

# Report of the Board of Directors

## First nine months 2016

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

- Pre-tax profit: NOK 1,430m (1,389m)
- Post-tax profit: NOK 1,185m (1,119m)
- Return on equity: 11.0 per cent (11.5 per cent)
- Growth in lending 6.6 per cent (8.3 per cent) and in deposits 4.2 per cent (9.5 per cent), in past 12 months
- Loan losses: NOK 417m (112m)
- CET1 capital ratio: 14.3 per cent (13.2 per cent)
- Earnings per equity certificate (EC): NOK 5.70 (5.57 NOK)

## Third quarter 2016

- Pre-tax profit: NOK 500m (309m)
- Post-tax profit: NOK 414m (248m)
- Return on equity: 11.3 per cent (7.4 per cent)
- Loan losses: NOK 130m (56m)
- Earnings per equity certificate (EC): NOK 2.00 (1.26 NOK)

## Good profit performance for first nine months of 2016

### Main points:

- Good profit performance
- Increased loan losses reduce profit compared with 2015
- Good profits at associates and high return on financial assets
- Strengthened financial position
- High customer influx and strong growth in home mortgage lending

In the first nine months of 2016 SpareBank 1 SMN achieved a pre-tax profit of NOK 1,430m (1,389m). Net profit was NOK 1,185m (1,119m) and return on equity was 11.0 per cent (11.5 per cent).

The pre-tax profit in the third quarter was NOK 500m (309m). Return on equity in the quarter was 11.3 per cent (7.4 per cent).

Overall operating revenues for the first nine months come to NOK 2,651m (2,567m), an increase of NOK 84m compared with the same period of 2015.

Return on financial investments was NOK 717m (350m), of which income from owner interests in associates and joint ventures accounted for NOK 349m (327m) in the first nine months.

Net losses on loans and guarantees came to NOK 417m (112m). The losses break down to NOK 402m on individually assessed write-downs and NOK 15m on collectively assessed write-downs. The losses are



attributed in all essentials to the restructuring of the bank's exposure to the oil/offshore industry. There is no significant change in expected credit losses for 2016.

At end-September 12-month lending growth was 6.6 per cent (8.3 per cent) and deposit growth was 4.2 per cent (9.5 per cent). In the first nine months lending rose by 5.6 per cent (4.8 per cent) and deposits by 3.4 per cent (4.8 per cent).

At the end of the first nine months of 2016 the CET1 ratio was 14.3 per cent (13.2 per cent). CET1 capital adequacy has strengthened by 1.1 percentage point in the 12 months to end-September.

SpareBank 1 SMN plans for a CET1 ratio of 14.5 per cent by 31 December 2016. The capital plan is further described in the section on financial position.

The market price of the bank's EC at end-September was NOK 55.75 (50.50 at end-2015).

Earnings per EC in the first nine months were NOK 5.70 (5.57). The book value per EC was NOK 71.17 (65.52). Earnings per EC in the third quarter were NOK 2.00 (NOK 1.26)

### **Net interest income**

Net interest income came to NOK 1,391m (1,399m) in the first nine months of 2016. Net interest income has been relatively stable quarter-on-quarter in 2015 and 2016, but shows substantial gross movements:

- Increased lending to and deposits from retail and corporate customers
- Increased margins on deposits
- Reduced home mortgage lending margins
- In the third quarter in isolation net interest income was reduced by NOK 12m as a result of reversed interest income on doubtful exposures

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 2016 totalled NOK 219m (253m).

Competition in the home mortgage market is strong, and margins on these loans have fallen by 80 points over the last two years. In the same period deposit rates to retail and corporate customers have been lowered, so that increased deposit margins are compensating for some of the margin lapse on home mortgages. In addition, an increase in interbank rates has raised the bank's funding costs.

### **Increased commission income**

Commission and other operating income rose to NOK 1,260m (1,168m) in the first nine months of 2016, an increase of NOK 93m from last year corresponding to 8 per cent.

