

Report of the Board of Directors

Accounts for the nine months ended 30 September 2014

(Consolidated figures. Figures in parentheses refer to the same period of 2013 unless otherwise stated).

- Pre-tax profit: NOK 1,709m (1,282m)
- Net profit: NOK 1,407m (1,038m)
- Return on equity: 16.1 per cent (13.3 per cent)
- Growth in lending: 5.4 per cent (6.7 per cent) last 12 months, growth in deposits: 8.5 per cent (5.1 per cent) last 12 months
- Loan losses: NOK 55m (68m)
- CET1 capital adequacy: 11.5 per cent (10.7 per cent)
- Earnings per EC: NOK 6.97 (5.13)

Third quarter accounts 2014

- Pre-tax profit: NOK 545m (501m)
- Net profit: NOK 443m (433m)
- Return on equity: 14.8 per cent (16.3 per cent)
- Loan losses: NOK 24m (30m)
- Earnings per EC: NOK 2.19 (2.14)

Excellent performance in first nine months of 2014

Highlights:

- Profit improvement of NOK 368m compared with the same period last year. Strengthened core business with increased net interest income and limited cost growth
- Low loan losses and a low level of defaults
- Good return on financial investments, mainly from a gain on the sale of the bank's shares in Nets Holding, taken to income essentially in the first quarter
- Financial position in keeping with the Group's capital plan: CET1 ratio 11.5 per cent
- Reduced growth in lending to corporates and retail customers alike, and increased deposit growth

In the first nine months of 2014 SpareBank 1 SMN achieved a pre-tax profit of NOK 1,709m (1,282m). Net profit came to NOK 1,407m (1,038m) and return on equity was 16.1 per cent (13.3 per cent).

Pre-tax profit in the third quarter in isolation was NOK 545m (501m). Return on equity in the same period was 14.8 per cent (16.3 per cent).

Operating income in the first nine months totalled NOK 2,446m (2,261m), an increase of NOK 185m compared with the same period of 2013. Operating income rose both at the parent company and subsidiaries.

Return on financial investments in the first nine months was NOK 629m (346m), of which total income from owner interests in affiliates accounted for NOK 383m (256m).

Operating expenses came to NOK 1,310m (1,256m) in the first nine months of 2014, which was NOK 53m or 4.2 per cent higher than in 2013 .

Net losses on loans and guarantees totalled NOK 55m (68m).

As of 30 September 2014, 12-month lending growth was 5.4 per cent (6.7 per cent) and deposit growth was 8.5 per cent (5.1 per cent). Overall lending growth in the first nine months was 3.7 per cent (5.1 per cent) and overall deposit growth was 3.4 per cent (2.2 per cent).

Capital adequacy as of the third quarter is measured under the new capital requirements directive (CRD IV), described in note 13, Capital Adequacy. Common equity Tier 1 (CET1) capital at quarter-end was 11.5% (10.7%), having strengthened in the quarter by 0.1 percentage point. A good result for the period has strengthened CET1 capital adequacy, at the same time as one-time effects related to the implementation of CRD IV have brought an increase in risk weighted assets.

SpareBank 1 SMN is planning for a CET1 ratio of 13.5 per cent by 30 June 2016. SpareBank 1 SMN's capital plan is further described in the section on financial strength.

The bank's EC was priced at NOK 59.25 (55.00 at year-end 2013).

Earnings per EC in the first nine months were NOK 6.97 (5.13) and book value per EC was NOK 60.53 (53.76).

Strengthened net interest income

Net interest income came to NOK 1,305m in the first nine months (1,180m). The improvement is ascribable to interest rate increases on loans to both retail and corporate customers in the first half of 2013 as a result of higher capital requirements. Net interest income for the third quarter was NOK 463m, an increase of NOK 33m from the second quarter. The increase in the third quarter is mainly ascribable to higher loan and deposit volumes and repricing of some deposit products in the third quarter. Margins on loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt are recorded as commission income, and commissions on loans sold to the two companies in the first nine months of 2014 totalled NOK 329m (302m).

In March the bank adopted a reduction in its lending rate on selected home mortgage loans, and a reduction in its deposit rate on some deposit products. The net profit effect on an annual basis is calculated at a negative NOK 30m. The rate changes had effect as from mid-June 2014. A further interest rate reduction has been decided on home mortgage loans and retail deposits with effect from 1 December 2014, which will bring a small decline in the bank's net interest income.

