# Pillar III 2014

SpareBank 1 NORD-NORGE

Report
capital adequacy
and risk management

# Contents

# 1. Introduction

This document describes SpareBank 1 Nord-Norge's risk and capital management in each risk area individually and together as a whole. The information is also intended to satisfy the requirements for disclosing risk information pursuant to part IX of the "Capital Requirements Regulations".

# 2. Important events and lessons in 2014

**Northern Norway is growing**
Northern Norway has been enjoying a period of strong growth since 2010. This is noticeable in all sectors of society. The business sector is undergoing a wide-ranging process of renewal driven by strong export industries. The labour market is tight and households have healthy finances and are optimistic about the future. Prices in the housing market in the north are growing strongly and house building is increasing, although growth and value creation in the region are still being hampered by a lack of skilled labour and inefficient infrastructure.

The strong growth is due to the greater economic importance of the region's access to natural resources due to healthy fish stocks, access to marine areas for farming, greater interest in Northern Norway as a travel destination, and significant oil and gas finds in the Norwegian Sea and Barents Sea. The growth in seafood exports is being driven by a strong salmon industry, while the value of exports in the cod sector has increased strongly. The tourism industry is undergoing renewal and change with the winter season becoming increasingly more important.

The oil sector is boosting the supplier industry thanks to large finds, the opening of new areas for exploration, and the level of activity in fields that are already in operation. House building and public investments have resulted in a persistent high level of activity in the building and construction sector.

SpareBank 1 Nord-Norge publishes analyses of economic trends in the region twice a year in the Business Barometer for Northern Norway.

Forecasts at the start of 2015 point to a continued good outlook for growth. However, the level of uncertainty has increased due to continued instability in the international economy and less oil-related activity, which is slowing growth in Norway. It is also likely that households will be more restrained when it comes to spending and investments.

**SpareBank 1 Nord-Norge – good profitability despite write-down in Russia**
In many ways, the consolidated financial statements for 2014 reflect the region's economic development. Nonetheless they have been affected by a write-down of NOK 299 million relating to the Group's venture in Russia.

Loans to the retail sector (including intermediary loans) increased by 6.2% in 2014, and deposits rose by 9.0%. Lending growth in the corporate sector was 3.8% and the growth in deposits was 7.1%.

The Group's lending and deposit growth rates are above the national average. This also reflects the generally higher economic growth in the north.

New regulatory requirements for equity in financial institutions also entail a requirement to increase the common equity tier 1 capital in SpareBank 1 Nord-Norge. The Group's goal is to have an internal capital buffer that is least 1 percentage point higher than the statutory minimum requirement for capital adequacy. The Group's financial strength is considered to be good.

SpareBank 1 Nord-Norge has increased the Group's net interest income (including commissions from transferred portfolios) by 9.4% from NOK 1,617 million in 2013 to NOK 1,769 million in 2014. Besides the growth in volume, the increase in net interest income is primarily attributable to lower funding costs in the money market. The reduced lending margins were largely compensated for by increased deposit margins.

The Group's net commissions and other operating income (excluding commissions from transferred portfolios) totalled NOK 623 million in 2014, NOK 24 million more than the year before. The Group will continue to work on increasing commissions and other operating income.

The importance of the strategic cooperation with the SpareBank 1 Alliance has grown in recent years. The collaboration has several dimensions to it, and the importance of the direct contribution to the result from the joint ventures in the SpareBank 1 Alliance has increased for SpareBank 1 Nord-Norge.

The contribution to the result from the joint ventures amounted to NOK 453 million in 2014. The equivalent figures for 2013 and 2012 were NOK 303 million and NOK 260 million respectively. The total profit after tax from financial investments was NOK 602 million for 2014, compared with NOK 346 million for 2013. The result for financial investments was heavily affected by an especially good year for SpareBank 1 Gruppen and the Bank's sale of its stake in Nets.

The cost/income ratio in the 2014 consolidated financial statements is 44.4%, a reduction from 47.2% in 2013. The nominal costs show an increase of 9.8% for the Group, while the corresponding figure for the Parent Bank is 6.2%.

A total of NOK 321 million was recognised in loan losses in the Group in 2014. NOK 192 million of this was from the loss associated with the venture in Russia due to the crisis in the Russian economy. The value of the Group's assets in the Russian banking venture was also written down by NOK 107 million. The loss provisions for the venture in Russia therefore total NOK 299 million.

The Group's risk classification system indicates that the overall credit risk in the loan portfolio remains low. Good work is currently being done on non-performing and doubtful commitments in the Group, and this work will remain a high priority. The general level of losses is expected to be moderate for the immediate future. Please also refer to note 11 to the financial statements for more information.

Despite the significant write-down in Russia, the Group's return on equity amounted to 12.2% for 2014, compared with 13% the year before.

Financial key figures for 2014 (2013):

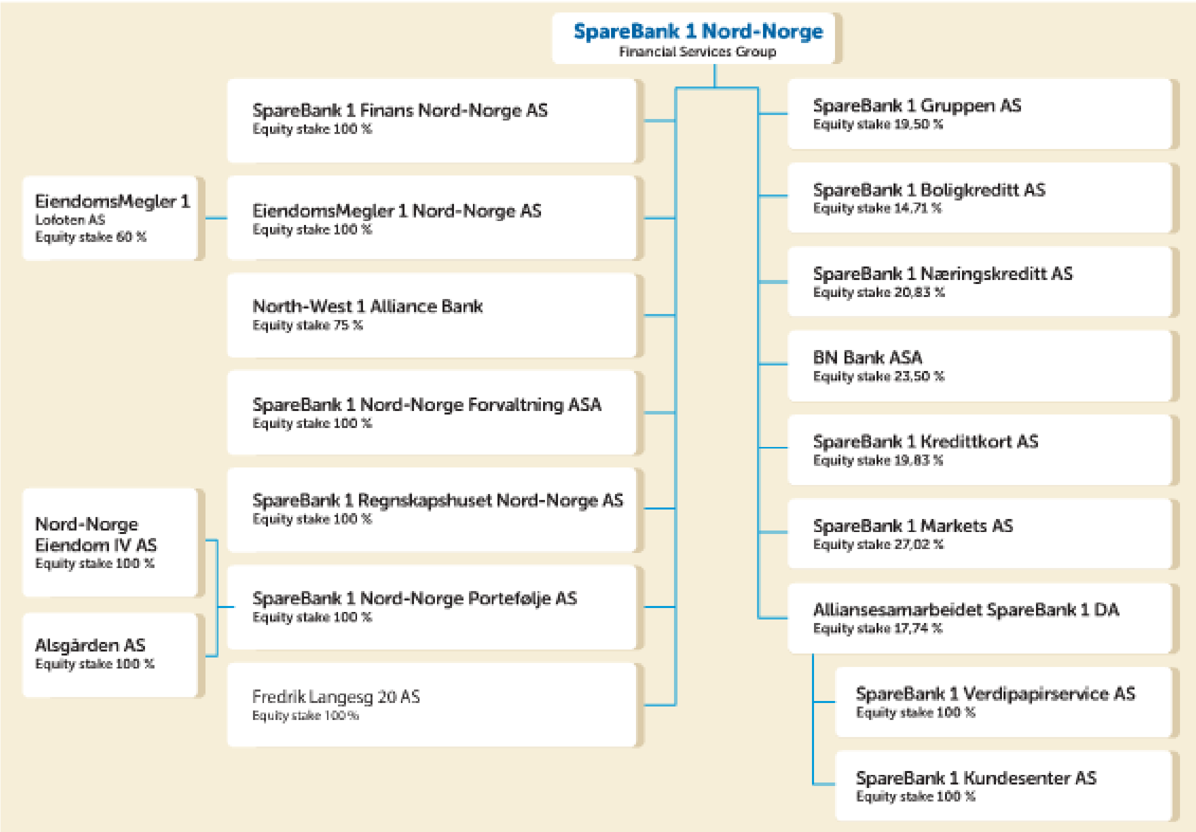
- Pre-tax profit was NOK 1,345 million (NOK 1,181 million).
- Profit for the year after tax of NOK 1,095 million (NOK 967 million)
- Return on equity (Group) was 12.2% (13%)
- Earnings per equity certificate (Group) of NOK 4.13 (NOK 3.78)
- The 2014 results were characterised by:
    - Very good and improved underlying banking operations
    - Good profit contributions from joint ventures
    - Improved profit contributions from subsidiaries
    - Losses still somewhat high in relation to economic situation
- Cost/income ratio (Group) of 44.4% (47.2%)
- Loan losses to customers of NOK 164 million (NOK 172 million). Total loan losses, incl. loan losses recognised as costs in Russia, amount to NOK 321 million.
- Loss of NOK 300 million recognised in connection with the Group's venture in Russia, NOK 192 million of which due to loan losses.
- Lending growth: 5.5% (6.1%) including intermediary loans
- Growth in deposits in last 12 months: 1.8% (3.1%)
- Deposit coverage ratio: 74.7% (78.5%)
- Financially strong with core capital adequacy (Group) of 13.7% (13.4%) and total capital adequacy of 15.7% (13.9%). Common equity tier 1 capital ratio: 12.6% (12.3%).
- Very good liquidity

# 3. Organisation, internal control and management model

## 3.1. Group structure

The SpareBank 1 Nord-Norge Group consists of the following companies:

**Figure 1 - Organisation of the financial service group**




Brief description of the companies:

**SpareBank 1 Finans Nord-Norge AS**
The company has commercial responsibility for the product areas leasing and secured loan financing, with Northern Norway as its primary market area. The company also offers consumer financing. The parent bank funds the company and is an important distribution channel.

**EiendomsMegler 1 Nord-Norge AS**
The company is wholly owned by SpareBank 1 Nord-Norge and is engaged in estate agency in Northern Norway. The company is a member of a nationwide alliance with other companies owned by the SpareBank 1 banks. EiendomsMegler 1 Nord-Norge owns 60% of EiendomsMegler 1 Lofoten AS.

**SpareBank 1 Nord-Norge Portefølje AS**
The company changed its name from SpareBank 1 Nord-Norge Invest AS to SpareBank 1 Nord-Norge Portefølje on 29 January 2014. As part of the Bank's greater focus on core activities, the company's former activities are being restructured/wound up. SpareBank 1 Nord-Norge Portefølje was continued as a legal entity for legal and practical reasons. The object of the company is to "manage stakes owned by the SpareBank 1 Nord-Norge Group and business naturally associated with this".

SpareBank 1 Nord-Norge Portefølje AS owns 100% of the company Bodøgruppen AS. It also owns the company Nord-Norge Eiendom IV, which in turn owns 100% of the company Alsgården AS. Both of these companies were consolidated into the consolidated financial statements as at 31 December 2014.

**North-West 1 Alliance Bank**

In September 2010, SpareBank 1 Nord-Norge established banking operations in Russia through North-West 1 Alliance Bank. SpareBank 1 Nord-Norge holds a 75% stake in the bank, while 25% of the shares are owned by SpareBank 1 Nord-Norge's Russian partner Bank Tavrichesky in St. Petersburg. The head office is located in St. Petersburg and it has a branch in Murmansk.

North-West 1 Alliance Bank employed 76 full-time equivalents as at 31 December 2014 (78 full-time equivalent as at 31 December 2013). On the same date, the Bank's total balance sheet was equivalent to NOK 400 million (NOK 527 million as at 31 December 2013).

Please refer to the section above on the loss provisions for the Group's operations in Russia.

**SpareBank 1 Nord-Norge Forvaltning ASA**
The company is a northern Norwegian knowledge-based management company, 100% owned by SpareBank 1 Nord-Norge. Its core activities are discretionary asset management for customer portfolios consisting of securities within the areas of listed equities and index funds, equity certificates and bonds.

**SpareBank 1 Regnskapshuset Nord-Norge AS**
The Bank started operations within financial management and accounting in 2011. The SpareBank 1 Regnskapshuset Nord-Norge AS venture is motivated by a desire to exploit synergy effects with the Group's other activities, such as through extra sales, improved customer satisfaction and payment services.

A number of companies in the sector have been bought up and merged with SpareBank 1 Regnskapshuset Nord-Norge AS since it started up in 2013. As at 31 December 2014, the company had a total of 118 employees and branches in Hammerfest, Alta, Tromsø, Balsfjord, Finnsnes, Harstad, Mo i Rana, Sandnessjøen and Mosjøen/Trofors. The focus on this sector is part of a collaboration with a number of the banks in the SpareBank 1 Alliance with similar activities, including in areas such as brands, IT, expertise, quality and work processes.

## 3.2 Direct ownership in companies in the SpareBank 1 Alliance and strategic ownership interests

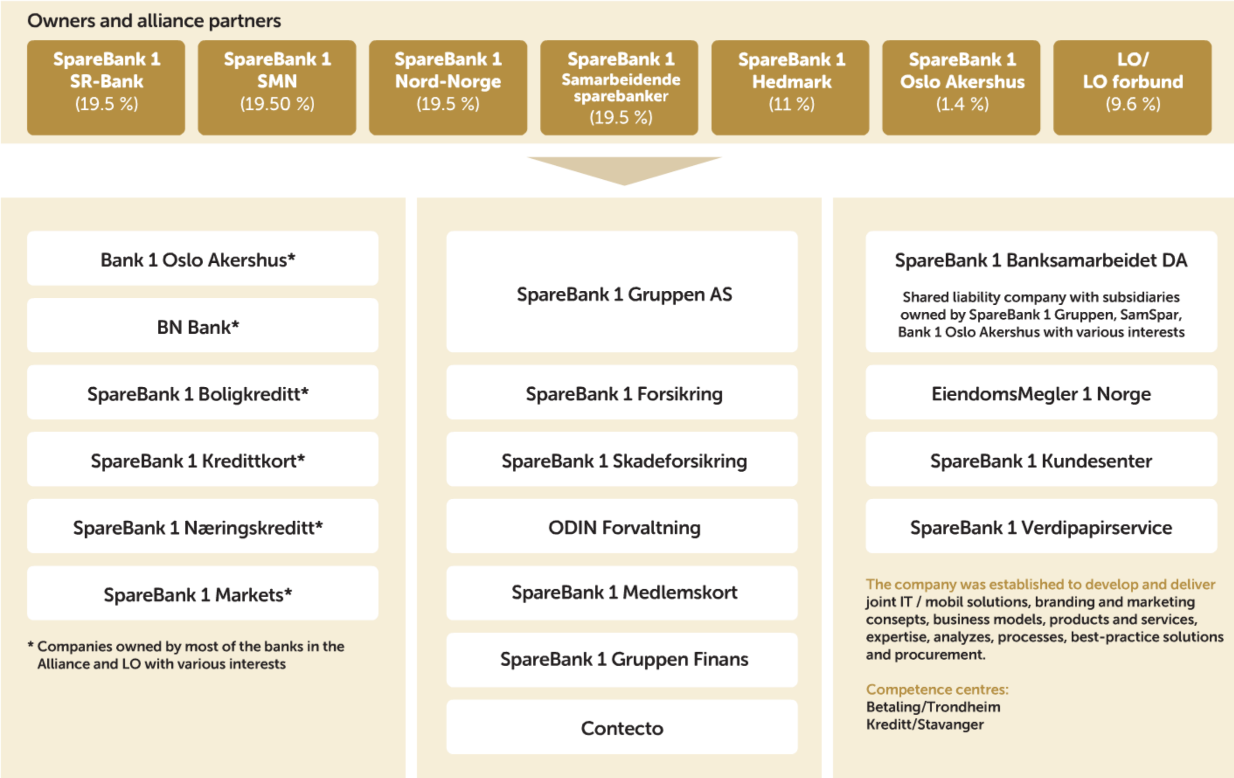
**The SpareBank 1 Alliance, SpareBank 1 Gruppen AS and SpareBank 1 Banksamarbeidet DA**
The purpose of the SpareBank 1 Alliance is to acquire and provide competitive financial services and products, and to exploit economies of scale in the form of lower costs and/or higher quality. Accordingly, the Alliance provides retail and corporate customers with local roots, competence and an easier day-to-day life. In addition, the Alliance helps ensure the creation of value by the banks for the benefit of their own regions and the banks' owners.

The SpareBank 1 banks conduct their alliance-related cooperation and the development of the Alliance's product companies through the jointly-owned company SpareBank 1 Banksamarbeidet DA and the holding company SpareBank 1 Gruppen AS. SpareBank 1 Nord-Norge owns 19.5% of SpareBank 1 Gruppen AS and 17.74% of SpareBank 1 Banksamarbeidet DA.

SpareBank 1 Gruppen bears administrative responsibility for all the alliance processes in the SpareBank 1 Alliance, where technology, brand names, competence, joint processes and the application of best practices and purchasing are all key factors. SpareBank 1 Banksamarbeidet DA owns SpareBank 1 Verdipapirservice and SpareBank 1 Kundesenter.

EiendomsMegler 1, Norway's second largest chain of estate agents, is part of the SpareBank 1 Alliance. EiendomsMegler 1 has a jointly owned head office, but the individual branches are owned directly by the SpareBank 1 banks.

**Figure 2 - The Alliance structure**




**BN Bank ASA**
BN Bank provides financial services in the retail and corporate markets. It is a purely online bank in the retail market. In the corporate market, BN Bank is a significant player in the field of commercial real estate financing, and BN Bank has corporate market offices in Oslo and Trondheim. SpareBank 1 Nord-Norge owns 23.5% of BN Bank.

**SpareBank 1 Boligkreditt AS**
SpareBank 1 Boligkreditt's (SB1BK) object is to fund first priority mortgage housing loans for the banks in the SpareBank 1 Alliance (security within 70% of the property's appraised value). The banks transfer home mortgages to SB1BK before the company borrows in the Norwegian and international capital markets by issuing covered bonds. SpareBank 1 Boligkreditt's covered bonds are rated Aaa and AAA respectively by Moody's and Fitch. As at 31 December 2014, SpareBank 1 Nord-Norge owned 14.71% of SB1BK.

**SpareBank 1 Næringskreditt AS**
SpareBank 1 Næringskreditt's object is to fund first priority commercial real estate loans for the banks in SpareBank 1 Alliance. The banks transfer first priority commercial property mortgages to SpareBank 1 Næringskreditt before the company borrows in the Norwegian and international capital market. SpareBank 1 Næringskreditt's bonds are rated Aa3 by Moody's rating agency. As at 31 December 2014, SpareBank 1 Nord-Norge owns 20.83% of SpareBank 1 Næringskreditt.

**SpareBank 1 Markets AS**
Together with SpareBank 1 SMN, Sparebanken Hedmark, Samspar and the Norwegian Federation of Trade Unions, SpareBank 1 Nord-Norge bought SpareBank 1 SR-Bank's stake in SpareBank 1 Markets AS in autumn 2013. As at 31 December 2014, the Bank owns 27.0% of this company. The owners have entered into an agreement on restructuring the company by integrating SpareBank 1 SMN's market activities into SpareBank 1 Markets. Following this, and a new offering in the company, SpareBank 1 SMN will have a 73.3% stake, while SpareBank 1 Nord-Norge's stake will be 9.9%. The plan is to continue the commercial cooperation between SpareBank 1 Markets and the owner banks. The plan is complete these transactions when the necessary formal approval has been received from the authorities. This is expected in the first quarter of 2015.

**SpareBank 1 Kredittkort AS**
The company was established in autumn 2012 and will offer credit card services to Alliance customers.
The company is owned by the various Alliance banks. SpareBank 1 Nord-Norge's stake was 19.83% as at 31 December 2014.

**Bank 1 Oslo Akershus AS**
Bank 1 Oslo Akershus operates under the market name SpareBank 1 Oslo Akershus. The main customer groups are the retail market, small and medium-sized companies and the organisation market, primarily the trade union movement. SpareBank 1 Nord-Norge owns a 4.9% stake in the company.

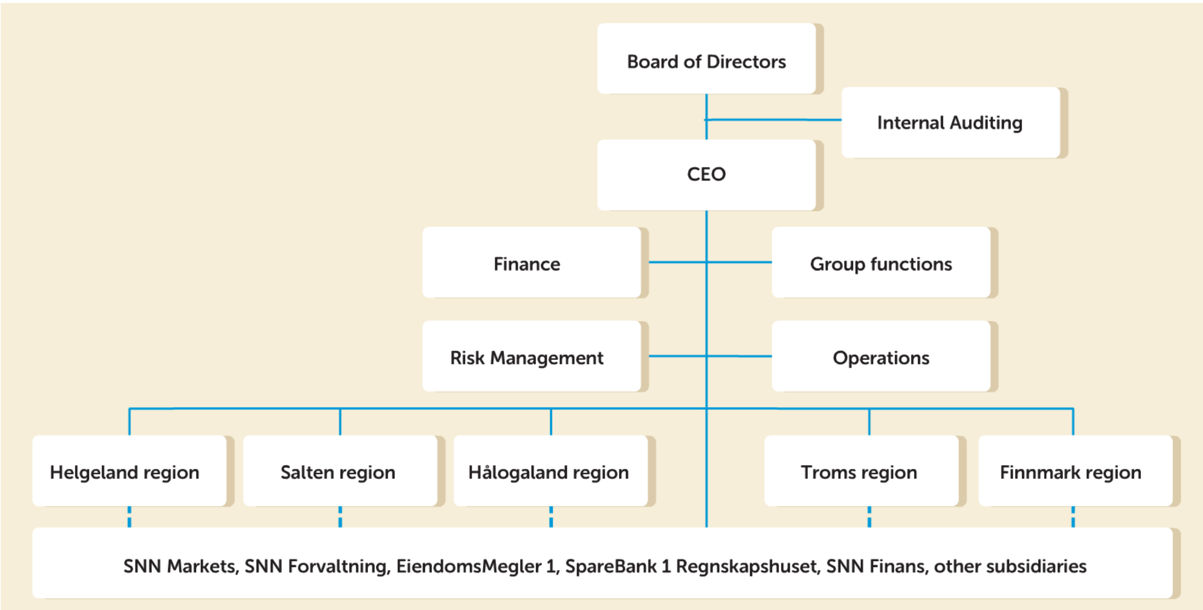
**Bank Tavrichesky**
In 2010, SpareBank 1 Nord-Norge started banking operations in Russia through North-West 1 Alliance Bank, which is owned 75% by SpareBank 1 Nord-Norge and 25% by SpareBank 1 Nord-Norge's Russian partner Bank Tavrichesky. Bank Tavrichesky OJSC has its head office in St. Petersburg and branches in seven Russian cities. The bank is the 11th largest regional bank in North-western Russia, and its activities are mainly aimed at small and medium-sized businesses. SpareBank 1 Nord-Norge owns around 10% of Bank Tavrichesky.

