

# Report of the Board of Directors

## Preliminary annual accounts 2011

Consolidated figures. Figures in parentheses refer to the same period of 2010 unless otherwise stated.

### Highest profit ever of NOK 1,024m after tax

- Profit before tax: NOK 1,279m (NOK 1,282m).
- Profit: NOK 1,024m (NOK 1,022m)
- Return on equity: 12.8% (14.6%)
- Tier 1 capital ratio: 10.4% (10.9%), common tier 1 ratio: 8.9% (9.3%)
- 12-month growth in lending: 8.6% (13.2%), 12-month growth in deposits: 11.9% (14.9%).
- Earnings per equity capital certificate (ECC): NOK 6.61 (NOK 6.43); book value per ECC, incl. dividend recommended for 2011: NOK 54.44 (NOK 50.60)
- Recommended dividend: NOK 2.00 per ECC
- The Board of Directors recommends the launch of an underwritten rights issue of up to NOK 750m, a private placing of up to NOK 200m, mainly with SpareBank 1 SMN Stiftelsen, and a placing of up to NOK 60m with employees.

### Fourth quarter 2011

- Profit before tax: NOK 333m (NOK 377m).
- Profit: NOK 279m (NOK 318m).
- Return on equity: 13.6% (16.6%)
- Earnings per ECC: NOK 1.80 (NOK 2.05)

### Good result in 2011

- Good underlying operations and positive income trend
- High return on financial investments
- Strong financial position and satisfactory funding
- Very good growth in lending to the retail market and high growth in deposits from retail and corporate customers alike
- Rise in costs due to one-time events and increased activity levels, particularly in subsidiaries

In 2011 SpareBank 1 SMN recorded a profit of NOK 1,024m (NOK 1,022m) and a return on equity of 12.8% (14.6%). Profit before tax was NOK 1,279m (NOK 1,282m). The good profit performance is ascribable to a positive income trend, reduced losses and high return on financial assets.

The profit before tax for the fourth quarter in isolation was NOK 333m (NOK 377m). The result for the quarter reflects:

- Continued pressure on lending margins
- Higher costs against a background of one-time events and increased activity
- Continued low losses and low defaults
- High return on securities and very good profits among affiliates

Return on equity for the quarter was 13.6% (16.6%).

Operating income rose by 6.5% in 2011 to a total of NOK 2,200m (NOK 2,065m).

Return on financial assets was NOK 588m (NOK 490m), of which the overall share of profits on owner interests in affiliates was NOK 290m (NOK 249m).

Operating expenses totalled NOK 1,482m in 2011 (NOK 1,140m) which is NOK 342m higher than in 2010. Of the growth, NOK 128m is due to the write-back of AFP (early retirement) provision in 2010.

A net loss of NOK 27m (NOK 132m) was recorded on loans and guarantees.

The Group achieved good growth in lending and deposits in 2011. Lending rose by 8.6% (13.2%) and deposits by 11.9% (14.9%). Both retail and corporate banking divisions saw a good supply of customers in the retail and corporate market.

Tier 1 capital adequacy at end-2011 was 10.4% (10.9%) and total capital adequacy was 12.0% (13.0%). In a press release dated 8 December 2011 Finanstilsynet announced its support for the European Banking Authority's new requirement for banks to maintain a common tier 1 capital (tier 1 capital excluding hybrid capital) ratio of 9.0%. At end-2011 SpareBank 1 SMN has a common tier 1 ratio of 8.9% (9.3%).

At year-end the Bank's equity capital certificate (ECC) was priced at NOK 39.30 (NOK 54.00 one year previously). A cash dividend of NOK 3.00 per ECC was paid in 2011 for the year 2010 (NOK 2.27).

Earnings per ECC were NOK 6.61 (NOK 6.43). Book value was NOK 54.44 (NOK 50.60).

The Board of Directors recommends the Supervisory Board to set a cash dividend of NOK 2.00 per ECC for 2011.

### **Proposed distribution of profit**

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

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

<b>Difference between Group - Parent Bank</b>	<b>2011</b>	<b>2010</b>
<b>Profit for the year, Group</b>	<b>1,024</b>	<b>1,022</b>
Profit, subsidiaries	-144	-42
Dividend, subsidiaries	68	108
Profit, associated companies	-290	-249
Dividend, associated companies	162	44
<b>Profit for the year, Parent Bank</b>	<b>820</b>	<b>883</b>

Annual profit for distribution reflects changes of NOK -25m in the revaluation reserve, leaving the total amount for distribution at NOK 795m.