The bank's deposit margins have been on a downward trend for a long period. In addition to the changes mentioned above, repricing of corporate deposits continues in order to gain a better balance between what the bank pays for deposits and the cost of market funding.

Increased commission income

Commission income and other operating income rose to NOK 1,140m (1,081m) in the first nine months of 2014, an increase of NOK 60m or 5 per cent. The increase is due mainly to increased income from SpareBank 1 Boligkreditt as a result of increased margins on home mortgage loans and increased income from accounting services.

Commission income (NOKm)	30 Sep 2014	30 Sep 2013	Change
Payment transfers	179	169	9
Savings	34	36	-3
Insurance	101	92	9
Guarantee commission	45	40	4
Real estate agency	239	255	-16
Accountancy services	134	96	39
Active management	11	9	2
Rent	32	32	0
Other commissions	37	48	-11
Commissions ex SB1 Boligkreditt and SB1 Næringskreditt	811	778	33
Commissions SB1 Boligkreditt and SB1 Næringskreditt	329	302	26
Total commissions	1,140	1,081	60

Financial investments

Overall return on financial investments (excluding the bank's share of the profit/loss of affiliates and joint ventures) in the first nine months of 2014 was NOK 245m (90m). This breaks down as follows:

- Return on the Group's share portfolios totalled NOK 216m (45m) of which the gain on the sale of and dividend on the bank's stake in Nets Holding amounted to 165m
- Net loss on bonds and derivatives in the first nine months was NOK 18m (net loss of 14m)
- Gains on foreign-exchange and fixed-income trading at SpareBank 1 SMN Markets was NOK 46m(58m)

Capital gains/dividends, shares (NOKm)	30 Sep 2014	30 Sep 2013	Change
Capital gains/dividends, shares	216	45	171
Bonds and derivatives	-18	-14	-5
SpareBank 1 SMN Markets	46	58	-12
Net return on financial investments	245	90	155
SpareBank 1 Gruppen	259	153	106
SpareBank 1 Markets	-22	-	-22
SpareBank 1 Boligkreditt	23	25	-3
SpareBank 1 Næringskreditt	30	5	26
BN Bank	78	75	3
Other jointly controlled companies	18	-	18
Income from investment in related companies	-3	-2	-1
Affiliates	383	256	127
Total	629	346	282

SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit in the first nine months of 2014 was NOK 1,343m (820m). The main contributor to the profit growth is the insurance business. The profit achieved by the non-life insurance arm is particularly good due to reduced compensation payments and recognition of gains from previous years' surplus of claims provisions over claims made. In addition, SpareBank 1 Gruppen's accounts are debited with a write-down of NOK 147m at SpareBank 1 Markets carried out in the second quarter of 2013. SpareBank 1 SMN's share of the profit in the first nine months of 2014 was NOK 259m (153m).

SpareBank 1 Markets

SpareBank 1 SMN has a stake of 27.3 per cent in SpareBank 1 Markets. The company's result for the first nine months was a deficit of NOK 86m. SpareBank 1 SMN's share was a negative 22m.

SpareBank 1 Markets has undergone a restructuring. The company has implemented wide-ranging improvement measures, thereby halving its cost level since 2012-2013, and adjustments to the business

model have brought lower market risk. SpareBank 1 SMN will integrate its capital market activities with SpareBank 1 Markets by agreement with the other owners, after which SpareBank 1 SMN will hold a stake of 73.3 per cent. The other ownership interests are as follows: SpareBank 1 Nord-Norge (10 per cent), SamSpar (Collaborating Savings Banks, 10.0 per cent), Sparebanken Hedmark (6.1 per cent) and the Norwegian Trade Union Confederation and employee shareholders (0.6 per cent).

SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt AS was established by the banks participating in the SpareBank 1-alliansen to benefit from the market for covered bonds. The banks sell their best secured home mortgage loans to the company, thereby achieving reduced funding costs and greater competitive power. As of 30 September 2014 the bank had sold loans worth a total of NOK 28.5bn to SpareBank 1 Boligkreditt (29.5bn), corresponding to 39 per cent (44 per cent) of total outstanding loans to retail borrowers.

