

## Note 4 - Capital adequacy

SpareBank 1 SMN utilises the Internal Rating Based Approach (IRB) for credit risk. Use of IRB imposes wide-ranging requirements on the bank's organisational set-up, competence, risk models and risk management systems. As from 31 March 2015 the bank has received permission to apply the Advanced IRB Approach to those corporate portfolios that were previously reported under the Basic Indicator Approach.

As of 31 December 2016 the capital conservation buffer requirement is 2.5 per cent, the systemic risk requirement is 3.0 per cent and the Norwegian countercyclical buffer is 1.5 per cent. These requirements are additional to the requirement of 4.5 per cent CET1 capital, so that the overall minimum requirement on CET1 capital is 11.5 per cent. In addition the financial supervisory authority has set a Pillar 2 requirement of 2.1 per cent for SpareBank 1 SMN, effective as from the fourth quarter of 2016. The total minimum requirement on CET1 capital is accordingly 13.6 per cent.

The countercyclical buffer increased to 1.5 per cent from 1.0 per cent with effect from 30 June 2016. The Ministry of Finance has decided to increase the buffer by 0.5 per cent to 2.0 per cent with effect from 31 December 2017.

As from the fourth quarter of 2016 differentiated rates came into force for the countercyclical buffer. For exposures in other countries the countercyclical buffer rate set by the authorities in the country concerned is applied. If that country has not set a rate, the same rate as for exposures in Norway is applied unless the Ministry of Finance sets another rate. For the fourth quarter of 2016 the parent bank is below the capital deduction threshold such that the Norwegian rate is applied to all relevant exposures. For groups, the risk-weighted countercyclical capital buffer is 1.5 per cent.

Parts of the group's hybrid capital and subordinated debt were issued under earlier rules. This will be subject to a write-down of 40 per cent in 2016 and thereafter 10 per cent per year. As at 31 December 2016 the bank held hybrid capital worth NOK 450 million subject to write-down. For subordinated debt the figure NOK 661 million. The financial supervisory authority may require the hybrid capital to be written down in proportion to equity capital if the bank's CET1 capital ratio falls below 5.125 per cent.

| Parent Bank  |               |   | Group         |               |
|--|---------------|---|---------------|---------------|
| 31 Dec 2015  | 31 Dec 2016   | (NOKm)  | 31 Dec 2016   | 31 Dec 2015   |
| 2,597  | 2,597         | Equity capital certificates   | 2,597         | 2,597         |
| -0   | -0            | - Own holding of ECCs   | -4            | -21           |
| 895  | 895           | Premium fund  | 895           | 895           |
| 3,790  | 4,487         | Dividend equalisation fund  | 4,484         | 3,790         |
| 4,105  | 4,498         | Savings bank's reserve  | 4,498         | 4,105         |
| 292  | 389           | Recommended dividends   | 389           | 292           |
| 40   | 220           | Provision for gifts   | 220           | 40            |
| 279  | 126           | Unrealised gains reserve  | 139           | 290           |
| -  | -             | Other equity  | 1,656         | 1,597         |
| -  | -             | Non-controlling interests   | 425           | 318           |
| <b>11,998</b>  | <b>13,212</b> | <b>Total book equity</b>  | <b>15,299</b> | <b>13,904</b> |
| -447   | -470          | Deferred taxes, goodwill and other intangible assets  | -741          | -662          |
| -  | -             | Part of reserve for unrealised gains, associated companies                                      | 117           | 264           |
| -332   | -609          | Deduction for allocated dividends and gifts   | -609          | -332          |
| -  | -             | Non-controlling interests recognised in other equity capital                                    | -425          | -318          |
| -  | -             | Non-controlling interests eligible for inclusion in CET1 capital                                | 220           | 132           |
| -93  | -             | Surplus financing of pension obligations  | -             | -43           |
| -33  | -29           | Value adjustments due to requirements for prudent valuation                                     | -48           | -55           |
| -164   | -190          | Positive value of adjusted expected loss under IRB Approach                                     | -248          | -239          |
| -  | -             | Deduction for common equity Tier 1 capital in significant investments in financial institutions | -337          | -458          |
| <b>10,928</b>  | <b>11,913</b> | <b>Total common equity Tier one</b>   | <b>13,229</b> | <b>12,192</b> |
| 950  | 950           | Hybrid capital, core capital  | 1,358         | 1,301         |
| 495  | 483           | Hybrid capital covered by transitional provisions   | 483           | 495           |
| <b>12,373</b>  | <b>13,346</b> | <b>Total core capital</b>   | <b>15,069</b> | <b>13,988</b> |
| <b>Supplementary capital in excess of core capital</b> |               |   |               |               |
| 1,000  | 1,000         | Subordinated capital  | 1,698         | 1,647         |
| 786  | 673           | Subordinated capital covered by transitional provisions   | 673           | 786           |
| -43  | -256          | Deduction for significant investments in financial institutions                                 | -256          | -43           |
| <b>1,743</b>   | <b>1,418</b>  | <b>Total supplementary capital</b>  | <b>2,116</b>  | <b>2,390</b>  |