Income from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt was reduced by NOK 35m due to reduced margins on loans sold to SpareBank 1 Boligkreditt. A positive development is seen in other commission income. The overall increase of NOK 128m in other commission income is ascribable to increased income from capital market activities, real estate agency and accounting 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)	January-September		
	2016	2015	Change
Payment transfers	149	143	6
Creditcard	46	42	5
Saving products	66	58	9
Insurance	119	114	5
Guarantee commission	60	52	8
Real estate agency	301	262	39
Accountancy services	161	143	18
Markets	86	43	43
Other commissions	54	58	-4
<b>Commissions ex SB1 Boligkreditt and SB1 Næringskreditt</b>	<b>1,042</b>	<b>914</b>	<b>128</b>
Commissions SB1 Boligkreditt	211	247	-36
Commissions SB1 Næringskreditt	8	7	1
<b>Total commissions</b>	<b>1,260</b>	<b>1,168</b>	<b>93</b>

### Financial investments

Overall return on financial investments (excluding the share of the profit/loss of associates and joint ventures) was NOK 368m (24m). This breaks down as follows:

- Return and dividend on the group's equity portfolios totalled NOK 110m (79m). Of the amount of NOK 110m, NOK 82m refers to the sale of Visa Europa to Visa Inc.
- Capital gains on bonds and derivatives came to NOK 158m (loss of 73m)
- Income on forex and fixed income transactions was NOK 99m (82m)

Capital gains/dividends, shares (NOKm)	January-September		
	2016	2015	Change
Capital gains/dividends, shares	110	79	31
Bonds and derivatives	158	-73	232
Change in discount factor in fair value model for fixed interest loans	-	-64	64
Income on forex and fixed income	99	82	17
<b>Net return on financial investments</b>	<b>368</b>	<b>24</b>	<b>344</b>
SpareBank 1 Gruppen	220	183	37
SpareBank 1 Boligkreditt	9	65	-55
SpareBank 1 Næringskreditt	20	22	-2
SpareBank 1 Kredittkort	20	15	5
BN Bank	79	31	48
Companies owned by SpareBank 1 SMN Invest	19	13	6
SpareBank 1 Mobilbetaling	-19	-	-19
Other companies	-0	-2	1
<b>Income from investment in related companies</b>	<b>349</b>	<b>327</b>	<b>22</b>
<b>Total</b>	<b>717</b>	<b>351</b>	<b>366</b>

### SpareBank 1 Gruppen

SpareBank 1 Gruppen's post-tax profit for the first nine months of 2016 was NOK 1,094m (939m). The main contributor to the profit was the insurance arm. SpareBank 1 SMN's share of the profit for the first nine months of 2016 was NOK 220m (183m).

### SpareBank 1 Boligkreditt

SpareBank 1 Boligkreditt was established by the banks participating in the SpareBank 1 Alliance to draw benefit from the market for covered bonds. By selling their best secured home mortgage loans to the company, the banks achieve reduced funding costs and better access to funding of these loans. As at 30 September 2016 the bank had sold loans worth NOK 32.9bn (29.9bn) to SpareBank 1 Boligkreditt, corresponding to 38 per cent (38 per cent) of overall loans to retail borrowers.



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 nine months of 2016 was NOK 9m (65m). The result in the third quarter in isolation was impaired by losses on the company's basis swaps. For SpareBank 1 SMN the effect of the basis swaps amounted to NOK 28m in the third quarter. The stake reflects the bank's relative share of the company's balance sheet.

### **SpareBank 1 Næringskreditt**

SpareBank 1 Næringskreditt was established along the same lines as SpareBank 1 Boligkreditt. As at 30 September 2016, loans worth NOK 2.0bn (1.4bn) had been sold to SpareBank 1 Næringskreditt.

SpareBank 1 SMN's stake in the company is 34.1 per cent, and the bank's share of the company's profit in the first nine months of 2016 was NOK 20m (22m). 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, 82 per cent have been transferred from BN Bank.

### **SpareBank 1 Kredittkort**

Profit for the first nine months of 2016 was NOK 110m (83m). 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 nine months' profit was NOK 20m (15m). The bank's share of the portfolio is NOK 840m (773m).

### **BN Bank**

SpareBank 1 SMN owns 33.0 per cent of BN Bank. BN Bank recorded a profit of NOK 239m (93m) in the third quarter of 2016. SpareBank 1 SMN's share of the profit of BN Bank was NOK 79m (31m). Return on equity was 9.0 per cent (5.8 per cent). The profit growth is largely due to repricing of the corporate banking portfolio.