The bank's stake in SpareBank 1 Boligkreditt is 17.5 per cent, and the bank's share of that company's profit in the first nine months of 2014 was NOK 23m (25m). The bank's stake reflects the bank's relative share of home mortgage loans sold.

The board of directors of SpareBank 1 SMN have like other alliance banks resolved to apply for a licence for a wholly-owned residential mortgage company. This company will be a supplement to SpareBank 1 Boligkreditt which remain the alliance banks' main instrument for borrowing through covered bonds. The residential mortgage company will be entitled to utilise loans beyond SpareBank 1 Boligkreditt's credit policy. Moreover, the establishment of a wholly-owned residential mortgage company will eliminate the issue posed by the regulations on large exposures which regulate maximum outstandings between SpareBank 1 SMN and SpareBank 1 Boligkreditt.

SpareBank 1 Næringskreditt

SpareBank 1 Næringskreditt was established along the same lines, and with the same administration, as SpareBank 1 Boligkreditt. As of end-September 2014, loans worth NOK 1.2bn (0.9bn) had been sold to SpareBank 1 Næringskreditt.

SpareBank 1 SMN's stake in the company is 33.7 per cent, and the bank's share of the company's profit in the first nine months of 2014 was NOK 30m (5m). The bank's stake reflects its relative share of commercial property loans transferred and the bank's stake in BN Bank. The profit growth is ascribable to the change in the interest rate applied between Næringskreditt and BN Bank. This rate reflects the capital cost for BN Bank's loans sold to Næringskreditt.

BN Bank

SpareBank 1 SMN has a 33 per cent stake in BN Bank as of 30 September 2014. SpareBank 1 SMN's share of the profit of BN Bank in the first nine months of 2014 was NOK 78m (75m), yielding a return on equity of 8.8 per cent. The profit is affected by the changed interest rate mentioned in the preceding section.

BN Bank's focus is on implementing profitability-enhancing measures, and it has achieved increased income and reduced losses since the same period last year. Work continues on further internal measures with a view to profitability enhancement. BN Bank received approval to apply the advanced IRB approach to its corporate portfolio in April 2014. This resulted in a CET1 ratio of 15.0 per cent at end-September 2014.

Other companies

The overall profit of NOK 15m in the first nine months of 2014 mainly comprises SpareBank 1 SMN's profit share in property companies owned by SpareBank 1 SMN Invest.

SpareBank 1 Kredittkort's profit share is included in "other companies". The company was in ordinary operation from 1 July 2014, and as of the third quarter had a deficit of NOK 5.1m. SpareBank 1 SMN share of the deficit as of the third quarter was NOK 0.9m. SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 18.1 per cent. In June SpareBank 1 Kredittkort carried out a successful conversion of the SpareBank 1 banks' credit card portfolio from Entercard. SpareBank 1 SMN's share of the portfolio is NOK 715m. In the third quarter SpareBank 1 Kredittkort achieved a net profit of NOK 23.2m, of which SpareBank 1 SMN's share in that quarter was NOK 4.2m. A positive profit performance is expected for the company for the year 2014.

Assets held for sale

A negative net profit of NOK 0.3m (33.9m) was recorded on assets held for sale in the first nine months of 2014. The 2013 figure of NOK 33.9m refers mainly to a gain realised on disposal of units in offshore vessels.

Operating expenses

Overall costs came to NOK 1,310m (1,256m) in the first nine months of 2014. Group costs have risen by NOK 54m or 4.2 per cent compared with the first nine months of 2013.

For the subsidiaries, overall cost growth was NOK 24m or 6.4 per cent. The growth is largely attributable to an increased cost base at SpareBank 1 Regnskapshuset SMN following company acquisitions.

The board of directors has adopted a new target for the bank's cost trend, i.e. zero growth in the bank's nominal costs in the years 2015 and 2016. This presupposes efficiency gains at the parent bank and a need to reduce the number of FTEs in the period to the turn of the year 2016-2017. In this connection consideration will in the fourth quarter be given to provisioning for reorganisation costs.

The parent bank has reduced the number of permanent FTEs by about 40 since the start of 2013. Permanent FTEs totalled 758 as of end-September 2014.

Operating expenses measured 1.51 per cent (1.51 per cent) of average total assets. The Group's cost-income ratio was 43 per cent (48 per cent).

