Finans Midt-Norge	128.3	103.4	24.9
SpareBank 1 Regnskapshuset SMN	60.3	42.9	17.4
Sparebank 1 Markets (proforma incl. Allegro)	1.9	19.6	-17.8
SpareBank 1 SMN Invest	27.9	73.7	-45.9
Other companies	21.6	20.4	1.2
<b>Total</b>	<b>242.7</b>	<b>326.8</b>	<b>-84.1</b>

**EiendomsMegler 1 Midt-Norge** leads the field in Trøndelag and in Møre and Romsdal with a very strong market position, Trondheim in particular. The ambition is to continue to strengthen the market share in the region. In collaboration with BN Bank, the company has established BN Bolig in which EiendomsMegler 1 Midt-Norge and BN Bank each hold a 50 per cent stake. This represents a focus on estate agency in the Oslo market which, in addition to enhancing earnings from estate agency, will contribute to stronger residential mortgage lending growth for BN Bank in this market.

EiendomsMegler 1 Midt-Norge's pre-tax profit in 2017 came to NOK 2.6m (66.7m). The profit is weakened by:

- Reduced incomes as a result of fewer dwelling units sold. Dwelling units sold in 2017 totalled 6,719 compared with 7,429 in 2016
- NOK 35m in start-up costs for BN Bolig. EiendomsMegler 1 Midt-Norge consolidates the profit from BN Bolig as a subsidiary

**SpareBank 1 Finans Midt-Norge** delivered a profit of NOK 128.3m in 2017 (103.4m) and shows positive profit growth as a result of strong growth in income, limited cost growth and good risk management. The company's business areas are mainly leasing to the SMB market and car loans to retail customers. The company operates leasing and car loan agreements worth a total of NOK 6.2bn, of which leasing agreements account for NOK 2.8bn (2.3bn) and car loans for NOK 3.4bn (2.7bn). The company also offers consumer loans, and at year-end that portfolio was worth NOK 208m (132m).

The company has seen good growth, particular in car loans with growth of 26 per cent over the last 12 months. The Samspar banks in SpareBank 1 held a 27.9 per cent stake in SpareBank 1 Finans Midt-Norge at end-2017 and Sparebanken Sogn og Fjordane a stake of 7.5 per cent. 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 60.3m (42.9m) in 2017. The profit growth is ascribable to sound operations and to the company's substantial expansion in Møre and Romsdal.

The company caters to the SMB segment with a technologically modern distribution model and a broad range of services.

SpareBank 1 Regnskapshuset SMN acquired all shares of Økonomisenteret Kunderegnskap in Molde along with about 110 employees with effect from 2017. The company now has 360 employees and an annual turnover of NOK 360m. This has contributed to improved profit in 2017 and to a considerable increase in income and expenses alike.

**SpareBank 1 SMN Invest** invests in shares, mainly in regional businesses. The company posted a net profit of NOK 27.9m (73.7m) in 2017.

Value changes and realisation of losses or gains on the company's overall holding of shares account for NOK 12.5m of the company's net total income. The company has in addition ownership interests in the property company Grilstad Marina and its share of the latter's profit in 2017 was NOK 15.4m.

**SpareBank 1 Markets** is a subsidiary of SpareBank 1 SMN with a stake of 66.7 per cent. The company is headquartered in Oslo and has offices in Trondheim, Ålesund and Stavanger. It has a staff of 132. In the fourth quarter the company acquired the trading desk at SpareBank 1 SR-Bank Markets. SpareBank 1 SR-Bank became co-owner of the company as a result of the transaction.

In 2017 SpareBank 1 Markets also acquired SpareBank 1 Kapitalforvaltning (formerly Allegro Kapitalforvaltning and SpareBank 1 Nord-Norge Forvaltning). The company is at centre-stage in SpareBank 1 Markets' focus on asset management with aggregate total assets of NOK 10bn. The company has a staff of 15.

SpareBank 1 Markets' (including SpareBank 1 Kapitalforvaltning) pre-tax profit in 2017 was NOK 1.9m (19.6m). The Group has seen a positive income trend in the past year, in particular in equity trading and investment banking (corporate).

