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 30 September 2019 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 2.0 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 12.0 per cent. In addition the financial supervisory authority has set a Pillar 2 requirement of 1.9 per cent for SpareBank 1 SMN. The total minimum requirement on CET1 capital is accordingly 13.9 per cent.

It has been announced that the countercyclical capital buffer is to be increased to 2.5 per cent as from 31 December 2019. In addition, a consultation document dated 25 June 2019 from the Ministry of Finance proposes increasing the systemic risk buffer to 4.5 per cent with effect from 31 December 2019. This coincides with the removal of the Basel 1 floor and the proposed introduction of an SME discount. If this is introduced with effect from 31 December 2019, the total minimum requirement on CET1 capital including the Pillar 2 requirement will be 15.9 per cent.

The countercyclical buffer is calculated using differentiated rates. 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 first nine months of 2019 both the parent bank and the group is below the capital deduction threshold such that the Norwegian rate is applied to all relevant exposures.

Parts of the group's hybrid capital and subordinated debt were issued under earlier rules. This has been subject to a write-down of 60 per cent in 2018 and 70 per cent in 2019. As at 30 September 2019 the bank held hybrid capital worth NOK 450 million subject to write-down.

Parent Bank				Group		
31 Dec 2018	30 Sept 2018	30 Sept 2019	(NOKm)	30 Sept 2019	30 Sept 2018	31 Dec 2018
16,409	16,428	17,228	Total book equity	19,904	18,650	18,686
-1,000	-1,268	-963	Additional Tier 1 capital instruments included in total equity	-1,004	-1,310	-1,043
-533	-538	-515	Deferred taxes, goodwill and other intangible assets	-1,106	-1,059	-1,079
-1,034	-	-	Deduction for allocated dividends and gifts	-	-	-1,034
-	-	-	Non-controlling interests recognised in other equity capital	-792	-623	-637
-	-	-	Non-controlling interests eligible for inclusion in CET1 capital	450	371	366
-	-1,649	-1,893	Net profit	-2,217	-1,689	-
-	825	804	Year-to-date profit included in core capital (50 per cent pre tax of group profit in 2018)	1,128	864	-
-31	-29	-32	Value adjustments due to requirements for prudent valuation	-44	-47	-44
-268	-308	-353	Positive value of adjusted expected loss under IRB Approach	-383	-316	-286
-	-	-	Cash flow hedge reserve	5	2	5
-163	-163	-185	Deduction for common equity Tier 1 capital in significant investments in financial institutions	-183	-147	-206
13,381	**13,298**	**14,091**	**Total common equity Tier one**	**15,758**	**14,697**	**14,727**
1,000	1,000	1,000	Additional Tier 1 capital instruments	1,384	1,478	1,378
367	367	275	Additional Tier 1 capital instruments covered by transitional provisions	275	367	367
14,748	**14,665**	**15,367**	**Total core capital**	**17,417**	**16,542**	**16,472**
			Supplementary capital in excess of core capital			
1,750	1,500	1,750	Subordinated capital	2,310	2,118	2,316
96	449	179	Subordinated capital covered by transitional provisions	179	449	96
-140	-140	-141	Deduction for significant investments in financial institutions	-141	-140	-140
1,705	**1,809**	**1,788**	**Total supplementary capital**	**2,348**	**2,427**	**2,272**
16,453	**16,473**	**17,155**	**Net subordinated capital**	**19,765**	**18,969**	**18,743**

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			Minimum requirements subordinated capital			
967	951	948	Specialised enterprises	1,128	1,107	1,116
1,156	1,173	1,183	Corporate	1,194	1,181	1,163
1,516	1,508	1,518	Mass market exposure, property	2,169	2,070	2,098
90	91	103	Other mass market	106	94	92
1,062	1,045	1,118	Equity investments	1	1	1
4,790	**4,768**	**4,870**	**Total credit risk IRB**	**4,597**	**4,453**	**4,470**
3	2	2	Central government	2	3	4
87	95	90	Covered bonds	149	145	124
390	375	435	Institutions	301	217	246
-	-	-	Local and regional authorities, state-owned enterprises	5	10	8
23	30	38	Corporate	237	241	221
73	70	32	Mass market	532	510	520
12	15	18	Exposures secured on real property	200	181	215
228	228	236	Equity positions	371	358	366
57	53	89	Other assets	157	109	107
873	**868**	**939**	**Total credit risk standardised approach**	**1,955**	**1,774**	**1,810**
30	31	25	Debt risk	27	33	31
-	-	-	Equity risk	6	24	7
-	-	-	Currency risk and risk exposure for settlement/delivery	3	3	3
370	370	387	Operational risk	656	575	575
39	33	35	Credit value adjustment risk (CVA)	130	80	122
-	-	-	Transitional arrangements	983	971	1,074
6,102	**6,071**	**6,256**	**Minimum requirements subordinated capital**	**8,357**	**7,913**	**8,093**
76,274	**75,887**	**78,196**	**Risk weighted assets (RWA)**	**104,464**	**98,915**	**101,168**
3,432	3,415	3,519	Minimum requirement on CET1 capital, 4.5 per cent	4,701	4,451	4,553
			Capital Buffers			
1,907	1,897	1,955	Capital conservation buffer, 2.5 per cent	2,612	2,473	2,529
2,288	2,277	2,346	Systemic rick buffer, 3.0 per cent	3,134	2,967	3,035
1,525	1,518	1,564	Countercyclical buffer, 2.0 per cent	2,089	1,978	2,023
5,721	**5,692**	**5,865**	**Total buffer requirements on CET1 capital**	**7,835**	**7,419**	**7,588**
4,228	**4,191**	**4,708**	**Available CET1 capital after buffer requirements**	**3,222**	**2,827**	**2,587**
			Capital adequacy			
17.5 %	17.5 %	18.0 %	Common equity Tier one ratio	15.1 %	14.9 %	14.6 %
19.3 %	19.3 %	19.7 %	Core capital ratio	16.7 %	16.7 %	16.3 %
21.6 %	21.7 %	21.9 %	Capital adequacy ratio	18.9 %	19.2 %	18.5 %
			Leverage ratio			
153,395	150,853	159,426	Balance sheet items	228,285	213,761	216,240
7,110	7,629	6,774	Off-balance sheet items	7,939	9,595	9,086
-832	-1,170	-900	Regulatory adjustments	-1,546	-1,729	-1,474
159,673	157,313	165,301	Calculation basis for leverage ratio	234,678	221,628	223,853
14,748	14,665	15,367	Core capital	17,417	16,542	16,472
9.2 %	**9.3 %**	**9.3 %**	**Leverage Ratio**	**7.4 %**	**7.5 %**	**7.4 %**