Low losses and low defaults

Net loan losses came to NOK 55m (68m) in the first nine months of 2014. Net losses in the third quarter in isolation were NOK 24m (30m).

A net loss of NOK 48m (loss of 64m) was recorded on loans to corporates in the same period, including losses at SpareBank 1 SMN Finans of NOK 4m (11m).

On the retail portfolio, a net loss of NOK 7m (5m) was recorded in the first nine months of 2014.

Individually assessed loan impairment write-downs on the balance sheet totalled NOK 182m (168m) in the first nine months of 2014.

Total problem loans (defaulted and doubtful) came to NOK 544m (600m), or 0.47 per cent (0.54 per cent) of gross loans including loans transferred to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

Defaults in excess of 90 days totalled NOK 338m (391m). Defaults measure 0.29 per cent (0.35 per cent) of gross lending. Of overall defaults, NOK 92m (79m) are loss provisioned, corresponding to 27 per cent (20 per cent).

Defaults break down to NOK 177m (247m) on corporate customers and NOK 161m (144m) on retail customers.

Other doubtful exposures totalled NOK 206m (209m), 0.18 per cent (0.19 per cent) of gross lending. Individually assessed write-downs on these exposures totalled NOK 90m (89m) corresponding to a share of 43 per cent (43 per cent).

Other doubtful exposures break down to NOK 192m (193m) on corporates and NOK 14m (16m) to the retail segment.

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)
- 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 conditions)

In 2014 no basis has been found for any change in collectively assessed impairment write-downs in the Group. The aggregate volume of such write-downs is NOK 295m (295m). Collectively assessed write-downs break down to NOK 90m on the retail market, NOK 188m on business and industry and NOK 16m on SpareBank 1 Finans Midt-Norge.

Total assets of NOK 117bn

The Group's assets totalled NOK 117.2bn (112.0bn) at 30 September 2014 having risen by NOK 5.2bn or 4.7 per cent over the last 12 months.

By end-September 2014 home mortgage loans worth 29.7bn (30.4bn) had been sold by SpareBank 1 SMN to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. These loans do not figure as lending in the bank's balance sheet. The comments covering lending growth include loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

Reduced growth in lending

(Distributed by sector – see note 5 and note 10)

In the last 12 months, total outstanding loans rose by NOK 6.0bn (7.0bn) or 5.4 per cent (6.7 per cent) to reach NOK 116.2bn (110.2bn) at 30 September 2014. Growth in the third quarter 2014 was 3.7 per cent (5.1 per cent).

Lending to retail customers rose by NOK 5.1bn (6.9bn) or 7.6 per cent (11.4 per cent) to reach NOK 72.5bn over the past 12 months. In 2014 growth in lending to retail customers has thus far been 5.8 per cent (7.6 per cent).

In keeping with the Group's capital plan, growth in lending to corporates has been limited; in the first nine months, twelve-month growth was NOK 859m (92m) or 2.0 per cent (0.2 per cent). Overall lending to corporates in 2014 in isolation has been 0.5 per cent (1.2 per cent).

Loans to retail customers accounted for 62 per cent (61 per cent) of total lending to customers as of 30 September 2014.

Good deposit growth

Customer deposits rose by NOK 4.5bn (2.6bn) in the last 12 months to reach NOK 58.0bn as of 30 September 2014. This represents a growth of 8.5 per cent (5.1 per cent) over the last 12 months.

Retail customer deposits rose by NOK 2.2bn (1.6bn) or 9.1 per cent (7.1 per cent) to reach NOK 25.9bn, while deposits from corporates rose by NOK 2.4bn (1.0bn) or 7.9 per cent (3.5 per cent) to NOK 32.1bn over the last 12 months.

Investment products

The overall customer portfolio of off-balance sheet investment products totalled NOK 5.7bn (4.7bn) at 30 September 2013. New sales and an increase in the value of underlying securities explain the increase on equity funds and active management portfolios.

Saving products, customer portfolio (NOKm)	30 Sep 2014	30 Sep 2013	Change
Equity funds	3,627	2,994	633
Pension products	540	555	-15
Active management	1,557	1,071	486
Energy fund management	-	79	-79
Total	5,724	4,699	1,025

Insurance portfolios

The bank's insurance portfolio grew by 5.1 per cent in the last 12 months. Non-life insurance showed 1.6 per cent growth, personal insurance 9.6 per cent and the occupational pensions portfolio 13.9 per cent growth.

