

# Report of the Board of Directors

## Accounts for nine months ending 30 September 2015

*(Consolidated figures. Figures in parentheses refer to the same period of 2014 unless otherwise stated)*

- Pre-tax profit: NOK 1,389 million (1,709 million)
- Post-tax profit: NOK 1,119 million (1,407 million)
- Return on equity: 11.5 per cent (16.1 per cent)
- Growth in lending 8.3 per cent (5.4 per cent) and deposits 9.5 per cent (8.5 per cent) in past 12 months
- Loan losses NOK 112 million (55 million)
- CET1 capital ratio: 13.2 per cent (11.5 per cent)
- Earnings per equity certificate: NOK 5.57 (6.97)

## Accounts for third quarter 2015

- Pre-tax profit: NOK 309 million (545 million)
- Post-tax profit NOK 248 million (443 million)
- Return on equity: 7.4 per cent (14.8 per cent)
- Loan losses: NOK 56 million (24 million), of which NOK 30 million are increased collectively assessed write-downs
- Earnings per equity certificate: NOK 1.26 (2.19)

## Third quarter results 2015 reflect turbulent markets

### Main points:

- Good performance for core business
- Profit NOK 288 million lower than same period last year due to capital losses on bond portfolio this year and high capital gains on sale of shares in Nets last year
- Low loan losses. Collectively assessed loss write-downs up NOK 30 million in third quarter
- Low cost growth, in keeping with plan
- Substantially strengthened CET1 capital ratio
- Good growth in lending and deposits

In the first nine months of 2015 SpareBank 1 SMN achieved a pre-tax profit of NOK 1,389 million (1,709 million). Net profit was NOK 1,119 million (1,407 million) and return on equity was 11.5 per cent (16.1 per cent).

Pre-tax profit for the third quarter was NOK 309 million (545 million). Return on equity in the quarter was 7.4 per cent (14.8 per cent).

Overall operating incomes for the first nine months came to NOK 2,567 million (2,446 million), an increase of NOK 121 million compared with the same period of 2014. Operating incomes have risen at the parent banks and subsidiaries alike.

Return on financial investments was NOK 350 million (629 million), of which overall income from owner interests in associates and joint ventures accounted for NOK 327 million (383 million) in the first nine months.

Net losses on loans and guarantees totalled NOK 112 million (55 million), of which NOK 31 million is accounted for by increased collectively assessed write-downs.

At end-September 12-month lending growth was 8.3 per cent (5.4 per cent) and deposit growth was 9.5 per cent (8.5 per cent). Lending growth in the first nine months was 4.8 per cent (3.7 per cent) and deposit growth 4.8 per cent (3.4 per cent).

At the third quarter-end the CET1 ratio was 13.2 per cent (11.5 per cent). CET1 capital adequacy has strengthened by 2 percentage points in 2015.

SpareBank 1 SMN is planning for a CET1 ratio of 13.5 per cent by 30 June 2016 and 14.0 per cent by 31 December 2016. The capital plan is further described in the section on financial strength.

The bank's equity certificate was priced at NOK 54.00 as of the third quarter (NOK 58.50 as of 31 December 2014).

In the first nine months earnings per EC were NOK 5.57 (6.97). Book value per EC was NOK 65.52 (60.53). Earnings per EC in the third quarter in isolation were NOK 1.26 (2.19).

### **Strengthened net interest income**

Net interest income strengthened compared with the first nine months of 2014, and came to NOK 1,399 million (1,305 million). The change from 2014 is ascribed to:

- Increased lending to and deposits from retail and corporate customers alike
- Increased margins on deposits
- Reduced lending margins

Net interest income on loans sold to SpareBank 1 Boligkreditt (residential mortgage company) and SpareBank 1 Næringskreditt (commercial mortgage company) is recognised as commission income. Commission on loans sold to these two companies in the first nine months of 2015 totalled NOK 253 million (329 million).

In the course of 2014 and in 2015 four general interest rate reductions have been carried out on loans to retail customers in order to adjust home mortgage rates to a falling interest rate level. Deposit rates to retail and corporate customers have also been reduced. A further reduction of home mortgage rates, and of retail and corporate deposit rates, has been signalled.

