

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. The EU capital adequacy framework (CRR/CRDIV) was incorporated into Norwegian law with effect from 31 December 2019. The Basel I floor was accordingly removed and an SME rebate introduced.

As of 30 September 2020 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 1.0 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 11.0 per cent. In addition the financial supervisory authority has set a Pillar 2 requirement of 1.9 per cent for SpareBank 1 SMN, however not below NOK 1,794 million in monetary terms. The total minimum requirement on CET1 capital is accordingly 12.9 per cent. The countercyclical capital buffer was reduced with immediate effect in March 2020 from 2.5 per cent to 1.0 per cent. The systemic risk buffer will rise to 4.5 per cent with effect from 31 December 2020.

The Supervisory Board adopted at its meeting on 26 March 2020 a revised proposal for application of the net profit for 2019 entailing an overall reduction of 303 NOK million compared with the original proposal of NOK 1,314 million for distribution as dividends and donations. Historical figures as at 31 December 2019 are not restated, but the effect of the above decision as at 31 December 2019 is shown in the table below.

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 month of 2020 the parent bank is below the capital deduction threshold such that the Norwegian rate is applied to all relevant exposures. For group the risk-weighted countercyclical capital buffer is 1.0 per cent.

The group's hybrid equity and subordinated debt issued under the old rules has now been redeemed such that as of the first quarter of 2020 the group has no holdings covered by the transitional provisions.

Parent Bank				Group		
31 Dec 19	30 Sept 19	30 Sept 20 (NOKm)		30 Sept 20	30 Sept 19	31 Dec 19
17,822	17,228	17,876	Total book equity	20,829	19,904	20,420
-1,250	-963	-1,203	Additional Tier 1 capital instruments included in total equity	-1,244	-1,004	-1,293
-512	-515	-494	Deferred taxes, goodwill and other intangible assets	-1,047	-1,106	-1,099
-1,314	-	-	Deduction for allocated dividends and gifts	-	-	-1,314
-	-	-	Non-controlling interests recognised in other equity capital	-800	-792	-761
-	-	-	Non-controlling interests eligible for inclusion in CET1 capital	414	450	438
-	-1,893	-1,155	Net profit	-1,528	-2,217	-
-	804	368	Year-to-date profit included in core capital (50 per cent (50 per cent) pre tax of group profit)	739	1,128	-
-33	-32	-47	Value adjustments due to requirements for prudent valuation	-59	-44	-45
-305	-353	-75	Positive value of adjusted expected loss under IRB Approach	-98	-383	-351
-	-	-	Cash flow hedge reserve	13	5	3
-185	-185	-186	Deduction for common equity Tier 1 capital in significant investments in financial institutions	-510	-183	-168
14,222	14,091	15,084	Common equity Tier 1 capital	16,711	15,758	15,830
1,250	1,000	1,250	Additional Tier 1 capital instruments	1,579	1,384	1,637
275	275	-	Additional Tier 1 capital instruments covered by transitional provisions	-	275	275
15,747	15,367	16,334	Tier 1 capital	18,290	17,417	17,742
			Supplementary capital in excess of core capital			
1,750	1,750	1,750	Subordinated capital	2,240	2,310	2,240
12	179	-	Subordinated capital covered by transitional provisions	-	179	12
-140	-141	-157	Deduction for significant investments in financial institutions	-157	-141	-140
1,623	1,788	1,593	Additional Tier 2 capital instruments	2,083	2,348	2,113
17,370	17,155	17,927	Total eligible capital	20,373	19,765	19,854

			Minimum requirements subordinated capital			
911	948	1,044	Specialised enterprises	1,236	1,128	1,101
1,139	1,183	981	Corporate	991	1,194	1,149
1,628	1,518	1,598	Mass market exposure, property	2,282	2,169	2,299
98	103	108	Other mass market	111	106	101
984	1,118	1,012	Equity investments	1	1	1
4,760	4,870	4,742	Total credit risk IRB	4,621	4,597	4,651
2	2	2	Central government	2	2	3
86	90	115	Covered bonds	162	149	132
419	435	507	Institutions	402	301	282
-	-	-	Local and regional authorities, state-owned enterprises	21	5	5
42	38	27	Corporate	253	237	239
22	32	16	Mass market	470	532	463
9	18	14	Exposures secured on real property	154	200	167
236	236	279	Equity positions	400	371	377
104	89	100	Other assets	161	157	151
918	939	1,058	Total credit risk standardised approach	2,025	1,955	1,818
31	25	42	Debt risk	43	27	34
-	-	-	Equity risk	9	6	15
-	-	-	Currency risk and risk exposure for settlement/delivery	3	3	3
407	387	407	Operational risk	720	656	720
29	35	60	Credit value adjustment risk (CVA)	192	130	115
-	-	-	Transitional arrangements	-	983	-
6,145	6,256	6,309	Minimum requirements subordinated capital	7,612	8,357	7,357
76,817	78,196	78,861	Risk weighted assets (RWA)	95,156	104,464	91,956
3,457	3,519	3,549	Minimum requirement on CET1 capital, 4.5 per cent	4,282	4,701	4,138
			Capital Buffers			
1,920	1,955	1,972	Capital conservation buffer, 2.5 per cent	2,379	2,612	2,299
2,305	2,346	2,366	Systemic risk buffer, 3.0 per cent	2,855	3,134	2,759
1,920	1,564	789	Countercyclical buffer, 1.0 per cent (2.5 and 2.0 per cent)	952	2,089	2,299
6,145	5,865	5,126	Total buffer requirements on CET1 capital	6,185	7,835	7,357
4,620	4,708	6,409	Available CET1 capital after buffer requirements	6,243	3,222	4,335
			Capital adequacy			
18.5 %	18.0 %	19.1 %	Common equity Tier 1 capital ratio	17.6 %	15.1 %	17.2 %
20.5 %	19.7 %	20.7 %	Tier 1 capital ratio	19.2 %	16.7 %	19.3 %
22.6 %	21.9 %	22.7 %	Capital ratio	21.4 %	18.9 %	21.6 %
			Leverage ratio			
161,905	159,426	179,304	Balance sheet items	252,366	228,285	230,048
6,830	6,774	7,518	Off-balance sheet items	8,333	7,939	7,897
-851	-900	-617	Regulatory adjustments	-1,543	-1,546	-1,503
167,885	165,301	186,205	Calculation basis for leverage ratio	259,156	234,678	236,441
15,747	15,367	16,334	Core capital	18,290	17,417	17,742
9.4 %	9.3 %	8.8 %	Leverage Ratio	7.1 %	7.4 %	7.5 %

Effect as at 31 December 2019 on the adopted application of net profit, as revised:

	31 Dec 2019	
	Parent Bank	Group
Common equity Tier 1 capital	14,525	16,133
Tier 1 capital	16,051	18,045
Total eligible capital	17,673	20,158
Common equity Tier 1 capital ratio	18.9 %	17.5 %
Tier 1 capital ratio	20.9 %	19.6 %
Capital ratio	23.0 %	21.9 %
Leverage Ratio	9.6 %	7.6 %