The profit is distributed between the ownerless capital and the equity certificate capital in proportion to their relative shares of the Bank's total equity, such that dividends and the allocation to the dividend equalisation fund constitute 61.3% of the distributed profit.

The Board of Directors recommends the Supervisory Board to set a cash dividend of NOK 2.00 per equity capital certificate, altogether totalling NOK 190m. This gives a payout ratio of 40%. The Board of Directors further recommends the Supervisory Board to allocate NOK 40m as gifts to non-profit causes, representing a payout ratio of 13%. NOK 297m and NOK 268m are added to the dividend equalisation fund and the ownerless capital respectively.

In light of new regulatory capital requirements and the expectation of more demanding market conditions, the Board of Directors has this year chosen to recommend lower payout ratios than in previous years.

The Board has further chosen to recommend a different payout ratio for the ownerless capital and the owner capital this year in order to partially offset the equity dilution resulting from the proposed stock issue.

After distribution of the profit for 2011 the ECC-holder ratio (ECC-holders' share of total equity) is 60.6%.

<b>Distribution of profit</b>	<b>2011</b>	<b>2010</b>
Profit for the year, Parent Bank	820	882
Transferred to / from revaluation reserve	-25	65
<b>Profit for distribution</b>	<b>795</b>	<b>947</b>
Dividends	190	285
Equalisation fund	297	281
Saving Bank's reserve	268	189
Gifts	40	192
<b>Total distributed</b>	<b>795</b>	<b>947</b>

### Increased net interest income

Net interest income in 2011 was NOK 1,281m (NOK 1,210m), an increase of NOK 71m.

The increase is mainly due to

- Higher loan and deposit volumes
- Increased commissions on establishment of business loans
- Banks' exemption from payment of levies to the Banks' Guarantee Fund for 2011

The steadily rising cost of money market funding reduced the Bank's lending margins through the year. The Bank implemented a general interest rate increase on loans to retail and corporate customers alike in

November 2011, and has chosen not to lower rates to customers after the reduction of market rates (NIBOR) at year-end.

Commission on home mortgage loans transferred to SpareBank 1 Boligkreditt is recorded as commission income, not as interest income. Commission income totalled NOK 71m in 2011 (NOK 107m).

As of end-2011 home mortgage loans transferred to SpareBank 1 SMN Boligkreditt AS amounted to NOK 22bn (NOK 18bn).

### Increased commission income

Commission income and other operating income came to NOK 919m in 2011 (NOK 855m), an increase of NOK 64m or 7.5%. The main contributors to the increase are property broking, accounting services and insurance. In addition, the Group earns rental income on the Bank's new head office. A decline in commissions from SpareBank 1 Boligkreditt is ascribable to higher costs of funding in the market for residential mortgage bonds. The competitive situation has thus far made it demanding to pass on this extra cost to borrowers.

Commission income, NOKm	2011	2010	Change
Payment transfers	195	198	-3
Savings	54	61	-7
Insurance	107	96	10
SpareBank 1 Boligkreditt	71	107	-36
Guarantee commission	28	29	-1
Real estate agency	308	245	64
Accountancy services	79	51	29
Active management	12	19	-7
Rent premises, mainly new head office	34	13	21
Other commissions	32	38	-6
<b>Total</b>	<b>919</b>	<b>855</b>	<b>64</b>

### Positive return on financial investments

Overall return on financial investments (excluding the Bank's share of the profit of affiliates and joint ventures) was NOK 298m (NOK 240m) in 2011.

Return on the Group's share portfolios totalled NOK 102m (NOK 122m).

SpareBank 1 SMN Invest, which manages parts of the Bank's share portfolio, posted net capital gains of NOK 92m (loss of NOK 19m). A substantial part of this comprises increased value of the company's portfolio in Det Norske Oljeselskap in the second half-year.

Gains on bonds and derivatives in 2011 came to NOK 100m (NOK 73m). SpareBank 1 SMN focuses on investing in solid issuers with low market volatility. The Bank adopts a conservative approach to bond portfolio management with little exposure to bank bonds; the bulk of investment is in government bonds, government guaranteed bonds, municipal bonds and well-rated covered bonds. The Group's overall interest rate risk is kept to a low level.

Gains on forex and fixed income trading at SpareBank 1 SMN Markets totalled NOK 96m (NOK 39m) after a very good second half-year.