### **Increased commission income**

Net commission and other operating income rose to NOK 1,168 million (1,140 million) in the first nine months of 2015, an increase of NOK 28 million from last year, corresponding to 2 per cent.

Income from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt was down NOK 75 million due to lower average volume of loans sold to SpareBank 1 Boligkreditt and reduced margins on retail lending. A positive trend is noted in other commission income. The increase of NOK 31 million from Markets is a consequence of the consolidation of SpareBank 1 Markets.

<b>Commission income (NOKm)</b>	<b>30 Sept 2015</b>	<b>30 Sept 2014</b>	<b>Change</b>
Payment transfers	143	141	3
Creditcard	42	38	4
Saving products	43	34	9
Insurance	114	101	13
Guarantee commission	52	45	7
Real estate agency	262	239	23
Accountancy services	143	134	9
Markets	43	12	31
Active management	15	11	4
Other commissions	58	56	2
<b>Commissions ex SB1 Boligkreditt and SB1 Næringskreditt</b>	<b>914</b>	<b>811</b>	<b>103</b>
Commissions SB1 Boligkreditt	247	321	-74
Commissions SB1 Næringskreditt	7	8	-1
<b>Total commissions</b>	<b>1,168</b>	<b>1,140</b>	<b>28</b>

### Financial investments

Overall return on financial investments (excluding the bank's share of the profit/loss of associates and joint ventures) was NOK 24 million (245 million). Overall return breaks down as follows:

- Return and dividend on the group's equity portfolios totalled NOK 79 million (216 million)
- Capital losses on bonds and derivatives were NOK 73 million (loss of NOK 18 million). Credit margins on the bond portfolios at the parent bank and SpareBank 1 Markets have risen due to the uncertain market situation
- As from the second quarter of 2015 a change was made to the reference interest rate in the model used to measure the fair value of fixed-rate loans, producing a negative effect of NOK 64 million.
- Income on forex and fixed income transactions was NOK 82 million (46 million)

Capital gains/dividends, shares (NOKm)	30 Sept 2015	30 Sept 2014	Change
Capital gains/dividends, shares	79	216	-137
Bonds and derivatives	-73	-18	-55
Change in discount factor in fair value model for fixed interest loans	-64	-	-64
Forex and fixed income business	82	46	36
<b>Net return on financial investments</b>	<b>24</b>	<b>245</b>	<b>-221</b>
SpareBank 1 Gruppen	183	259	-76
SpareBank 1 Boligkreditt	65	23	42
SpareBank 1 Næringskreditt	22	30	-8
SpareBank 1 Kredittkort	15	-	15
BN Bank	31	78	-47
Companies owned by SpareBank 1 SMN Invest	13	18	-5
Other companies	-2	-25	23
<b>Income from investment in related companies</b>	<b>327</b>	<b>383</b>	<b>-57</b>
<b>Total</b>	<b>350</b>	<b>629</b>	<b>-278</b>

### SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit for the first nine months of 2015 was NOK 939 million (1,343 million). The main contributor to the profit was the insurance business. SpareBank 1 Gruppen's profit is lower than last year due to the excellent results achieved in 2014 after recognition of run-off gains in the insurance business. SpareBank 1 SMN's share of the profit in the first nine months of 2015 was NOK 183 million (259 million).

### SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt was established by the banks participating in the SpareBank 1-alliance to benefit from the market for covered bonds. The banks sell well-secured home mortgage loans to the company, affording them reduced funding costs and better access to funding. As of 30 September 2015 the bank had sold loans worth NOK 29.9 billion (28.5 billion) to SpareBank 1 Boligkreditt, corresponding to 38 per cent (39 per cent) of overall loans to retail borrowers.

The bank's stake in SpareBank 1 Boligkreditt is 17.7 per cent, and the bank's share of that company's profit in the first nine months of 2015 was NOK 65 million (23 million). The holding reflects the bank's relative share of SpareBank 1 Boligkreditt's balance sheet assets.

### SpareBank 1 Næringskreditt

SpareBank 1 Næringskreditt was established along the same lines as SpareBank 1 Boligkreditt. As of 30 September 2015, loans worth NOK 1.4 billion (1.2 billion) had been sold to SpareBank 1 Næringskreditt.