Please refer to the section above on the loss provisions for the Group's operations in Russia.

## 3.3 Organisation of the Bank

The organisation of customer-oriented business and specialist departments in SpareBank 1 Nord-Norge is illustrated in the organisational chart below:

**Figure 3 - Organisation chart**




The chief executive is responsible for implementing strategies and risk management that contributes to achieving the targets set by the Board for the business, including efficient management systems and internal control.

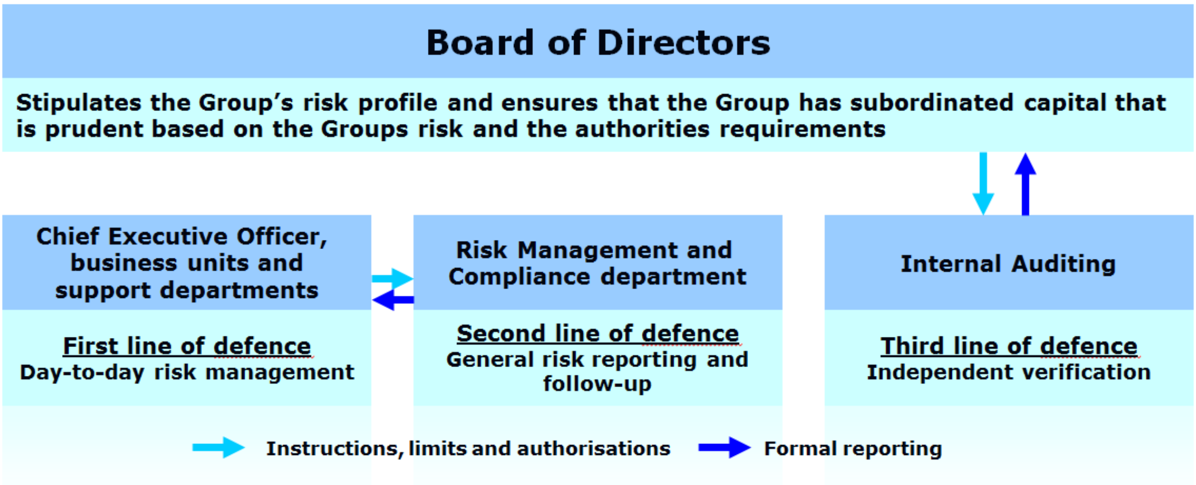
The executive management team is the chief executive's collegium for the overarching management of the Bank. It consists of the chief executive, senior group general managers for the regions, CFO, COO, Senior Group General Manager Group Functions, and Senior Group General Manager Risk Management and ICT.

## 3.4 The Group's internal control and management model

The Group's internal control and management model addresses the organisational requirements concerning the independence of risk reporting, in which responsibilities and roles in day-to-day risk management are in particular stressed.
SpareBank 1 Nord-Norge has invested a great deal of resources in the development of effective risk management processes for the identification, measurement and management of risk under its own direction and through the SpareBank 1 Alliance over many years.

All managers are responsible for maintaining a full overview of the risk picture in their own business areas and/or area of expertise at any given time. In order to satisfy the Group's primary goals, the Group has chosen to divide the risk management process into three parts:

**Figure 4 - Responsibilities and roles in the risk management process**




The most central roles in the risk management process are:

- an executive function (includes both line (customer responsibility) and specialist departments (management/support/control))
- an independent monitoring function (Risk Management and IT Department)
- an independent verification function (Internal Audit)

The Group's control and management model is intended to ensure independence in relation to decisions and reporting. It is, therefore, an important principle that the risk management process is an integral part of day-to-day activities.
The Risk Management Department shall follow up and support the line and specialist departments in their work on quality and risk management.

### *3.4.1 Responsibility for internal control and risk management*

An important foundation for effective risk management is a strong risk culture that is characterised by a high degree of awareness of risk and risk management throughout the entire Group. Such a foundation entails that each employee must have a good understanding of the Bank's operations and their own actions, as well as the risks that are associated with this.

The responsibility for risk management is divided between the Board, boards of the subsidiaries, executive management team and line management. Risk management and control are part of SpareBank 1 Nord-Norge's corporate governance, which is described under 'Corporate Governance' (see our website). Emphasis is placed on responsibility through personal authority and independence between the business areas and the organisational units that monitor the business areas.

The Board of SpareBank 1 Nord-Norge bears overall responsibility for the Group's risk exposure and management of the various risk areas. This entails responsibility for stipulating the overall objectives that define the risk profile, return targets and how the capital should be divided between the various business areas. The Board also stipulates the overall limits, authorisations and guidelines for risk management in the Group, as well as all significant aspects of the risk management models and decision-making processes.

The Group's principles and framework for risk management and internal control are set out in the Bank's 'Policy for Risk Management and Compliance'. This is reviewed annually by the Board and forms the Group's internal framework for good management and control. The framework provides guidelines for the Group's overall approach towards risk management, and is intended to ensure that the Group has an effective and appropriate process for this.

An annual plan is prepared for the Board to ensure that all the significant commercial and risk areas are managed satisfactorily by the executive management team and Board. This annual plan shall ensure:

- a regular review and revision of important commercial documents and areas
- a focus on commercial opportunities and threats - increased competitiveness
- the revision of priority areas and management targets
- an evaluation of the organisation's capabilities and competence – including opportunities and vulnerabilities
- an evaluation of responsibilities and roles – management model

The Board has established a compensation committee to assess the chief executive's salary and bonus terms/schemes. The committee consists of the Chairman of the Board, the Deputy Chairman and one member of the Board.

The Board has established audit and risk committees. The committees are preparatory bodies for the Board in matters concerning the monitoring of financial information and the company's internal control and risk management. The chief executive is responsible for making information and recommendations available to the committees as required and upon request.

The audit and risk committees consist of three members of the Board. These members are independent in accordance with the definition in the "Norwegian Code of Practice for Corporate Governance".

The **Chief Executive Officer** (CEO) is responsible for the Group's risk management, including the development of efficient management systems, internal control and continuous follow-up. The chief executive is also responsible for the delegation of authority and reporting to the Board.

The **business areas** are responsible for overall risk management within their own area. This means that the managers must establish and execute responsible risk management within their areas of responsibility and make sure that this responsibility is exercised in an active manner in accordance with the Bank's policy for risk management, authority, instructions and routines.

The **Risk Management and IT Department** is organised independently of the business units and reports to the chief executive. The department bears overall responsibility for comprehensive risk management, internal control and the Group's compliance with rules and provisions, including responsibility for the Group's risk models and the further development of effective risk management systems.

The **Credit Department** is the Group's key department in the area of credit. The department is responsible for the preparation and maintenance of targets, strategies, guidelines and routines, operative management and follow-up of the Group's credit operations and credit risk management. The credit department has an independent role in relation to the business areas and local banks.

The **Internal Audit** is tasked with providing objective advice to the Board and management concerning the Group's risk management and formulation of controls, as well as compliance with established routines, procedures and guidelines. An external supplier of auditing services bears professional responsibility for the Group's internal auditing function, which ensures independence, competence and capacity.

The Group's **Credit Committee** makes recommendations on any matter that shall be reviewed by the Board in accordance with the Group's guidelines. The committee plays a central role in connection with the formulation of the Group's credit strategies, credit policies and credit regulations.

**The Balance Sheet Committee** is chaired by the CFO The committee deals with matters related to the management of market and financial risk, and it is responsible for following up compliance with the frameworks stipulated by the Board. The committee follows up and stipulates the transfer pricing of capital and the capital structure.

The **Validation Committee** is chaired by the Senior Group General Manager Risk Management and IT. The committee's main duties are to ensure that:

- The IRB system is adapted to the portfolios on which it is used.
- The assumptions on which the IRB system is based are reasonable.
- The IRB system measures what it is meant to measure.
- The IRB system is well-integrated throughout the organisation and represents a key part of the Group's risk management and decision-making process.
- SpareBank 1 Nord-Norge complies with the Capital Requirements Regulations.

### *3.4.2 Management information systems and reporting/follow-up*

The Bank focuses heavily on developing and operating good management and management information systems.

Several of the management information systems are key to the reading, analysis, documentation, reporting and storage of information related to important parameters in the Group's IRB system and commercial follow-up and management, as well as the follow-up of improvement measures. The most important systems in this context are:

- Balanced scorecards (BSC)
    - The Group's strategic scorecards measure key indicators that are closely related to the IRB system. Applies, for example, to the risk-adjusted return, share of high risk exposure and credit quality.

- Portfolio management system (PorTo)
  The Group’s central system for reading and reporting key risk parameters:
    - Probability of default (PD)
    - Loss given default (LGD)
    - Exposure at default (EAD)
    - Expected loss (EL)
    - Unexpected loss (UL)
    - Risk-adjusted return
    - Doubtful commitments

  The portfolio management system also provides a summary of the actual migration and master data for validation and stress testing.

- Early warning
  The Group's early warning system allows it to constantly monitor key risk drivers: these are important indicators that improve its monitoring of customers and the development of potential default situations. The information from the early warning system is important for detecting key trends at the earliest possible point in time.

- Risk and information system (RIs) and the loss and incident database
    - A database of improvements for the structured and documented follow-up of work on improvement areas and measures related to various main and sub-processes, incidents or important areas of expertise within the Group. A key system in connection with the monitoring and management of operational risk.

<u>Internal control reporting/manager verification</u>
Management personnel, defined as bank managers, specialist managers, department managers and directors, shall report in their respective areas of responsibility how the risk management has been carried out in relation to the approved framework and risk exposure. This should provide the chief executive and Board with sufficient material to determine whether risk management is being carried out properly. Such verification or reporting shall take place at least once a year or when dictated by major circumstances. The manager verification is coordinated by the Risk Management and IT Department.

The purpose of the annual reporting is primarily:

- to fulfil the managers' responsibility for proper and goal-oriented operations and to ensure that this responsibility is fulfilled in a systematic and uniform manner throughout the Group
- to lay the foundation for the active involvement of the Board, Control Committee and general managers
- to help the Bank's organisation and its managers regularly assess the various commercial and control-related risks, as well as the choice of control measures
- to learning and the development of quality, as well as the development of local ownership of quality and risk management

The recording is important to the Group's management development process to create a better understanding of the importance of good risk management and quality. This reporting should be a key tool in connection with training in the Bank. The reporting is standardised, process-oriented and follows a fixed structure for the following areas:

- policy/strategy/routines
- competence
- laws/regulations
- organisational culture

The improvement areas are included as part of a special action program and the chief executive presents the report to the Bank's Board.

Risk report for the chief executive and Board
The Risk Management and IT Department prepares a risk report every quarter that is presented to the chief executive and the Board. The purpose of this risk report is to:

- brief the chief executive and Board of SpareBank 1 Nord-Norge on the status and expected development of the risk profile of the Bank and the Group
- provide the chief executive and Board with a better basis for management and making decisions
- confirm to the chief executive and Board that the strategic key figures and limits defined in the Bank's strategies are being complied with and met
- enable the chief executive and Board to fulfil their statutory control responsibilities

# 4. Capital adequacy

## 4.1 Capital adequacy regulations

On 22 August 2014, the Ministry of Finance laid down regulations that govern the more technical provisions of the CRD IV regulations. The overall provisions have already been incorporated into the Financial Institutions Act and the Securities Trading Act. These came into effect on 1 July 2013 and entail a gradual increase in the minimum requirements for common equity tier 1 capital in the lead up to 1 July 2016. Other CRD IV requirements have as yet not been introduced in Norway.

The new regulations specify minimum requirements for the common equity tier 1 capital ratio (4.5%), tier 1 capital ratio (6%) and capital adequacy ratio (8%), where the tier 1 capital ratio can consist of up to 1.5% of hybrid capital and the capital adequacy ratio can consist of up to 2% of tier 2 capital. A set of buffers that must be covered by common equity tier 1 capital has also been defined. These are: a capital preservation buffer (2.5%), a systemic risk buffer (3%), a SIFI buffer (2%) and a countercyclical capital buffer (0-2.5%).

Norway has chosen to introduce the requirements slightly faster than the implementation deadline in the international rules. The common equity tier 1 capital ratio requirement has been 10.0% and the capital adequacy ratio requirement 13.5% since 1 July 2014, and these are met by a good margin by SpareBank 1 SR-Bank.

Financial activities entail a need to control and manage risk. The purpose of the capital adequacy regulations is to strengthen the stability of the financial system through:

- A risk sensitive capital requirement
- Better risk management and control
- Closer supervision
- Disclosure of more information to the market

Good corporate governance at SpareBank 1 Nord-Norge is a strategic means of increasing the Group's value creation.

The capital requirements are based on three pillars:

- Pillar 1: Minimum primary capital requirements
- Pillar 2: Assessment of total capital requirement and individual supervisory follow-up
- Pillar 3: Institution's publication of information

*Pillar 1 – Minimum capital requirements*
The first pillar concerns the minimum capital requirements and represents a further development of the former capital adequacy regulations, Basel II. The new regulations do not entail any change to the fundamental structure of the capital requirement, where the *minimum requirement* is still 8%, but some changes were made to the regulations with regard to what can be considered primary capital and the composition of such capital, and some changes were made to the rules concerning deductions. A special Norwegian LGD floor has also been introduced that specifies that the total LGD for the home mortgage portfolio must be a minimum of 20% of EAD.

$$\frac{\text{Tier 1 capital + tier 2 capital}}{\text{Credit risk + Market risk + Operational risk}} \geq 8\%$$

The capital adequacy regulations contain various methods for calculating capital requirements. The various methods are illustrated in the figure below:

**Figure 5 - Methods for calculating the capital requirement**

| Credit risk | Market risk | Operational risk |
|---|---|---|
| Standard method | Standard method | Basic method |
| Foundation IRB method (1) | Internal measuring methods (1) | Standardised approach |
| Advanced IRB method (1) | | AMA method 1) |

1) The methods require the approval of the Financial Supervisory Authority of Norway.

For banks that have received approval to use internal measuring methods (Internal Rating Based Approach) for credit risk, the statutory minimum requirement for capital adequacy will be based on the Group's internal risk assessments. The statutory minimum requirement for capital adequacy makes it more risk-sensitive, meaning that the capital requirement will to a larger extent correspond to the risk in the underlying portfolios.

When Foundation IRB is used, the risk parameter probability of default (PD) and size parameter (S) are calculated using the Bank's own models. The risk parameters conversion factor (CF) used to determine exposure given default and loss given default (LGD) are standard value rules stipulated in the Capital Requirements Regulations.

When Advanced IRB is used for the mass market, the risk parameters PD, S, CF and LGD are calculated using special models for calculating capital requirements.

*Pillar 2 – Supervisory review process of capital adequacy*

The second pillar is based on two main principles. The banks must have a process for the evaluation of their overall capital in relation to the risk profile and a strategy for maintaining an adequate level of capital.

The risk assessment process includes an assessment of the risk profile and capital requirements in parent companies, important subsidiaries and stakes in associated companies. The review is conducted annually and the risk is quantified by calculating the risk-adjusted capital. The banks use both quantitative models and qualitative assessments to determine the capital requirement. Stress tests for credit risk and market risk provide important guidelines for final assessments.

The Financial Supervisory Authority of Norway shall also review and evaluate the banks' internal assessment of their capital needs and strategies, in addition to monitoring and ensuring observance of the capital requirements imposed by the authorities. The Financial Supervisory Authority of Norway has the authority to implement suitable supervisory measures if they are not satisfied with the results of this process.
As part of the supervisory process the Financial Supervisory Authority of Norway shall prepare an annual overall risk assessment for the Group. The assessment provides feedback on the Group's capitalisation and risk level.

On 12 March 2015, the Financial Supervisory Authority of Norway published a circular clarifying that IRB models must be used for measuring and reporting risk to executive management teams and boards, as well as in Pillar 3 reporting. This will reduce the differences between capital requirements measured using internal and regulatory models.

SpareBank 1 Nord-Norge has established processes to assess the capital requirements in light of the risk profile and the quality of the established internal control and risk management systems. The process and its results are documented in writing in an annual ICAAP report. The Group's ICAAP report was sent to the Financial Supervisory Authority of Norway in December 2014 and the Senior Group General Manager Risk Management and IT is responsible for conducting the capital assessment process.
The Group has systematically worked on quantifying risk in all parts of the organisation for a long time. Risk-adjusted capital is the Group's target for risk.

There is broad participation from the executive management team, various specialist departments and risk experts in the work on risk assessments and capital requirements. The Group's capitalisation and capitalisation goal form an important of the Group's planning work and strategy process. The results of the quantitative and qualitative assessments are thoroughly checked by the specialist groups, Balance Sheet Committee and executive management team before being considered by the Board.

*Pillar 3 – Market discipline and disclosure*
The purpose of the third pillar is to supplement the minimum requirements in the first pillar and the supervisory follow-up in the second pillar. The third pillar should contribute to greater market discipline through requirements for the publication of information that makes it possible for the market, including analysts and investors, to evaluate the institution's risk profile and capitalisation, as well as its management and control. The publication requirements are particularly important when the banks can use their own systems and methods to a greater extent to calculate the capital requirement.

The information requirements stipulate that all institutions must publish information on their organisational structure, risk management system, reporting channels and how their risk management is built up and organised. In addition, detailed requirements are stipulated for the publication of the capital level and structure, as well as the risk exposure, and the latter depends on what calculation methods the banks use in Pillar 1.

This document meets, together with a bank's annual report, the requirements for the publication of information in accordance with the current regulations.

*Internal Audit*
The Internal Audit shall regularly audit the IRB system and its use, including compliance with the Capital Requirements Regulations. This assessment shall, as a minimum, be conducted annually and form part of the independent reporting to the Board. The audit work also includes an assessment of

the ICAAP process, embedding in the organisation and whether the capital is adequate in relation to the risk profile of the Group and the most important subsidiaries and joint ventures.

## 4.2 Financial strength targets

Effective capital management is closely related to the Group's strategic plans, market opportunities (including growth strategies), risk tolerance and capital targets.

SpareBank 1 Nord-Norge's capital management shall primarily ensure it has a sufficiently large amount of capital (financial strength) and that its application of capital is efficient in relation to protecting creditors against losses (creditor protection). One of the Group's strategic goals is to ensure its financial strength cannot be doubted.

SpareBank 1 Nord-Norge's capital management is based on the Group's general capital targets, which are also described in this document. The targets should be seen in the context of the Group's risk profile and the capital targets must be designed in line with the risk based approach in the capital adequacy regulations.

The **capital target set** shall ensure that SpareBank 1 Nord-Norge, for each company individually and at a Group level, has sufficient capital to satisfy:

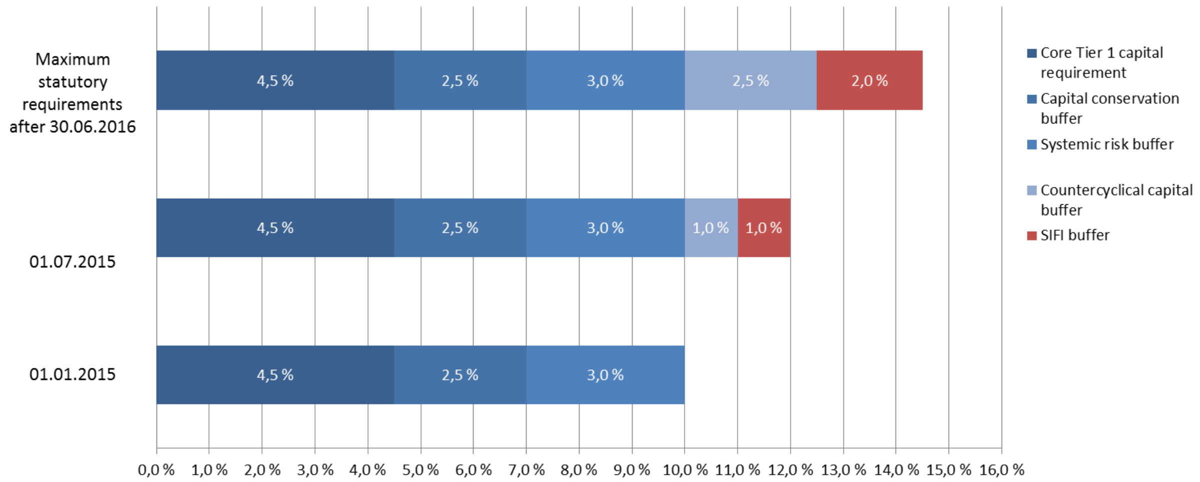
a) *Internally set requirements* for capital in relation to underlying risk in the organisation, i.e. the Group's own assessment of its capital requirements pursuant to ICAAP (Pillar 2). This requirement should also be compared to the capital market's expectations concerning financial strength.

   *Creditor protection:* Creditor protection describes how probable it is that creditors may suffer a loss within a 1-year time horizon. Creditor protection is expressed as a level of confidence.

   The Group's capital plan defines limits for capital adequacy. These entail a common equity tier 1 capital ratio of at least 1 percentage point above the regulatory requirement (currently 10%).