Insurance, premium volume (NOKm)	30 Sep 2014	30 Sep 2013	Change
Non-life insurance	707	696	11
Personal insurance	239	218	21
Occupational pensions	188	165	23
Total	1,134	1,079	55

Retail banking segment and corporate banking segment, parent bank

Organisational readjustments are being carried out as from 2014. The retail banking segment is to cover agricultural customers, associations etc and sole proprietorships. In 2013 these customers were part of the SMB segment. Other customers in the SMB segment are included in the corporate banking segment as from 2014. Historical data for the retail segment and the corporate segment are therefore incomplete and in the following no comparison is made with the previous year's figures for each of the segments overall. Economic capital is used to calculate return on capital employed.

Results (NOKm)	Retail Market	Corporate Market
Net interest	629	621
Interest from allocated capital	33	51
Total interest income	661	672
Commission income and other income	568	121
Net return on financial investments	1	20
Total income	1,230	812
Total operating expenses	596	226
Ordinary operating profit	634	586
Loss on loans, guarantees etc.	7	44
Result before tax including held for sale	626	542
Post-tax return on equity	46.1%	23.2%

Retail Banking

Operating income has increased substantially due to increased margins on home loans on the bank's own books and on home loans sold to SpareBank 1 Boligkreditt, and totalled NOK 1,230m as of 30 September 2014. Net interest income came to NOK 661m and commission income to NOK 569m. Return on capital employed in the retail market segment was 46.1 per cent.

Retail Banking exc. agricultural customers, associations etc and sole proprietorships:

The lending margin as of 30 September 2014 was 2.34 per cent (2.27 per cent), while the deposit margin was -0.50 per cent (-0.33 per cent)(measured against three-month NIBOR). Average three-month NIBOR was unchanged from the second quarter to the third quarter.

In the last 12 months, lending to retail customers rose by 7.6 per cent (11.4 per cent) and deposits from the same segment by 9.1 per cent (7.1 per cent).

Lending to retail borrowers generally carries low risk, as reflected in continued very low losses. There are no indications of increased loss and default levels in the bank's loan portfolio. The loan portfolio is secured on residential properties, and the trend in house prices has been satisfactory in the market area.

Corporate Banking

Operating income totalled NOK 812m in the first nine months of 2014. Net interest income was NOK 672m, while commission income was NOK 141m, including NOK 20m on fixed-income and foreign exchange business. In the corporate segment, too, net interest income has risen after the portfolio was repriced in 2013.

Return on capital employed for the corporate segment was 23.2 per cent in the first nine months.

The lending margin was 2.97 per cent and the deposit margin was -0.65 per cent in the first nine months.

Lending rose by 0.3 per cent and deposits rose by 8.0 per cent over the last 12 months.

SpareBank 1 SMN Markets

SpareBank 1 Markets delivers a complete range of capital market products and services and is an integral part of the parent bank activity at SMN.

SpareBank 1 Markets recorded total income of NOK 61.3m (85.7m) as of 30 September 2014. CSD and other income as of the third quarter contains income from the corporate banking business which was transferred to SpareBank 1 Markets as from the fourth quarter of 2013.

Markets (NOKm)	30 Sep 2014	30 Sep 2013	Change
Currency trading	51.4	54.8	-3.4
Corporate	12.7	16.0	-3.3
Securities, brokerage commission	-6.9	4.7	-11.6
SpareBank 1 Markets	4.1	18.2	-14.1
Investments	-	-8.0	8.0
Total income	61.3	85.7	-24.4

Of gross income of NOK 61.3m, NOK 20m is transferred to Corporate Banking and NOK 1m to Retail Banking. These amounts are the entities' share of income deriving from own customers on forex and fixed income business.

Subsidiaries

The subsidiaries posted an aggregate pre-tax profit of NOK 148.8m (130.8m) in the first nine months of 2014 (exc. minority shares).

Pre-tax profit (NOKm)	30 Sep 2014	30 Sep 2013	Change
EiendomsMegler 1 Midt-Norge	42.2	53.3	-11.1
SpareBank 1 Finans Midt-Norge	49.9	42.6	7.3
SpareBank 1 Regnskapshuset SMN	24.1	12.2	11.9
SpareBank 1 SMN Invest	31.1	27.0	4.1
Other companies	1.6	-4.3	5.9
Total	148.8	130.8	18.0

The figures are the respective companies' comprehensive income. The bank's stake in EiendomsMegler 1 Midt-Norge is 86.98 per cent and in SpareBank 1 SMN Finans Midt-Norge 90.1 per cent.