SpareBank 1 SMN's stake in the company is 33.6 per cent, and the bank's share of the company's profit in the first nine months of 2015 was NOK 22 million (30 million). The holding reflects the bank's relative share of commercial property loans sold and the bank's stake in BN Bank. Of aggregate loans at SpareBank 1 Næringskreditt, 82 per cent were transferred from BN Bank.

**BN Bank**

SpareBank 1 SMN had a 33.0 per cent stake in BN Bank as of 30 September 2015. SpareBank 1 SMN's share of the profit of BN Bank in the first nine months of 2015 was NOK 31 million (78 million), yielding a return on equity of 3.5 per cent. The result is substantially affected by one-time effects due to the wind-down of the corporate portfolio and increased credit margins on the liquidity portfolio.

The board of directors of BN Bank has resolved to cultivate the bank as a retail bank and to wind down the corporate business which consists of lending to commercial property.

The background to this decision is a desire to further develop the retail banking business by cultivating BN Bank as a bank for customers who prefer a self-service concept and favourable borrowing rates over time.

BN Bank's corporate banking business has focused on funding well secured commercial property exposures, and the corporate market has traditionally been an important area for BN Bank. However, capital adequacy rules specific to Norway mean that return on equity on this low risk segment is too low. There is no prospect of changes to this specifically Norwegian capital adequacy regime. As a result, profitability will remain too low since the prices are set by actors operating under different framework conditions.

The bank has in recent years built up a substantial retail banking operation with satisfactory profitability. The board of directors of BN Bank sees a major development potential in this area, and will channel all effort and energy to the retail business. The bank aspires to increased growth and a further increase in profitability.

BN Bank will remain a part of the SpareBank 1-alliance. SpareBank 1 SMN will maintain its owner stake in BN Bank and will play its part in ensuring that the business change is carried through in a manner that safeguards creditors' interests.

The process of winding down the corporate banking business will be carried out in a controlled manner over time. For SpareBank 1 SMN this will in isolation reduce consolidated risk weighted assets, thereby improving capital adequacy. Of SpareBank 1 SMN's risk weighted balance sheet assets of NOK 90 billion, about NOK 9 billion relates to corporate exposures at BN Bank along with BN Bank's exposures sold to SpareBank 1 Næringskreditt. For SpareBank 1 SMN this amounts to about 1.3 percentage points of CET1 capital adequacy once the scaling back is completed. The process of winding down the corporate portfolio is well under way, although the effect is limited after such a short space of time.

**SpareBank 1 Kredittkort**

Profit for the first nine months of 2015 was NOK 83 million. SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 18.4 per cent. SpareBank 1 SMN's share of the first nine months' profit was NOK 15 million and its share of the portfolio is NOK 773 million (715 million). The company was in ordinary operation as from 1 July 2014, and comparatives with previous periods are therefore not available.

**Operating expenses**

Overall operating expenses came to NOK 1,416 million (1,310 million) in the first nine months of 2015. The Group expenses have increased by NOK 106 million compared with the first nine months of 2014. Of the Group's increase, NOK 83 million refers to the consolidation of SpareBank 1 Markets as a subsidiary as from the second quarter of 2015. Excluding the effect of SpareBank 1 Markets, the Group's growth in expenses was NOK 23 million, equivalent to 1.8 per cent.

The parent bank reduced costs by NOK 26 million in the 12 months to end-September. SpareBank 1 SMN transferred its capital market activities to SpareBank 1 Markets as from the second quarter. This represents a cost reduction of NOK 28 million for the parent bank in the second and third quarter, and, when this is taken into account, net cost growth at the parent bank comes to NOK 2 million compared with the same period of 2014. Parent bank costs will be kept to their 2014 level in 2015 and 2016.

At the parent bank the number of full time employee equivalents (FTEs) has been reduced by 60 to 660 in 2015 (there is an additional reduction of 32 FTEs due to the transfer of capital market activity to SpareBank 1 Markets).

Operating expenses measured 1.48 per cent of average total assets capital (1.51 per cent). The Group cost-income ratio was 49 per cent (43 per cent).

