

Report of the Board of Directors

First half 2016

(Consolidated figures. Figures in parenthesis refer to the same period of 2015 unless otherwise stated)

- Pre-tax profit: NOK 930m (1,080m)
- Post-tax profit: NOK 771m (871m)
- Return on equity: 10.9 per cent (13.7 per cent)
- Growth in lending 6.5 per cent (8.4 per cent) in past 12 months
- Growth in deposits 1.3 per cent (11.4 per cent) in past 12 months
- Loan losses: NOK 287m (56m), 0.44 per cent (0.09 per cent) of gross loans
- CET1 capital ratio: 14.1 per cent (12.7 per cent)
- Earnings per equity certificate (EC): NOK 3.71 (4.31)

Second quarter 2016

- Pre-tax profit: NOK 546m (513m)
- Post-tax profit: NOK 460m (430m)
- Return on equity: 12.9 per cent (13.4 per cent)
- Loan losses: NOK 118m (35m), 0.36 per cent (0.11 per cent) of gross loans
- Earnings per equity certificate (EC): NOK 2.21 (2.13)

Good profit performance in first half 2016

Main points:

- Good underlying operations
- Increased loan losses reduce profit compared with first half 2015. Loss write-downs are in keeping with indications given in the first quarter
- Good profits at affiliates and high return on financial assets
- Strengthened financial position
- High customer influx and strong growth in home mortgage loans

In the first half of 2016 SpareBank 1 SMN achieved a pre-tax profit of NOK 930m (1,080m). Net profit was NOK 771m (871m) and return on equity was 10.9 per cent (13.7 per cent).

Profit in the second quarter was NOK 460m (430m) which is NOK 131m better than in the first quarter. Return on equity in the quarter was 12.9 per cent (13.4 per cent).

The Group increased its operating incomes in the first half of 2016 by NOK 67m to NOK 1,791m (1,724m), both as a result of increased net interest income and increased commission income.

Return on financial investments was NOK 443m (362m), of which income from owner interests accounted for NOK 246m (248m).

Group operating expenses came to NOK 1,016m in the first half of 2016 (950m). Of the increase of NOK 66m, the effect of the consolidation of SpareBank 1 Markets accounts for NOK 59m. The bank is well placed to reach its target of zero growth in parent bank costs in the period 2014 to 2016.

First-half loan losses totalled NOK 287m (56m) corresponding to 0.44 per cent (0.09 per cent) of overall lending. The losses break down to NOK 245m on individually assessed write-downs and NOK 42m on collectively assessed write-downs. The losses are attributed in their entirety to the restructuring of the bank's exposure to the oil/offshore industry.

At end-June 12-month lending growth was 6.5 per cent (8.4 per cent) and deposit growth was 1.3 per cent (11.4 per cent). In the first half-year lending rose by 4.1 per cent (3.4 per cent) and deposits by 4.6 per cent (9.1 per cent).

SpareBank 1 SMN has targeted a CET1 ratio of 14.5 per cent to be reached by 31 December 2016. The capital plan is further described in the section on financial position. At the end of the first half-year SpareBank 1 SMN's CET1 ratio was 14.1 per cent (12.7 per cent).

First-half earnings per EC were NOK 3.71 (4.31). The book value per EC at end-June 2016 was NOK 69.18 (64.18).

The market price at the same point was NOK 46.70 (65.50 at end-2015). Dividend of NOK 2.25 per EC was paid in the second quarter 2016 for the year 2015.

Increased net interest income

Net interest income came to NOK 942m (934m) in the first half of 2016. Net interest income has been relatively stable per quarter in 2015 and 2016, but is characterised by substantial gross movements:

- Increased lending to and deposits from retail and corporate customers
- Increased margins on deposits
- Reduced home mortgage 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 half of 2016 totalled NOK 149m (175m).

Over the course of the last two years several general interest rate reductions were carried out on loans to retail customers in order to adjust home mortgage rates to the market level, and the latest interest rate reduction was effective as from June 2016. Deposit rates to retail and corporate customers were also reduced in the same period. Parts of the portfolio of loans to corporates are being repriced to better reflect various levels of credit risk. The aim is to increase interest margins on this portfolio.