In 2017 SpareBank 1 Markets made a number of staff appointments which are expected to strengthen earnings in the company once the new staff attain normalised earning power. This has resulted in considerable cost growth in 2017.

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 27bn and has the funding needed for 30 months of ordinary operation without fresh external finance.

The government authorities require 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 164 per cent as at 31 December 2017 (129 per cent). The requirement is 100 per cent.

The Group's deposit-to-loan ratio at 31 December 2017, including SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt, was 51 per cent (49 per cent).

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 80 per cent (88 per cent).

SpareBank 1 Boligkreditt is the bank's most important source of funding, and loans totalling NOK 35bn had been sold by 31 December 2017.

### Rating

SpareBank 1 SMN has a rating of A1 (negative outlook) with Moody's and a rating of A- (stable outlook) with Fitch Ratings. Moody's revised in July 2017 its outlook for SpareBank 1 SMN and other Norwegian banks from a stable to a negative outlook. The change was triggered by the expected introduction of the EU's Bank Recovery and Resolution Directive (BRRD), which is likely to entail a lower probability of support from public authorities to Norwegian banks.

### Financial position

The CET1 capital ratio at 31 December 2017 was 14.9 per cent (14.9 per cent). The group's CET1 target is 15.0 per cent. The authorities' CET1 requirement is 14.1 per cent.

Risk weighted assets increased by 5.4 per cent of 2017, but this is offset by an increase in CET1 capital as a result of an excellent profit of NOK 1.8bn in 2017 and retention of 50 per cent of this profit.

The bank increased its lending by 8.2 per cent in 2017, but, as a result of a deliberate shift in the composition of lending, risk-weighted assets increased by only 5.3 per cent. Retained profits enabled a 5.3 per cent increase in CET1 capital in 2017.

The CET1 capital ratio is 0.1 percentage point below the target level. This is considered to be within natural fluctuations. The leverage ratio is 7.2 per cent (7.4 per cent). The board of directors are satisfied with the bank's level of capitalisation.

As of 31 December 2017 the countercyclical capital buffer increased from 1.5 per cent to 2.0 per cent, bringing the CET1 requirement to 12.0 per cent, including combined buffer requirements. Including a Pillar 2 requirement of 2.1 per cent, the overall regulatory requirement is 14.1 per cent.

Finanstilsynet's final assessment of the add-on for risks not adequately covered by Pillar 1 was set at 2.1 per cent in 2015. The add-on relates mainly to owner risk, market risk and concentration risk with regard to credit. This add-on is subject to assessment by Finanstilsynet every second year, and Finanstilsynet will set a new Pillar 2 add-on in the course of 2018. SpareBank 1 SMN aims for a management buffer of about 1 per cent above overall Pillar 1 and Pillar 2 requirements in order to absorb fluctuations in risk-weighted assets and fluctuations in Group profit. Against this background the Group's capital target stands at 15 per cent.

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 2017, including a recommended dividend of NOK 4.40, was NOK 78.81 (73.35), and earnings per EC were NOK 8.71 (7.93).

The Price / Income ratio was 9.44 (8.17) and the Price / Book ratio was 1.04 (0.88).



As at 31 December 2017 the EC was priced at NOK 82.25 and dividend of NOK 3.00 per EC was paid in 2017 for the year 2016.

SpareBank 1 SMN's articles of association set no restrictions on investors' trade in ECs.

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**

The Group's problem loans reflect the changes facing the offshore industry. Loans to oil-related activity account for 3.2 per cent of the Group's overall outstanding loans as at 31 December 2017. The credit quality of the bank's wider loan portfolio is satisfactory. There have been no contagion effects from oil-related activity to other sectors and no other significant concentrations in defaulted and problem exposures are in evidence.

Positive growth signals are noted both internationally and in Norway. A weaker Norwegian krone has impacted positively on Norwegian export industries, but a certain strengthening of the krone is expected ahead. Real wage growth is expected to increase somewhat. Combined with continued low interest rates, the bank considers the loss risk in the bank's retail market portfolio to be low. Unemployment has declined in the bank's market area, and the bank expects the level of unemployment to remain relatively moderate ahead.