### **Low losses and low defaults, increased provision for collectively assessed write-downs**

Loan losses came to NOK 112 million in the first nine months (55 million). Net losses in the third quarter in isolation came to NOK 56 million (24 million).

A net loss of NOK 102 million (45 million) was recorded on loans to corporate clients in the first nine months, including an increase of NOK 30 million (0 million) in collectively assessed write-downs.

A net loss of NOK 10 million (10 million) was recorded on loans to retail clients in the first nine months.

Total individually assessed loan impairment write-downs entered in the balance sheet came to NOK 191 million (182 million) at the end of the first nine months of 2015.

Total problem loans (defaulted and doubtful) came to NOK 667 million (544 million), or 0.53 per cent (0.47 per cent) of gross loans including loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt at end-September.

Defaults in excess of 90 days totalled NOK 218 million (338 million), measuring 0.17 per cent (0.29 per cent) of gross lending. Of total defaults, NOK 30 million are loss provisioned (92 million), corresponding to 14 per cent (27 per cent).

Defaults break down to NOK 50 million (152 million) on corporates and NOK 169 million (186 million) on retail customers.

Other doubtful exposures totalled NOK 448 million (206 million), corresponding to 0.36 per cent (0.18 per cent) of gross outstanding loans. Individually write-downs on these exposures came to NOK 160 million (90 million), corresponding to a share of 36 per cent (44 per cent).

Other doubtful exposures break down to NOK 431 million (190 million) on corporate customers and NOK 17 million (16 million) on retail customers.

### **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 after granting of loans)

- 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 factors)

In the third quarter of 2015 a basis was found for increasing collectively assessed impairment write-downs at the parent bank by NOK 30 million, based on an increased likelihood of loss in individual lines of business as a result of a more challenging market situation. Overall collectively assessed loss write-downs are accordingly NOK 326 million (295 million). Collectively assessed write-downs break down to NOK 95 million on retail exposures and NOK 231 million on corporates.

### **Total assets of NOK 129 billion**

The Group's assets totalled NOK 129.2 billion at 30 September 2015 (117.2 billion), having risen by NOK 12.0 billion or 10.3 per cent over the preceding 12 months.

As of end-September 2015 loans worth a total of 31.3 billion (29.7 billion) 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 do however include loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.

### **Good growth in lending and deposits**

(For distribution by sector, see note 5 and note 10).

In the 12 months to end-September total outstanding loans rose by NOK 9.7 billion (6.0 billion) or 8.3 per cent (5.4 per cent) to reach NOK 126.2 billion (NOK 116.5 billion). Growth in 2015 is 4.8 per cent (3.7 per cent).

Loans to retail customers rose by NOK 6.3 billion (5.1 billion) to reach NOK 78.9 billion in the last 12 months, equivalent to growth of 8.7 per cent (7.7 per cent). In 2015 growth in lending to retail customers is 6.4 per cent (5.8 per cent).

Lending to corporates rose by NOK 3.4 billion (0.9 billion) or 7.8 per cent (2.4 per cent) in the 12 months to end-September. Overall lending to corporates totalled NOK 47.3 billion as of 30 September 2015. Lending to corporates increased in the first nine months of 2015 by 2.1 per cent (0.5 per cent reduction). This is in keeping with the bank's capital plan.

Loans to retail customers accounted for 63 per cent (62 per cent) of total lending to customers as of 30 September 2015.

### **Good growth in deposits**

Total customer deposits rose by NOK 5.5 billion (4.5 billion) to reach NOK 63.6 billion in the 12 months to 30 September 2015. This represents a growth of 9.5 per cent (8.5 per cent).

Retail deposits rose by NOK 2.1 billion (2.2 billion) or 8.2 per cent (9.4 per cent) to reach NOK 28.2 billion, while corporate deposits rose by NOK 3.4 billion (2.4 billion) or 10.6 per cent (7.9 per cent) to NOK 35.4 billion.

**Investment products**

The customer portfolio of off-balance sheet investment products totalled NOK 7.6 billion (5.7 billion) at 30 September 2015. New sales and value changes in underlying securities explain the increase recorded on equity funds and active asset management.