Increased commission income

Net commission and other operating income totalled NOK 849m (790m) in the first half of 2016.

Income from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt was reduced by NOK 26m due to lower margins on loans sold to SpareBank 1 Boligkreditt. The overall increase of NOK 85m in other commission income is in all essentials ascribable to SpareBank 1 Markets becoming a subsidiary of SpareBank 1 SMN as from the second quarter of 2015, and to an increase in income from estate agency

services. In addition, positive growth is noted in the other income types as a result of good sales of other financial products.

Commission income (NOKm)	First Half 2016	First Half 2015	Change
Payment transfers	94	94	0
Creditcard	30	27	3
Saving products and active management	42	35	7
Insurance	79	74	5
Guarantee commission	40	31	9
Real estate agency	197	179	18
Accountancy services	119	110	9
Markets	63	23	40
Rent	25	22	2
Other commissions	12	19	-7
Commissions ex SB1 Boligkreditt and SB1 Næringskreditt	700	616	85
Commissions SB1 Boligkreditt	144	170	-26
Commissions SB1 Næringskreditt	5	5	0
Total commissions	849	790	59

Return on financial investments

Overall return on financial investments (excluding the share of the profit/loss of associates and joint ventures) was NOK 197m (114m). Overall return breaks down as follows:

- Return and dividend on the group's equity portfolios totalled NOK 65m (70m). Of the amount of NOK 65m, NOK 63m refers to the sale of Visa Europa to Visa Inc. At the same time, NOK 52m of a previously recognised unrealised value change of Visa Norge FLI was reversed against other incomes and expenses (OCI). (See note 2)
- Capital gains on bonds and derivatives came to NOK 78m (-21m)
- Income on forex and fixed income transactions was NOK 54m (64m)

Return on financial investments (NOKm)	First Half 2016	First Half 2015	Change
Capital gains/dividends, shares	65	70	-5
Bonds and derivatives	78	-21	99
Income on forex and fixed income	54	64	-10
Net return on financial investments	197	114	84
SpareBank 1 Gruppen	141	128	13
SpareBank 1 Boligkreditt	22	50	-28
SpareBank 1 Næringskreditt	15	15	-0
SpareBank 1 Kredittkort	14	10	5
BN Bank	51	35	16
Companies owned by SpareBank 1 SMN Invest	13	13	-0
Other companies	-10	-2	-8
Income from investment in related companies	246	249	-3
Total	443	362	81

SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit for the first half of 2016 was NOK 694m (653m). The main contributors to the profit are the personal and non-life insurance arms, both of which are on a satisfactory trend. Odin Forvaltning also shows improved profit.

SpareBank 1 SMN's share of the profit for the first half of 2016 was NOK 141m (128m).

SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt was established by the banks participating in the SpareBank 1 Alliance to secure funding through the market for covered bonds. By selling their best secured home mortgage loans to the company, the banks achieve reduced funding costs and securer access to funding. As of 30 June 2016 the bank had sold loans worth NOK 33bn (29bn) to SpareBank 1 Boligkreditt, corresponding to 39 per cent (38 per cent) of overall loans to wage earners.

The bank's stake in SpareBank 1 Boligkreditt is 19.0 per cent, and the bank's share of that company's profit in the first half of 2016 was NOK 22m (50m). The bank's stake reflects the bank's relative share of total loans transferred to SpareBank 1 Boligkreditt as at end-2015.

Like the result for the first half of 2015, the result for the first half of 2016 is affected by unrealised gains on the company's basis swaps.

SpareBank 1 Næringskreditt

SpareBank 1 Næringskreditt was established along the same lines, and with the same administration, as SpareBank 1 Boligkreditt. As at 30 June 2016, loans worth NOK 1.8bn (1.4bn) 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 half of 2016 was NOK 15m (15m). The holding reflects the bank's relative share of sold loans to commercial property and the bank's stake in BN Bank. Of aggregate loans at SpareBank 1 Næringskreditt, 78 per cent were bought from BN Bank.

