Note 10 - Capital adequacy

New capital adequacy rules were introduced in Norway as from 1 January 2007 (Basel II - the EU's new directive on capital adequacy). SpareBank1 SMN applied to and received permission from Finanstilsynet (Financial Supervisory Authority of Norway) to use internal rating methods (Internal Rating Based Approach - Foundation) to calculate charges for credit risk from 1 January 2007 onwards. This will make the statutory minimum capital adequacy requirement more risk-sensitive, so that it better reflects the risk in the underlying portfolios. Using IRB demands high standards of the Bank's organisation, competence, risk models and risk management systems. Under interim regulations issued by Finanstilsynet, IRB banks are not yet seeing the full effect of the reduced capital requirements. As from 2009, a 20% reduction of the risk-weighted basis of calculation was allowed.

The Norwegian State Finance Fund has in a period to 30 September 2009 offered tier 1 capital to solid Norwegian banks to help them meet tighter capital adequacy requirements and improve their lending capacity. SMN applied for, and was granted, a capital infusion which was disbursed from the State Finance Fund in the form of hybrid equity worth NOK 1.25 billion as of 30.9.09. In March 2010, with Finanstilsynet's approval, this was partially redeemed in an amount of NOK 450 million, and the remainder was repaid in April 2010.

Subordinated debt ranks behind all other liabilities. Dated subordinated loans are eligible at a maximum of 50% of tier 1 capital for capital adequacy purposes, while perpetual subordinated loans are eligible at a maximum of 100% of tier 1 capital. Subordinated loans are classified as a liability in the balance sheet and are measured at amortised cost in the same way as other long-term loans.

Hybrid capital denotes bonds with a nominal interest rate, but the bank is not obliged to pay interest in a period where dividends are not paid, and neither is the investor subsequently entitled to interest that has not been paid, i.e. interest does not accumulate. Hybrid capital is approved as an element of tier 1 capital up to limit of 15% of aggregate tier 1 capital. Finanstilsynet (Norway's FSA) can require hybrid capital to be written down in proportion with equity capital should the bank's tier 1 capital adequacy fall below 5% or total capital adequacy falls below 6%. Written-down amounts on hybrid capital must be written up before dividends can be paid to shareholders or before equity capital is written up. Hybrid capital is shown as other long-term debt at amortised cost.

For detailed information about subordinated debt and hybrid capital, see note 34 in the Bank's annual report.

Parent bank				Group		
31 Dec 2010	31 March 2010	31 March 2011		31 March 2011	31 March 2010	31 Dec 2010
2,373	1,736	2,373	Equity capital certificates	2,373	1,736	2,373
0	-2	0	- Own holding of ECCs	0	-2	0
182	0	182	Premium fund	182	0	182
1,159	877	1,160	Dividend equalisation fund	1,160	877	1,159
2,345	2,155	2,345	Savings bank's reserve	2,345	2,155	2,345
285	27	0	Recommended dividends	0	27	285
192	0	0	Provision for gifts	0	0	192
45	110	45	Unrealised gains reserve	75	124	66
0	0	0	Other equity and minority interest	1,250	1,115	1,244
0	178	172	Net profit	255	188	0
6,581	**5,081**	**6,276**	**Total book equity**	**7,639**	**6,219**	**7,846**
-447	-447	-447	Deferred taxes, goodwill and other intangible assets	-643	-481	-466
0	0	0	Part of reserve for unrealised gains, associated companies	65	0	65
-477	-27	0	Deduction for allocated dividends and gifts	0	-27	-477
-348	-374	-343	50 % deduction for subordinated capital in other financial institutions	0	0	0
-208	-218	-140	50 % deduction for expected losses on IRB, net of write-downs	-90	-218	-216
0	0	0	50 % capital adequacy reserve	-626	-374	-571
0	0	0	Share of non-performing, non-amortizsed estimate deviations	0	0	0
0	-178	-172	Net profit	-255	-188	0
0	120	86	Year-to-date profit included in core capital (50% pre tax)	126	128	0
936	922	898	Hybrid capital, core capital	1,114	1,022	1,106
0	800	0	State Finance Fund, core capital	0	800	0
6,037	**5,679**	**6,158**	**Total core capital**	**7,330**	**6,880**	**7,283**
			Supplementary capital in excess of core capital			
0	16	0	Hybrid capital, supplementary capital	0	0	0
0	0	0	State Finance Fund, supplementary capital	0	0	0
466	456	452	Perpetual subordinated capital	452	456	466
1,358	1,278	1,306	Non-perpetual subordinated capital	1,571	1,674	1,680
-348	-374	-343	50 % deduction for subordinated capital in other financial institutions	0	0	0
-208	-218	-140	50 % deduction for expected losses on IRB, net of write-downs	-90	-218	-216
0	0	0	50 % capital adequacy reserve	-626	-374	-571
1,268	**1,158**	**1,276**	**Total supplementary capital**	**1,308**	**1,539**	**1,360**
7,305	**6,837**	**7,434**	**Net subordinated capital**	**8,638**	**8,418**	**8,643**
			Minimum requirements subordinated capital, Basel II			
1,386	1,274	1,389	Involvement with spesialised enerprises	1,389	1,274	1,386
1,115	1,112	1,161	Other corporations exposure	1,168	1,116	1,120
66	53	62	SME exposure	64	55	68
311	308	298	Retail morgage exposure	450	442	451
33	46	31	Other retail exposure	32	47	34
496	709	568	Equity investments	0	147	0
3,406	**3,501**	**3,509**	**Total credit risk IRB**	**3,103**	**3,080**	**3,058**
165	0	176	Debt risk	176	0	165
46	50	44	Equity risk	15	15	15
0	0	0	Currency risk	0	0	0
275	275	293	Operational risk	400	331	331
537	373	532	Exposures calculated using the standardised approach	1,949	1,640	1,864
-59	-63	-58	Deductions	-106	-67	-98
0	0	0	Transitional arrangements	0	0	0
4,371	**4,137**	**4,497**	**Minimum requirements subordinated capital**	**5,537**	**4,999**	**5,335**
			Capital adequacy			
11.05 %	10.98 %	10.95 %	Core capital ratio	10.59 %	11.01 %	10.93 %
13.37 %	13.22 %	13.22 %	Capital adequacy ratio	12.48 %	13.47 %	12.97 %