Note 13 - Capital adequacy

SpareBank 1 SMN has used the IRB - Foundation approach for credit risk since January 2007. Use of IRB makes wide ranging demands on the Bank’s organisation, competence, risk models and risk management systems. The effect of the risk weights under IRB is limited by transitional rules laid down in regulations issued by Finanstilsynet (Norway’s FSA). The transitional rules are assumed to apply to the end of 2017.

Subordinated debt ranks behind all other debt. Dated subordinated debt cannot make up more than 50 per cent of tier 1 capital for capital adequacy purposes, while perpetual subordinated debt cannot make up more than 100 per cent of tier 1 capital. Subordinated debt is classified as a liability in the balance sheet and is measured at amortised cost like other long-term debt.

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 characterised by moderate repayment incentives is approved as an element of tier 1 capital up to limit of 15 per cent of aggregate tier 1 capital. If however hybrid capital does not have a fixed term and is without repayment incentives, it can be included as an element of up to a limit of 35 per cent 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 per cent or total capital adequacy falls below 8 per cent. 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 recognised as other long-term debt at amortised cost.

For detailed information regarding subordinated debt and hybrid capital, see note 5 in the bank’s annual report.

As from second quarter 2013 the method of quantifying operational risk was changed from the basic indicator approach to the standardised approach at the parent bank. At Group level the basic indicator approach is still applied to subsidiaries.

Finanstilsynet announced in May 2013 changed capital requirements with effect from 1 July 2013. The new requirements are a common equity tier 1 ratio of 9 per cent, a tier 1 ratio of 10.5 per cent and a total capital ratio of 12.5 per cent.

Parent bank				Group		
2012	30 Sep 2012	30 Sep 2013	(NOKm)	30 Sep 2013	30 Sep 2012	2012
2,597	2,597	2,597	Equity capital certificates	2,597	2,597	2,597
-0	-0	-0	- Own holding of ECCs	-0	-0	-0
895	896	895	Premium fund	895	896	895
1,889	1,457	1,889	Dividend equalisation fund	1,889	1,457	1,889
2,944	2,611	2,944	Savings bank's reserve	2,944	2,611	2,944
195	-	-	Recommended dividends	-	-	195
30	-	-	Provision for gifts	-	-	30
106	70	106	Unrealised gains reserve	123	94	123
0	-	38	Other equity and minority interest	1,377	1,295	1,370
-	801	1,089	Net profit	1,038	816	-
8,656	**8,431**	**9,557**	**Total book equity**	**10,863**	**9,765**	**10,042**
-447	-447	-447	Deferred taxes, goodwill and other intangible assets	-589	-701	-674
-	-	-	Part of reserve for unrealised gains, associated companies	57	64	57
-225	-	-	Deduction for allocated dividends and gifts	-	-	-238
-448	-460	-399	50 % deduction for subordinated capital in other financial institutions	-90	-2	-2
-165	-199	-234	50 % deduction for expected losses on IRB, net of write-downs	-210	-211	-179
-	-	-	50 % capital adequacy reserve	-554	-714	-703
-55	-82	-109	Surplus financing of pension obligations	-107	-74	-49
-	-801	-1,089	Net profit	-1,038	-816	-
-	400	795	Year-to-date profit included in core capital (as from 2013 73% pre tax - previous 50% pre tax)	758	408	-
7,316	**6,843**	**8,075**	**Total common equity Tier one**	**9,089**	**7,717**	**8,254**
918	931	1,431	Hybrid capital, core capital	1,619	1,108	1,103
8,234	**7,773**	**9,506**	**Total core capital**	**10,707**	**8,826**	**9,357**
			Supplementary capital in excess of core capital			
-	-	-	State Finance Fund, supplementary capital	28	37	31
312	325	307	Perpetual subordinated capital	307	323	312
1,810	1,368	1,602	Non-perpetual subordinated capital	1,866	1,633	2,127
-448	-460	-399	50 % deduction for subordinated capital in other financial institutions	-90	-2	-2
-165	-199	-234	50 % deduction for expected losses on IRB, net of write-downs	-210	-211	-179
-	-	-	50 % capital adequacy reserve	-554	-714	-703
1,509	**1,033**	**1,277**	**Total supplementary capital**	**1,346**	**1,066**	**1,586**
9,742	**8,807**	**10,783**	**Net subordinated capital**	**12,053**	**9,891**	**10,943**
			Minimum requirements subordinated capital, Basel II			
1,654	1,647	1,592	Involvement with spesialised enterprises	1,592	1,647	1,654
1,470	1,686	1,442	Other corporations exposure	1,443	1,686	1,470
39	38	70	SME exposure	76	41	42
316	309	336	Retail morgage exposure	591	532	560
28	28	31	Other retail exposure	35	30	30
1,118	1,087	1,076	Equity investments	-	-	-
4,625	**4,796**	**4,548**	**Total credit risk IRB**	**3,736**	**3,937**	**3,756**
205	209	225	Debt risk	225	209	205
14	14	11	Equity risk	13	15	15
-	-	-	Currency risk	-	-	-
315	315	297	Operational risk	398	420	420
553	659	590	Exposures calculated using the standardised approach	2,135	2,178	2,074
-75	-76	-67	Deductions	-110	-121	-120
-	-	-	Transitional arrangements	403	-	246
5,637	**5,916**	**5,604**	**Minimum requirements subordinated capital**	**6,802**	**6,638**	**6,596**
70,468	73,950	70,051	Risk weigheted assets (RWA)	85,019	82,976	82,446
			Capital adequacy			
10.4 %	9.3 %	11.5 %	Common equity Tier one ratio	10.7 %	9.3 %	10.0 %
11.7 %	10.5 %	13.6 %	Core capital ratio	12.6 %	10.6 %	11.3 %
13.8 %	11.9 %	15.4 %	Capital adequacy ratio	14.2 %	11.9 %	13.3 %