SpareBank 1 Kredittkort

Profit for the first half of 2016 was NOK 78m (52m). SpareBank 1 Kredittkort is owned by the SpareBank 1 banks, and SpareBank 1 SMN has a stake of 18.3 per cent. SpareBank 1 SMN's share of the first half profit was NOK 14m (10m). The bank's share of the credit portfolio is NOK 823m.

BN Bank

SpareBank 1 SMN owns 33.0 per cent of BN Bank. Profit for the first half of 2016 was NOK 154m (105m). SpareBank 1 SMN's share of the profit of BN Bank in the first half of 2016 was NOK 51m (35m). Return on equity was 8.7 per cent (5.8 per cent).

The board of directors of BN Bank decided in 2015 to cultivate the bank as a retail bank and to wind down the corporate business consisting of lending to low-risk commercial property. BN Bank's new strategy is to cultivate the retail banking business.

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. By the end of the first half of 2016 the corporate portfolio had been reduced by NOK 11.5bn or 36 per cent since 30 June 2015. The board of directors of BN Bank aims to wind down 50 per cent of the corporate portfolio by 31 December 2016. Wind-down of the remaining corporate portfolio will strengthen CET1 capital adequacy of SpareBank 1 SMN by 0.6 percentage point.

SpareBank 1 Mobilbetaling (mCASH)

In the fourth quarter of 2015, the SpareBank 1 banks acquired the Norwegian arm of mCASH and established a mobile payments company, SpareBank 1 Mobilbetaling. The intention is to strengthen the bank's position on new mobile interfaces such as friend-to-friend payments and mobile payments in stores. Mid-February saw the start of nationwide marketing of mCASH through TV/digital advertising, and a substantial focus on events, along with associations. Nationally more than 1500 associations have taken mCASH into use as a payments solution. mCASH also offers solutions for internet commerce, stores and friend-to-friend payments.

The first-half result shows a deficit of NOK 63m of which SpareBank 1 SMN's share is NOK 9m. The deficit is a consequence of start-up costs and marketing of mCASH. The company is owned by the SpareBank 1 banks, and SpareBank 1 SMN's stake is 19.7 per cent.

Operating expenses

Overall operating expenses came to NOK 1,016m (950m) in the first half of 2016. Of the increase of NOK 66m, NOK 59m is ascribable to SpareBank 1 Markets' consolidation as a subsidiary as from the second quarter of 2015.

The parent bank reduced costs by NOK 3m to NOK 603m. Wide-ranging efficiency improvement measures have been initiated at the bank. Since 31 December 2014 the number of FTEs at the parent bank has been reduced from 720 to 632, i.e. by 88. This is in keeping with the bank's target of zero growth in costs in the period 2014 to 2016.

The development in the bank's costs is also related to changes at SpareBank 1 Markets, and the parent bank's operating expenses in the first half of 2015 include NOK 14m related to capital market activity at SpareBank 1 SMN.

In addition, NOK 14m was set aside for increased reorganisation costs related to severance agreements entered into in connection with planned downstaffing in 2016.

The Group cost-income ratio was 46 per cent (46 per cent).

Increased losses but still low defaults

Losses on loans and guarantees totalled NOK 287m (56m) in the first half of 2016 of which NOK 42m (1m) is increased collectively assessed impairment write-downs.

Net individually assessed impairment write-downs of NOK 236m were recorded on loans to corporates in the first half of 2016. Of this increase NOK 200m relates to three exposures in the offshore segment. In the first quarter NOK 150m was set aside for collectively assessed impairment write-downs related to uncertainties in the same segment. In the second quarter NOK 110m of this provision was reversed as a consequence of the increase in individual impairment write-downs in the quarter. A net loss of NOK 12m was recorded on the retail customer portfolio in the first half of 2016.

Individually assessed write-downs on loans and guarantees at mid-2016 totalled NOK 415m (169m), an increase of NOK 246m over the last 12 months.

Total problem loans (defaulted and doubtful) came to NOK 1,453m (655m), or 1.10 per cent (0.53 per cent) of gross loans, at the half-year mark.