<b>Saving products, customer portfolio (NOKm)</b>	<b>30 Sept 2015</b>	<b>30 Sept 2014</b>	<b>Change</b>
Equity funds	4,819	3,627	1,192
Pension products	671	540	131
Active management	2,140	1,557	583
<b>Total</b>	<b>7,630</b>	<b>5,724</b>	<b>1,906</b>

**Insurance portfolios**

The bank's insurance portfolio showed an increase of 3.5 per cent in the 12 months to end-September. Non-life insurance delivered 1.8 per cent growth, personal insurance 10.5 per cent and occupational service pensions 1.1 per cent.

<b>Insurance, premium volume (NOKm)</b>	<b>30 Sept 2015</b>	<b>30 Sept 2014</b>	<b>Change</b>
Non-life insurance	720	707	13
Personal insurance	264	239	25
Occupational pensions	190	188	2
<b>Total</b>	<b>1,174</b>	<b>1,134</b>	<b>40</b>

**Retail Banking**

Operating income has increased due to increased lending and improved deposit margins, and increased commission income from insurance sales. Concurrently reduced lending margins have reduced incomes. Operating income in the first nine months totalled NOK 1,239 million of which net interest income accounted for NOK 709 million and commission income for NOK 530 million. Return on equity in the retail banking segment was 16.2 per cent in terms of regulatory capital employed converted to 13.5 per cent.

The lending margin in the first nine months of 2015 was 2.11 per cent (2.41 per cent), while the deposit margin was minus 0.20 per cent (minus 0.44 per cent) (measured against three-month NIBOR).

In the 12 months to end-September retail lending and retail deposits grew by 8.1 per cent and 5.1 per cent respectively.

Lending to retail borrowers carries low risk, as reflected in continued very low losses. Losses and defaults are expected to remain at a low level. The loan portfolio is secured on residential property, and the trend in house prices has been relatively high throughout the market area. Housing demand remains high due to underlying demand growth caused by several years' failure of housing construction to keep pace with the need for housing.

Retail banking operations have become considerably more efficient in 2015 due to the resource input being reduced by 30 FTEs, corresponding to 8 per cent.



## Corporate Banking

Operating income totalled NOK 874 million in the first nine months of 2015. Net interest income was NOK 729 million, while commission income totalled NOK 146 million including NOK 11 million on fixed income and forex business. Operating income in the corporate segment has increased very largely due to higher lending volume and increased deposit margins.

Return on equity for the corporate banking segment was 12.9 per cent in the first nine months in terms of regulatory capital employed converted to 13.5 per cent.

The lending margin was 2.68 per cent (2.93 per cent) and the deposit margin was minus 0.31 per cent (minus 0.58 per cent) in the first nine months.

Lending increased by 7.8 per cent and deposits by 16.2 per cent in the 12 months to end-September.

## Subsidiaries

The subsidiaries posted an overall profit of NOK 104.8 million (147.5 million) before tax and minority interests in the first nine months of 2015.

Pre-tax profit (NOKm)	30 Sept 2015	30 Sept 2014	Change
EiendomsMegler 1 Midt-Norge	39.5	42.2	-2.7
SpareBank 1 Finans Midt-Norge	63.6	49.9	13.7
SpareBank 1 Regnskapshuset SMN	26.0	24.1	1.9
Allegro Kapitalforvaltning	2.1	-1.3	3.4
SpareBank 1 SMN Invest	33.0	31.1	1.9
Sparebank 1 Markets (from second quarter 2015)	-62.7	-	-62.7
Other companies	3.3	1.6	1.8
<b>Total</b>	<b>104.8</b>	<b>147.5</b>	<b>-42.6</b>

**EiendomsMegler 1 Midt-Norge** leads the field in Trøndelag and in Møre og Romsdal with a market share of 40 per cent, and in Trondheim about 50 per cent. The company's first nine months' profit of NOK 39.5 million (42.2 million) is satisfactory. The number of dwellings sold totalled 5,294 in the first nine months of 2015 compared with 4,905 in the first nine months of 2014.

**SpareBank 1 Finans Midt-Norge** reported a profit of NOK 63.6 million in the first nine months (49.9 million) and shows profit growth due to increased income from car loans and leasing alike. At quarter-end the company managed leases and car loan agreements worth a total of NOK 4.1 billion of which leases accounted for NOK 2.1 billion and car loans for NOK 2.0 billion.