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 nine months of 2016 the corporate portfolio had been reduced by NOK 14.3bn or 45 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 SpareBank 1 SMN's CET1 capital adequacy by 0.5 percentage point.

### **SpareBank 1 Mobilbetaling (mCASH)**

SpareBank 1 Mobilbetaling is SpareBank 1's project to strengthen the SpareBank 1 banks' position on new mobile interfaces through 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. At the end of the quarter more than 4,300 associations and 7,500 payment locations have taken mCASH into use as a payments solution. Total number of registered users of mCASH is 445,000.



The company recorded a deficit of NOK 95m in the first nine months of 2016 of which SpareBank 1 SMN's share is NOK 19m. 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 1,521m (1,416m) in the first nine months of 2016. Of the increase of NOK 105m, NOK 59m is ascribable to SpareBank 1 Markets' consolidation as a subsidiary as from the second quarter of 2015.

Parent bank costs rose by NOK 8m to NOK 898m. 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 83 from 720 to 637. The bank aims for zero growth in costs in the period 2014 to 2016. Changing customer behaviour and new technology will set the stage for increased efficiency in the period ahead.

The development in the bank's costs is also related to changes at SpareBank 1 Markets. As from the second quarter of 2015 the capital market business at SpareBank 1 SMN was transferred to 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 in the second quarter for increased reorganisation costs related to severance agreements entered into in connection with planned downstaffing in 2016.

The Group cost-income ratio was 45 per cent (49 per cent).

The bank's board of directors has decided to wind down the defined benefit pension plan and has introduced new rates for defined contribution pensions. This, together with a number of other measures, is not expected to result in higher operating expenses. Employees in the defined benefit plan will switch to defined contribution pension as from 1 January 2017. This will bring a reduction in the pension liability which will result in a one-time gain estimated NOK 85m for the parent bank and NOK 91m for the group in the accounts for the fourth quarter.

### **Loan losses in offshore segment but otherwise low defaults**

Net losses on loans and guarantees totalled NOK 417m (112m) in the first nine months of 2016 of which NOK 15m (31m) is increased collectively assessed impairment write-downs. Net losses in the third quarter in isolation were NOK 130m (56m).

A net loss of NOK 401m was recorded on loans to corporates in the first nine months of 2016. Of this increase, NOK 342 refers to four exposures in the offshore segment. A net loss of NOK 16m was recorded on the retail banking portfolio in the first nine months of 2016.

Individually assessed write-downs on loans and guarantees in the first nine months of 2016 totalled NOK 562m (192m), an increase of NOK 370m over the last 12 months.

Total problem loans (defaulted and doubtful) came to NOK 1,581m (667m), or 1.18 per cent (0.53 per cent) of gross loans including loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt.



Defaults in excess of 90 days totalled NOK 221m (218m), measuring 0.16 per cent (0.17 per cent) of gross lending. Of the overall default volume, NOK 35m (29m) is loss provisioned corresponding to 16 per cent (13 per cent).

Defaults break down to NOK 44m (50m) on corporates and NOK 177m (169m) on retail borrowers.

Other doubtful exposures totalled NOK 1,360m (448m), i.e. 1.01 per cent (0.36 per cent) of gross loans. Individually assessed write-downs on these exposures came to NOK 526m (164m) corresponding to a share of 39 per cent (37 per cent).

Other doubtful exposures break down to NOK 1,344m (431m) on corporates and NOK 26m (17m) on retail borrowers.

At end-September 2016 collectively assessed write-downs related to the offshore portfolio is 8.1 per cent. The exposure in offshore has been reduced by 1.1 billion during the last 12 months.

The whole of this industry is now undergoing restructuring. The process is challenging as the companies have a debt structure which includes several banks with separate loan facilities and bond debt. The suggested solutions entails new equity capital, forbearance and renegotiated or converted bond debt. Thus far this work has provided good results. The solutions now being established for individual businesses can be expected to be of a lasting nature, load balanced between the financial institutions and to curb the bank's risk. The bank has not observed impacts to other industries at end-September 2016.