Defaults in excess of 90 days totalled NOK 255m (287m), measuring 0.19 per cent (0.23 per cent) of gross lending. Defaults on the corporate portfolio came to NOK 36m (105m) and on the retail portfolio to NOK 219m (182m). Individually assessed write-downs on non-performing exposures totalled NOK 31m (58m), corresponding to a share of 12 per cent (20 per cent).

Other doubtful exposures totalled NOK 1,198m (368m), breaking down to NOK 1,171m (357m) on the corporate portfolio and NOK 28m (11m) on the retail portfolio. The increase in doubtful corporate exposures refers to the same exposures as those that resulted in increased individually assessed losses. Other doubtful exposures account for 0.90 per cent (0.30 per cent) of gross outstanding loans. Individually assessed impairments on these exposures came to NOK 384m (111m), corresponding to a share of 32 per cent (30 per cent).

Much attention was given to the bank's exposure to the oil and offshore segment in the second quarter. The whole of this industry is now undergoing restructuring. This entails loss of equity capital, losses on bond debt and to some extent also write-downs of collateralised debt. Thus far this work has provided good results. Industrial actors that invest in this segment are of major significance. The solutions now being established for individual businesses can be expected to be of a lasting nature and to curb the bank's risk.

In SpareBank 1 SMN's assessment there is no basis for revising the loss estimates of NOK 400m – 500m for the current year that were announced at the presentation of the first quarter.

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)

Collectively assessed impairment write-downs were increased by NOK 150m in the first quarter. This was done on the basis that an increased probability of default and reduction in ship values entail a greater likelihood of loss in oil related activity in a challenging market situation. An increase in individually assessed impairment write-downs in the second quarter of 2016 related to this sector provide a basis for reducing the provision for collectively assessed write-downs, and the write-downs were reduced by NOK 110m in the second quarter.

Overall collectively assessed loss write-downs accordingly come to NOK 418m (296m), measuring 0.32 per cent (0.24 per cent) of total loans. Collectively assessed write-downs break down to NOK 97m on retail exposures and NOK 321m on corporates. Of the provision of NOK 321m on the corporate portfolio, the provision related to oil-related activity accounts for NOK 139m. Remaining collectively assessed loss write-downs of NOK 182m on the corporate portfolio are relatively evenly distributed across other sectors.

Total assets of NOK 141bn

The Group's assets totalled NOK 141.1bn at 30 June 2016 (130.9bn), having risen by NOK 10.2bn or 8 per cent over the preceding 12 months. The increase is primarily due to lending growth and an increased liquidity holding.

As at end-June 2016 home mortgage loans worth a total of 33.0bn (29.0bn) had been sold to SpareBank 1 Boligkreditt and corporate loans worth NOK 1.8bn to SpareBank 1 Næringskreditt (1.4bn). These loans do not figure as loans 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 home mortgage lending, virtually zero growth in lending to corporates over the last 12 months

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

In the 12 months to end-June total outstanding loans rose by NOK 8.1bn (9.7bn) or 6.5 per cent (8.4 per cent) to reach NOK 132.6bn (including SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt). Growth in the first half in isolation was 4.1 per cent (3.4 per cent).

Loans to retail borrowers rose by NOK 7.9bn (6.0bn) to reach NOK 85.2bn in the last 12 months, equivalent to growth of 10.2 per cent (8.2 per cent). Growth in the first half-year was 5.5 per cent (4.3 per cent).

Growth in lending to corporates was NOK 0.2bn (3.7bn) or 0.4 per cent (8.6 per cent) in the 12 months to end-June. Overall lending to corporates was NOK 47.4bn at the half-year mark. Lending to corporates increased in the first half of 2016 by 1.6 per cent (1.9 per cent).

Loans to retail borrowers accounted for 64 per cent (62 per cent) of ordinary lending to customers as at end-June 2016.

Deposits

Customer deposits rose by NOK 0.8bn (6.8bn) over the last 12 months to reach NOK 67.0bn as at 30 June 2016. This represents a growth of 1.3 per cent (11.4 per cent). Deposit growth in the first half of 2016 was 4.6 per cent (9.1 per cent).