EiendomsMegler 1 Midt-Norge leads the field in its catchment area with a market share of about 40 per cent. The company recorded a good profit performance in 2013, but a slower market at year-end and at the start of the current year brought a weaker pre-tax profit than in the same period of 2013. Profit was NOK 42.2m (53.3m).

SpareBank 1 SMN Finans posted a profit of NOK 49.9m as of 30 September 2014 (42.6m). At quarter-end the company managed leased and car loan agreements worth a total of NOK 3.5bn of which leases accounted for NOK 1.9bn and car loans for NOK 1.6bn.

SpareBank 1 Regnskapshuset SMN posted a pre-tax profit of NOK 24.1m (12.2m).

SpareBank 1 Regnskapshuset SMN has a growth strategy based on acquisition of smaller accounting firms. This represents a consolidation of a fragmented accounting industry. A further four accounting firms have been acquired in 2014.

Sparebanken SMN Invest's mission is to invest in shares, mainly in regional businesses. The company posted a pre-tax profit of NOK 31.1m in the first nine months of 2014 (27.0m). The company's profit is a consequence of value changes and realisation of losses or gains on the company's overall shareholding.

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 for 12 months of ordinary operations without requiring fresh external funding.

With liquidity reserves of NOK 17bn, the bank has the funding needed for 24 months of ordinary operations without fresh external finance.

The bank's funding sources and products are amply diversified. At quarter-end the proportion of money market funding in excess of 1 year was 87 per cent (65 per cent).

SpareBank 1 Boligkreditt is the bank's most important funding source. As of 30 September 2014 the bank had transferred loans worth a total of NOK 28.5bn (29.5bn) to SpareBank 1 Boligkreditt.

In the first quarter of 2014 SpareBank 1 SMN raised a five-year loan of EUR 500m.

Rating

SpareBank 1 SMN has a rating of A2 (negative outlook) with Moody's and a rating of A- (stable outlook) with Fitch Ratings. SMN, like a number of other Norwegian and European banks, was put on negative outlook by Moody's in May 2014.

Financial strength

CET1 capital adequacy as of 30 September 2014 was 11.5% (10.7%), an improvement of 0.1 percentage point over the quarter. CET1 capital has strengthened due to a good result for the quarter. Concurrently one-time effects of a new capital requirements directive, implemented as of the third quarter 2014, brought an increase in risk weighted assets. The minimum requirement on CET1 capital as of 30 September 2014 was 10%, of which overall buffer requirements as of 30 September accounted for 5.5%. CET1 capital is Tier 1 capital excluding hybrid capital.

Capital adequacy as of 30 September 2014 is computed under the new Capital Requirements Directive (CRD IV). The changes affect the deductions in CET1 capital and supplementary capital alike. The main rule is that all deductions are made in CET1 capital whereas previously one half was in Tier 1 capital and one half in supplementary capital. Concurrently new capital requirements are introduced for credit valuation risk.

This is further described in note 13 Capital Adequacy.

The Group has shifted lending growth more towards the retail market segment. Since this means that growth in risk-weighted assets will be lower than the underlying growth in credit, it is in isolation positive for the bank's capital charges.

A countercyclical buffer of 1 per cent will be introduced at the end of the second quarter of 2015, and the Ministry of Finance decided on 26 September 2014 that no change would be made in the buffer. This decision was in keeping with Norges Bank's recommendation.

The board of directors of SpareBank 1 SMN continually assesses the capital situation and future capital requirements. The directors consider it important for the Group to be sufficiently capitalised to fulfil all regulatory requirements, as well as the market's expectations. This means in practice that the bank's CET1 capital target remains unchanged, even though SMN was not defined as a SIFI bank. The board of directors

are planning for a CET1 ratio of 13.5 per cent, consisting of 12 per cent plus a countercyclical buffer of 1 per cent plus a reserve of 0.5 per cent.

SpareBank 1 SMN applied to use the advanced IRB approach for its corporate portfolio in June 2013. At the end of the third quarter 2014 Finanstilsynet has yet to make a decision regarding approval. The net effect of approval will be limited by the transitional rules (the “floor”).