<b>Return on financial investments, NOKm</b>	<b>2011</b>	<b>2010</b>
Capital gains/dividends, shares	102	129
Bonds and derivatives	101	73
SpareBank 1 SMN Markets	96	39
<b>Net return on financial investments</b>	<b>298</b>	<b>241</b>
SpareBank 1 Gruppen	94	164
SpareBank 1 Boligkreditt	16	16
SpareBank 1 Næringskreditt	9	2
Bank1 Oslo Akershus	15	37
BN Bank	89	59
Polaris	23	-
Other jointly controlled companies	43	-29
<b>Income from investment in related companies</b>	<b>289</b>	<b>249</b>
<b>Total</b>	<b>588</b>	<b>490</b>

### **SpareBank 1 Gruppen**

SpareBank 1 Gruppen's preliminary post-tax profit was NOK 482m (NOK 841m). SpareBank 1 Skadeforsikring and SpareBank 1 Livsforsikring are the main contributors to the profit growth.

SpareBank 1 SMN's share of the profit was NOK 94m (NOK 164m).

### **SpareBank 1 Boligkreditt**

SpareBank 1 Boligkreditt was established by the banks participating in the SpareBank 1 Alliance to take advantage of the market for covered bonds. By transferring their highest quality residential mortgage loans to the company, the SpareBank 1 banks benefit from reduced funding costs.

The Bank's equity stake in SpareBank 1 Boligkreditt at end-2011 was 17,8%, and the Bank's share of the company's profit in 2011 was NOK 16.0m (NOK 16.0m).

### **SpareBank 1 Næringskreditt**

In 2010 the SpareBank 1 banks established SpareBank 1 Næringskreditt along the same lines, and with the same administration, as SpareBank 1 Boligkreditt.

SpareBank 1 SMN owns 37% of the company, and SpareBank 1 SMN's share of the company's profit in 2011 was NOK 9m (NOK 2m).

As of end-2011 SpareBank 1 Næringskreditt had purchased loans worth NOK 8.3bn from BN Bank and issued covered bonds to a value of NOK 7.0bn.

### **Bank 1 Oslo Akershus**

SpareBank 1 SMN has a stake of 19.5% in Bank 1 Oslo Akershus. SpareBank 1 SMN's share of the profit of Bank 1 Oslo Akershus was NOK 15m (NOK 37m) in 2011.

### **BN Bank**

SpareBank 1 SMN's equity stake in BN Bank at end-2011 is 33%.

SpareBank 1 SMN's share of the profit of BN Bank for 2011 was NOK 89m (NOK 59m), including amortisation effects.

### **Polaris Media**

After acquiring 18.81% of the shares of Polaris Media on 28 March 2011, the SMN Group owns 23.45% of the shares of the company. The company is therefore classified as an affiliate of SpareBank 1 SMN.

The book value of the shares at end-2011 is NOK 332m. This includes SpareBank 1 SMN's estimated share of the profit from the date of acquisition of the shares which was taken to income in an amount of NOK 22.9m.

### **Other companies**

These companies were essentially established to handle corporate exposures taken over from other entities. The positive result of NOK 43m essentially represents a tax benefit related to loss carried forward in the companies.

### **Venture in Ålesund**

SpareBank 1 SMN took over BN Bank's operation in Ålesund in 2009. The loan portfolio will for a period be guaranteed by BN Bank against a guarantee commission. At the end of 2011 customers representing total loans of NOK 3.1bn were covered by the guarantee.

SpareBank 1 SMN also took over responsibility for 36 employees, leases and other commitments in Ålesund. The Bank receives compensation from BN Bank for its outlays in the initial years based on a phase-out model. The BN Bank portfolio forms the basis for SpareBank 1 SMN's venture in Sunnmøre.

On 1 February 2012 an agreement was signed with BN Bank whereby BN Bank withdraws the guarantee in respect of NOK 2.4bn of the portfolio, with the consequent lapse of the guarantee commission from 1 February 2012. This leaves NOK 0.7bn in the guarantee portfolio. The guarantee will expire in three years.

### **Increased costs due to increased effort towards the market**

Overall costs came to NOK 1,482m (NOK 1,140m) in 2011, an increase of NOK 342m.

Of the increase, the write-back of pension liabilities accumulated under the AFP (early retirement) scheme in 2010 accounts for NOK 128m.