   Figure 7 below illustrates the phasing in of the capital requirements, as well as a maximum level for capital requirements that takes into account the maximum levels of the various buffers. SpareBank 1 Nord-Norge has a long-term goal of adjusting to the SIFI requirement even though the Group has not been defined as systemically important by the Ministry of Finance. The SIFI requirement will largely be addressed by Sparebankstiftelsen SpareBank 1 Nord-Norge. The Group's long-term goal for common equity tier 1 capital ratio is currently 14.5%

**Figure 6 - Phasing in of regulatory capital requirements**




The capital plan seeks to ensure that the Group does not incur a deficit that could result in it losing its independence. Such calculations are based on stress tests over a 5-year economic downturn. The Group's goal is for the common equity tier 1 capital ratio in a projected crisis scenario to have sufficient buffers to ensure that it does not fall below 9.5% (minimum requirement 4.5% + systemic risk buffer 3.0% + SIFI requirement 2.0%), assuming that in a crisis scenario the countercyclical capital buffer and capital conservation buffer can be drawn on.

b) *Regulatory capital ratio:* Statutory capital adequacy requirement, i.e. regulatory capital (Pillar 1) that is used to determine the minimum capital adequacy requirement in relation to the rules of the Capital Requirements Regulations: total capital adequacy ratio, tier 1 capital ratio and common equity tier 1 capital ratio.

In addition to the above, the Group's capital management must also:

- ensure competitive terms in the funding market (rating perspective)
- satisfy the owners' return on equity requirements (competitive return on equity)
- ensure that the Group and its subsidiaries can take advantage of growth opportunities in the market (organic or via acquisitions)

The capital targets must be reviewed annually and approved by the Board.

A new assessment of the capital target will be conducted, at the latest, as part of the new regulatory capital requirements for Norwegian banks or as part of the consideration of the Group's ICAAP and capital plan towards the end of 2015.

## 4.3 IRB authorisations

Credit risk

SpareBank 1 Nord-Norge has been approved by the Financial Supervisory Authority of Norway to use internal measuring methods (IRB) for credit risk since 2007. As at 31 December 2014, the Bank has received approval to use Foundation IRB (FIRB) for the corporate market and Advanced IRB (A-IRB) for the retail market. This means that the statutory minimum requirement for capital adequacy for credit risk will wholly or partially be based on the Group's internal risk models.

Loss given default (LGD) is statutorily set at 45%. SpareBank 1 Nord-Norge's validation results show that losses from defaulted commitments in the corporate market are somewhere in the region of 15-30%.
In the first quarter of 2015, SpareBank 1 Nord-Norge received authorisation to use Advanced IRB for its corporate portfolio as well. This entails the use of a specific LGD model in a regulatory fashion from and including the first quarter of 2015. The effect of this on risk weightings for the corporate market is a reduction from approx. 91% (31 December 2014) to approx. 75%.

The models for home mortgages will be adapted to meet the Financial Supervisory Authority of Norway's requirements in circular 8/2014 from the first quarter of 2015.
This involves the introduction of a minimum PD of 0.2% (elimination of our risk class A) and some significant tightening-up in the LGD model via the Financial Supervisory Authority of Norway's reference model.
The effect of this for SpareBank 1 Nord-Norge has been calculated as being about equal to the reduction in risk weighting that comes through the A-IRB authorisation for the corporate market.

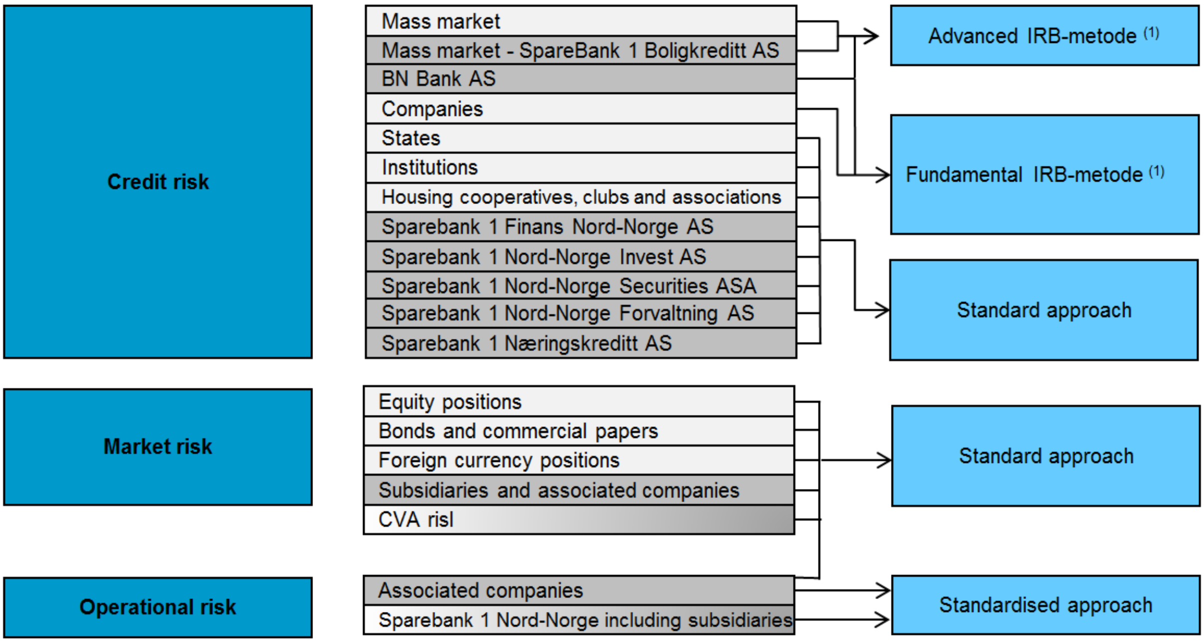
Operational risk

SpareBank 1 Nord-Norge reports operational risk in accordance with the standardised approach for the parent bank. The Bank has over time developed internal control and quality systems that enable it to report operational risk in accordance with the requirements of the standardised approach set forth in the Capital Requirements Regulations. The rest of the Group still reports using the basic method.

## 4.4 Capital adequacy

The figure below illustrates the methods SpareBank 1 Nord-Norge uses to calculate its capital requirements for credit, market and operational risk, respectively.

**Figure 7 - Methods for calculating the capital requirement**




1) The methods require the approval of the Financial Supervisory Authority of Norway.

SpareBank 1 Nord-Norge owns 14.71% of the shares in SpareBank 1 Boligkreditt AS as at 31 December 2014. SpareBank 1 Boligkreditt AS operates as a mortgage company and has been granted a licence by the Financial Supervisory Authority of Norway. The main purpose of the mortgage company is to ensure the owners of stable and long-term financing at competitive prices. SpareBank 1 Boligkreditt AS received IRB approval in 2009. The ownership interest has been included in the capital adequacy ratio based on the proportional consolidation rules upon approval by the Financial Supervisory Authority of Norway.

The ownership interests in BN Bank ASA (23.5%) and SpareBank 1 Næringskreditt AS (20.83%) have also been included in the capital adequacy ratio based on the proportional consolidation rules.

As far as capital adequacy is concerned, SpareBank 1 Gruppen is treated in accordance with the regulations for important stakes in other financial undertakings. This results in a deduction in common equity tier 1 capital of NOK 591 million and also increases the basis for calculation by NOK 2,199.5 million.

# 4.5 Consolidations/subsidiaries/associated companies

## Figure 8 - Consolidation principles

| Subsidaries | Org.number | Number of shares | Cost value | Book value | Voting rights | Accounting purpose | Capital requirement | Net equity and related capital | Capital adequacy ratio |
|---|---|---|---|---|---|---|---|---|---|
| **Companies which have been fully consolidated** | | | | | | | | | |
| North-West 1 Alliance Bank, Russia | 0 | 3.450.000 | 91 | 0 | 75,00 % | Acquisition method 75 % | 0 | 0 | 0 |
| EiendomsMegler 1 Nord-Norge AS | 931262041 | 21.100 | 28 | 30 | 100,00 % | Acquisition method 100 % | | | IA |
| EiendomsMegler 1 Lofoten AS | 968382454 | 3.735 | 4 | 4 | 60,00 % | Acquisition method 60 % | | | IA |
| SpareBank 1 Nord-Norge Finans AS | 930050237 | 61.400 | 366 | 366 | 100,00 % | Acquisition method 100 % | 269.970 | 511.834 | 15,2 % |
| SpareBank 1 Nord-Norge Portefølje AS | 935491533 | 18.227 | 67 | 81 | 100,00 % | Acquisition method 100 % | | | IA |
| Nord-Norge Eiendom IV AS | 991391142 | 1.685 | 20 | 20 | 100,00 % | Acquisition method 100 % | | | IA |
| Alsgården AS | 966850582 | 513 | 78 | 78 | 100,00 % | Acquisition method 100 % | | | IA |
| Fredrik Langesg 20 AS | 962315666 | 42 | 30 | 30 | 100,00 % | Acquisition method 100 % | | | IA |
| SpareBank 1 Nord-Norge Forvaltning ASA | 982699355 | 200.000 | 7 | 7 | 100,00 % | Acquisition method 100 % | 811 | 5.203 | 51,3 % |
| SpareBank 1 Regnskapshuset Nord-Norge A | 851987142 | 1.500 | 44 | 44 | 100,00 % | Acquisition method 100 % | | | IA |
| BN Bank ASA | 914864445 | 3.317.338 | 209 | 846 | 23,50 % | Equity method 23,50 % | 1.716.823 | 4.223.702 | 19,7 % |
| SpareBank1 Boligkreditt AS | 988738387 | 6.984.080 | 1.048 | 1.095 | 14,71 % | Equity method 14,71% | 5.617.128 | 9.893.161 | 14,1 % |
| SpareBank1 Næringskreditt AS | 894111232 | 2.853.400 | 357 | 362 | 20,83 % | Equity method 20,83% | 1.339.201 | 2.338.880 | 14,0 % |
| SpareBank1 Markets AS | 992999101 | 14.133 | 35 | 26 | 27,03 % | Equity method 27,03% | 36.441 | 69.280 | 15,2 % |
| **Companies which are not consolidated where there are no deposits of equity and related capital which have been deducted from the insitiution's equity and related capital** | | | | | | | | | |
| SpareBank 1 Gruppen AS | 975966372 | 381.498 | 715 | 1.168 | 19,50 % | Equity method 19,50 % | | | |
| **Companies which are not consolidated where there are no deposits of equity and related capital which have been deducted from the institution's equity and related capital** | | | | | | | | | |
| Alliansesamarbeidet SpareBank 1 DA | 986401598 | 2 | 18 | 18 | 17,74 % | Equity metod 17,74 % | | | |
| SpareBank 1 Kredittkort AS | 975966453 | 126607 | 39 | 35 | 19,83 % | Equity metod 19,83% | | | |
| Bank 1 Oslo Akershus AS | 910256351 | 218.841 | 78 | 137 | 4,80 % | Acquisition method 4,80% | | | |
| Bank Tavrichesky, Russia | 0 | 104.821.999 | 122 | 0 | 9,26 % | Acquisition method 9,26% | | | |

SpareBank 1 Nord-Norge places great importance on all the units in the Group having satisfactory capital at any given time. The Group's governing bodies have not imposed any restrictions on the Board's opportunity to transfer capital between the parent bank and the subsidiaries or between the subsidiaries beyond what follows from regulatory and other statutory restrictions. Nor are there any provisions in the Articles of Association that impose any such restrictions.

## Figure 9 - Capital adequacy ratio calculation - Group

Amounts in NOK million

| | 31.12.14 | | 31.12.13 | | 31.12.12 | |
|---|---|---|---|---|---|---|
| **Core capital** | | | | | | |
| PCC-capital | 1.807 | | 1.807 | | 1.655 | |
| Premium Fund | 843 | | 843 | | 245 | |
| Saving Bank's Fund | 3.745 | | 3.565 | | 3.083 | |
| Dividend Equalisation Fund | 1.020 | | 776 | | 456 | |
| Donations | 332 | | 163 | | 150 | |
| Fund for unrealised gains | -30 | | -2 | | -3 | |
| Other equity | 1.611 | | 1.327 | | 1.224 | |
| Minority interests | 15 | | 23 | | | |
| Total equity capital | 9.343 | | 8.502 | | 6.810 | |
| Deduction set asite dividend | -522 | | -154 | | -106 | |
| Deduction net pension fund | -51 | | -136 | | -29 | |
| Deduction Fund for unrealised gains | 0 | | 69 | | 41 | |
| Adjusted subordinated capital from consolidated financial institutions | 80 | | -163 | | -58 | |
| Hybrid Tier 1 bonds | 681 | | 653 | | 989 | |
| Deferred tax, goodwill and other intangible assets | -113 | | -114 | | -66 | |
| Deduction subordinated capital in other financial institutions (50 %) | -591 | | -174 | | -106 | |
| Deduction adjusted expected amount lost (50 %) | -385 | | -94 | | -97 | |
| Capital adequacy reserve | 0 | | -606 | | -706 | |
| **Core capital** | **8.442** | | **7.783** | | **6.672** | |
| **Supplementary capital** | | | | | | |
| Prepetual non-call bonds | 0 | | 0 | | 0 | |
| Subordinated loan capital | 1.284 | | 1.160 | | 1.507 | |
| Deduction subordinated capital in other financial institutions (50 %) | -43 | | -174 | | -106 | |
| Deduction adjusted expected amount lost (50 %) | 0 | | -94 | | -97 | |
| Capital adequacy reserve | 0 | | -606 | | -706 | |
| **Supplementary capital** | **1.241** | | **286** | | **598** | |
| **Net equity and related capital** | **9.683** | **Capital requirement (8%)** | **8.069** | **Capital requirement (8%)** | **7.270** | **Capital requirement (8%)** |
| *Risk-weighted asset base* | | | | | | |
| Credit risk - IRB | 36.638 | 2.931 | 26.778 | 2.142 | 25.966 | 2.077 |
| Credit risk - Standardised approach | 20.457 | 1.637 | 20.443 | 1.635 | 21.261 | 1.701 |
| Debt risk | 235 | 19 | 263 | 21 | 141 | 11 |
| Equity risk (Market risk) | 500 | 40 | 501 | 40 | 479 | 38 |
| Currency risks | 143 | 11 | 276 | 22 | 396 | 32 |
| Operational risk (Basic approach) | 3.177 | 254 | 2.966 | 237 | 3.317 | 265 |
| Deduction subordinated capital in other financial institutions | 0 | 0 | -348 | -28 | -269 | -22 |
| Deduction adjusted expected amount lost (50 %) | 0 | -4 | -47 | -4 | -57 | -5 |
| Credit Valuation Adjustment (CVA) | 688 | | | | | |
| Capital adequacy reserve | 0 | -97 | -1.211 | -97 | -1.411 | -113 |
| Total risk-weighted assets base - 100 % | 61.838 | 4.791 | 49.621 | 3.969 | 49.823 | 3.986 |
| Complements to overall floor Capital Requirements | 0 | 0 | 8.368 | 669 | 5.275 | 422 |
| **Total risk-weighted assets base IRB** | **61.838** | 4.791 | **57.989** | 4.639 | **55.098** | 4.408 |
| Risk-weighted asstes base IRB in 2008 are 90 % of Basel I assets base. | 20 % | | 20 % | | 20 % | |
| **Capital adequacy ratio** | **15,7 %** | | **13,9 %** | | **13,2 %** | |
| Core Tier 1 adequacy ratio | 12,6 % | | 12,3 % | | 10,3 % | |
| Core capital adequacy ratio | 13,7 % | | 13,4 % | | 12,1 % | |

1) Hybrid tier 1 capital can account for up to 15% of tier 1 capital with any excess counting as perpetual tier 2 capital.

## Figure 10 - Specification of primary capital

| **Specification of capital requirements (Pilar I)** | **31.12.14** Capital requirement | **31.12.13** Capital requirement | **31.12.12** Capital requirement |
|---|---|---|---|
| Credit risk | 4.467 | 3.649 | 3.639 |
| Market risk | 70 | 83 | 81 |
| Operational risk | 254 | 237 | 265 |
| Additional capital requirement according to transition rules | 0 | 669 | 422 |
| **Total capital requirements** | **4.791** | **4.639** | **4.408** |

## Figure 5 Subordinated loan capital and hybrid tier 1 capital

| **Subordinated loan capital and capital bonds** Maturity structure | **31.12.14** | **31.12.13** | **31.12.12** |
|---|---|---|---|
| **Subordinated loan capital with definite maturities** | | | |
| 2018 3 months Nibor + margin 1.25 (call opt. 2013) | | | 0 |
| 2018 3 months Nibor + margin 2.75 (call opt. 2013) | | | 0 |
| 2019 3 months Nibor + margin 2.40 (call opt. 2014) | | 100 | 100 |
| 2019 Fixed rate of interest 8,35 (call opt. 2014) | | 350 | 350 |
| 2015 3 months Euribor + margin 0.45 (call opt. 2010) EUR | | | |
| 2013 mnd Euribor + 2,75 (Call option 2017) | | | |
| 2022 mnd Nibor + 2,75 (Call option 2017) | 500 | 500 | 500 |
| 2024 mnd Nibor + 1,5 (Call option 2019) | 350 | | |
| Premium/discount relating to subordinated loans | | | |
| Currency premium, limited in time | | | |
| **Total sunordinated capital with definite maturities** | **850** | **950** | **950** |
| **Perpetual capital bonds** | | | |
| 2033 6 months Libor + margin (US$ 60 mill.)(call opt. 2013) | | | 0 |
| 2099 3mnd Nibor + 4,75 (Call option 2017) | 500 | 500 | 500 |
| Capital bonds - currency premium | | | 0 |
| **Total perpetual capital bonds** | **500** | **500** | **500** |
| **Total subordinated loan capital and capital bonds** | **1.350** | **1.450** | **1.450** |
| Average interest rate NOK | **5,33 %** | **5,33 %** | **5,33 %** |
| Average interest rate USD | **2,92 %** | **2,92 %** | **2,92 %** |

**Figure 6 - Capital adequacy ratio calculation - SpareBank 1 Nord-Norge Finans**

Amounts in NOK 1,000s

| **Core capital** | **31.12.2014** | **31.12.2013** |
|---|---|---|
| Common equity | 307.000 | 307.000 |
| Premium fund | 59.000 | 59.000 |
| Other equity | 155.604 | 144.395 |
| Total equity capital | 521.604 | 510.395 |
| | | |
| Deduction set aside dividend | -85.770 | -72.415 |
| Deduction net pension fund | | -2.587 |
| Defered tax, goodwill and other intangible assets | | |
| **Core capital** | **435.834** | **435.393** |
| | | |
| **Supplementary capital** | - | 30.000 |
| **Sum supplementary capital** | 76.000 | 30.000 |
| | | |
| **Net equity and related capital** | **511.834** | **465.393** |
| | | |
| **Risk weighted asset base** | | |
| | | |
| Capital requirements: | | |
| Credit risk - IRB | - | - |
| Credit risk - Standarised approach | 3.144.563 | 3.276.150 |
| Debt risk | - | - |
| Equity risk (Marked risk) | - | - |
| Currency risks | - | - |
| Operational risk | 230.059 | 198.225 |
| Deduction subordinated capital in other financial institutions | - | - |
| Deduction adjusted expected amount lost (50 %) | - | - |
| Capital adequacy reserve | - | - |
| Total risk weighted assets | 3.374.622 | 3.474.375 |
| | | |
| **Capital adequacy ratio** | **15,17 %** | **13,40 %** |
| Core capital adequacy ratio | 12,92 % | 12,53 % |
| Supplementary capital adequacy ratio | 2,25 % | 0,86 % |

**Figure 7 - Capital adequacy ratio calculation - SpareBank 1 Nord-Norge Forvaltning**

Amounts in NOK 1000

| **Core capital** | **31.12.2014** | **31.12.2013** |
|---|---|---|
| Common equity | 2.000 | 2.000 |
| Premium fund | 3.600 | 3.617 |
| Other equity | 18 | 64 |
| Total equity capital | 5.618 | 5.681 |
| | | |
| Deduction set aside dividend | - | - |
| Deduction net pension fund | - | - |
| Defered tax, goodwill and other intangible assets | -31 | -52 |
| **Core capital** | **5.587** | **5.629** |
| | | |
| Risk weighted assets | 14.125 | 13.100 |
| Capital adequacy ratio | 39,55 % | 42,97 % |

**Calculation basis ref. Capital Requirements Regulations.**
The calculation basis used is the highest amount after calculations using the standard method, minimum requirement for initial capital or the proportion of fixed costs. The minimum requirement for initial capital was used in 2014, NOK 14,125,000, which results in capital adequacy ratio of 39.55% (42.97% in 2013).

# 5. Risk and capital management

## 5.1 Risk management

Responsibility for monitoring and managing risk within the framework and guidelines adopted by the Board lies with the various business areas and disciplines in the Group. This corresponds with the Group's internal control and management model which is described in more detail in chapter 3.4.2.

Ongoing responsibility for the overall risk assessment and risk reporting lies with the Risk Management and IT Department, which reports to the chief executive. The quarterly risk report, ICAAP and annual management confirmation are drawn up by the Risk Management and IT Department and are also reported to the Board together with the chief executive's supplementary comments.

The Group's management structure reflects the legal requirements for listed companies generally and financial institutions.

## 5.2 ICAAP

### *5.2.1 Purpose*

The management of risk and capital employment is a key instrument that SpareBank 1 Nord-Norge uses to achieve the Bank's objectives as they are defined in the Bank's business strategy. The Group's profitability and opportunities to achieve its objectives in relation to its equity certificate holders, employees and society in general are dependent on its ability to identify, measure, manage and price the risks that arise in connection with offering financial products and services. The risk management shall ensure financial stability and safe and secure asset management through:

- A strong organisational structure characterised by high risk management awareness and high quality
- A good understanding of what risks drive earnings
- Efficient procurement and application of capital in relation to the Group's strategic target and adopted business strategy
- Satisfactory capital adequacy
- A competitive return
- That the Group manages at least to maintain its current international ratings
- Preventing unexpected incidents from causing serious damage to the Group's financial position
- Exploitation of synergy and diversification effects
- Exploitation of growth opportunities in the Group's defined market area

### *5.2.2 Framework and process for risk and capital management*

The renewal and revision of overarching and central government documents is subject to an annual discussion and review by the Board. This is to ensure broad comprehension of the relationship between a good framework for management and control and the active use of limits/targets for the management of risk in relation to the requirements in the capital adequacy regulations.