The following are the most important measures in the Group’s capital plan:

- Continued sound banking operation through efficiency enhancements and prioritisation of profitable segments.
- The dividend policy to entail an effective payout ratio of 25–35 per cent
- Moderate growth in the bank’s asset-intensive activities, giving priority to lending to households and firms in the bank’s catchment area
- Introduction of the advanced IRB approach at SpareBank 1 SMN

SpareBank 1 SMN currently has no plans to issue equity capital, and the directors are of the view that other measures are sufficient to attain a CET1 ratio of 13.5 per cent by 30 June 2016.

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

The bank’s equity certificate (MING)

The book value of the bank’s EC at quarter-end was NOK 60.53, and earnings per EC were NOK 6.97 (5.13). At 30 September 2014 the EC was priced at NOK 59.25 (NOK 55.00 at 31 December 2013). Dividend of NOK 1.75 per EC has been paid in 2014 for the year 2013.

The Price / Income ratio was 6.38 (6.68), and the Price / Book ratio was 0.98 (0.85).

Risk factors

The credit quality of the bank’s loan portfolio is satisfactory, and loss and default levels are low.

The bank expects the cyclical recovery in Norway to continue, but to be somewhat weaker than previously assumed. This is due to moderate activity growth resulting from very weak international growth impulses. Falling oil prices bring increased uncertainty regarding developments in parts of Norwegian business and industry. The bank considers the region, and thereby the bank’s loan portfolio, to be less vulnerable than is the case for the country as a whole.

The bank has limited credit exposure to oil service related industry (about 4% of aggregate lending), an industry experiencing weaker demand. No basis has been found to carry out impairment write-downs on such exposures.

Unemployment is expected to remain at a low level in Norway and, combined with an expectation of continued low interest rates, the bank considers that loss risk in the bank’s retail portfolio will remain low. Credit demand from Norwegian households is still higher than wage growth but has diminished. The bank expects house price growth to be somewhat lower ahead. The bank also expects moderate growth in mid-Norwegian business and industry ahead.

Steadily rising capital requirements combined with uncertainty particularly regarding the countercyclical buffer and possible continuation of the floor provisions in the capital requirements regulations suggests that Norwegian banks will implement a more conservative credit policy towards business and industry.

The bank's results are affected directly and indirectly by fluctuations in the securities markets. The indirect effect relates above all to the bank's stake in SpareBank 1 Gruppen, where both the insurance business and fund management activities are affected by the 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).

Outlook ahead

The directors are well satisfied with the results for the first nine months, and expect 2014 to be a good year for SpareBank 1 SMN.

A falling oil price and somewhat more negative market sentiment have focused increasing attention on risk in banks' lending exposure. Defaults at SpareBank 1 SMN are at a very low level, and no basis has been found to increase individually or collectively assessed write-downs.

SpareBank 1 SMN expects the CET1 capital target of 13.5 per cent in 2016 to be achieved by moderate lending growth, profit retention and without an ordinary stock issue.

The bank shows sound growth in mortgage lending and house sales have picked up after a slow start in 2014. With higher mortgage lending growth than market growth, the bank is strengthening its market position.

A shift in customer behaviour towards more self-service solutions and growing automation of work processes creates a need for a new configuration of distribution of the bank's products and services.

Through the SpareBank 1-alliance, SpareBank 1 SMN has a sound platform on which to implement the system adjustments needed in a cost-efficient manner.

This is crucial to maintaining competitive power and market position. Necessary investments in technology will be undertaken at the same time as efficiency improvements are made at the bank.

The board of directors have established a new objective for the parent bank's costs which presupposes zero growth in nominal kroner for the years 2015 and 2016.

Through the SMN 2020 project new service concepts will be developed and cost levels adjusted to enable SpareBank 1 SMN to come across as best for customer experience and to maintain its competitive power.

Trondheim, 30 October
The Board of Directors of SpareBank 1 SMN

Kjell Bordal
(chair)

Bård Benum
(deputy chair)

Paul E. Hjelm-Hansen

Aud Skrudland

Morten Loktu

Janne Thyø Thomsen

Arnhild Holstad

Venche Johnsen
(employee rep.)

Finn Haugan
(Group CEO)