Other staff and operating expenses in the Group grew by NOK 214m or 17% compared with 2010 (2010 figures corrected for AFP).

Of the growth of NOK 214m, NOK 67m or 21% comprises growth at the Bank's subsidiaries. The growth in costs is ascribable to

- Increased activity at Eiendomsmegler 1. NOK 30m of the growth at the subsidiaries is a result of a substantial increase in activity at Eiendomsmegler 1. The pre-tax profit of NOK 76m was the best ever reported by the company.
- Increased costs at SpareBank 1 SMN Regnskap as a result of the acquisition of several local accounting firms in 2011. This has increased Group operating expenses by NOK 27m. Turnover rose by NOK 30m in 2011.

Parent Bank costs rose by NOK 146m or 15%. Much of the growth is related to increased customer facing activity. The growth roughly breaks down as follows:

Wage growth	NOK 35m
IT og telephony	NOK 31m
Premises, mainly new HQ	NOK 27m
Other increase in activity	NOK 33m
<b>Total</b>	<b>NOK 126m</b>

In addition an operational loss of NOK 20m related to a customer exposure in the Group's capital market business was recorded as a cost.

Operating expenses were 1.50% (1.39%) of average total assets. The Group's cost-income ratio was 53% (50%) (2010 figures corrected for the effect of AFP).

### Very low losses and low defaults

In 2011 net loan losses came to NOK 27m (NOK 132m). There has been no cause to revise collectively assessed impairment write-downs in 2011. Net loan losses in the fourth quarter were NOK 26m.

A net loss of NOK 20m (NOK 128m) was recorded in 2011 on the Group's corporate customers. Of this, losses at SpareBank 1 SMN Finans came to NOK 15m (NOK 25m). A net loss of NOK 7m was recorded on the retail portfolio (NOK 4m).

Individually assessed impairment write-downs came to NOK 172m (NOK 222m), a fall of NOK 50m in the last 12 months.

Total problem loans (defaulted and doubtful) came to NOK 542m (NOK 710m), or 0.57% (0.81%) of gross outstanding loans.

Defaults in excess of 90 days came to NOK 338m (NOK 499m). Defaults measure 0.36% (0.57%) of gross lending. Of overall defaults, NOK 89m (NOK 100m) or 26% (20%) are loss provisioned.

Other doubtful exposures totalled NOK 204m (NOK 211m), or 0.21% (0.24%) of gross lending. NOK 83m (NOK 122m) or 41% (58%) are loss provisioned.

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

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

At end-2011 no basis has been found for revising collectively assessed write-downs. The aggregate volume of such write-downs is NOK 290m (NOK 290m).

### Total assets of NOK 101bn

The Bank's assets totalled NOK 101bn as of end-2011 (NOK 98bn), having risen by NOK 3bn or 3.6%. The increase in total assets is a consequence of lending growth.

As of end-2011, loans worth a total of NOK 22bn (NOK 18bn) had been transferred by SpareBank 1 SMN to SpareBank 1 Boligkreditt. These loans do not figure as lending in the Bank's balance sheet. However, the comments dealing with growth in lending include loans transferred to SpareBank 1 Boligkreditt.

### Strong growth in retail lending, slower growth in corporate lending

Total outstanding loans rose by NOK 7.6bn (NOK 10.2bn) or 8.6% (13.2%) in 2011 to reach NOK 95.2bn at end-2011.

Demand for home mortgage loans has been heavy, and lending to retail customers rose by NOK 5.4bn (NOK 4.5bn) to NOK 55.0bn in 2011, equivalent to growth of 10.9% (9.9%). SpareBank 1 SMN is taking market shares in the home loan market in its catchment area. Growth in credit to Norwegian households in 2011 look set to reach about 7.2%.

Growth in lending to corporates has slowed, with an increase of NOK 2.2bn (NOK 5.8bn) in 2011, equivalent to 5.7% (17.9%). Overall lending to corporates came to NOK 40.2bn in 2011.

Lending to retail customers accounted for 58% (57%) of ordinary loans to customers in 2011.

### High growth in both retail and corporate customer deposits

In the last 12 months customer deposits rose by NOK 5.1bn (NOK 5.6bn) or 11.9% (14.9%) to NOK 47,9bn.

Retail customer deposits rose by NOK 1.8bn (NOK 1.2bn) or 9.5% (6.5%) to NOK 20.9bn, while deposits from corporates rose by NOK 3.3bn (NOK 4.4bn) or 14.1% (22.8%) to NOK 27.0bn. Substantially higher corporate deposits are in part ascribable to an increased focus on institutions and foundations.