Retail deposits rose by NOK 1.5bn (1.4bn) or 5.3 per cent (9.1 per cent) to reach NOK 30.2bn, while corporate deposits fell by NOK 0.7bn (growth of 4.4bn) or 1.8 per cent (growth of 13.3 per cent) to NOK 36.9bn in the 12 months to end-June. In the first half-year deposits at Retail Banking and Corporate Banking rose by 6.4 per cent (8.1 per cent) and 3.1 per cent (9.8 per cent) respectively.

Investment products

The customer portfolio of off-balance sheet investment products totalled NOK 8.2bn (7.5bn) at 30 June 2016, an increase of 9.1 per cent on a 12-month basis. The increase is related to value changes in underlying securities along with good sales, in particular of active management products.

Saving products, customer portfolio (NOKm)	First Half 2016	First Half 2015	Change
Equity funds	5,177	5,001	176
Pension products	681	658	23
Active management	2,371	1,886	485
Total	8,229	7,545	684

Insurance products

The bank's insurance portfolio showed an increase of 5.5 per cent in the 12 months to end-June and the overall premium volume was NOK 1,122m at the half-year mark (1,158m). Non-life insurance delivered 2.5 per cent growth, personal insurance 10.9 per cent and occupational service pensions 9.6 per cent. Total income on the bank's insurance portfolio passed NOK 120m in 2015 and growth is also forecast for 2016.

Insurance, premium volume (NOKm)	First Half 2016	First Half 2015	Change
Non-life insurance	731	713	18
Personal insurance	286	258	28
Occupational pensions	205	187	18
Total	1,222	1,158	64

Retail Banking

Operating income in the first half-year totalled NOK 812m (821m) of which net interest income accounted for NOK 474m (473m) and commission income for NOK 338m (348m). Operating income has increased due to increased lending and improved deposit margins along with increased commission income from payments, savings and investment and insurance. At the same time reduced lending margins have in isolation reduced incomes, and overall income fell by NOK 9m. Return on capital employed in the retail banking segment was 13.3 per cent (17.0 per cent). Regulatory capital of 14.5 per cent is used as capital employed, corresponding to the Group's targeted CET1 capital ratio to be attained by 31 December 2016.

The lending margin in the first half of 2016 was 1.79 per cent (2.17 per cent), while the deposit margin was 0.21 per cent (minus 0.25 per cent) (measured against three-month NIBOR). The average three-month NIBOR has fallen by about 50 basis points since the start of 2015.

In the 12 months to end-June retail lending and retail deposits grew by 9.8 per cent (7.7 per cent) and 4.5 per cent (5.7 per cent) respectively.

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

Corporate Banking

Operating income totalled NOK 594m (578m) in the first half of 2016. Net interest income was NOK 492m (487m), while commission income totalled NOK 103m (91m) including NOK 6m (7m) on fixed income and forex business. Operating income in the corporate segment has increased due very largely to increased deposit margins and higher guarantee commissions.

Total losses recorded in the Corporate Banking Division were NOK 275m (50m) of which individually assessed write-downs accounted for NOK 236m and collectively assessed write-downs for NOK 39m. Losses are in all essentials related to the crisis in the oil and offshore segment.

Return on equity for the corporate banking segment was 2.4 per cent in the first half of 2016 (13.0 per cent). Regulatory capital of 14.5 per cent is used as capital employed, corresponding to the Group's CET1 capital ratio to be attained by 31 December 2016.

The lending margin was 2.63 per cent (2.71 per cent) and the deposit margin was minus 0.17 per cent (minus 0.37 per cent) in the first half-year.

Lending was reduced by 1.7 per cent and deposits by 0.1 per cent in the 12 months to end-June.

Subsidiaries

The subsidiaries posted an overall profit of NOK 147m (109m) before tax.