SpareBank 1 Nord-Norge's framework for the identification and management of risk is illustrated in the diagram below:

**Figure 83 - Risk and capital management framework**


Through the "Policy for Risk Management and Compliance" for the Group the Board has established guidelines on the structure, responsibilities and methods related to comprehensive risk management in SpareBank 1 Nord-Norge.

Work on comprehensive risk management forms an important part of the Group's overall business process. Central specialist departments are involved in the process through the analysis, monitoring, management and reporting of risk.

In order to ensure an efficient and appropriate process for risk and capital management, the framework has been based on significant elements that reflect the manner in which the Board and the executive management team manages the Group.

- Strategic goals
- Organisation and organisational culture
- Identification of risk
- Risk analysis
- Risk strategies
- Capital management (including return and capital adequacy)
- Reporting
- Follow-up
- Contingency plans
- Compliance

In the risk and capital management process, corporate culture provides the foundation for the other elements.

Business strategy
SpareBank 1 Nord-Norge revises the Group’s business strategy on an ongoing basis. This entails a review of changes in the regulatory framework, including the competitive situation, requirements from public authorities, changes in customer behaviour and requirements for competence and organisation.

Organisational culture
The organisational culture is the foundation of the Group's risk and capital management and comprises management philosophy, management style and the people in the organisation with their individual qualities such as integrity, values and ethical attitudes. It is difficult to compensate for an adequate organisational culture by out of control and management measures, and

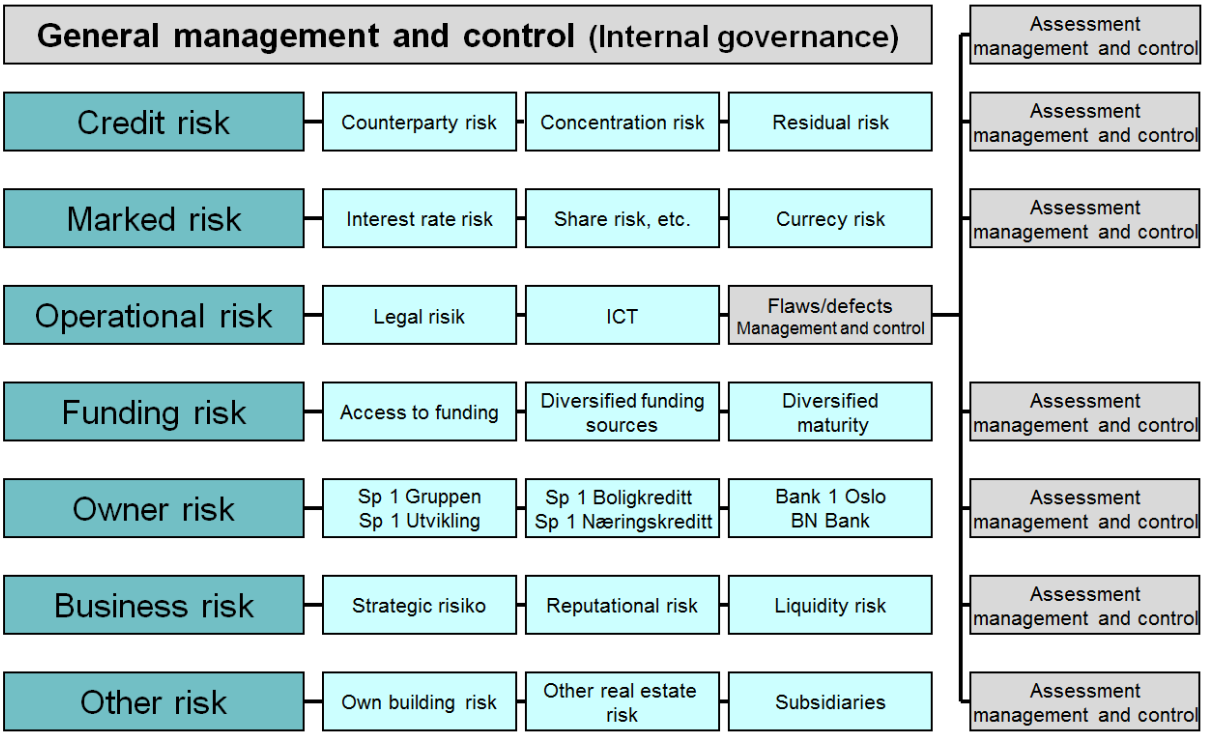
SpareBank 1 Nord-Norge has, therefore, established clear values and ethical guidelines (the SNN code) which is communicated and made known throughout the entire organisation.

The Group's framework and guidelines for Corporate Governance and the 'SNN code' play an important role in the commercial management of the business. The guidelines focus on attitudes and ethics and how we do business with customers and other associates at SpareBank 1 Nord-Norge. These constitute an important element in the Bank's management of its reputation risk.

Risk and capital management

All significant risks are subject to continuous assessment throughout the year. The most important risks are quantified through the expected losses and need for economic capital, and this is an important foundation for the Bank's capital management process. The capital assessment process includes main and sub-risk groups as illustrated below. The assessment of the management and control related to the various business and risk areas is also key to the assessment of the capital requirements.

**Figure 94 - Risk types, control and management**

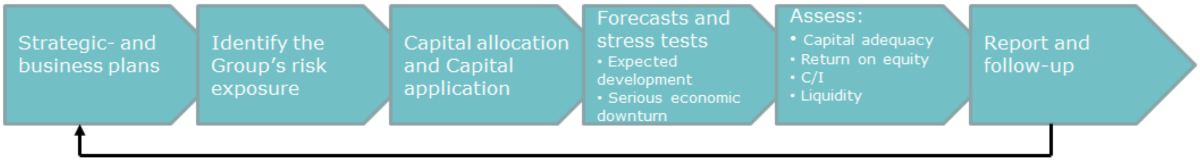



It is a fundamental goal that the risk-adjusted capital will, to the greatest degree possible and within the adopted business strategy, be allocated to the areas that provide the highest risk-adjusted return.

SpareBank 1 Nord-Norge is subject to minimum capital adequacy and financial strength regulations through legislation. The CEBS (Committee of European Banking Supervisors) has issued guidelines for supervisory authorities when they are to assess the institutions' processes for the management of risk and capital requirements in the form of an Internal Capital Adequacy Assessment Process (ICAAP).

The Board is responsible for initiating the ICAAP process and capital planning, as well as approving the structure and methods chosen. In addition, the Board is responsible for setting targets for the Group’s capital level that are adapted to the risk profile and commercial framework conditions. This process is an integral part of the Group's overall risk management. The process should be risk-driven and consist of:

**Figure 105 - ICAAP**




The risk and capital assessment process takes the Group's strategic goals as its starting point. Forecasts of the expected financial development, as well as future scenarios with an economic downturn and capital stress that lasts for a minimum of 5 years, are then drawn up based on the strategic goals and business plan.

### *5.2.3 Prognoses and stress tests*

5.2.3.1 Description of forecast models and stress tests

In the last few decades, financial stability analysis has played an increasingly important role in many central banks and thus new requirements for financial institutions. This must be viewed in the context of the financial markets having become deeper and financial crises having occurred more frequently. One important element in the analysis of financial stability is investigating how vulnerable the financial system is with respect to macroeconomic disturbances. This can be done using prognoses and stress tests.

The main purpose of the forecast model is to assess the development of the Group's results, risk and financial strength in various scenarios when economic growth is weak and produce the associated estimates for capital requirements. The challenge is to identify relevant future scenarios in which risk increases, and to construct a good relationship between the macroeconomic developments in the scenarios and the microeconomic developments for all the key variables that affect the results, balance sheet and risk levels. The scenarios should be relevant in the sense that they cover the situations that are regarded as capable of disturbing the macroeconomic stability of the Norwegian economy and thus increase the risk in the Group.

The forecast model must satisfy the requirements set by the capital adequacy regulations. These are the requirements that are stipulated for IRB banks through the Capital Requirements Regulations (Pillar 1) and guidelines on the assessment of risk levels and calculation of capital requirements in institutions (Pillar 2).

5.2.3.2 External requirements for stress tests and scenarios

Section 16-1 of the Capital Requirements Regulations states:

1. The institution shall identify factors that could have a negative impact on credit risk and capital adequacy and conduct stress testing. The stress tests shall reflect situations which involve changes that could particularly affect credit risk, including economic downturns. The stress tests shall include all significant elements of the institution's portfolio, as well as an assessment of the impact on the Group's financial strength.
2. Stress testing shall be conducted regularly and at least once a year.
3. The Financial Supervisory Authority of Norway can lay down further rules for stress testing.

In other words, stress testing is a condition for IRB approval. The stress tests must show the impact on capital adequacy and the ability to satisfy the minimum capital requirement. The regulations say nothing about the severity of the scenario one should analyse, but point out that the impact an economic downturn would have on credit risk must be discussed. The minimum requirement set by the EU Council[1] is a 'mild recession' scenario. We also note that 'all significant elements of the institution's portfolio' shall be stress tested.

The Committee of European Banking Supervisors (CEBS)[2] published revised guidelines on stress testing in a circular dated 26 August 2010. The Financial Supervisory Authority of Norway

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[1] Source: Directive 2006/48/EC of the European Parliament and of the Council; Relating to the Taking up and Pursuit of the Business of Credit Institutions

[2] New guidelines on stress testing called 'CEBS Guidelines on Stress Testing (GL32)' applicable from 31 December 2010

underscores that the guidelines on stress testing form part of the guidelines on the Pillar 2 process and supplement circular 21/2006 "Pillar 2 of the revised capital adequacy framework – guidelines for assessing risk profile and calculating capital needs at institutions".
The new guidelines came into force on 31 December 2010. ICAAP 2014 calculations are based on the new guidelines.

There is a requirement that the effects of a serious recession (capital stress) must be analysed in connection with the ICAAP. With reference to the Financial Supervisory Authority of Norway's circular 21/2006[3]:

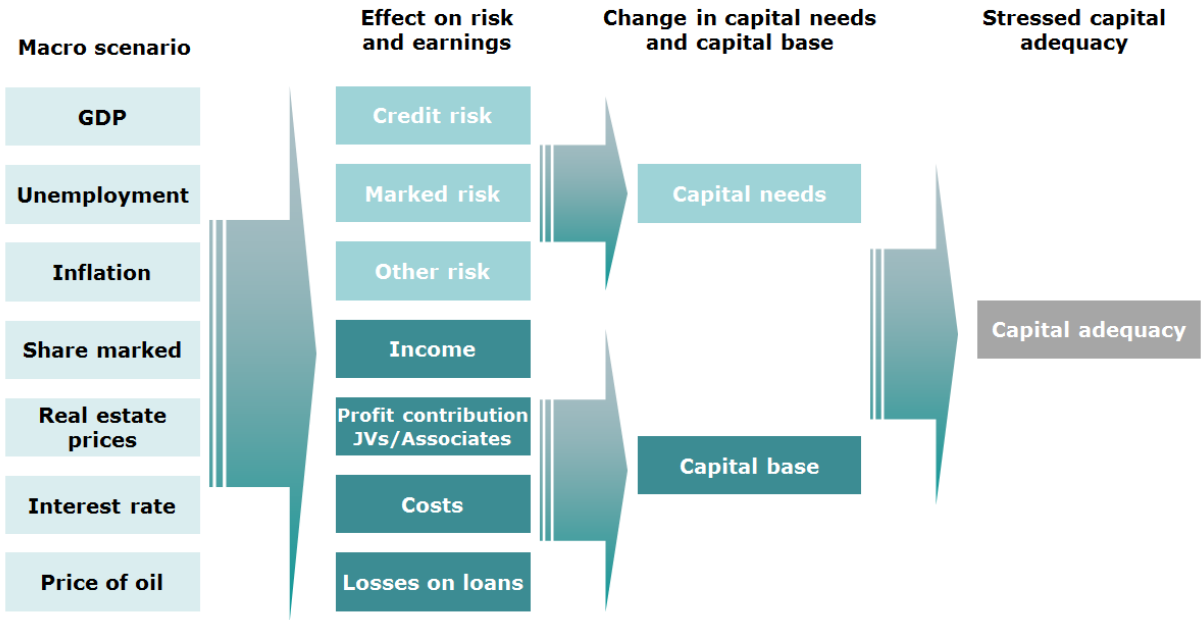
- Stress testing constitutes a key part of ICAAP and capital planning.
- The institution shall consider how it can survive an economic downturn with negative results and in which raising new equity could be problematic.
- An extraordinary but probable scenario shall include:
  - The recession shall last for at least 3 years
  - Show the impact on earnings and financial strength
  - Show the impact on complying with the minimum requirement
  - Show how the capital requirements will be satisfied through the recession, including management measures
  - Forecast of the financial situation/funding situation

Another important reference is the CEBS's 'Technical Aspects of Stress Testing under the Supervisory Review Process – CP12', which also provides a number of guidelines on what Pillar 2 stress tests should include. We particularly note chapter IV.3.b. 'Stress testing for IRB institutions' and the definition of 'scenario stress test' and 'sensitivity stress test' in section 16:

- Scenario stress test – shows the impact on the result/financial strength of movements in a number of risk drivers (simulation); due to a well-defined stress event. Expected to be used by larger institutions.
- Sensitivity stress test – shows the impact on the result/financial strength of movement in a specific risk driver; where the stress event is unknown. May be enough for smaller banks.

5.2.3.3 Relationship between scenarios and stress tests
The Group's model for stress tests and scenarios can be illustrated as follows:

**Figure 116 - Forecast/stress test model**




[3] This section is based on the presentation by Jon Hellevik of the Financial Supervisory Authority of Norway on 18 September 2007 at Norges Bank.

One significant challenge is to use macro assumptions and convert them to business variables when assessing:

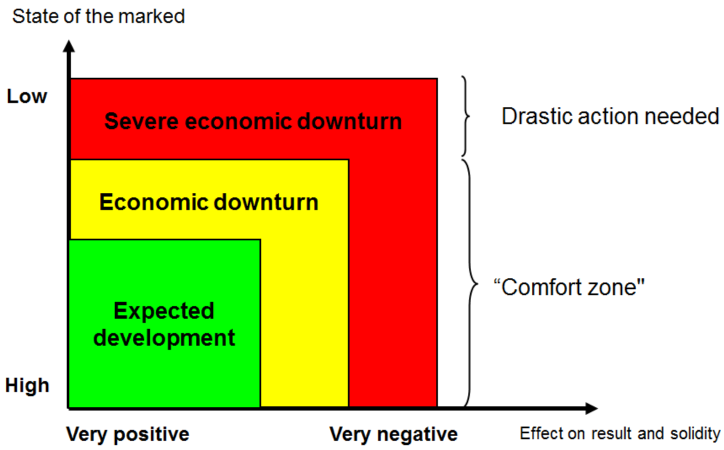
- credit score models - assessment of migration and changes in default probability, expected and unexpected losses
- financial strength and profitability - forecasts for normal development and various economic recessions
- liquidity (funding) – the Group's challenges and vulnerability associated with changes in funding levels and situations associated with any general financial crises or special situations for the Bank (SpareBank 1 Nord-Norge)
- financial performance of associated companies
- impact of market and competition situations in Northern Norway and reputation risk

5.2.3.4 Setting the scenarios

For the Bank it is important that the scenario and stress test for capital stress is based on serious - but possible - disturbances in the economy so that it provide answers about how much could be lost, not necessarily how much it is likely will be lost. This means that these do not need to express changes we regard as likely because in the assumptions we say that all events occur at the same time (correlation = 1).

The figure below illustrates the purposes of the various stress tests/forecasts.

**Figure 127 - Forecast/stress test model**




As far as the effects of "financial strength stress" are concerned, this is a basis for illustrating the effects of major disturbances in the economy that have an impact on several key results and risk areas simultaneously. This is to stress financial strength and profitability to the maximum. The results from the capital stress will form the basis for the management's discussions concerning potential and necessary measures more of out of contingency considerations than the fact that such a crisis would probably occur.

It is important to the authorities that the banks carry out scenarios and stress tests to reveal the robustness of the financial sector. The results from joint national stress tests and the banks' stress tests will also be important input in a discussion about future capital levels and capital targets.

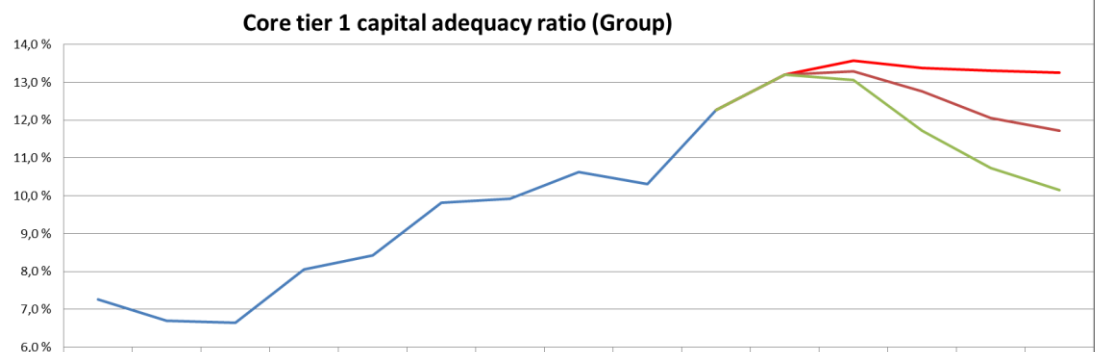
The results from the scenarios and stress tests are processed as an important part of the annual ICAAP. In the assessments the Bank attaches importance to presenting the results from the forecast "LTP reference track" (expected development) and the forecasts "LTP economic downturn" (probably economic cycle in an economic downturn) and "LTP capital stress" (powerful negative impact on the economy). The Bank also conducts a sensitivity analysis in relation to the development of the reference track, and a reverse stress test to see which events could cause a powerful negative impact on the Group's results and capital adequacy.

**Figure 138 - Forecasts and stress tests**

| | |
|---|---|
| **LTP Exp.dev** | Forecast of expected development in the parent bank, the Group and JVs. |
| **Sensitivity analysis** | Effect on core capital ratio when changing condition on one single growth- of result parameter |
| **LTP Economic downturn** | Forecast of an economic downturn in the parent bank, the Group and JVs. |
| **LTP Severe economic downturn** | Forecast of an severe economic downturn in the parent bank, the Group and JVs. |
| **Reverse stress test** | Assessment of areas that can generate severe negative effects. Special considereations are given to solidity and liquidity. |

The effects on the Group's tier 1 capital ratio of the various forecasts/stress tests are shown in the figure below.

**Figure 149 - Development of tier 1 capital ratio in the scenarios**




| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Carrying value | 7,3 % | 6,7 % | 6,6 % | 8,1 % | 8,4 % | 9,8 % | 9,9 % | 10,6 % | 10,3 % | 12,3 % | | | | | |
| Expected development | | | | | | | | | | 12,3 % | 13,2 % | 13,6 % | 13,4 % | 13,3 % | 13,2 % |
| Economic downturn | | | | | | | | | | 12,3 % | 13,2 % | 13,3 % | 12,7 % | 12,1 % | 11,7 % |
| Severe economic downturn | | | | | | | | | | 12,3 % | 13,2 % | 13,1 % | 11,7 % | 10,7 % | 10,1 % |

The calculation of ICAAP was conducted in 2014 with data as per 30 September 2014. The year-end common equity tier 1 capital ratio was forecast at 13.2% before the effects of the provisions in Russia were known.

## 5.4 Risk measurement and risk-adjusted capital

Internally the Group uses risk-adjusted capital as a measure for the calculation of risk.

Risk-adjusted capital indicates how great a loss an enterprise may incur under extreme conditions. The calculation of the risk-adjusted capital is thus a key element in the assessment of the Group's need for equity to do business in a responsible manner. Risk-adjusted capital allows risk to be compared across types of risk and business areas.

At year-end 2014, the Group's capital adequacy ratio was 15.7%, 12.6% of which was common equity tier 1 capital ratio. At year-end 2013, the capital adequacy ratio was 13.9% and the common equity tier 1 capital ratio was 12.3%.

Both the external and internal requirements are compared with the Group's core capital, and the book equity and core capital will normally be higher than the risk-adjusted capital. This gives a buffer in relation to the stipulated external and internal minimum requirements, which gives the Group the necessary strategic freedom of action and long-term stability.

### 5.5 Reporting and follow-up

One important element of effective risk management is monitoring ongoing risk exposure. All managers are responsible for the day-to-day risk management within their own areas of responsibility, and they must make sure at any given time that the risk exposure is within the limits that have been determined by the Board or the chief executive.

The Group's overall risk exposure and risk development are followed up through periodic risk reports to the chief executive and Board. Overall risk monitoring and reporting are performed by the Risk Management and IT Department, which is independent of the individual business units in the Group.

### 5.6 Compliance

The Group stresses the importance of good processes to ensure compliance with the current laws and regulations, as well as internal guidelines and policies. Effective tools for achieving this include:

- Clear values that are clearly communicated and understood throughout the organisation
- A process to identify, communicate and implement changes in acts and regulations
- A process to follow up and report compliance with acts and regulations
- A process for monitoring, reporting and evaluating compliance with internal limits, guidelines and policies.

## 6. Key risk groups and measuring methods

SpareBank 1 Nord-Norge is exposed to various types of risk, and the most important risk groups are:

- Operational risk: Risk of loss as the result of inadequate or defective internal processes or systems, human error, or external circumstances. Operational risk encompasses legal risk, but not strategic or reputation risk.
- Compliance risk: Risk that the Group incurs government sanctions/fines, financial losses or a weakened reputation as a result of a failure to comply with acts/regulations, standards or internal guidelines.
- Market risk: Risk of loss due to changes in observable market variables such as interest rates, foreign exchange rates and securities markets.
- Credit risk: Risk of loss due to customers not having the ability or willingness to fulfil their obligations.
- Funding risk: Risk of the Group being unable to fund increases in assets and being unable to meet its obligations as its overall funding requirements increase.
- Owner risk: Risk of losses in subsidiaries, SpareBank 1 Gruppen AS, SpareBank 1 Boligkreditt AS, SpareBank 1 Næringskreditt AS and BN Bank AS, is related to the risk that the individual companies assume in their operations, as well as the risk of a need for the injection of fresh capital into one or more of these companies.
- Business risk: Risk of inadequate earnings and funding related to a lack of diversification in the commercial basis or the lack of adequate and permanent profitability due, for example, to a high cost/income rate.
- Strategic risk: Risk of inadequate earnings or generation of capital attributed to changes in the framework conditions, poor business decisions, poor implementation of decisions or failure to adapt to changes in the commercial framework conditions.
- Reputation risk: Risk of inadequate earnings and funding due to declining confidence and reputation in the market, customers, contracting parties, equity certificate holders and the authorities.