### Reduced values for investment products

Off-balance sheet investment products totalled NOK 4.6bn (NOK 5.1bn) at end-2011. Some decline was seen in portfolio values during the autumn, bringing the total decline since 2010 to NOK 473m.

Saving products, customer portfolio, NOKm	2011	2010	Change
Equity funds	2,284	2,416	-132
Pension products	711	876	-165
Active management	941	1,018	-77
Energy fund management	218	317	-99
Property funds	447	447	0
<b>Total</b>	<b>4,601</b>	<b>5,074</b>	<b>-473</b>

### Sound growth in the Bank's insurance portfolio

The Bank's insurance portfolio grew by 9% in the last 12 months, with a rise of 10% for non-life and 13% for personal insurance. A 3% increase was recorded on the occupational pensions portfolio.

Insurance, premium volume, NOKm	2011	2010	Change
Non-life insurance	621	567	54
Personal insurance	175	155	20
Occupational pensions	129	125	4
<b>Total</b>	<b>925</b>	<b>847</b>	<b>78</b>



### Profitability and growth in the retail market

The retail market business achieved a return on equity of 21.3% (25.5%) in 2011.

Operating income came to NOK 883m (NOK 913m) in 2011. Net interest income totalled NOK 551m (NOK 592m) and commission income NOK 333m (NOK 321m). The lending margin is under heavy pressure from intense competition and stable low interest rates, but is compensated for by high growth and an increased deposit margin.

The lending margin in 2011 was 1.22% (1.43%), while the deposit margin was 0.73% (0.54%). The margin is defined as the average customer interest rate minus the three-month moving average of three-month NIBOR.

In the last 12 months lending to retail customers rose by 10.9% (8.7%) and deposits from the same segment by 10.9% (4.3%).

Lending to retail borrowers generally carries low risk, as reflected in continued low losses. Losses and defaults are expected to remain low. The loan portfolio is secured by residential property, and the trend in house prices has been satisfactory throughout the market area.

Retail market (NOKm)	2011	2010	Change
Net interest income	551	592	-42
Commission and other income	333	321	12
Total income	883	913	-30
Operating expenses	603	468	135
Pre-loss profit	280	445	-165
Losses	7	4	3
<b>Profit before tax</b>	<b>273</b>	<b>441</b>	<b>-168</b>
<b>ROE after tax</b>	<b>21.3 %</b>	<b>25.5 %</b>	
Allocated capital (NOK mill)	890	1,031	
Loans (NOKbn)	52.1	46.9	5.1
Deposits (NOKbn)	21.2	19.1	2.1

*The Retail Market Division is part of the Parent Bank, and therefore does not include figures for the Bank's subsidiaries.*

### Income growth, low losses and reduced lending growth in the corporate market

The Corporate Market Division reported a return on equity of 13.8% (12.0%). The improvement is due mainly to increased income and reduced loan losses.

Total operating income came to NOK 1,069m in 2011 (NOK 921m).

Lending and deposit margins in the division were, respectively, 2.12% (2.14%) and 0.20% (0.26%). The margins are measured with reference to three-month NIBOR. Lending grew by 6.3% (20.7%) and deposits by 11.5% (22.1%).

Net interest income totalled NOK 900m (NOK 770m), while commission income came to NOK 169m (NOK 151m). The increase in net interest income is ascribable to a stable lending margin and high establishment commissions.

Commission incomes rose by NOK 18m. The increase is mainly related to incomes from forex transactions and fruitful collaboration with the Bank's capital markets business.

<b>Corporate market (NOKm)</b>	<b>2011</b>	<b>2010</b>	<b>Change</b>
Net interest income	900	770	130
Commission and other income	169	151	18
<b>Total income</b>	<b>1,069</b>	<b>921</b>	<b>148</b>
Operating expenses	352	278	73
Pre-loss profit	717	642	75
Losses	5	104	-99
<b>Profit before tax</b>	<b>712</b>	<b>539</b>	<b>174</b>
<b>ROE after tax</b>	<b>13.8 %</b>	<b>12.0 %</b>	
Allocated capital (NOK mill)	2,873	2,869	
Loans (NOKbn)	38.7	36.4	2.3
Deposits (NOKbn)	25.3	22.7	2.6

*The Corporate Market Division is part of the Parent Bank, and therefore does not include figures for the Bank's subsidiaries.*

### Income growth for SpareBank 1 SMN Markets

SpareBank 1 SMN Markets delivers a complete range of capital market products and services, and has strengthened staffing in its forex and corporate finance areas. It has also set up in Ålesund.