A number of Samspar banks joined as owners of SpareBank 1 Finans Midt-Norge in June 2015, raising their overall stake to 27.9 per cent. This considerably boosts the company's distribution power.

**SpareBank 1 Regnskapshuset SMN** posted a pre-tax profit of NOK 26.0 million (24.1 million) for the first nine months.

SpareBank 1 SMN Regnskapshuset SMN has a growth strategy based on the acquisition of small accounting firms. This represents a consolidation of a fragmented accounting industry.

**Allegro Kapitalforvaltning** is an active management company that manages portfolios for clients primarily in SpareBank 1 SMN and the SamSpar banks. These banks are the company's distribution channel. The company posted a profit of NOK 2.1 million in the first nine months of 2015 (minus 1.3 million). The company manages a portfolio worth NOK 5.2 billion which includes the bank's pension fund totalling NOK 0.7 billion.

**Sparebanken SMN Invest** invests in shares, mainly in regional businesses. The company posted a pre-tax profit of NOK 33.0 million in the first nine months of 2015 (31.1 million). The result is a consequence of value changes and realisation of losses or gains on the company's overall shareholding measuring NOK 20.1 million of the overall profit. The company has in addition owner interests in the property companies Grilstad Marina and Hommelvik Sjøside and its share of those companies' profits in the first nine months of 2015 was NOK 12.9 million.

**SpareBank 1 Markets** has been a subsidiary of SpareBank 1 SMN since 1 April 2015 and is consolidated in the Group accounts on a par with the other subsidiaries as from the same date. SpareBank 1 SMN's capital market activities in the parent bank were transferred to SpareBank 1 Markets as part of the transaction. SpareBank 1 SMN's stake is 73.4 per cent.

The company's pre-tax result in the second quarter was a loss of NOK 10.1 million and in the third quarter a loss of NOK 52.5 million. The large deficit in the third quarter is mainly due to a loss of NOK 51.9 million related to increased credit margins on the bond portfolio.

#### **mCASH**

The SpareBank 1 banks announced on 15 October 2015 the acquisition of the Norwegian arm of mCASH. The intention is to strengthen the bank's position on new mobile interfaces such as friend-to-friend payment and mobile payments in stores.

#### **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 12 months of ordinary operation without need of fresh external funding.

As of 30 September 2015 the bank has liquidity reserves of NOK 19 billion and thus has the funding needed for 18 months of ordinary operation without fresh external finance. Although the third quarter was a demanding one for Norwegian banks with increased credit spreads and poorer access to funding, this did not pose a particular challenge for SpareBank 1 SMN.

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 88 per cent (87 per cent).

SpareBank 1 Boligkreditt is the bank's most important funding source. As of 30 September 2015 the bank had transferred loans totalling NOK 29.9 billion (28.5 billion) to SpareBank 1 Boligkreditt.

#### **Rating**

SpareBank 1 SMN has a rating of A1 (stable outlook) with Moody's and a rating of A- (stable outlook) with Fitch Ratings. The bank was upgraded by Moody's in May 2015, as were several other Norwegian banks.

**Financial position**

The CET1 capital ratio at 30 September 2015 was 13.2 per cent (11.5 per cent), an increase of 0.5 percentage points since 30 June 2015. The increase is due to:

- Increased equity capital from the third quarter profit
- Growth in risk weighted assets related to lending activity somewhat weakens CET1 capital. There was zero growth in lending to corporates in the third quarter, while growth in lending to retail borrowers increases risk weighted assets in the IRB portfolio and risk weighted assets related to the Basel 1 floor
- The third quarter saw disinvestment in the bank's bond portfolios which reduces the risk weighted assets related to debt risk
- Credit risk calculated using the standardised approach is reduced because the bank has revised its method for calculating capital requirements on derivatives exposures

As of 30 September 2015 the regulatory requirement on CET1 capital is 11.0 per cent, including combined buffer requirements. The requirement will rise to 11.5 per cent as from 30 June 2016.

The board of directors of SpareBank 1 SMN continuously assesses the capital situation and future capital requirements.