Statistical methods are used for the calculation of expected losses in the risk-adjusted capital (economic capital), but the calculations require nevertheless the use of expert assessments in some cases. For risk types where there are no recognised methods for the calculating capital requirements, the Bank attaches importance to defining limits for management of the risk that seek to ensure a low probability that a greater loss incident will occur.

The Group's risk is quantified, for example, through calculation of the expected loss and the requirements for risk-adjusted capital (unexpected loss).

Expected loss: Describes the amount that the Bank must statistically expect to lose during a 12-month period.
Risk-adjusted (financial) capital: Describes how much capital the Group believes it needs to cover the actual risk the Group has assumed. The Board has decided that the risk-adjusted capital should cover 99.9% of possible, unexpected losses.

The return on risk-adjusted capital is an important strategic result-related target in the internal management of SpareBank 1 Nord-Norge. The most important business areas are allocated capital in relation to the calculated risk relating to the activities, and the return on capital is monitored continuously. The calculation of risk-adjusted capital enables the comparison of risk across risk groups and business areas.

A detailed description of the most important risks is given in the following sections.

## 6.1 Operational risk

### 6.1.1 Management and control

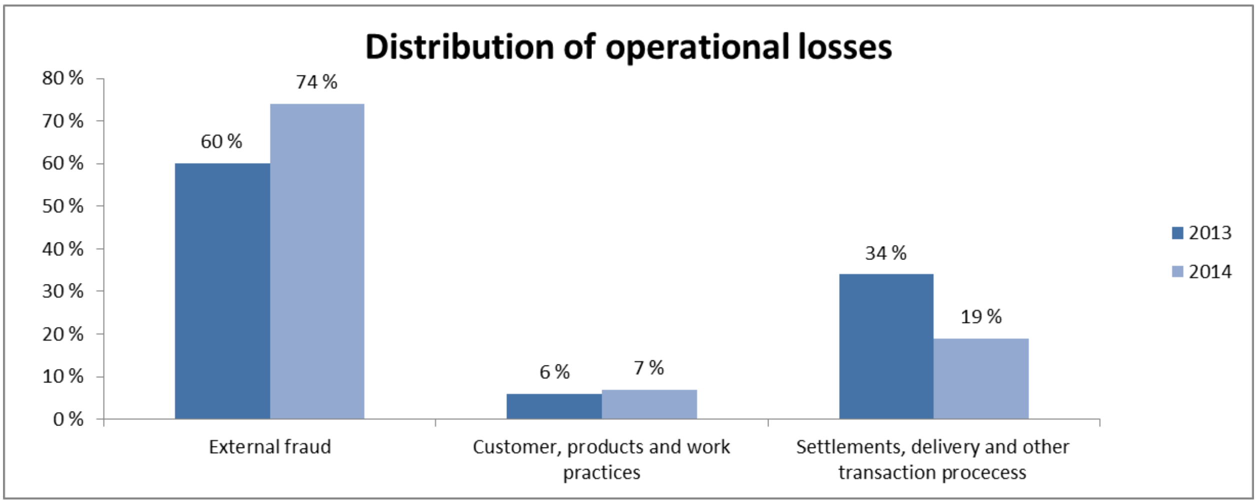
In the opinion of the Bank, the management of the operational risk is closely associated with how the Bank manages its overall risk. The management of operational risk is, therefore, an important part of the Group's comprehensive risk management. The Bank's ability to work systematically with management and control, including the systematic follow-up of weaknesses/improvement areas is the foundation of the Bank's management of operational risk.

The daily risk management is performed as a direct line function, but to improve the comprehensive operational risk management, the Bank has developed/implemented new systems and methods in this area in recent years. This includes a special Risk Information System for the systematic documentation and follow-up of risk, as well as improving risk management and control. This includes:

- All the reporting from internal auditing, external auditing and the Financial Supervisory Authority of Norway is followed up.
- A database for incident reporting, which is a Basel II oriented reporting system with 7 defined "Basel categories" and the associated subcategories and causal relationships.
- Manager verification and monitoring of improvement areas.

Registered operational losses are at a low level (NOK 1.35 million in 2014 compared with NOK 2.5 million in 2013) and are spilt among the different base categories:

**Figure 20 - Categorisation of operational losses**




A self-assessment of the management and control is performed annually. The Financial Supervisory Authority of Norway's modules for risk-based supervision with the addition of the

CoBiT framework for the assessment of ICT (IT Governance and Control) are used in this assessment. This review is an important part of the Group's annual ICAAP.

The Risk Management and IT Department is responsible for the ongoing, independent monitoring of the operational risk. Each year, the Board receives an independent assessment from the internal auditor and the responsible auditor for the Group’s risk management, confirming whether the internal control works in an appropriate and reassuring manner.

6.1.2 Minimum capital requirements for operational risk

The minimum capital requirement is calculated using the standardised approach for the parent bank and the basic method for subsidiaries and associated companies.
The Group's capital requirements as at 31 December 2014 related to operational risk are calculated as follows:

| | |
|---|---|
| SpareBank 1 Nord-Norge (Group): | |
| Standardised approach parent bank | NOK 249.9 million |
| Total consolidation items for deduction | NOK -38.2 million |
| Basic method for subsidiaries and associated companies | NOK 42.6 million |
| Total | **NOK 254.3 million** |

The minimum capital requirement calculated using the standardised approach for operational risk is calculated as a percentage of average income for each business area for the past 3 years. Own account and procurement 18%, brokering for mass market customers 12%, banking services for mass market customers 12%, banking services for corporate customers 15%, payment and settlement services 18%, associated services 15%, asset management 12%.
The minimum capital requirement calculated using the basic method for operational risk is calculated using 15% of the total average income of the business areas for the past 3 years.

The capital for operational risk is included in the Group's process for the assessment of economic capital in accordance with Pillar 2. In Pillar 2 an assessment is made as to whether the Group requires additional buffers beyond the calculated minimum capital requirements. Our assessment includes an assessment of the quality of the management and control as well as other circumstances that can affect the capital requirements.

## 6.2 Compliance risk

6.1.2 Management and control

The Group's must efficiently monitor and manage compliance risk so that no events are capable of seriously harming the Group's reputation and financial position. The Group therefore manages this area according to the following principles:

- Clear responsibilities and roles within compliance work
- Effective routines for identifying, communicating and implementing changes in acts/regulations and industry standards
- Efficient routines and uniform system for monitoring and reporting compliance to the chief executive and Board
- Reporting system that ensures uniform monitoring and reporting within the area of compliance for the Group
- Independent assessment of compliance conducted by internal and external auditors within their respective areas of responsibility

The Compliance Committee is responsible for coordinating general compliance work, including frameworks, receiving part-reports and drawing up the Group's overall compliance report which must be presented to the chief executive and Board.

The Group has its own compliance manager for the investment firm who is responsible for ensuring the Bank's activities associated with the performance of investment services comply with the regulations for securities trading.

The managers in the Group are operationally responsible for the practical implementation of and compliance with acts/regulations and industry standards.  All employees are responsible for ensuring day-to-day compliance.

Events and breaches in the area of compliance are recorded and followed up by in the Bank's Risk Information System.

## 6.3 Market risk

SpareBank 1 Nord-Norge's market risk is related primarily to long-term investments in equity instruments and interest-bearing securities. There will also be a certain degree of market risk as a result of trading activities and traditional banking activities such as loans and deposits.

6.1.3 Management and control

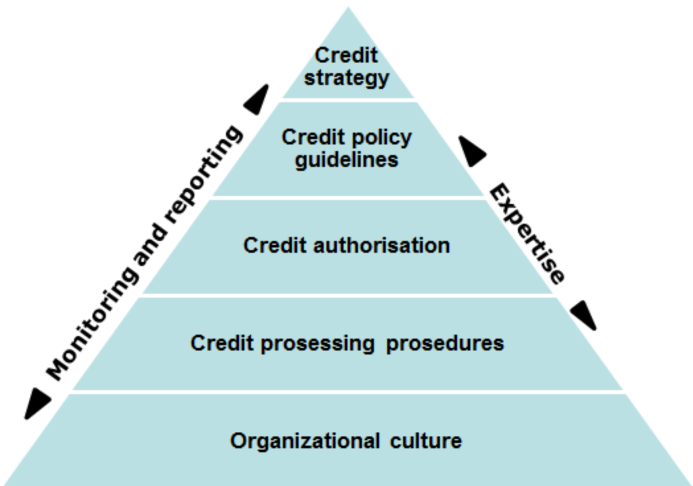
SpareBank 1 Nord-Norge reviews the Bank's capital market activities every year.
Individual matters are presented to the Board concerning the Bank's capital market activities based on this review. The matters include status within the area with a view to the Bank's own capital market activities - Treasury and SNN Markets, where all customer activities within the capital market area are gathered. Proposed new exposure limits are also considered.
The limits are determined based on stress tests and analysing market movements, as well as the risk capacity and willingness.

The Group's market risk is otherwise managed and controlled primarily through the daily follow-up of risk exposures against the limits stipulated by the Board and ongoing analysis of outstanding positions.
The Risk Management and IT Department is responsible for the ongoing, independent monitoring of market risk. Monthly reports for each portfolio are submitted to the Bank's Balance Sheet Committee and Board.

## 6.4 Credit risk

### *6.1.4 Management and control*

**Figure 21 - Elements in the Group's overall framework for credit management**




Credit risk is managed through the Group's overall credit strategy, credit policy, appropriation regulations and credit management routines. The individual elements are described in greater detail in the sections below:

- The Group's credit strategy is determined by the Board and updated at least once a year. The Group's credit strategy limits are defined so that they measure and identify changes in the ongoing risk exposure in the most appropriate and efficient manner through, for example, the expected loss and need for economic capital. In addition, the Bank's credit strategy limits place special restrictions on the concentration risk related to exposure and the risk profile of individual customers, customer groups and industries.

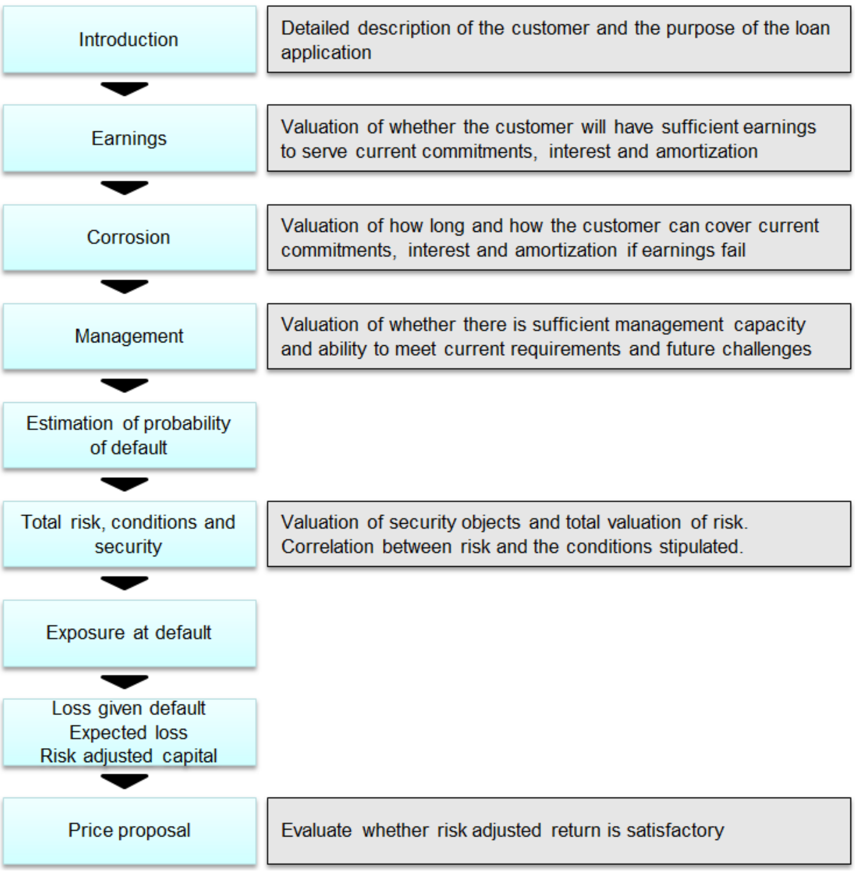
- The Group's credit policy is determined by the chief executive and updated at least once a year. The credit policy describes the principles for granting credit both at the general level and related to certain specific areas such as real estate financing and project financing. Examples of such principles include requirements for the percentage of equity financing and restrictions for the financing of commitments with a high level of risk and for individual industries.

- The Group's appropriation regulations are determined by the Board and updated at least once a year. The Board delegates authority, within certain limits, for the operational responsibility with respect to decisions in loan and credit cases to the chief executive. The chief executive can delegate authority to others within the scope of his own authority.

- The credit management routines regulate in detail all the circumstances related to the Group's granting of credit and follow-up of commitments.

The credit granting process can be described as shown in figure 24 below.

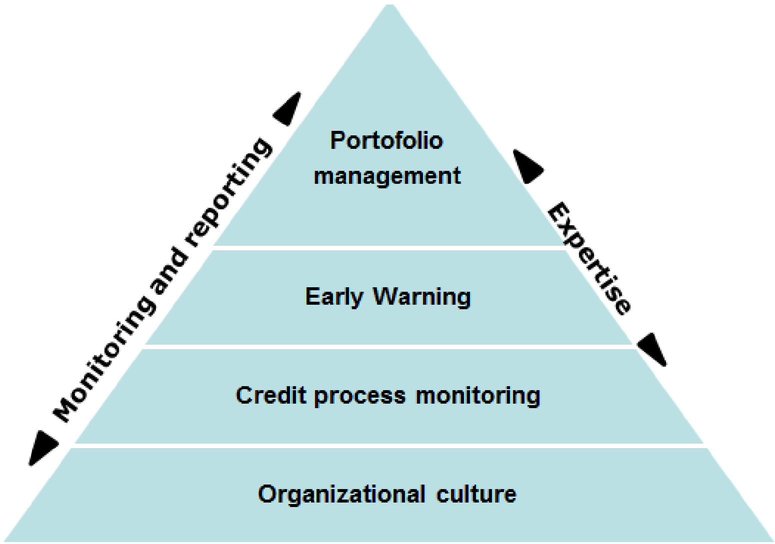
**Figure 15 Credit rating process**




The ongoing monitoring and follow up of commitments and credit portfolios are central to the Group's risk management. The Group's risk exposure is followed up by means of the Group's portfolio management system. The system contains information on individual customers and portfolios, and provides efficient follow-up of the risk profile and management of the portfolio. SpareBank 1 Nord-Norge updates the portfolio information monthly by means of internal and external customer data. The risk-related development of the portfolio is followed up monthly, with special emphasis on the development of the risk classification (migration), and expected loss, economic capital requirements and the risk-adjusted return.

The framework for commitment and portfolio monitoring is shown in figure 25 below.

**Figure 16 Framework for credit monitoring**




The Risk Management and IT Department performs independent risk monitoring and reports the overall risk exposure to the executive management team and Board.

## 6.5 Funding risk

6.5.1 Management and control

The management of the Group's financial structure is based on an overall funding strategy that is reviewed and approved by the Board at least annually. The funding strategy reflects the desire for low to moderate funding risk.

An analysis is conducted of the Bank's stress scenarios as part of the annual review of the funding strategy. The stress test includes a minimum of four stress scenarios in which the impact on the Bank's funding needs is analysed in the event of changed market conditions for the Bank. Different development trends for the Bank's most important asset and liability items are stress tested on the basis of given assumptions, including full utilisation of the limits.

The principal objective of the funding strategy is to maintain the Bank's ability to survive in a normal situation without any external funding for a period of 12 months. The Bank must also survive for a minimum of 30 and 90 days in a 'major stress situation' for the Bank, banking market and a combination of these. Survival is based on a predefined liquidity buffer/reserve. The scenarios assume no external funding. The Group also has an internal LCR goal of 15 percentage points above the regulatory minimum requirement.

The Bank's funding strategy also attaches importance to adaptation to the international and Norwegian trends with regard to the management of the funding area for banks. This applies in particular in relation to BIS's 14 principles for good liquidity management. This entails, for example, that the liquidity management strategy is defined specifically in the form of limits and guidelines adopted by the Board.

Balance Sheet Committee
The Balance Sheet Committee is an advisory body in relation to the market and liquidity area in the Bank.
The Balance Sheet Committee's field covers the Bank's total balance sheet, including funding risk, market risk, credit risk and interest rate risk. The Balance Sheet Committee meets regularly and the bank's funding strategy is reviewed annually or more frequently if special circumstances otherwise dictate a need for this.

The Balance Sheet Committee reviews funding risk, limit utilisation, balance sheet composition and funding structure once a month. Maturity diversification is reported once a month to the Board and the Balance Sheet Committee via a graphical presentation of the maturity structure. The frequency of meetings depends on the situation in the market.

Contingency plan
The Group has prepared a contingency plan for the management of the liquidity situation during periods of unrest in the financial markets. The contingency plan forms part of the Bank's funding strategy and is approved by the Board. The contingency plan is updated as needed and at least once a year as part of the Board's annual review of the Bank's funding strategy.
The purpose of the contingency plan is to describe the management's strategy for handling funding crises. The contingency plan also describes the procedures for releasing capital in a crisis situation. It also identifies and explains which events can trigger use of the contingency plan.

The contingency plan has 4 levels:

- Level 1: Risk of funding crisis in the market or Bank
- Level 2: Mid-level crisis in the Bank or market
- Level 3: Major crisis in the Bank or market
- Level 4: Major crisis in the market and SpareBank 1 Alliance

The treasurer is responsible for:

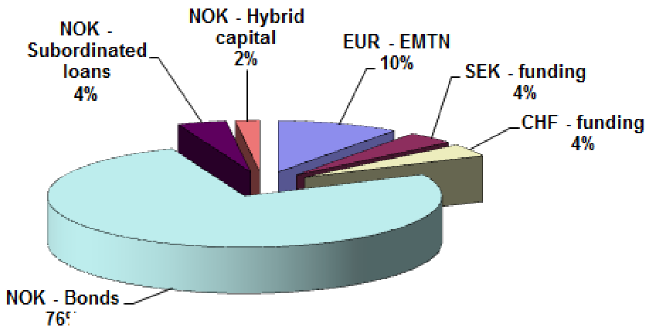
- Identifying potential funding crises
- Determining the contingency level
- Situational reporting to the CFO and contingency group

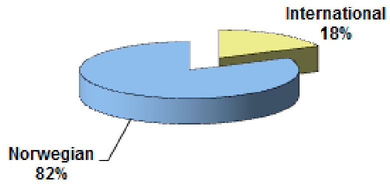
The funding risk is reduced by diversifying funding across several markets, funding sources, instruments and maturities. Too much maturity concentration increases the vulnerability of refinancing. An attempt is made to limit this risk through defined limits.

It is the Group's Treasury Department that is responsible for operative funding management through day-to-day monitoring and measuring.  Compliance with the limits is monitored by the Risk Management and IT Department. The status of the limits adopted by the Board is reported to the Board every month.

### *6.5.2 Diversification and maturity information*

**Figure 17 Diversification of the Group's funding sources and markets**



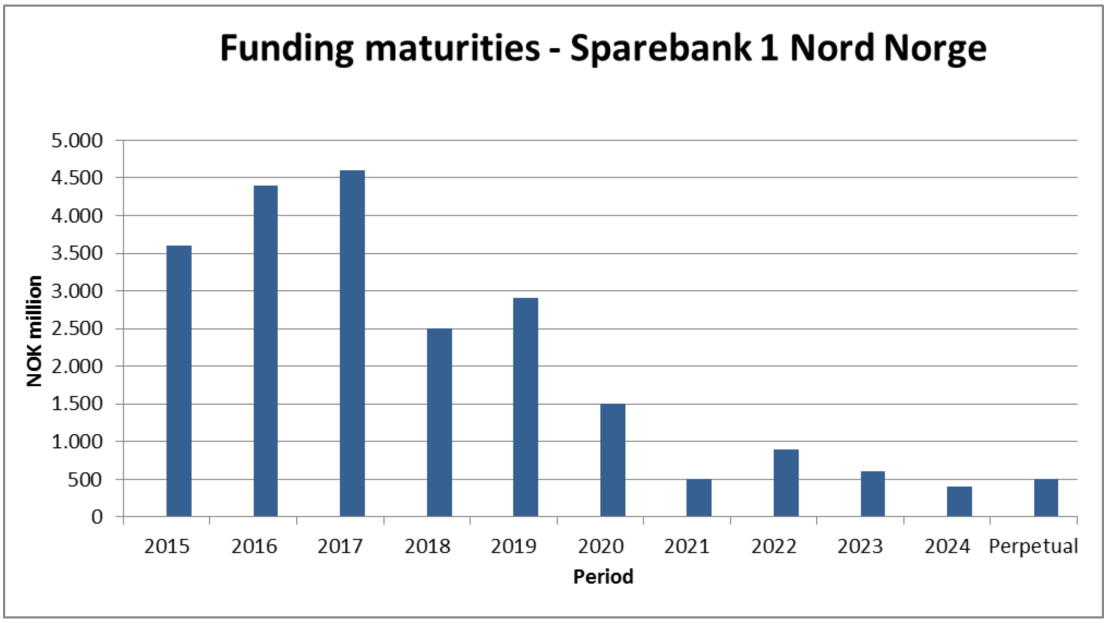




At the end of 2014, the Group obtained 82% of its funding from the Norwegian market, while the share from the international market was 18%. The market shares were 89% and 11%, respectively, as at 31 December 2013.