SpareBank 1 Markets reported total income of NOK 139,1m (NOK 93,4m) in 2011. Activity was high in all business areas, and this bore fruit especially in the second half-year with substantial income growth.

<b>Markets (NOKm)</b>	<b>2011</b>	<b>2010</b>	<b>Change</b>
Currency trading	53.8	45.2	8.6
Fixed income products	42.2	16.5	25.7
Corporate	14.6	20.0	-5.4
Securities, brokerage commission	17.4	12.7	4.7
Investments	11.1	-1.0	12.1
<b>Total income</b>	<b>139.1</b>	<b>93.4</b>	<b>45.7</b>

*Of gross income of NOK 139m, a total of NOK 36m and NOK 6m respectively was transferred to the corporate market and retail market divisions. These figures are the respective divisions' share of incomes from forex and fixed income transaction on their own customers.*

### Subsidiaries

The Bank's subsidiaries posted an aggregate pre-tax profit of NOK 167.8m (NOK 73.9m) in 2011.

<b>Pre-tax profit, NOKm</b>	<b>2011</b>	<b>2010</b>	<b>Change</b>

EiendomsMegler 1 Midt-Norge	75.6	50.8	24.8
SpareBank 1 SMN Finans	26.3	35.1	-8.8
SpareBank 1 SMN Regnskap	5.0	11.4	-6.4
Allegro Finans	-5.3	2.2	-7.5
SpareBank 1 SMN Invest	87.5	-21.6	109.1
SpareBank 1 Kvartalet	-21.3	-4.0	-17.3
<b>Total</b>	<b>167.8</b>	<b>73.9</b>	<b>93.9</b>

**Eiendomsmegler 1 Midt-Norge** leads the field in its catchment area with a market share of some 40%. Profit growth in 2011, as previously, was very good, and the company recorded a pre-tax profit of NOK 75.6m (NOK 50.8m) in 2011.

**SpareBank 1 SMN Finans** posted a profit of NOK 26.3m (NOK 35.1m) in 2011. At year-end the company managed leases and car loan agreements worth a total of NOK 2.9bn of which leases accounted for NOK 1.9bn.

**SpareBank 1 SMN Regnskap** posted a pre-tax profit of NOK 5.0m (NOK 11.4m). The company increased its turnover by NOK 32m to NOK 83m compared with 2010. SpareBank 1 SMN Regnskap wrote back AFP (early retirement scheme) liabilities worth NOK 5.9m in 2010. In 2012 the company acquired 40% of the shares of the accounting chain Consis. The remaining 60% are owned by Sparebanken Hedmark.

**Allegro Finans** reported a loss of NOK 5.2m (profit of NOK 2.2m) before tax in 2011. The company has a portfolio of about NOK 2bn under active management.

The mission of **SpareBank 1 SMN Invest** is to invest in shares, mainly in regional businesses. The company posted a profit of NOK 87.5m in 2011 (loss of NOK 21.6m) as a result of capital gains on its share portfolio, the main contributor being the rise in the market price of Det norske oljeselskap (included in net change in value of financial assets in the Group's income statement).

### Satisfactory funding and good liquidity

The Bank has a conservative liquidity strategy. This strategy stresses the importance of maintaining liquidity reserves sufficient to ensure the Bank's ability to conduct ordinary operations for a period of 12 months without recourse to new external funding.

The Bank has liquidity reserves of NOK 17bn, which corresponds to the funding needed for 18 months including expected lending growth and ordinary operations.

The Bank's funding sources and products are amply diversified. At year-end the proportion of money market funding in excess of 1 year was 81% (79%).

SpareBank 1 Boligkreditt is the Bank's chief source of funding, and in 2011 loans totalling NOK 4.3bn were transferred to this residential mortgage company. As of end-2011 loans totalling NOK 22bn had been transferred to SpareBank 1 Boligkreditt.

### Good financial position

As of end-2011 the tier 1 capital ratio was 10.4% (10.9%) and the total capital ratio was 12.0% (13.0%).

The Group aims for a tier 1 capital ratio of 11% and a total capital ratio of 12%. The tier 1 target was revised in autumn 2011 in light of the foreshadowed increase in regulatory capital requirements.