SpareBank 1 SMN is engaged in a regular dialogue with Finanstilsynet (Norway's FSA) regarding its capital level. Finanstilsynet has communicated to the bank a capital expectation of 14.5 per cent CET1 capital by 31 December 2016. This will be considered by the board in its annual capital evaluation process to be completed by year-end. Finanstilsynet will not establish individual Pillar 2 add-ons for SpareBank 1 SMN before implementing the SREP (Supervisory Review and Evaluation Process) in 2016.

The assumption and expectation of SpareBank 1 SMN's board of directors is that implementing the bank's capital plan will ensure that the bank attains the capital requirements expected of it by the market and the authorities without carrying out a stock issue.

The board is planning for a CET1 capital ratio of 13.5 per cent by 30 June 2016, including a countercyclical buffer of 1.5 per cent. The further objective is increase the CET1 ratio to at least 14.0 per cent by end-2016.

Winding down the corporate portfolio at BN Bank will upon completion represent a reduction of NOK 9 billion in SpareBank 1 SMN's risk weighted assets, equivalent to boosting SMN's CET1 ratio by 1.3 percentage points.

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 of the group profit
- Moderate growth in the bank's asset-intensive activities, with priority given to lending to households

**The bank's equity certificate (MING)**

The book value of the bank's EC at quarter-end was NOK 65.52 (60.53), and earnings per EC were NOK 5.57 (6.97). As at 30 September 2015 the EC was priced at NOK 54.00 (NOK 59.25 at 31 December 2014), and dividend of NOK 2.25 per EC has been paid in 2015 for the year 2014.

The Price / Income ratio was 7.27 (6.38) and the Price / Book ratio was 0.82 (0.98).

### **Risk factors**

The credit quality of the bank's loan portfolio is satisfactory, loss and default levels are low, and there are no concentrations in non-performing and problem exposures.

The bank expects a falling rate of GDP growth as a result of declining oil investment. A weaker Norwegian krone has impacted positively on export industries, and will partially offset some of these effects. The bank also expects moderate growth in lending to mid-Norway's business sector ahead as a result of the low level of investment.

The bank expects unemployment to show a slight increase, but to remain relatively low. This, combined with continued real wage growth and a low interest rate level, suggests that loss risk in the bank's retail banking portfolio will remain low.

Credit demand from Norwegian households remains higher than wage growth and will be heavily affected by the trend in house prices. If house prices stagnate, or fall, there is a risk that the household saving rate will quicken and that this will result in reduced turnover for parts of Norwegian 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 performance in the core business for the first nine months featuring income growth, virtually zero growth in costs at the parent bank and low loan losses and defaults. Results for the third quarter are affected by capital losses on the bond portfolios and reorganisation costs at BN Bank which the board views as one-time effects.

The bank is experiencing price pressures on lending to retail and corporate borrowers alike, but the board is well pleased with the bank's ability to largely compensate for this by way of strengthened deposit margins, good sales and improved efficiency at the bank.

The goal of a CET1 ratio of 13.5 per cent in the first half of 2016 will be achieved by profit retention and moderate growth. Finanstilsynet has communicated to the bank a capital expectation of 14.5 per cent by 31 December 2016. This will be considered by the board of directors in its annual capital evaluation process to be completed before year-end. The board of directors considers it has the leeway needed to meet the authorities' requirements without launching a stock issue and to maintain dividend capacity at the same time. Winding down the loan portfolio at BN Bank will make a positive contribution in that context.

The board of directors maintains its high focus on risk in the bank's loan exposure. The oil-related sector in particular is the object of ongoing reporting to the board. SpareBank 1 SMN has low exposure to oil-related activities over and above offshore vessels. Defaults at SpareBank 1 SMN are at a very low level. In light of increased uncertainty in oil-related manufacturing, the bank has nonetheless opted to increase its collectively assessed loss write-downs.

Major change projects are under way in the areas of distribution and work processes. This will make for more efficient banking operations and enhance the quality of customers' experience of the bank. The investment in mCASH is an important element in securing the bank's position on the payments front.

The board expects 2015 to be a good year for SpareBank 1 SMN.

Trondheim, 29 October  
The Board of Directors of SpareBank 1 SMN

Kjell Bjordal  
(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)