Customer deposits are the most important source of funding for the Group. The ratio between deposits from and lending to customers for the Group was 74.7% (53.8% including intermediary loans) as at 31 December 2014, compared with 78.3% and 75.6%, respectively, one and two years ago.

The funding risk of SpareBank 1 Nord-Norge is reduced by transferring well-secured home mortgages to SpareBank 1 Boligkreditt, which is an issuer of covered bonds. As at 31 December 2014, the Bank had transferred a total of NOK 23.7 billion in home mortgage loans to SpareBank 1 Boligkreditt.

**Figure 18 Maturity structure for capital market funding**




The Bank's funding risk in the future will also be affected by developments in other risk areas – particularly the development of the credit risk. A systemic crisis in the financial services industry could also affect the Bank's funding risk. The risk borders on the Bank's strategic/commercial risk.

SpareBank 1 Nord-Norge's funding situation was considered satisfactory as at 31 December 2015. The actual surplus liquidity at the end of the year was NOK 17.8 billion, defined as cash and cash equivalents in Norges Bank, Level I and Level II papers, and home mortgage loans ready for transfer to SpareBank 1 Boligkreditt AS.
Of the Group's total funding volume of NOK 22.5 billion at the end of the year, NOK 3.6 billion must be refinanced in 2015.

The risk of inadequate refinancing of debt is managed through the Group's overall funding strategy and contingency plan.

Risk-adjusted capital funding risk
Economic capital is calculated for the risk of the Group incurring additional costs for refinancing during periods of unrest in the capital markets. This is calculated as part of the Group's commercial risk.

## 6.6 Owner risk

Owner risk varies from company to company depending on the company's operations and the underlying risk, and SpareBank 1 Nord-Norge's stake.

At the end of the fourth quarter of 2014, SpareBank 1 Nord-Norge was primarily exposed to owner risk through stakes in:

- SpareBank 1 Gruppen (19.5%)

- SpareBank 1 Boligkreditt AS (14.71%)
- SpareBank 1 Næringskreditt AS (20.83%)
- BN Bank ASA (23.5%)
- SpareBank 1 Utvikling DA (17.74%)

Please also see chapters 3.1 and 3.2 for more information about the Group's structure and the SpareBank 1 Alliance.

### *6.1.6 Management and control*

SpareBank 1 Nord-Norge has a strong focus on management and control in companies in which the Bank has full or partial ownership.

In companies that are partially owned, either through direct ownership by SpareBank 1 Nord-Norge or indirectly through ownership of 19.5% of SpareBank 1 Gruppen, SpareBank 1 Nord-Norge is represented on the boards of all the major companies.

A good supply of information is provided through active board participation, which safeguards SpareBank 1 Nord-Norge's ownership interests. In cases that are of importance to SpareBank 1 Nord-Norge's other operations, the individual board chairman/member will submit the matter for a plenary discussion by the executive management team, which meets every week.

### *6.6.2 Risk-adjusted capital owner risk*

Calculation of the risk-adjusted capital is based on the results from the companies' own risk and capital assessment process, taking into account SpareBank 1 Nord-Norge's ownership interest.

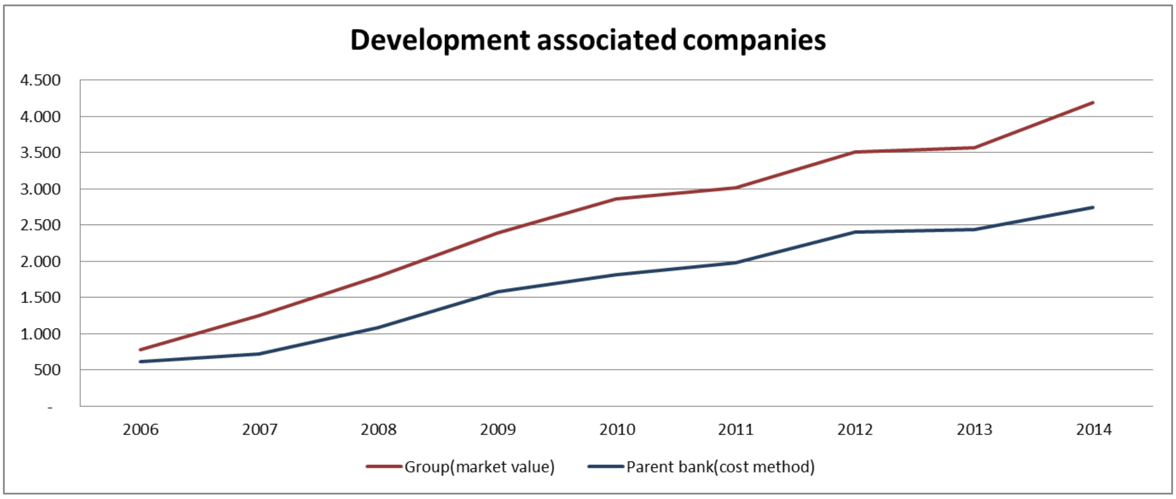
The owner risk related to ownership interests in BN Bank ASA, SpareBank 1 Boligkreditt AS and SpareBank 1 Næringskreditt AS are included in the capital adequacy in accordance with the principle of proportional consolidation, and the risk is in Pillar 2 allocated to the individual risk types.
Of the companies owned by SpareBank 1 Gruppen AS the ownership of SpareBank 1 Livsforsikring is considered entailing the highest owner risk. This is due primarily to the company's investment of customer funds in the equity and bond markets, where the return varies over time.

Owner risk in SpareBank 1 Næringskreditt AS and BN Bank ASA generally consists of the underlying credit risk in the company.

Owner risk in SpareBank 1 Boligkreditt AS depends on the proportion of the portfolio transferred. The risk is therefore monitored and reported as credit risk.

The development in exposure measured as the booked amount for associated companies in the consolidated financial statements is shown in the graph below (NOK million).

**Figure 19 Development of book value of stakes in associated companies**




As can be seen from the graph the historic cost price (book value parent bank) and book value in the consolidated balance sheet have increased in the last few years. The fact that the book value of stakes in associated companies has risen to 5.2 % of the total assets in the Group (3.5 % in the parent bank) is in of itself not dramatic, but the stakes' significance vis-à-vis tying up capital and financial performance is sizeable. The capital associated with the Bank's ownership of Boligkreditt has in particular increased in the last few years. This, together with the stake in Næringskreditt, is important when one considers the Bank's ability to reduce its funding risk through transferring portfolios to these companies. The stakes in Boligkreditt, Næringskreditt and SpareBank 1 Gruppen are strategically important items viewed in the context of the Bank's total business model and ability to operate efficiently and with competitive products and prices.

## 6.7 Business risk

The Group's business risk arises from potential falls in earnings, significant changes in capital requirements due to new regulatory requirements, and/or declining confidence, or damage to its reputation, in the market due to serious events. The risk can manifest as a weakening of the result that may be attributed to competitive conditions that result in lower volumes and pressure on the prices, competitors that introduce new products, government regulations or negative media coverage. Negative effect results arise if the Group is unable to adapt its costs to such changes.

Good strategic planning is the most important tool for reducing business risk and involves both preventive measures and plans for how incidents should be managed. The Board reviews business strategies and plans for the area of risk management every year. The Group's limits and guidelines for good corporate governance and the SNN Code of Conduct play an important role in the commercial management of its operations. The guidelines focus on attitudes and ethics and how SpareBank 1 Nord-Norge does business with its customers and other associates, and are intended to support a good, positive corporate culture.
Reputation risk is governed through policies and business activities, including compliance.

Since business risk can arise as a result of different risk factors, a broad range of methods (quantitative and qualitative) are used to identify and report such risks.

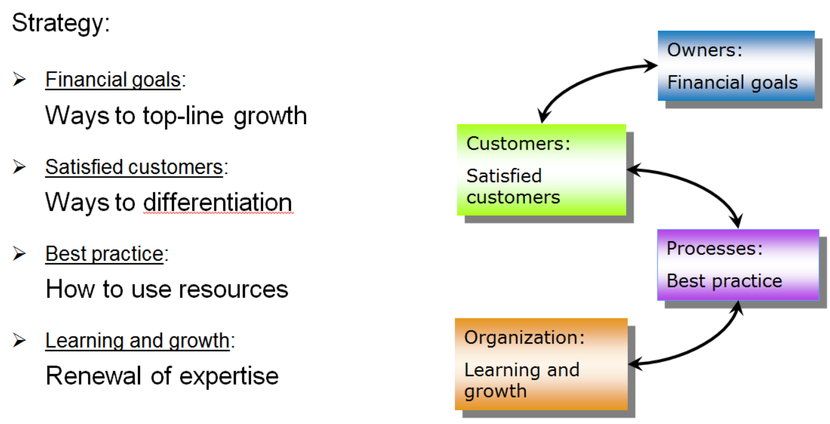
Reputation risk and strategic risk are treated as part of the Group's business risk.

### *6.7.1 Strategic risk*

Continuously monitoring competitors and the market keeps the management team and Board constantly apprised of external changes that are significant enough to warrant minor or larger strategic changes.

The Bank operationalises the strategy through various indicators within the various perspectives used in balanced goal management.

**Figure 20 Strategy and perspective in the scorecard are closely related**




***<u>Main strategies</u>***

*<u>Employees:</u>*
As the Bank's most important resources, we will continuously seek to develop the employees' skills and knowledge so they can meet the requirements of both customers and the authorities. Continuous training is ensured via our own 'academy'. To safeguard expertise and reduce vulnerability, employees will belong to larger market areas. The culture will be characterised by transparency, both internal and external, so that the Bank's integrity can never be questioned.

*<u>Process:</u>*
The Bank has a unique competitive advantage thanks to its broad distribution. The local banks will remain the most important sales units in the Bank. The division of work between the local bank and the digital channels (online bank and mobile bank) will be clearer. The vast majority of daily banking services will be provided electronically. Simple advice will also be offered online or in combination with a customer service centre. Corporate customers will be served by a limited number of local banks and via digital solutions.

*<u>Customers:</u>*
The main focus will be on ensuring the most profitable customers remain with the Bank and developing them. However, over its long history the Bank has had a relationship with around 45% of everyone who lives in its market area. This huge 'customer base' provides important access to more sales and new sales. Obtaining new customers is the main strategy in market areas where market share is low.
Our cooperation in the SpareBank 1 Alliance will ensure that our customers always have access to modern, effective products.

Strategy and policy reviews look at all key factors (both external and internal) that could impact the Bank's financial strength and profitability over time. The process involves regions, specialist departments, the executive management team and Board before the matter is finally presented to the Board for discussion and a decision.

### *6.7.2 Reputation risk*

Reputation risk is defined as the risk of losses due to a diminished reputation. This includes the risk of inadequate earnings and funding due to declining confidence and reputation in the market, i.e. customers, contracting parties, equity certificate holders and the authorities.

**Social involvement strategy**
SpareBank 1 Nord-Norge audits the Group's corporate social responsibility strategy annually.

The strategy is intended to turn our social involvement into the best possible tool for enhancing our reputation among relevant interested parties. The strategy is a management tool that sets targets and areas for where our main focus should be directed. It also states the responsibilities and authorities relating to this work and forms a natural part of the work of maintaining/enhancing our reputation.

**Reputation management**
Good reputation management entails raising awareness about all important factors that create a good reputation and establishing standards against which it is possible to measure performance

and conduct. Internal communication is the key to this work. This is because everybody needs to understand how each person contributes to creating a reputation. Only then it is possible to establish a culture in which everyone takes responsibility and feels as if they are participating in the development of the company's standing.

Our social involvement is placed in a larger context in our strategy document:

- Historic
- Our role as a savings bank and leading financial institution in Northern Norway
- Our vision and our values
- Our customer-oriented strategy and the promises we make to customers
- The importance of reputation

# 7. Credit exposure

## 7.1 Definition of default, etc.

Probability of default (PD)

Commitments are classified in risk classes according to the probability that the will customer default on their commitments during a 12-month period. The probability of default is calculated based on a long-term average, which is to represent the probability of default throughout an economic cycle. The probability of default is calculated, for example, on the basis of historical data series.

In order to classify customers according to the probability of default, nine risk classes (A–I) are used. In addition, the Group has two risk classes (J and K) for customers with commitments in default or commitments that have been written down. Classification into high, medium and low risk is determined based on the probability of default.

**Figure 21 Definition of default classes**

| Risk classes of default (PD) | Lower level | Upper level |
|---|---|---|
| A | - | 0,10 % |
| B | 0,10 % | 0,25 % |
| C | 0,25 % | 0,50 % |
| D | 0,50 % | 0,75% |
| E | 0,75 % | 1,25 % |
| F | 1,25 % | 2,50 % |
| G | 2,50 % | 5,00% |
| H | 5,00 % | 10,00% |
| I | 10,00 % | 99,99% |
| J | Non-performing commitments, not impaired | |
| K | Non-performing commitments, impaired | |

A commitment is deemed to be in default if one of the following criteria applies:

- a claim has been due for more than 90 days and the amount is over NOK 1,000, or
- when the Bank considers it unlikely that the customer will meet their payment obligations as a result of:
    - the debtor suffering significant financial problems
    - non-payment or other type of significant breach of contract
    - customer is granted new terms (special concessions) due to financial problems
    - debt negotiations or bankruptcy are probable (over 50% probability)
    - it is deemed that the customer will not meet his payment obligations to two of the reasons

Defaults and write-downs

Individual commitments, and thereby the entire portfolio, are scored monthly based on objective data. The Bank makes individual write-downs for loans where there is objective evidence that the loan in question is doubtful. Individual write-downs for impaired value are calculated as the difference between the loan's book value and the present value of the discounted cash flow based on the effective interest rate at the time of the initial write-down. Subsequent changes in interest rates are taken into account for loan agreements with adjustable interest rates.

The Bank assesses its entire portfolio of business customers each year, and large and especially risky commitments are examined on a quarterly basis. Quarterly assessments form the basis for individual write-downs or other measures in relation to individual customers. The assessment is mandatory and is performed on commitments with the following characteristics:

- large commitment
- high risk
- negative migration in the risk class
- commitments subject to special follow-up (watch list)

Beyond this an ongoing assessment is performed on the actual commitments that are in default or written off.

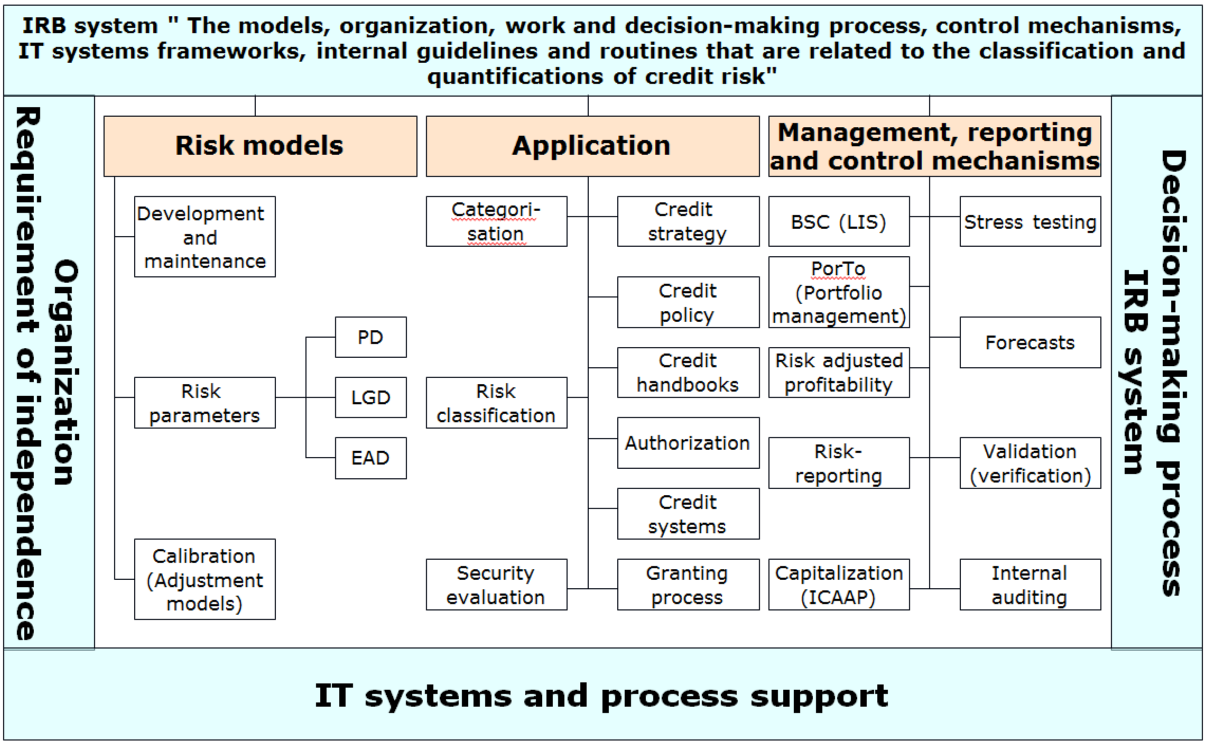
Loans to private individuals are assessed when more than 55 days have elapsed since a default or when there are indications of loss incidents, or they actually exist.

Commitments that are not written down individually are included in the basis for group write-downs. Group write-downs for impaired value are calculated for sub-groups of loans, where there is objective information showing an increase in the credit risk, but where it is not possible to examine all the commitments on an individual basis or where it is not possible to specify the information at the commitment level. Such information may consist of a negative development in the credit risk classification or information about a negative development in the value of assets pledged as collateral security, the profitability in a particular industry, or the ability of groups of debtors to pay.

## 7.2 Structure of the IRB system

The schematic diagram below illustrates how the IRB system affects several key areas in the Bank. The objective is to ensure satisfactory fulfilment of the capital adequacy requirements stipulated for the banks. This objective presupposes high quality, involvement, compliance and transparency throughout the entire value chain up until the Board's assessment and stipulation of strategies and the level of satisfactory capitalisation for the entire operations. This includes quantitative methods for the measurement of risk, the quality of the administrative processes that produce data for the quantitative risk estimates and requirements that the organisation integrate and use this data at all the relevant levels of the organisation.

**Figure 22 Organisation of IRB**




The Board assesses the capital adequacy requirements on an ongoing basis, based on the risk that is measured and an overall assessment of the framework conditions and commercial and strategic goals. To monitor and verify all the links in the value chain, they must be validated with a focus on whether the authorities' requirements and the internal quality requirements have been met. This validation shall take place at least once a year. An annual validation report shall be prepared that is to be reviewed by the Board, where both the quantitative and qualitative areas are validated to verify the adequacy of the system and identify needs for adaptations and improvements.

## 7.3 Description of model and application

Credit models and risk classification system
The risk models used in the risk classification system for the credit process are based on statistical calculations, and they are subject to continuous development and testing. The models are based primarily on the following components:

**Figure 23 Risk classification system**

| | |
|---|---|
| Probability of default | The customers are classified into default classes based on the probability of default over a 12 month period, based on a long term outcome |
| Exposure at default | This is an estimated figure which specifies the Group's exposure if a customer were to default |
| Loss given default | The loss given default describes how much the Group potentially can lose if the customer defaults on his obligation |
| Expected loss | This is the figure the Group statistically expects to lose (log term outcome) on its lending portfolio over a 12 month period |
| Risk group | The customer is allocated a risk group based on the expected loss of a commitment |
| Risk adjusted capital | Risk adjusted capital describes how much capital the Group has to set aside as a buffer for future expected loss |
| Risk pricing | SpareBank 1 Nord-Norge follows a strategy for correct pricing of risk and has a pricing model which estimates correct price on the risk of a commitment |

Probability of default (PD)
Statistically calculated probability of the customer defaulting on their payment obligations during a 12-month period calculated on the basis of a long-term outcome.

Expected exposure at default (EAD):
The EAD is an estimate of what the exposure will be if a customer defaults. The calculation is based on the customer's overall exposure, including facilities and guarantees that have been granted, but have not been drawn on.

The conversion factor for the expected exposure at default is set at 0.75 for facilities and guarantees to the corporate market that have not been drawn on, and 1 for the remainder of the portfolio. This is in accordance with section 12-1, subsection 3 of the Capital Requirements Regulations.

Loss given default (LGD):
LGD is an assessment of how much the Group could potentially lose if the customer defaults on their commitments.

Seven different classes are used (1–7) for classifying commitments in relation to security cover.

**Figure 24 Definition of security classes**

| Security class | Corresponds to the collateral coverage (Realisation value) |
|---|---|
| 1 | Over 120 % |
| 2 | Over 100 % |
| 3 | Over 80 % |
| 4 | Over 60 % |
| 5 | Over 40 % |
| 6 | Over 20 % |
| 7 | Up to 20 % |

For the mass market, the assessment takes into consideration the value of the assets that the customers have pledged as security, and the costs incurred by the Group in connection with recovering commitments in default. The Group stipulates the realisation value of the security pledged based on its own experience over time, and this value should reflect a conservative assessment of the realisation value in a recession.

The types of security that are used for the mass market are primarily mortgages on real estate. The realisation value is calculated as the object's market value after the deduction of a standard reduction factor and any additional value adjustments.

As at 31 December 2014, the authority's fixed factors for LGD (45% - Foundation IRB) was used to calculate minimum regulatory capital for the corporate market (states, institutions and enterprises). In the first quarter of 2015, SpareBank 1 Nord-Norge has received permission to use its own models for LGD for enterprises as well (A-IRB). This will reduce the risk-weighting for enterprises - the reduction expected is from approx. 91% to approx. 75%.