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

Figures in NOKm	2011	2010
Tier 1 capital	7,856	7,283
Subordinated loan	1,199	1,360
<b>Capital base</b>	<b>9,055</b>	<b>8,643</b>
<b>Required subordinated debt</b>	<b>6,027</b>	<b>5,335</b>
<b>Tier 1 capital ratio</b>	<b>10.4 %</b>	<b>10.9 %</b>
<b>Total capital ratio</b>	<b>12.0 %</b>	<b>13.0 %</b>

### The Bank's primary capital certificate (MING)

The book value of the Bank's ECC was NOK 54.44 (NOK 50.60) at end-2011, and earnings per ECC were NOK 6.61 (NOK 6.43).

The Price / Income ratio was 5.94 (8.40), and the Price / Book ratio 0.72 (1.07).

The price at year-end was NOK 39.30, and a dividend of NOK 3.00 per ECC was paid in 2011 for the year 2010.

### Stock issues

The Bank's Board of Directors has resolved to recommend the Supervisory Board to approve a rights issue of up to NOK 750m in favour of existing owners.

The Board of Directors also recommends the launch of a placing of up to NOK 200m with the foundation, Sparebankstiftelsen SpareBank 1 SMN.

The Board of Directors also recommends a placing with employees in the Group and board members. The amount of this placing will be up to NOK 60m.

The Bank's objective with the proposed capital increase is to strengthen the bank's Tier 1 capital and the financial platform for profitable growth and for capitalising on business opportunities in the bank's market area. The Bank sees value in giving its employees and board members the opportunity to subscribe through a private placement. In line with the bank's strategy at the establishment of the savings bank foundation, Sparebankstiftelsen SpareBank 1 SMN, a private placement towards the savings bank foundation is proposed.

The issues will strengthen the Group's tier 1 capital ratio by about 1.2 percentage points up to 11.6%. The common tier 1 ratio excluding hybrid capital will increase up to 10.1% after the issues.

### Risk factors

The international financial crisis affected the economy of Norway as of other countries. Unemployment subsided in 2010 and into 2011, but showed signs of levelling in summer 2011. Forecasts indicate continued low unemployment ahead. This, together with an expectation of continued low interest rates, suggests little risk of increased losses on the retail market.

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

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

The credit quality of the Bank's loan portfolio is satisfactory, and loss and default levels are low. The cooling of the Norwegian economy as from 2008 brought increased loss levels in Norwegian financial institutions, but the last two years have again shown falling loss levels among banks.

The continuing turmoil in global financial markets makes economic framework conditions increasingly uncertain, and growth impulses from a debt-stricken EU are very weak which, although offset by domestic growth, will make for low export growth. Mid-Norwegian businesses anticipate reduced growth.

Although Norwegian banks are negligibly exposed to the PIIGS countries, the disquiet associated with European banks' loss risk may cause lack of confidence to feed through to Norwegian banks. New tier 1 capital requirements from the European Banking Authority are prompting substantial stock issues in Europe, at the same time as financial institutions are likely to deleverage in order to meet the new capital targets. There is a risk that deleveraging will compound uncertainty and volatility, and that the Bank's opportunity to access foreign funding will continue to be affected in the period ahead.

#### **Outlook ahead**

Prospects for the international economy are demanding. The consequences for business in the Bank's market area have thus far been limited. This is as reflected by low levels of defaults and losses in the Bank's portfolio.

The Board of Directors is prepared possible changes in the situation. Unemployment is however low and there are few signs in the region's macroeconomy in isolation of any change in the risk picture for 2012.

The Bank's objective with the proposed capital increase is to further strengthen the Bank's core capital and thus be positioned for capitalising on business opportunities. The Bank is also very well funded.

The Bank has a strong market position. To reinforce this position the Board of Directors has resolved to launch a programme with the aim of further strengthening the Group's customer orientation.

The Board of Directors is satisfied with the Group's profit for 2011. SpareBank 1 SMN has a sound basis for achieving a good profit performance in 2012 as previously.

Trondheim, 1 February 2012

The Board of Directors of SpareBank 1 SMN

Per Axel Koch  
Chair

Eli Arnstad  
Deputy chair

Paul E. Hjelm-Hansen

Aud Skrudland

Bård Benum

Kjell Bjordal

Arnhild Holstad

Venche Johnsen  
Employee rep.

Finn Haugan  
Group CEO