Credit growth among Norwegian households remains higher than wage growth and will, over time, be influenced by house price developments. Households' indebtedness has risen from already high levels. Falling house prices and expectations of high interest rates will probably lead to a higher savings rate among Norwegian households, which could result in reduced turnover in parts of Norwegian business and industry.

The bank's profits are affected directly and indirectly by fluctuations in securities markets, and the valuation of basis swaps in particular contributes to volatility. The indirect effect relates very largely to the bank's ownership interest in SpareBank 1 Gruppen where both the insurance business and fund management activities are affected by such 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 four core values wholehearted, responsible, likeable and competent are all connected to corporate social responsibility. However, 'responsible' singles itself out as the most important guide for SpareBank 1 SMN's CSR efforts.

The bank's focus on corporate social responsibility is designed to strengthen competitiveness, reduce risk, attract good customers, investors and skilled staff, boost innovation and contribute to the further

development of the region of which the Group is a part. By this means the bank creates value in a responsible and sustainable manner for all stakeholders.

The bank is now reporting for the first time on the bank's performance in the field of CSR and sustainability under the globally recognised standard, the Global Reporting Initiative (GRI). Read more about the bank's social responsibility in a separate section in the annual report.

In 2017 SpareBank 1 SMN also endorsed the UN's Global Compact, with the commitments this entails.

SpareBank 1 SMN developed a new strategy for corporate social responsibility in 2017. The strategy builds on the bank's values, approved by the board of directors and anchored in the organisation.

The strategy describes concrete objectives under the following themes:

- Responsible products and services
- Communication and openness
- Ethics and anti-corruption
- Environment and climate
- Staff and organisation

SpareBank 1 SMN has seen a good sustainable development in 2017. The bank has established new strategies, policies, guidelines and procedures, and will show the results of its efforts in 2018. The bank will report each year its CSR results under the GRI standard together with its annual report.

### **Responsible products and services**

SpareBank 1 SMN has separate policies for sustainability in lending, the positions and asset management. In addition, the bank is developing its own sustainable products. In day-to-day operations the policies entail inter alia that SMN will:

1. Not take owner positions in or grant loans to companies that do not abide by our principles, and include caveats regarding follow-up and consequences in the event of any deviation (covenants) for funding where the companies concerned operate in industries, countries and regions posing a particularly high risk
2. Exert pressure on customers and companies in which we invest to ensure that they maintain sound procedures and processes for making appropriate ethical, environmental and sustainable choices, and for influencing companies in which they hold owner positions through active governance
3. Require documentation that customers have taken action on circumstances that violate our principles
4. Take the consequence of deviations that are not acted on by not renewing or prolonging loans, or by winding down owner positions.

The bank will also conduct an ESG screening of all the bank's existing mutual fund suppliers in the course of 2018.

### **Communication and openness**

SpareBank 1 SMN's CSR strategy defines how the bank is to engage its stakeholders. The bank endeavours on a continuous basis to identify and engage its own surroundings, and to integrate inputs into important decision processes. The bank endeavours to meet legitimate demands and expectations of the

bank's stakeholders in an open and constructive manner. To this end the bank has an annual process devoted to stakeholder activities, rooted in the board of directors. For example, the strategy states that SpareBank 1 SMN shall:

1. Define stakeholders on a broad and strategic basis and seek opportunities
2. Prioritise stakeholders according to their value to the bank
3. Be open, clear, inquisitive and constructive in dialoguing with stakeholders
4. Seek partnerships and share success stories with the stakeholders
5. Take the stakeholders' views on board in company governance.

In 2017 SpareBank 1 SMN has conducted a series of structured stakeholder interviews as a step in identifying the bank's most significant themes in the field of sustainability.

### **Ethics and anti-corruption**

The bank adopted updated ethical guidelines in 2017. The guidelines regulate each staff member's relationship to customers, suppliers, competitors and the world at large.

In addition to the ethical guidelines, SpareBank 1 SMN has established a procedure for whistleblowing. This procedure covers the requirements of the Working Environment Act for notifying censurable circumstances at enterprises.