Risk pricing

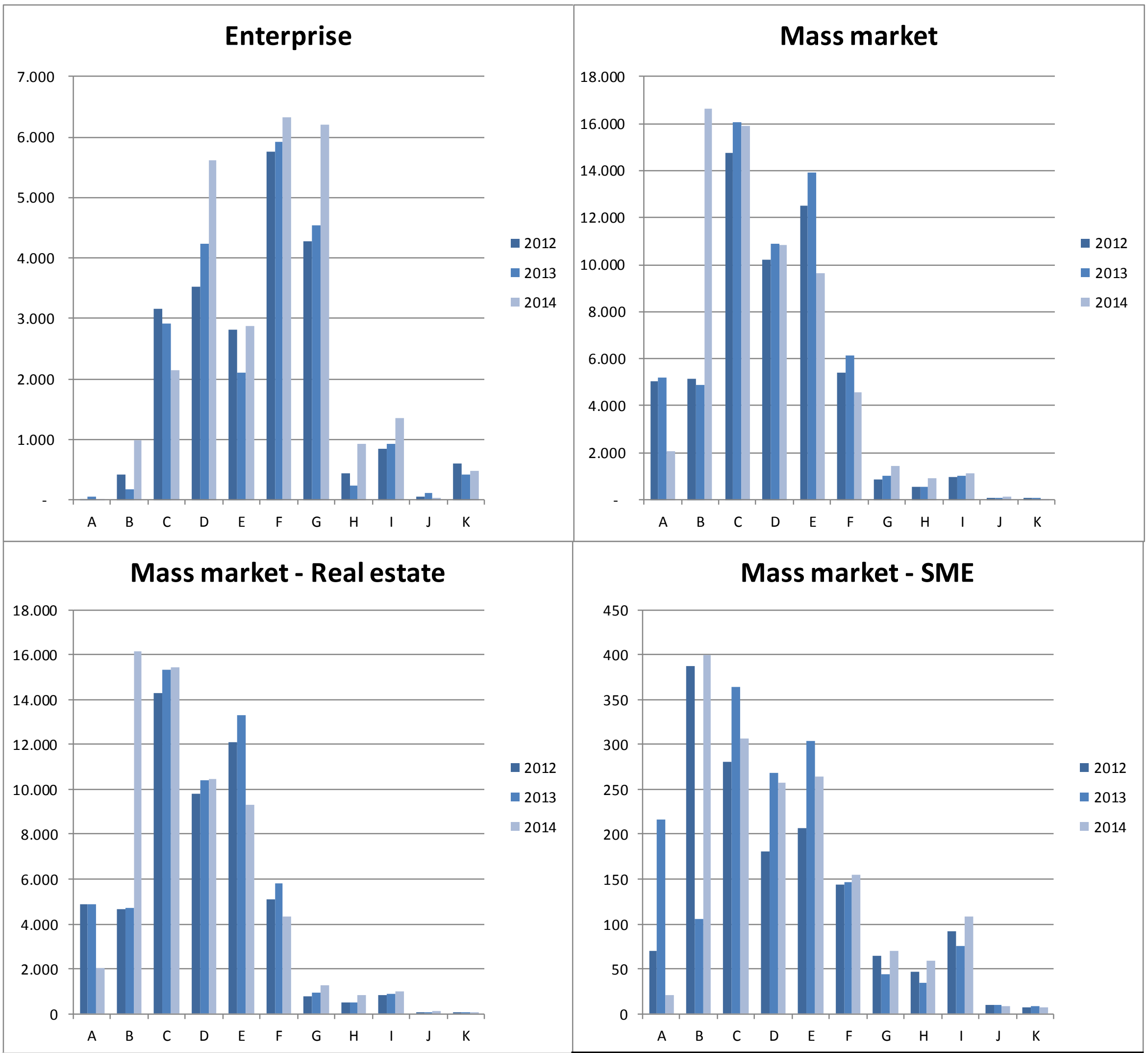
SpareBank 1 Nord-Norge is concerned about pricing risk, and it measures, therefore, the risk-adjusted return in connection with the granting of credit and follow-up. The risk pricing model is based on the same main components as the Group's risk classification system, and these components establish the basis for the calculation of the return on the economic capital for the individual commitment.

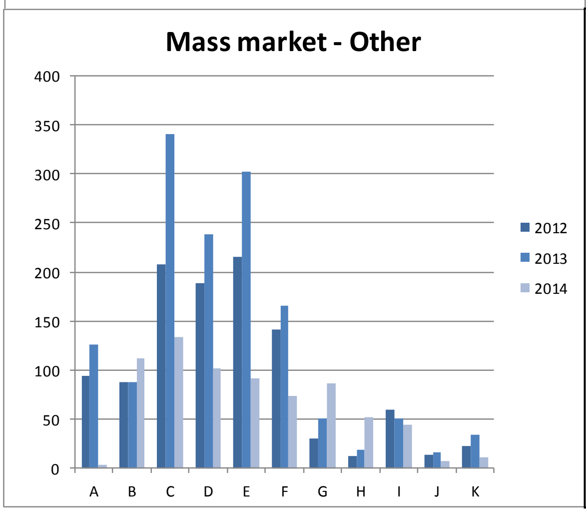
**Figure 25 Risk class by commitments when the IRB method is used**

Amounts in NOK million

| Category | Risk class | EAD | EAD off-balance | Average risk weight | Average LGD | Average CCF |
|---|---|---|---|---|---|---|
| Enterprise | A | 2 | 0 | 30 % | 45 % | 99 % |
| | B | 985 | 361 | 31 % | 35 % | 89 % |
| | C | 2.150 | 464 | 51 % | 43 % | 93 % |
| | D | 5.608 | 379 | 64 % | 43 % | 98 % |
| | E | 2.866 | 281 | 82 % | 45 % | 97 % |
| | F | 6.329 | 855 | 88 % | 40 % | 96 % |
| | G | 6.201 | 498 | 111 % | 43 % | 97 % |
| | H | 918 | 22 | 120 % | 35 % | 99 % |
| | I | 1.349 | 136 | 166 % | 42 % | 97 % |
| | J | 34 | 2 | 0 % | 45 % | 98 % |
| | K | 487 | 2 | 45 % | 45 % | 100 % |
| Total enterprise | | 26.929 | 3.000 | 87 % | 42 % | 97 % |
| Mass marked -SME | A | 20 | 9 | 4 % | 16 % | 99 % |
| | B | 400 | 77 | 9 % | 23 % | 99 % |
| | C | 307 | 24 | 15 % | 23 % | 100 % |
| | D | 258 | 26 | 22 % | 23 % | 100 % |
| | E | 264 | 9 | 31 % | 24 % | 100 % |
| | F | 154 | 8 | 42 % | 24 % | 100 % |
| | G | 70 | 2 | 69 % | 26 % | 100 % |
| | H | 60 | 2 | 106 % | 27 % | 99 % |
| | I | 108 | 1 | 205 % | 38 % | 100 % |
| | J | 8 | 0 | 5 % | 27 % | 99 % |
| | K | 7 | - | 0 % | 56 % | 100 % |
| Total mass marked -SME | | 1.655 | 159 | 37 % | 24 % | 100 % |
| Mass marked -real estate | A | 2.055 | 841 | 4 % | 17 % | 100 % |
| | B | 16.139 | 2.649 | 7 % | 19 % | 100 % |
| | C | 15.444 | 482 | 13 % | 20 % | 100 % |
| | D | 10.471 | 92 | 19 % | 20 % | 100 % |
| | E | 9.299 | 59 | 27 % | 21 % | 100 % |
| | F | 4.336 | 17 | 39 % | 21 % | 100 % |
| | G | 1.292 | 4 | 62 % | 21 % | 100 % |
| | H | 823 | 2 | 91 % | 22 % | 100 % |
| | I | 1.000 | 4 | 120 % | 21 % | 100 % |
| | J | 99 | 0 | 4 % | 26 % | 100 % |
| | K | 35 | 0 | 8 % | 34 % | 100 % |
| Total mass marked -real estate | | 60.995 | 4.150 | 20 % | 20 % | 100 % |
| Mass marked -other | A | 3 | 2 | 13 % | 50 % | 100 % |
| | B | 112 | 31 | 19 % | 48 % | 100 % |
| | C | 134 | 12 | 31 % | 49 % | 100 % |
| | D | 102 | 14 | 41 % | 48 % | 100 % |
| | E | 91 | 8 | 50 % | 48 % | 100 % |
| | F | 74 | 5 | 61 % | 47 % | 100 % |
| | G | 87 | 7 | 76 % | 50 % | 100 % |
| | H | 52 | 1 | 77 % | 48 % | 100 % |
| | I | 45 | 1 | 125 % | 51 % | 100 % |
| | J | 7 | 0 | 1 % | 51 % | 100 % |
| | K | 12 | 0 | 0 % | 84 % | 100 % |
| Total mass marked -other | | 719 | 81 | 50 % | 49 % | 100 % |
| Total mass marked | | 63.369 | 4.390 | 21 % | 20 % | 100 % |

**Figure 26 Distribution of risk classes**



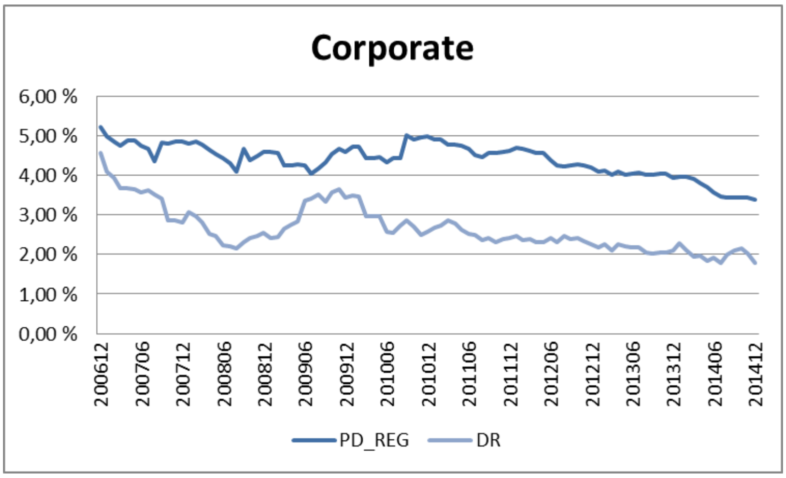



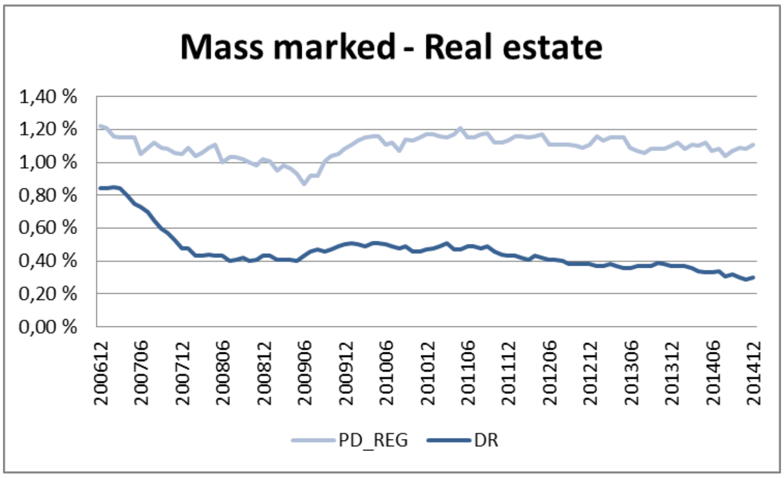

In the first quarter of 2014, we transitioned, for mass market property, from PD model version 1 to version 2 from a regulatory perspective. The changes were implemented without any effect on risk weightings. During 2014, EAD in mass market property grew by 7.3 %. From December 2013 to December 2014, the EAD-weighted PD for mass market property fell from 1.37 % to 1.27 %. At the same time, the LGD floor for home mortgages was raised from 10% to 20 %, which has increased the risk-weighting from 10.9 % to 20.0 %.

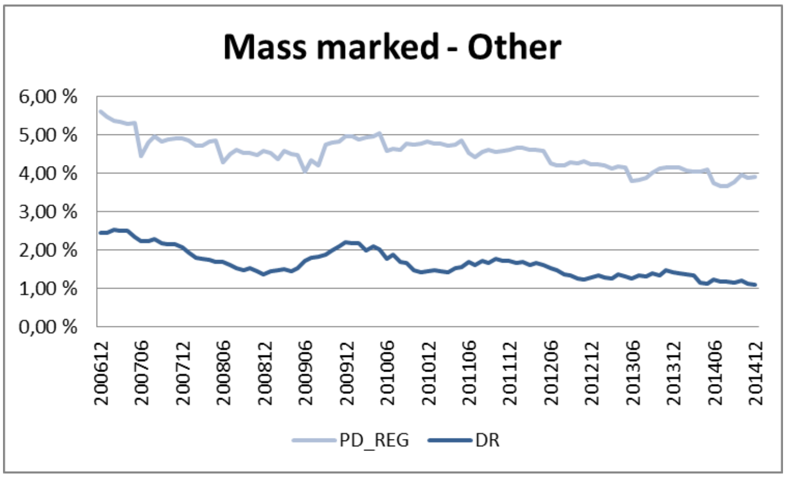
When we compare the calculated default probability with the actual outcome for the next 12 months, we compare on the basis of the scoring model and not on the basis of the regulatory classification. This entails some differences, e.g. sole proprietors that are scored using a retail customer model are not necessarily classified as mass market.

The differences between PD and the observed default rate (DR) are continuously monitored using monthly measurements over the last 12-month period.

**Figure 27 Comparison of the risk parameters with actual outcomes**



## 7.4 Credit exposure incl. defaulted commitments

**Figure 28 Group's exposure in various geographic areas, as well as the distribution of commitments that are in default, doubtful and written off in relation to this**

Amount in NOK million

| Type of commitment | Finnmark | Troms og Svalbard | Nordland | Others | Total |
|---|---|---|---|---|---|
| Gross lending to customers | 9.673 | 21.153 | 23.324 | 7.099 | 61.249 |
| Unutilised credit and guarantees | 1.052 | 2.788 | 2.175 | 386 | 6.401 |
| Total gross customer commitments | 10.725 | 23.942 | 25.499 | 7.485 | 67.650 |
| | | | | | |
| Defaulted and doubtful commitments | 79 | 171 | 275 | 22 | 547 |
| Individual write-downs | 11 | 30 | 79 | 51 | 171 |
| Net defaulted and doubtful commitments | 68 | 141 | 196 | -30 | 376 |
| Individual losses | 6 | 22 | 66 | 70 | 164 |

The reason for the negative net non-performing and impaired commitments amount in the "Other" class is that the individual write-downs are larger than the gross default in North-West 1 Alliance Bank due to the Russian rules for writing down commitments that are not classified as being in default.

**Figure 29 Group's overall commitments broken down by commitment type**

| Amounts in NOK million<br>Type of commitment | Commitment amount as at 31.12.2012 | Average commitment amount in 2012 | Commitment amount as at 31.12.2011 | Average commitment amount in 2011 |
|---|---|---|---|---|
| Businesses(business customers) | 29.203 | 28.594 | 27.984 | 28.138 |
| Mass marked(retail customers) | 37.181 | 35.857 | 34.532 | 33.044 |
| Public sector(central and local government) | 1.266 | 1.197 | 1.127 | 1.042 |
| Gross customer commitment | 67.650 | 65.647 | 63.643 | 62.224 |
| Individual write-downs | 171 | | 244 | |
| Write-downs of groups of loans | 236 | | 209 | |
| Write-downs of guarantees | 0 | | 0 | |
| Net customer commitment | 67.243 | 65.216 | 63.190 | 61.746 |
| | | | | |
| Cash and deposits with central banks | 655 | 655 | 655 | 463 |
| Loans and deposits with institusions | 1.392 | 1.392 | 1.392 | 1.632 |
| Individual write-downs (institutions) | 157 | 79 | | |
| Total commitment amount | 69.133 | 67.263 | 65.237 | 63.841 |

## Figure 30 Group's overall commitments, and commitments in default and written off broken down by customer group

Amounts in NOK million

| Type of commitment | Gross lending | Commitment | Gross defaulted and doubtful commitments | Individual write-downs | Net defaultet and doubtful sommitments | Individual losses |
|---|---|---|---|---|---|---|
| Building and Construction | 72 | 79 | 0 | - | 0 | - |
| Ship and boat building | 972 | 1.431 | 42 | 14 | 28 | 2 |
| Power, Gas, Steam and Hot Water Supply | 117 | 218 | 0 | - | 0 | 2 |
| Professional and Financial Services | 698 | 1.612 | 0 | - | 0 | - |
| Finance and Insurance | 623 | 645 | 9 | 4 | 5 | 13 |
| Fishing and Hunting | - | 3 | - | - | - | - |
| Fish Farming and Hacheries | 2.421 | 2.714 | 6 | - | 6 | 2 |
| Business Services | 611 | 571 | 2 | - | 2 | 4 |
| Insurance, Securities Funds and Other Finacial Enterprises | 603 | 720 | 4 | - | 4 | - |
| Industry | 742 | 1.032 | - | 1 | -1 | - |
| Information and Communication | 1.664 | 2.016 | 15 | - | 15 | - |
| Agriculture and Related Services | 72 | 84 | 1 | 7 | -6 | 5 |
| International Business | 1.011 | 1.096 | 22 | - | 22 | 27 |
| Sale and Management Of Real Estate | 172 | - | 9 | 58 | -49 | 9 |
| Accomondation and Food Services | 7.614 | 8.036 | 117 | 2 | 115 | - |
| Forestry and Related Services | 411 | 509 | 4 | - | 4 | - |
| Services Related To Extraction Of Crude Oil and Natural Gas | 10 | 11 | 0 | - | 0 | - |
| Other Service Sector Industries | 18 | 19 | 0 | - | 0 | 11 |
| Other Transport and Storage | 701 | 863 | 5 | 9 | -4 | 8 |
| International Shipping and Pipeline Transport | 3.427 | 3.804 | 16 | 34 | -18 | 37 |
| Development Of Construction Projects | 758 | 893 | 105 | 7 | 98 | -20 |
| Extraction Of Crude Oil and Natural Gas | 794 | 1.210 | 13 | - | 13 | - |
| Unspecified | - | - | - | - | - | 31 |
| Water Supply, Sewerage and Sanitation Services | 270 | 300 | 1 | - | 1 | - |
| Retail Trade, Repair Of Motor Vwehicles | 1.014 | 1.337 | 14 | 7 | 7 | - |
| Total business customers | 24.795 | 29.203 | 384 | 143 | 241 | 131 |
| Central government and social security funds | - | - | 0 | - | 0 | - |
| Counties and Municipalities | 359 | 1.266 | - | - | - | 3 |
| Retail Banking Marked | 35.830 | 37.128 | 162 | 28 | 134 | 40 |
| Retail Banking Marked - International | 265 | 53 | 0 | - | 0 | - |
| Totalt | 61.249 | 67.650 | 547 | 171 | 376 | 174 |

## Figure 31 Gross loans broken down by the remaining term to maturity

Amounts in NOK million

| | On demand | 1 - 3 months | 3 - 12 months | 1 - 5 years | Over 5 years | No maturity | Total |
|---|---|---|---|---|---|---|---|
| Gross loans to customers | 9 320 | 661 | 2 227 | 11 883 | 37 158 | 0 | 61 249 |
| Guarantees and unutilised credit facilities | 0 | 0 | 0 | 0 | 0 | 6 401 | 6 401 |
| Toral commitments to customers and financial institutions | 9 320 | 661 | 2 227 | 11 883 | 37 158 | 6 401 | 67 650 |

## Figure 32 Development of loss write-downs

Amount in NOK million

| | Individual write-downs | 2014 | 2013 | 2012 |
|---|---|---|---|---|
| | Individual write-downs to cover losses on loans and guarantees as at 1. January | 244 | 303 | 208 |
| - | Write-off of loans and guarantees previously written down individually for the period | 125 | 117 | 144 |
| - | Reversal of write-downs from prior years | 66 | 12 | 24 |
| + | Increase in write-downs on commitments previously written down individually | 22 | 30 | 9 |
| + | Write-downs on commitments not previously written down individually | 96 | 40 | 254 |
| = | **Individual write-downs to cover losses on loans and guarantees to customers as at 31.12** | 171 | 244 | 303 |
| + | Individual write-downs to cover losses on loans to institutions as at 31.12 | 157 | | |
| = | **Individual write-downs to cover losses on loans and guarantees as at 31.12** | 328 | 244 | 303 |

Beløp i mill kroner

| | Group write-downs | 2014 | 2013 | 2012 |
|---|---|---|---|---|
| | Group write-downs to cover losses and guarantees as at 1. January | 209 | 198 | 226 |
| + | Group write-downs to cover losses and guarantees for the period | 27 | 11 | -28 |
| = | **Group write-downs to cover losses and guarantees as at 31.12** | 236 | 209 | 198 |

Beløp i mill kroner

| Recognised losses | 2014 | 2013 | 2012 |
|---|---|---|---|
| Change in individual write-downs for the period | 30 | 40 | 97 |
| Change in group write-downs/change in long-term monitoring for the period | 30 | 12 | -40 |
| Write-offs for the period, for witch individual write-downs were made earlier | 109 | 117 | 144 |
| Write-offs for the period, for witch individual write-downs were not made earlier | 5 | 11 | 5 |
| Recoveries on loans, guarantees, etc. previously written down | -10 | -8 | -11 |
| **Total losses on loans and guarantees** | 164 | 172 | 195 |
| Other losses | 157 | | |
| **Total losses on loans and guarantees** | 321 | 172 | 195 |

**Figure 33 Development of individual loss write-downs (balance sheet) when the IRB method is used, Mass market**

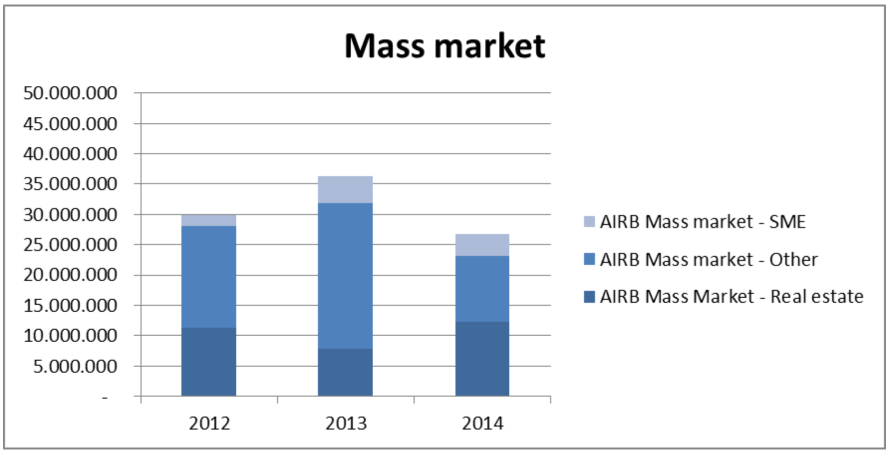
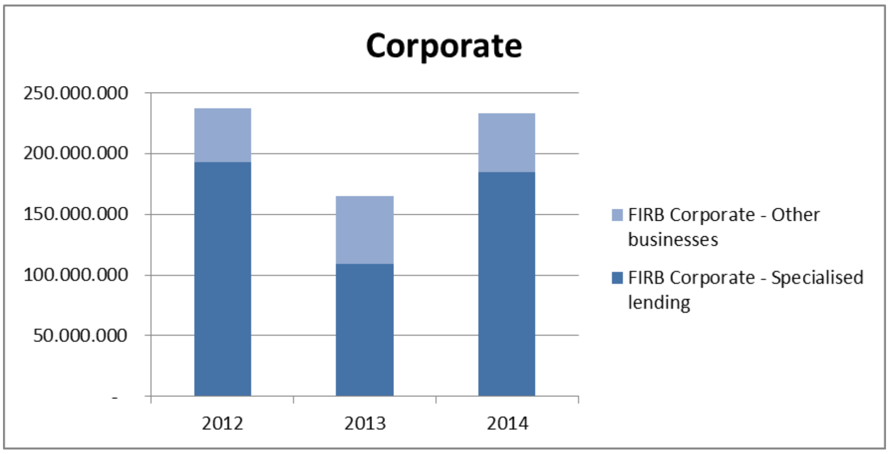



**Figure 34 Development of individual loss write-downs (balance sheet) when the IRB method is used, Corporate**



## 7.5 Security – credit risk

The following main types of security are used: security in real estate, receivables, movable property, stock, operating equipment, fishing vessels with permits and farming licences. As far as guarantors are concerned, the main categories are private people through guarantees for consumer loans, enterprises, banks and the public sector.