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

### **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 due to a challenging market situation. An increase in individually assessed impairment write-downs in the second and third quarter of 2016 related to this sector provided a basis for reducing the provision for collectively assessed write-downs, and the write-downs were reduced by NOK 110m in the second quarter and NOK 25m in the third quarter.

Overall collectively assessed loss write-downs accordingly come to NOK 391m (326m), measuring 0.29 per cent (0.26 per cent) of total loans. Collectively assessed write-downs break down to NOK 98m on retail exposures and NOK 293m on corporates. Of the provision of NOK 293m on the corporate portfolio, the provision related to oil-related activity accounts for NOK 115m. The remaining collectively assessed write-downs of NOK 178m on the corporate portfolio are fairly evenly spread across other sectors.

### **Total assets of NOK 140bn**



The Group's assets totalled NOK 139.8bn at 30 September 2016 (129.2bn), having risen by NOK 10.6bn or 8.2 per cent over the preceding 12 months.

As at end-September 2016 home mortgage loans worth a total of 34.9bn (31.3bn) had been sold by SpareBank 1 SMN to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. 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.

### High 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 9).

In the 12 months to end-September total outstanding loans rose by NOK 8.3bn (9.7bn) or 6.6 per cent (8.3 per cent) to reach NOK 134.5bn (126.2bn). Growth in 2016 has been 5.6 per cent (4.8 per cent).

Loans to retail borrowers rose by NOK 8.5bn (6.3bn) to reach NOK 87.4bn in the last 12 months, equivalent to growth of 10.8 per cent (8.7 per cent). Growth so far in 2016 has been 8.3 per cent (6.4 per cent).

Growth in lending to corporates in the last 12 months was reduced by NOK 0.2bn (growth of NOK 3.4bn) corresponding to minus 0.5 per cent (growth of 7.8 per cent). Overall lending to corporates was NOK 47.1bn in the first nine months of 2016. Lending to corporates has risen by 0.9 per cent (2.1 per cent) in 2016.

Loans to retail borrowers accounted for 65 per cent (63 per cent) of lending to customers as at end-September 2016.

### Deposits

Customer deposits rose by NOK 2.7bn (5.5bn) over the last 12 months to reach NOK 66.3bn as at 30 September 2016. This represents a growth of 4.2 per cent (9.5 per cent).

Retail deposits rose by NOK 1.5bn (2.1bn) or 5.3 per cent (8.2 per cent) to reach NOK 29.7bn, while corporate deposits rose by NOK 1.2bn (3.4bn) or 3.3 per cent (10.6 per cent) to NOK 36.6bn.

### Investment products

The customer portfolio of off-balance sheet investment products totalled NOK 8.2bn (7.6bn) at 30 September 2016. New sales and value changes in underlying securities explain the increase in equity funds and active asset management.

Saving products, customer portfolio (NOKm)	January-September		Change
	2016	2015	
Equity funds	4,966	4,819	147
Pension products	679	671	8
Active management	2,518	2,140	378
<b>Total</b>	<b>8,163</b>	<b>7,630</b>	<b>533</b>



## Insurance products

The bank's insurance portfolio showed growth of NOK 65m corresponding to 5.5 per cent in the 12 months to end-September. Non-life insurance delivered 2.1 per cent growth, personal insurance 12.1 per cent and occupational service pensions 9.5 per cent.

Insurance, premium volume (NOKm)	January-September		Change
	2016	2015	
Non-life insurance	735	720	15
Personal insurance	296	264	32
Occupational pensions	208	190	18
<b>Total</b>	<b>1,239</b>	<b>1,174</b>	<b>65</b>

## Retail Banking

Operating income in the first nine months totalled NOK 1,277m (1,239m) of which net interest income accounted for NOK 713m (709m) and commission income for NOK 513m (530m). 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 12m. Return on capital employed in the retail banking segment was 13.5 per cent (16.2 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 nine months of 2016 was 1.76 per cent (2.11 per cent), while the deposit margin was 0.24 per cent (minus 0.20 per cent) (measured against three-month NIBOR). The average three-month NIBOR has fallen by 30 basis points since the start of 2015.