Pre-tax profit (NOKm)	First Half 2016	First Half 2015	Change
EiendomsMegler 1 Midt-Norge	43.3	29.2	14.1
SpareBank 1 Finans Midt-Norge	48.5	43.4	5.1
SpareBank 1 Regnskapshuset SMN	25.9	20.3	5.6
Allegro Kapitalforvaltning	4.4	1.3	3.0
SpareBank 1 SMN Invest	22.5	13.0	9.5
Sparebank 1 Markets	5.5	-	5.5
Other companies	-3.4	1.5	-4.9
Total	146.7	108.7	38.0

Eiendomsmegler 1 Midt-Norge achieved its best ever results in the first half of 2016. The company leads the field in Trøndelag and in Møre and Romsdal with a market share of 40 per cent, and in Trondheim of about 50 per cent. The company's first half profit of NOK 43.3m (29.2m) is very good and is NOK 14.1m better than in the first half of 2015. The profit in the second quarter is as expected substantially better than in the first quarter. Good sales – in particular of new housing projects – explain much of the profit improvement, at the same time as the total number of dwellings sold also showed an increase. The number of dwelling units sold totalled 3,846 in the first half of 2016 compared with 3,615 in the first half of 2015.

SpareBank 1 Finans Midt-Norge reported a profit of NOK 48.5m in the first half-year (43.4m) and shows positive profit growth due to increased income from car loans in particular. The company manages leases and car loan agreements worth a total of NOK 4.6bn of which leases account for NOK 2.2bn and car loans for NOK 2.4bn.

Sound growth has been noted – in particular in car loans which show 40 per cent growth over the last 12 months. At last year-end the Samspar banks participating in SpareBank 1 held a 27.9 per cent stake in SpareBank 1 Finans Midt-Norge. Sparebanken Sogn og Fjordane joined as co-owners in January 2016 with a stake of 7.5 per cent, thereby further strengthening the company's distributive power. SpareBank 1 SMN now owns 64.6 per cent of the shares of SpareBank 1 Finans Midt-Norge.

SpareBank 1 Regnskapshuset SMN posted a pre-tax profit of NOK 25.9m (20.3m) for the first half of 2016. SpareBank 1 SMN Regnskapshuset SMN has a growth strategy based on the acquisition of small accounting firms. In 2016 the company has acquired three businesses in Sunnmøre which were consolidated into the company at the half-year mark.

The company caters to the SMB segment with a modern distribution model and a broad range of services.

Allegro Kapitalforvaltning 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 pre-tax profit of NOK 4.4m in the first half of 2016 (1.3m). The company manages a portfolio worth NOK 5.9bn.

Sparebanken SMN Invest invests in shares, mainly in regional businesses. The company posted a net profit of NOK 22.5m (13.0m) in the first half of 2016.

Value changes and realisation of losses or gains on the company's overall shareholding represents NOK 9.7m of the overall profit. The company has in addition owner interests in the property company Grilstad Marina and its share of that company's profit in the first half of 2016 was NOK 12.8m.

SpareBank 1 Markets is a subsidiary of SpareBank 1 SMN with a stake of 73.5 per cent. The company is headquartered in Oslo and has offices in Trondheim and Ålesund. It has a staff of 108.

SpareBank 1 Markets AS is an investment firm offering a complete product range. The company's aspires to being a profitable capital market unit able to deliver all capital market services in collaboration with its owner banks.

The company's pre-tax profit in the first half of 2016 was NOK 5.5m. Results across all the company's business lines have been satisfactory. Underlying operations for these business lines are sound, with a solid customer base.

The company is the leading capital market unit in SpareBank 1 SMN's market area. SpareBank 1 Markets' main focus is on clients where the company is in a strong competitive position alone or in collaboration with its owner banks.

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.

The bank has liquidity reserves of NOK 27bn and has the funding needed for 32 months of ordinary operation without fresh external finance.

The Ministry of Finance requires all credit institutions to maintain sufficient liquidity buffers to withstand periods of limited access to market funding. The liquidity coverage ratio (LCR) measures the size of banks' liquid assets relative to net liquidity outflow 30 days ahead in time given a stressed situation.

The LCR was extra high at the half-year mark due to expectations of seasonally large liquidity outflows in the third quarter, and is calculated at 149 per cent as at 30 June 2016. The bank has in addition funded parts of its refinancing needs for the second half-year in light of possible major financial market uncertainty. In June the bank raised a new five-year loan of EUR 500m in the Euro market. The loan was well received and attracted an order book of EUR 1000 million spread across 150 investors in Europe and Asia.