|               |               |   |               |               |
|---------------|---------------|---|---------------|---------------|
| <b>14,116</b> | <b>14,764</b> | <b>Net subordinated capital</b>                         | <b>17,185</b> | <b>16,378</b> |
|               |               | <b>Minimum requirements subordinated capital</b>        |               |               |
| 1,027         | 1,065         | Involvement with specialised enterprises                | 1,206         | 1,213         |
| 1,049         | 1,064         | Other corporations exposure                             | 1,102         | 1,105         |
| 1,093         | 1,128         | Mass market exposure, property                          | 1,602         | 1,557         |
| 157           | 156           | Mass market exposure, SMEs                              | 166           | 167           |
| 38            | 71            | Other retail exposure                                   | 74            | 40            |
| 1,221         | 1,223         | Equity investments                                      | 3             | 0             |
| <b>4,585</b>  | <b>4,707</b>  | <b>Total credit risk IRB</b>                            | <b>4,153</b>  | <b>4,082</b>  |
| 64            | 35            | Debt risk   | 36            | 64            |
| -             | -             | Equity risk   | 5             | 10            |
| -             | -             | Currency risk   | 1             | -             |
| 316           | 334           | Operational risk  | 479           | 457           |
| 922           | 898           | Exposures calculated using the standardised approach    | 1,772         | 1,805         |
| 53            | 51            | Credit value adjustment risk (CVA)                      | 84            | 106           |
| -             | -             | Transitional arrangements                               | 574           | 634           |
| <b>5,939</b>  | <b>6,026</b>  | <b>Minimum requirements subordinated capital</b>        | <b>7,103</b>  | <b>7,157</b>  |
| <b>74,243</b> | <b>75,325</b> | <b>Risk weighted assets (RWA)</b>                       | <b>88,788</b> | <b>89,465</b> |
| 3,341         | 3,390         | Minimum requirement on CET1 capital, 4.5 per cent       | 3,995         | 4,026         |
|               |               | Capital Buffers   |               |               |
| 1,856         | 1,883         | Capital conservation buffer, 2.5 per cent               | 2,220         | 2,237         |
| 2,227         | 2,260         | Systemic risk buffer, 3.0 per cent                      | 2,664         | 2,684         |
| 742           | 1,130         | Countercyclical buffer, 1.5 per (1.0 per cent)          | 1,332         | 895           |
| <b>4,826</b>  | <b>5,273</b>  | <b>Total buffer requirements on CET1 capital</b>        | <b>6,215</b>  | <b>5,815</b>  |
| <b>2,761</b>  | <b>3,251</b>  | <b>Available CET1 capital after buffer requirements</b> | <b>3,018</b>  | <b>2,351</b>  |
|               |               | <b>Capital adequacy</b>                                 |               |               |
| 14.7 %        | 15.8 %        | Common equity Tier one ratio                            | 14.9 %        | 13.6 %        |
| 16.7 %        | 17.7 %        | Core capital ratio                                      | 17.0 %        | 15.6 %        |
| 19.0 %        | 19.6 %        | Capital adequacy ratio                                  | 19.4 %        | 18.3 %        |
| 9.1 %         | 9.5 %         | Leverage ratio  | 7.4 %         | 6.7 %         |