Note 5 - Capital adequacy and capital management

SpareBank 1 SMN utilises the Internal Rating Based Approach (IRB) for credit risk. Use of IRB imposes wide-ranging requirements on the bank's organisational set-up, competence, risk models and risk management systems. As from 31 March 2015 the bank has received permission to apply the Advanced IRB Approach to those corporate portfolios that were previously reported under the Basic Indicator Approach.

As of 31 December 2019 the capital conservation buffer requirement is 2.5 per cent, the systemic risk requirement is 3.0 per cent and the Norwegian countercyclical buffer is 2.5 per cent. These requirements are additional to the requirement of 4.5 per cent CET1 capital, so that the overall minimum requirement on CET1 capital is 12.5 per cent. In addition the financial supervisory authority has set a Pillar 2 requirement of 1.9 per cent for SpareBank 1 SMN, however not below NOK 1,794 million in monetary terms. As at 31 December 2019, reduced risk weighted assets mean that the minimum monetary requirement of NOK 1,794 million is binding for the Pillar 2 requirement. The Pillar 2 requirement therefore rises from 1.9 per cent to 1.95 per cent. The overall minimum requirement as of 31 December 2019 has accordingly increased from 14.4 per cent to 14.45 per cent.

The EU capital adequacy framework (CRR/CRDIV) was incorporated into Norwegian law with effect from 31 December 2019. The Basel I floor was accordingly removed and an SME rebate introduced. At the same point the countercyclical buffer was raised by 0.5 per cent to 2.5 per cent. The systemic risk buffer will rise to 4.5 per cent with effect from 31 December 2020.

The countercyclical buffer is calculated using differentiated rates. For exposures in other countries the countercyclical buffer rate set by the authorities in the country concerned is applied. If that country has not set a rate, the same rate as for exposures in Norway is applied unless the Ministry of Finance sets another rate. For the fouth quarter of 2019 both the parent bank and the group is below the capital deduction threshold such that the Norwegian rate is applied to all relevant exposures.

Parts of the group's hybrid capital and subordinated debt were issued under earlier rules. This will be subject to a write-down of 60 per cent in 2018 and 70 per cent in 2019. As at 31 December 2019 the bank held hybrid capital worth NOK 287 million subject to write-down.

Parent Bank			Group	
31 Dec 2018	**31 Dec 2019**	**(NOK million)**	**31 Dec 2019**	**31 Dec 2018**
16,409	**17,822**	**Total book equity**	**20,420**	**18,686**
-1,000	-1,250	Additional Tier 1 capital instruments included in total equity	-1,293	-1,043
-533	-512	Deferred taxes, goodwill and other intangible assets	-1,099	-1,079
-1,034	-1,314	Deduction for allocated dividends and gifts	-1,314	-1,034
-	-	Non-controlling interests recognised in other equity capital	-761	-637
-	-	Non-controlling interests eligible for inclusion in CET1 capital	438	366
-31	-33	Value adjustments due to requirements for prudent valuation	-45	-44
-268	-305	Positive value of adjusted expected loss under IRB Approach	-351	-286
-	-	Cash flow hedge reserve	3	5
-163	-185	Deduction for common equity Tier 1 capital in significant investments in financial institutions	-168	-206
13,381	**14,222**	**Common equity Tier 1 capital**	**15,830**	**14,727**
1,000	1,250	Additional Tier 1 capital instruments	1,637	1,378
367	275	Additional Tier 1 capital instruments covered by transitional provisions	275	367
14,748	**15,747**	**Tier 1 capital**	**17,742**	**16,472**
		Supplementary capital in excess of core capital		
1,750	1,750	Subordinated capital	2,240	2,316
96	12	Subordinated capital covered by transitional provisions	12	96
-140	-140	Deduction for significant investments in financial institutions	-140	-140
1,705	**1,623**	**Additional Tier 2 capital instruments**	**2,113**	**2,272**
16,453	**17,370**	**Total eligible capital**	**19,854**	**18,743**

		Minimum requirements subordinated capital		
967	911	Specialised enterprises	1,101	1,116
1,156	1,139	Corporate	1,149	1,163
1,516	1,628	Mass market exposure, property	2,299	2,098
90	98	Other mass market	101	92
1,062	984	Equity investments	1	1
4,790	**4,760**	**Total credit risk IRB**	**4,651**	**4,470**
3	2	Central government	3	4
87	86	Covered bonds	132	124
390	419	Institutions	282	246
-	-	Local and regional authorities, state-owned enterprises	5	8
23	42	Corporate	239	221
73	22	Mass market	463	520
12	9	Exposures secured on real property	167	215
228	236	Equity positions	377	366
57	104	Other assets	151	107
873	**918**	**Total credit risk standardised approach**	**1,818**	**1,810**
30	31	Debt risk	34	31
-	-	Equity risk	15	7
-	-	Currency risk and risk exposure for settlement/delivery	3	3
370	407	Operational risk	720	575
39	29	Credit value adjustment risk (CVA)	115	122
-	-	Transitional arrangements	-	1,074
6,102	**6,145**	**Minimum requirements subordinated capital**	**7,357**	**8,093**
76,274	**76,817**	**Risk weighted assets (RWA)**	**91,956**	**101,168**
3,432	3,457	Minimum requirement on CET1 capital, 4.5 per cent	4,138	4,553
		Capital Buffers		
1,907	1,920	Capital conservation buffer, 2.5 per cent	2,299	2,529
2,288	2,305	Systemic rick buffer, 3.0 per cent	2,759	3,035
1,525	1,920	Countercyclical buffer, 2.5 per cent (2.0 per cent)	2,299	2,023
5,721	**6,145**	**Total buffer requirements on CET1 capital**	**7,357**	**7,588**
4,228	**4,620**	**Available CET1 capital after buffer requirements**	**4,335**	**2,587**
		Capital adequacy		
17.5 %	18.5 %	**Common equity Tier 1 capital ratio**	17.2 %	14.6 %
19.3 %	20.5 %	Tier 1 capital ratio	19.3 %	16.3 %
21.6 %	22.6 %	Capital ratio	21.6 %	18.5 %
		Leverage ratio		
153,395	161,905	Balance sheet items	230,048	216,240
7,110	6,830	Off-balance sheet items	7,897	9,086
-832	-851	Regulatory adjustments	-1,503	-1,474
159,673	167,885	Calculation basis for leverage ratio	236,441	223,853
14,748	15,747	Core capital	17.742	16,472
9.2 %	**9.4 %**	**Leverage Ratio**	**7.5 %**	**7.4 %**