The bank's funding sources and products are amply diversified. At the half-year mark the proportion of money market funding in excess of 1 year was 87 per cent (83 per cent).

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 June 2016 was 14.1 per cent (12.7 per cent). The change over the last 12 months is ascribable to:

- The CET1 ratio has risen by 1.4 percentage point to 14.1 per cent, and CET1 capital has risen by NOK 1.3bn. This is in all essentials ascribable to profit retention
- Risk weighted assets in terms of need for capital have increased by NOK 36bn or 0.5 per cent over the last 12 months. Low growth in risk weighted assets is due largely to reduced credit exposure to the business sector at BN Bank

As of 30 June 2016 the regulatory requirement on CET1 capital is 11.5 per cent, including combined buffer requirements. As from 30 June 2016 the countercyclical requirement rose to 1.5 per cent.

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

Finanstilsynet (Norway's FSA) has communicated a capital expectation of 14.5 per cent CET1 capital by 31 December 2016. This was considered by the bank's board of directors in December 2015 and a new CET1 target of at least 14.5 per cent, to be reached by 31 December 2016, was adopted. Finanstilsynet will not set individual Pillar 2 add-ons for SpareBank 1 SMN prior to Supervisory Review and Evaluation Process (SREP) in 2016.

The board of directors of SpareBank 1 SMN assumes and expects that carrying through the bank's capital plan will ensure that the bank attains the capital levels expected by the market and set by the authorities without need of a stock issue.

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
- Moderate growth in the bank's asset-intensive activities, with priority given to lending to households
- Wind-down of the commercial property portfolio of BN Bank. By the end of the second quarter of 2016 the portfolio had been reduced by 36 per cent since 30 June 2015

The bank's equity certificate (MING)

The book value of the bank's EC at 30 June 2016 was NOK 69.18 (64.18), and earnings per EC were NOK 3.71 (4.31).

As at 30 June 2016 the EC was priced at NOK 46.70 (NOK 65.50), and dividend of NOK 2.25 per EC (NOK 2.25) has been paid in 2016 for the year 2015.

The Price / Income ratio was 6.30 (7.60) and the Price / Book ratio was 0.68 (1.02) at 30 June 2016.

Risk factors

The Group's problem loans have increased substantially, and individually assessed write-downs have been carried out on three offshore exposures. As at 30 June 2016 loans to oil-related activity accounted for 4.1 per cent of the Group's overall loan volume. The credit quality of the bank's remaining loan portfolio is satisfactory and, with the exception of oil-related activity, 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 expects low growth in lending to mid-Norway's business sector ahead as a result of the low level of investment.

Real wage growth will be low, but with a lasting low interest rate level the bank considers the risk of loss on the bank's retail market portfolio to be low. Uncertainty relates above all to the trend in unemployment. The bank expects unemployment to show a slight increase, but to be relatively moderate in the bank's market areas as a whole.

Credit demand from Norwegian households has fallen somewhat, but remains higher than wage growth and will be heavily affected by the trend in house prices. The bank expects losses on home mortgage loans to remain low. If house prices stagnate, or fall, there is a risk that the household saving rate will quicken, which 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 satisfied with the trend in the Group. A return on equity of 10.9 per cent despite a considerable increase in loan losses bears witness to a robust bank. The Group is experiencing growth and a stronger financial position. Progress is noted in all of the Group's business lines.

The board of directors notes that the work on restructuring the oil and offshore exposures is developing well and is pleased with the results of this process so far. There are still few signs to suggest that the challenges faced in oil-related activity have fed through to the economy in the bank's market area to any appreciable extent. The board maintain their expectation that overall loan losses for the whole of 2016 will be in the region of NOK 450m to 500m.

The board of directors is content with the development of the bank's CET1 capital position and assumes and expects the target of 14.5 per cent to be met by 31 December 2016 by means of the instruments set out in the bank's capital plan.

The board expects 2016 to be a good year for SpareBank 1 SMN.

Trondheim, 11. August 2016
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

Erik Gunnes
(employee rep.)

Oddny Lysberg
(employee rep.)

Finn Haugan
(Group CEO)