The procedure also enables staff members to notify the bank's external reception centre, and to report anonymously if the whistleblower so wishes.

The bank initiated in 2017 a process to establish a new system of event reporting in collaboration with an external supplier. The new system will be implemented in the first quarter of 2018.

### **Environment and climate**

It is particularly important for us as a regional bank to assume a responsibility for sustainability in investments and in lending. SpareBank 1 SMN is duty bound to do what it can to support the UN's sustainability objectives, and the bank is concerned that companies in which it invests or to which it lends money should make sustainable choices.

SpareBank 1 SMN's environment management system is certified under the 'Environmental Lighthouse' standard. The bank reports its energy consumption and climate emissions each spring to the Environmental Lighthouse Foundation (Stiftelsen Miljøfyrtårn). The environment management system ensures continuous improvement of the bank's own environmental performances.

### **Staff and organisation**

Major changes are ongoing in the banking industry, creating a major need to revise the bank's competence profile. In the future the bank will need fewer staff in production, more staff in digital development and more staff in digital sales, analysis and business development.

The SpareBank 1 Alliance has a shared digital teaching platform (LMS), which makes courses and training programmes available to staff. In 2017 the bank also worked on a new process and new tools for competence development and competence management. The project New Workday is designed to ensure that the bank, in parallel with its development and implementation of new systems and processes, develops the appropriate competence. Read more about this and the work environment, gender equality and other staff-related matters in the chapter The People and in note 22 Personnel expenses.

**Prospects**

SpareBank 1 SMN achieved good results in 2017. Most business lines have posted a strong performance. A high influx of new retail market customers and lower loan losses are highlighted in particular.

The group has a very solid financial position with a leverage ratio of 7.2 per cent. The board of directors is satisfied with a CET1 capital ratio of 14.9 per cent, approximately as targeted after a year of strong growth. The target of a 15 per cent CET1 capital ratio is retained.

There is still in the board's assessment a considerable potential for further digitalisation and optimisation of channel interaction in selling and advisory activities. The bank's customers will primarily meet their needs for financial products, payments and simple advisory services digitally. At the same time competent teams of advisers are retained to attend to more demanding advisory assignments and to the establishment of new customer relationships. The distribution strategy includes relatively numerous, but cost-efficient, offices and first-class self-service customer interfaces. Substantial investments are also being made to standardise and automate processes with a view to improving the efficiency and simplifying compliance with regulatory requirements. At the start of 2018 the Norwegian financial industry faces major changes. The revised Payment Services Directive, PSD2, will be introduced in the course of the year. The bank and the SpareBank 1 Alliance have set an ambitious goal: to exploit this opportunity to offer improved services and create more value for existing and new customers.

The bank will continue its efforts to strengthen its market position among small and medium-sized businesses. In 2018 the bank will launch a digital platform for small and medium-sized firms. The platform combines banking and accounting data and makes for effective and efficient communication between the firm and the bank. This, together with a local presence, will provide the bank with a competitive edge in the market for small and medium-sized businesses.

The economic prospects for Trøndelag and for Møre and Romsdal are good.

Loan losses in recent years have almost exclusively related to oil-related activities. Low losses are anticipated ahead. Virtually all customers in this sector have been restructured and are now seeing increased activity levels due to a higher oil price and thus growing activity on the Norwegian shelf. Through its continued thorough monitoring of customers, the bank is well prepared should a new reduction in the oil price and demand materialise.

The board's assessment is that a certain reduction in demand for housing is likely after a long period of vigorous demand and price growth. Price growth in the region has been lower than in other high pressure areas. The bank has a sound portfolio of residential mortgages and expects any fall in house prices to inflict modest losses on the bank.

The bank's subsidiaries and related companies have shown a sound trend in 2017. This positive picture is expected to continue in 2018.

The Board of Directors is well satisfied with the Group's performance and results in 2017 and expects 2018 to be a good year for SpareBank 1 SMN.

Trondheim, 28 February 2018  
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.)

Venche Johnsen  
(employee rep.)

Finn Haugan  
(Group CEO)