In the 12 months to end-September retail lending and retail deposits grew by 10.3 per cent (8.1 per cent) and 4.4 per cent (5.1 per cent) respectively.

Lending to retail borrowers consistently 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 889m (874m) in the first nine months of 2016. Net interest income was NOK 731m (729m), while commission income totalled NOK 158m (146m) including NOK 10m (11m) on fixed income and forex business. Operating income in the corporate segment has increased mainly due to increased deposit margins and higher guarantee commissions.

Total losses recorded in the Corporate Banking Division were NOK 398m (100m) of which individually assessed write-downs accounted for NOK 383m and collectively assessed write-downs for NOK 15m. Losses are in all essentials related to the challenges faced in the oil and offshore segment.

Return on capital employed for the corporate banking segment was 4.1 per cent in the first nine months of 2016 (12.9 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 was 2.60 per cent (2.68 per cent) and the deposit margin was minus 0.16 per cent (minus 0.31 per cent) in the first nine months.

Lending was reduced by 2.5 per cent (growth of 7.8 per cent) and deposits by 6.4 per cent (16.2 per cent) in the 12 months to end-September.

## Subsidiaries

The subsidiaries posted an overall profit of NOK 220.3m (167.5m) before tax and minority interests.

Pre-tax profit (NOKm)	January-September		
	2016	2015	Change
EiendomsMegler 1 Midt-Norge	59.5	39.5	20.0
SpareBank 1 Finans Midt-Norge	74.9	63.6	11.4
SpareBank 1 Regnskapshuset SMN	32.9	26.0	6.9
Allegro Kapitalforvaltning	5.1	2.1	3.0
SpareBank 1 SMN Invest	36.7	33.0	3.7
Sparebank 1 Markets (from second quarter 2015)	6.0	-62.7	68.6
Other companies	5.3	3.3	2.0
<b>Total</b>	<b>220.3</b>	<b>104.8</b>	<b>115.5</b>

*The figures are the respective companies' results. The bank's stake in EiendomsMegler 1 Midt-Norge is 87.0 per cent, in SpareBank 1 Finans Midt-Norge 64.6 per cent, in Allegro 90.1 per cent and in SpareBank 1 Markets 73.5 per cent. The stake in the other companies is 100 per cent.*

**EiendomsMegler 1 Midt-Norge** posted a very good result in the first nine months of 2016. The company leads the field in Trøndelag and in Møre og Romsdal with a market share of 40 per cent, and in Trondheim of about 50 per cent. The company's first nine months' profit of NOK 59.5m (39.5m) is very good and is NOK 20.0m better than in the same period of 2015. 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 5,776 in the first nine months of 2016 compared with 5,290 in the same period of 2015.

**SpareBank 1 Finans Midt-Norge** reported a profit of NOK 74.9m in the first nine months of 2016 (63.6m) and shows positive profit growth due to increased income from car loans in particular. The company's business areas are mainly leasing to the SMB market and car loans to retail customers. Leases account for NOK 2.3bn and car loans for NOK 2.6bn.

Sound growth has been noted – in particular in car loans which show 38 per cent growth over the last 12 months. The Samspar banks in SpareBank 1 hold a 27.9 per cent stake in SpareBank 1 Finans Midt-Norge. Sparebanken Sogn og Fjordane joined as co-owner 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 32.9m (26.0m) for the first nine months 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 are consolidated into the company at quarter-end.

The company caters to the SMB segment with a technologically modern distribution model and a broad range of services. In order to be better equipped to implement a major digital project and to modernise its accounting services, the company bought the IT consultancy Areto Solutions in the third quarter. This company has 20 employees and offices in Trondheim.



**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 5.1m in the first nine months of 2016 (2.1m). The company manages a portfolio worth NOK 6.1bn.

**Sparebanken SMN Invest** invests in shares, mainly in regional businesses. The company posted a net profit of NOK 36.7m (33.0m) in the first nine months of 2016.

Value changes and realisation of losses or gains on the company's overall shareholding represents NOK 20.8m of the company's 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 nine months of 2016 was NOK 19.1m.

**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 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 nine months of 2016 was NOK 6.0m. 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 25bn and has the funding needed for 29 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 relatively high at quarter-end and is calculated at 138 per cent as at 30 September 2016.

In the second quarter the bank raised a new loan in the Euromarket of EUR 500m with a five-year term.

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 85 per cent (88 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.



**Financial position**

The CET1 capital ratio at 30 September 2016 was 14.3 per cent (13.2 per cent). The change over the last 12 months is ascribable to:

- An increase of NOK 1.2bn, or 10.4 per cent, in CET1 capital over the last 12 months. This is in all essentials retained profit.
- Overall capital needs have risen by NOK 141m corresponding to 2.0 per cent over the last 12 months. The low growth in need for capital is largely because growth has been in the area of home mortgage lending rather than in lending to corporates. Reduced lending to commercial property at BN Bank has also made a positive contribution to the low growth in the need for capital. A change in the composition of lending has brought a higher capital requirement related to the Basel floor transitional rule, and this represents 10 per cent of the group's overall capital requirement.

As at 30 September 2016 the regulatory requirement on CET1 capital is 11.5 per cent, including combined buffer requirements. The countercyclical buffer was raised to 1.5 per cent on 30 June 2016.

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

SpareBank 1 SMN aims to achieve a CET1 target of at least 14.5 per cent by 31 December 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 third quarter of 2016 the portfolio had been reduced by 45 per cent since 30 June 2015.

The bank has received a letter from Finanstilsynet (Norway's FSA) giving an assessment of risks that are not adequately covered by Pillar 1. Finanstilsynet's assessment provides for an add-on of 2.3 per cent mainly related to owner risk, market risk and credit concentration risk. The directors' assessment is that this add-on is higher than the underlying conditions in the bank warrant. However, this has no impact on the directors' CET1 capital target of 14.5 per cent. The bank will deliver its reply by 1 November 2016. .

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

The book value of the bank's EC at quarter-end was NOK 71.17 (65.52), and earnings per EC were NOK 5.70 (5.57). As at 30 September 2016 the EC was priced at NOK 55.75 (NOK 50.50 at 31 December 2015). Dividend of NOK 2.25 per EC has been paid in 2016 for the year 2015.

The Price / Income ratio was 7.33 (7.27) and the Price / Book ratio was 0.78 (0.82).



**Risk factors**

The challenges in the offshore industry entail a high level of losses and problem loans. The increase in individually assessed write-downs and collectively assessed write-downs is in all essentials ascribable to customers in this market segment. The bank sees little evidence of contagion effects to the rest of the loan portfolio. Credit quality in the rest of the portfolio is satisfactory, and loss and default levels in other portfolios are low.

The bank expects a continued low rate of GDP growth as a result of declining oil investment. The Norwegian krone has appreciated, thereby reducing some of the positive impact enjoyed by export industries, and will partially offset some of these effects. The bank expects moderate growth in credit demand from mid-Norway's business sector ahead as a result of the continued low level of investment.

The bank expects a slight increase in unemployment, but that unemployment will remain relatively low, and, given continued low interest rates, the bank considers that the risk of loss 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, 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**

SpareBank 1 SMN is on a satisfactory trend. The board of directors highlight good profit performances at subsidiaries and associates.

Strong growth in home mortgage lending confirms that the bank is strengthening its solid market position among retail customers. More and more small and medium-sized businesses are opting to become customers of SpareBank 1 SMN. The competitive situation for lending to commercial property is demanding. Norwegian and foreign banks price differently as a result of differing regulatory requirements. This dampens an otherwise positive margin trend in the corporate area.

The work on restructuring businesses in the oils and offshore segment receives much attention. Impairment write-downs in this segment total NOK 509m, of which NOK 356m in 2016. The directors assume that challenges in this segment will continue and expect losses of around NOK 500m for the year as a whole.

The bank's plan for zero cost growth at the parent bank has been carried through. The directors expect and assume that changing customer behaviour and new technology will pave the way for increased efficiency.



The directors are pleased that the CET1 capital ratio has strengthened to 14.3 per cent. The group's target of a CET1 ratio of 14.5 per cent by 31 December 2016 is expected to be achieved.

2016 is expected to be a good year for SpareBank 1 SMN.

Trondheim, 23. October 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)