**Figure 35 Total commitments and percentage that are secured by a mortgage, broken down by commitment category**

Amounts in NOK million

| Type of commitment | | Commitment | Of witch secured by a morgage on real estate [1] [2] | Of witch secured by other type of mortgage/security [1] | Of witch unsecured [1] |
|---|---|---|---|---|---|
| Mass marked | Commitment secured by a morgage on real estate | 60.998 | 100 % | 0 % | 0 % |
| | Mass marked - SME | 1.663 | 94 % | 6 % | 1 % |
| | Other mass marked commitments | 720 | 24 % | 26 % | 50 % |
| **Sum** | | 63.381 | 99 % | 0 % | 1 % |

1) Share of total commitment with provision of security that matches the total commitment for the current commitment category.
2) A commitment for a retail customer, where the realisation value of residential property is valued at less than 30% of the customer's commitment, is not classified as a commitment secured by collateral in real estate.

SpareBank 1 Nord-Norge does not provide any security that entails a reduced commitment amount. No account is taken of the pledged security in LGD calculations for enterprises, but factors set by the authorities are used.

The Bank uses the realisation value of the security for new approvals. The realisation value is determined by valuing the individual object/security and then reducing the value in line with an extensive framework of reduction factors associated with various types of security and security objects. The valuation takes place for new approvals and in annual reviews.

SpareBank 1 Nord-Norge is entitled to set-off in accordance with the general provisions of Norwegian law. Our standard debt certificates, covenants and account agreements incorporate special provisions concerning access to set-off. The access to set-off is not added to the value when calculating risk/capital.

The Group has no specific guidelines on managing concentration risk in relation to types of security. However, the Group does have guidelines on concentration within industries, which necessarily also use the same types of security. Therefore, SpareBank 1 Nord-Norge has indirectly addressed the management of concentration risk in relation to types of security.

# 8 Counterparty risk derivatives

**Figure 36 Financial derivatives**

| Amounts in NOK thousand | Nominal value | Credit equivalent | Net value | Capital requirement |
|---|---|---|---|---|
| FX- and interest rate instruments in the trading portfolio | 11.750.999 | 196.013 | 39.203 | 3.136 |
| FX- and interest rate instruments outside the trading portfolio | 35.673.420 | 2.391.938 | 852.680 | 68.214 |
| Commodity derivatives | 81.592 | 11.302 | 3.919 | 314 |
| **Total** | 47.506.011 | 2.599.253 | 895.802 | 71.664 |

# 9 Equity positions outside the trading portfolio

**Figure 37 Equities outside the trading portfolio**

| **P/L shares outside trading port.** **(1.000 NOK)** | Booked value | Capital requirement | Unrealised gain/(loss) | Realised gain/(loss) |
|---|---|---|---|---|
| *Strategic purpose* | | | | |
| Tavrichesky Bank | | | | (122.284) |
| Bank 1 Oslo | 136.854 | 136.854 | 58.849 | |
| Other | 231.091 | 231.091 | 24.304 | 4.821 |
| Total strategic shares outside trading portfolio | 367.945 | 367.945 | 83.153 | (117.463) |

| **Shares outside trading portfolio** **(1.000 NOK)** | Risk weigthed | Mehtod | Capital Basis | requirement |
|---|---|---|---|---|
| Stategic purpose | 100 % | Std.approach | 348.244 | 27.860 |
| Other | 100 % | Std.approach | | |
| Total capital requirement equity capital instruments outside trading portfolio calculated by standard approach included in Credit risk | | | | 27.860 |

## 10 Interest rate risk outside the trading portfolio

Interest rate risk arises through the Bank's assets and liabilities having different interest rate lock-in periods.

Interest rate risk is managed within the limits set by the Bank's Board where the interest rate risk is expressed by a maximum value change of 2% in parallel to an interest rate shift given by a yield curve. Limits for total interest rate risk are given, and within specified time intervals. The interest rate risk is monitored daily.
The interest rate risk is reported to the Board every month, both the status at the time of the report and the highest utilisation of the limits during the period since the last report.

Figure 47 shows a sensitivity analysis conducted on the basis of relevant balance sheet items as at 31 December 2014 and going forward. The Bank's interest rate risk is calculated by simulating a parallel interest rate shift of 2% for the entire interest rate curve.
All the interest rate sensitive balance sheet items on the asset and liability sides are included in the analysis. In addition, all the off-balance items that are used in the Bank's risk management are included, including interest rate swaps.
The calculations are made on the basis of the Bank's positions as at 31 December 2014 and market interest rates on the same date.

The interest rate risk has been low throughout 2014 and within the overall limit of NOK 60 million established by the Bank's Board. The market risk linked to the interest rate risk has a limited effect on the Bank's profit performance due to the low exposure.

**Figure 38 Change in value with interest rate rise of 2 percentage points**

*All amounts are equal for the parent bank and the Group*

| Beløp i mill kroner | **2014** | 2013 |
|---|---|---|
| Bonds and notes | **-30** | -39 |
| Fixed-rate loans to customers | **-22** | -4 |
| Funding | **151** | 47 |
| Other funding and investment | **0** | 1 |
| Loans / deposits from customers | **-21** | -13 |
| Other derivatives | **6** | 7 |
| **Total interest rate risk** | **84** | -2 |

A minus sign indicates that the Bank will lose if interest rates rise.

The table below shows the interest rate risk within the various time intervals with a 2% parallel interest rate shift.

| | **2014** | 2013 |
|---|---|---|
| 0 - 1 months | **8** | 2 |
| 1 - 3 months | **-22** | -21 |
| 3 - 6 months | **-2** | -2 |
| 6 - 12 months | **2** | 9 |
| 1 - 3 years | **-3** | 6 |
| 3 - 5 years | **3** | -6 |
| 5 - 10 years | **98** | 11 |
| **Total interest rate risk** | **84** | -2 |

**Figure 39 Effect on the result of stress tests conducted using book values and full limit utilisation**

Amounts in NOK million

| Type | Stress | Severe stress | Full utilisation of the limit |
|---|---|---|---|
| Strategic shares | 24 | 47 | 47 |
| Shares available for sale - long-term investments | 8 | 15 | 15 |
| Shares held for trading | 15 | 18 | 18 |
| **Total shares parent bank** | **47** | **80** | **80** |
| Shares SNN Invest | 47 | 93 | 160 |
| Interest rate risk | 13 | 18 | 64 |
| Foreign currency risk - shares | 21 | 30 | 30 |
| Foreign currency risk | 11 | 14 | 50 |
| Spread risk | 322 | 322 | 350 |
| **Total loss potential - Market risk** | **461** | **557** | **734** |

## 11. Summary – calculation of capital requirements

Economic capital describes how much capital the Group believes it needs to cover the actual risk the Group has assumed. Since it is impossible to fully protect against all losses, the Group has stipulated that the economic capital shall cover 99.9% of possible unexpected losses in the course of one year.

Statistical methods are used for the calculation of the economic capital, but the individual risk types require nevertheless the use of expert models and qualitative assessments.

The diagram below shows the distribution of the economic capital across various risk groups based on the risk exposure as at 30 September 2014. The economic capital was calculated for the credit, market, operational, owner and commercial risk (including strategic risk).

**Figure 40 Economic capital by risk group**

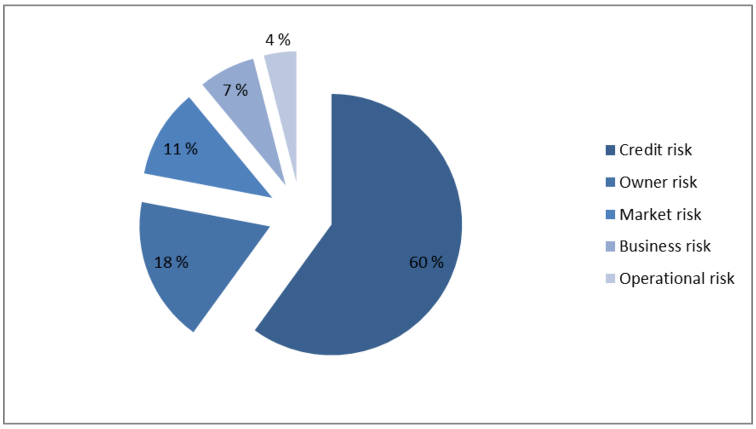
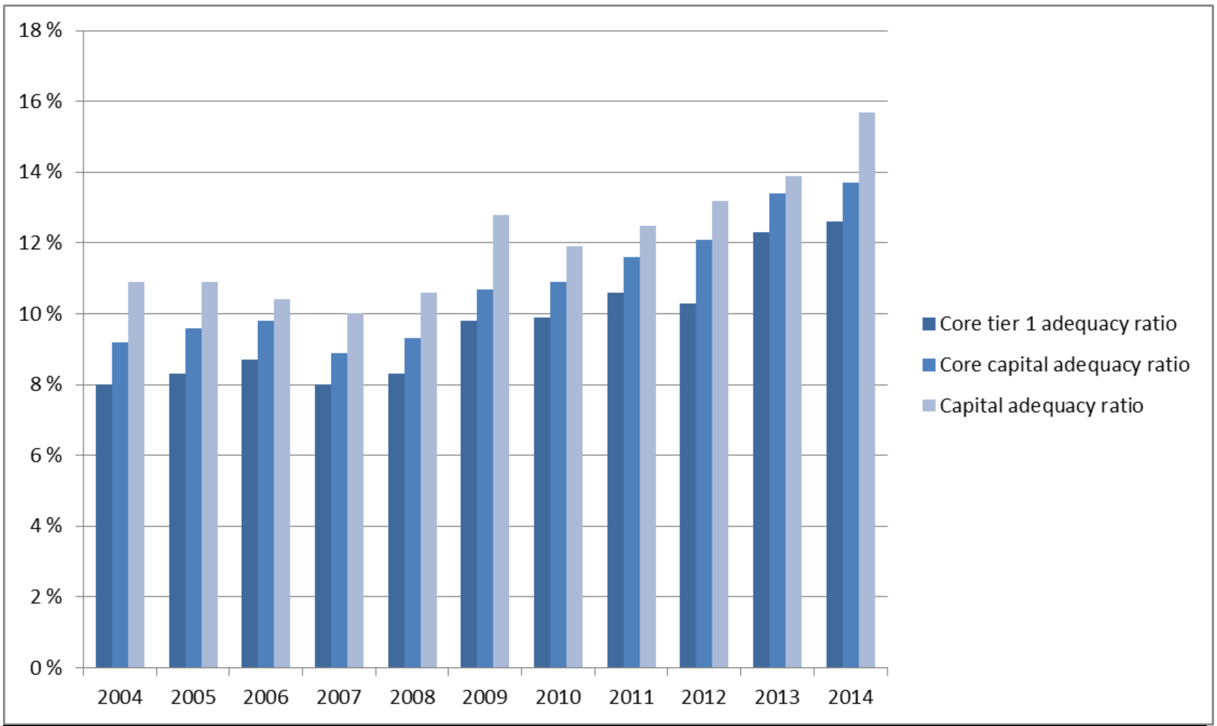



**Figure 41 Capital adequacy ratio development**




| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Core tier 1 adequacy ratio | 8,0 % | 8,3 % | 8,7 % | 8,0 % | 8,3 % | 9,8 % | 9,9 % | 10,6 % | 10,3 % | 12,3 % | 12,6 % |
| Core capital adequacy ratio | 9,2 % | 9,6 % | 9,8 % | 8,9 % | 9,3 % | 10,7 % | 10,9 % | 11,6 % | 12,1 % | 13,4 % | 13,7 % |
| Capital adequacy ratio | 10,9 % | 10,9 % | 10,4 % | 10,0 % | 10,6 % | 12,8 % | 11,9 % | 12,5 % | 13,2 % | 13,9 % | 15,7 % |

## 12. Comparison of regulatory and financial capital requirements

A comparison is made between the minimum requirement for equity and subordinated loan capital (Pillar 1) and the economic capital requirement (Pillar 2) in the table below. An account is also given of the main reason for the differences between the two pillars.

**Figure 42 Regulatory and economic capital requirements as at 30 September 2014**

| Capital requirement categories | Pilar 1 | Pilar 2 (ICAAP) | Authoroty's method (SREP) |
|---|---|---|---|
| Credit risk | 4.226 | 3.176 | 4.226 |
| Consentration risk | - | 306 | 306 |
| Sum credit risk | 4.226 | 3.482 | 4.532 |
| Market risk | 426 | 612 | 612 |
| Operational risk | 254 | 254 | 254 |
| CVA | 82 | | 82 |
| Business risk | | 411 | 411 |
| Owner risk | | 1.049 | 1.049 |
| Sum gross risk | 4.989 | 5.809 | 6.941 |
| Deduction in the capital requirement | -120 | - | - |
| Diversification (10%) | - | -581 | -694 |
| Sum net risk | 4.868 | 5.228 | 6.247 |
| RWA | 60.856 | | |
| Capital requirement (12,5% core tier 1) | 7.607 | | |
| Capital requirement (14,5% core tier 1) | 8.824 | | |
| Capital base (including profits as at 30.09.2014) | | | |
| Core tier 1 (including profits as at 30.09.2014) | 8.026 | | |
| Core capital | 8.660 | | |
| Core tier 1 adequacy ratio (inkluding 50% of profits) | 13,2 % | | |

The main differences between the economic capital (Pillar 2) before the diversification effects of NOK 5.8 billion kroner and the minimum capital requirements (Pillar 1) of NOK 4.8 billion (incl. transitional rules) are due primarily to:

- *Credit risk:*
  - *Loss Given Default:* When the economic capital is calculated for the credit risk for states, institutions and enterprises the risk parameter Loss Given Default is calculated based on internal models, while it is stipulated based on a standard value in accordance with the Capital Requirements Regulations for the calculation of the minimum regulatory capital.

    The Group stipulates the realisation value of the security pledged based on its own experience over time, and this value should reflect a conservative assessment of the realisation value in a recession. SpareBank 1 Nord-Norge's internal estimates for the LGD are lower than the standard values stipulated by the authorities.

  - *Concentration risk:* Economic capital takes the concentration risk into account.

- *Owner risk:* The economic capital (Pillar 2) for owner risk in SpareBank 1 Gruppen AS is estimated to be NOK 1.2 billion. In connection with the calculation of the minimum capital requirement (Pillar 1) the ownership interest in SpareBank 1 Gruppen AS will be deducted (capital adequacy reserve) with 50% from the tier 1 capital and 50% from the tier 2 capital, and it will thus not be reflected directly in the minimum capital requirement. The Bank has used proportional consolidation to calculate the regulatory capital requirement for the ownership interests in BN Bank ASA, SpareBank 1 Boligkreditt AS, SpareBank 1 Markets AS and SpareBank 1 Næringskreditt AS.

- *Business risk (including strategic risk):* The economic capital (Pillar 2) is calculated for the business risk (including strategic risk), but no capital requirement is associated with this form of risk when calculating the minimum regulatory capital requirement and the funding risk.

# 13 Changes in framework conditions

The EU's new capital requirement regulations came into force on 1 January 2014 and are called the CRR/CRD IV regulations. CRR/CRD IV entails significantly stricter requirements for equity and new requirements for long-term funding and liquidity reserves. The regulations are meant to apply to all banks and investment firms in the European Economic Area and will be phased in during the run up to 2019. The new regulations will be a major challenge for the banks with their requirement for higher earnings in order to build up equity, at the same time as the requirement to increase long-term funding and liquidity will increase funding costs.

The Norwegian Constitution's provisions concerning limiting the ability to cede sovereignty mean that it has not been possible to implement the EU's supervisory regulations, CRR/CRD IV and a number of other legislative acts, in the EEA Agreement.

Norway and the EU reached agreement on a solution to this in the autumn of 2014. The government will probably submit a special proposition concerning this during the first half of 2015. Only after this proposition has been adopted will it be possible to include CRR/CRD IV in the EEA Agreement and Norwegian legislation. This notwithstanding, Norway introduced new capital requirements on 1 July 2013 as the first stage of adjusting to CRR/CRD IV, which entails a gradual increase in the requirements for capital adequacy in the run up to 1 July 2016.

On 12 May 2014, the Ministry of Finance adopted the 'Regulations relating to the identification of systemically important financial institutions'. It was clear from these that the largest regional banks, including SpareBank 1 Nord-Norge, would not be defined as systemically important financial institutions (SIFI). The central authorities have pointed out the importance of regional savings banks, because of their importance for the regions, adapting their level of capital regardless of the ministry's SIFI decisions.

The Norwegian authorities have like the EU chosen to continue the so-called Basel I floor. The Ministry of Finance has clarified in the Capital Requirements Regulations that the Basel I floor in Norway applies as the basis for calculating capital requirements. Meanwhile, the EU regulations stipulate a precise definition of the Basel I floor as the lower limit for primary capital. This is also reflected in the EU Commission's common reporting standard for banks in the EU/EEA. This supervisory practice means that Norwegian banks appear to be more poorly capitalised in international comparisons than would be the case had the EU's definition of the Basel I floor been used.

The Norwegian authorities have, based on systemic risk considerations, increased the capital requirements for home mortgages when these are calculated using internal models. The minimum requirement for the model parameter 'loss given default' (LGD) increased from the first quarter of 2014 from 10% to 20% in the Capital Requirements Regulations. The minimum requirement applies for the average of the home mortgage portfolio.

On 1 July 2014, the Financial Supervisory Authority of Norway published further requirements for calibrating the IRB banks' home mortgage models. Among other things, the minimum requirement for the banks' probability of default (PD) was increased for individual loans to 0.2%. The level for the long-term average PD has also been raised. The banks performed a recalibration in the second half of 2014 and will from the first quarter of 2015 report capital adequacy figures based on the recalibrated models.

On 1 January 2015, the EU introduced regulations concerning the closing and restructuring of banks, the Bank Recovery and Resolution Directive (BRRD), as an element of the EU banking union. The directive also applies to Norway through the EEA Agreement. The purpose of BRRD is to ensure that even the largest banks can be closed without any need to supply state funds. It must be possible to continue systemically important functions by recapitalising all or parts of the banks (the systemically important portion) by writing down subordinated loans and unsecured senior debt or converting them to share capital. The authorities have been given wide-ranging authorisation to restructure banks that are deemed non-viable. The directive requires the establishment of a fund that must be capable of funding crisis solutions and which is recapitalised in advance. Norway can probably build on the existing Norwegian Banks Guarantee Fund and is open to integration of the crisis management fund and existing deposits guarantee fund. Norway has a limit for guaranteed deposits of NOK 2 million. However, the EU's revised deposit guarantee schemes directive means that Norway must lower its guarantee to the harmonised level of EUR 100,000. A transition period of up to the end of 2018 has been set for countries with higher coverage. The implementation of BRRD and the revised deposit guarantee schemes directive requires significant changes in the crisis solution system in Norway, including the rules on public administration and the role of the Norwegian Banks Guarantee Fund. The Norwegian Banking Law

Commission is in the process of examining how the directives should be implemented in Norwegian legislation.

The requirement that the institutions, in addition to the Pillar 1 requirements, should have a process for assessing the overall capital requirements in relation to the risk profile (Pillar 2) and a strategy for maintaining the level continues to apply. However, the new buffer requirements will partly cover some of the areas that must be assessed under Pillar 2. The authorities' assessments of capital requirements in excess of the minimum requirements must be adjusted to these conditions. It will be possible to assess the capital requirements for institution-specific risk factors independent of the buffer requirements. The supervisory authorities will base their assessment of the banks' ICAAP on the risks the banks themselves identify. The risks the banks should assess are credit, liquidity, funding, market and currency risk, as well as operational risk, systemic risk and other risk associated with the individual business areas. It is suggested that the risk associated with imprudent debt accumulation be included in the list of risks that must be taken into consideration in the Capital Requirements Regulations. The Financial Supervisory Authority of Norway will assess whether the banks have adequately identified individual risks and whether the assessed capital requirements are sufficient.

**New requirements for liquidity management**

The CRD IV package came into effect in the EU in January 2014, with a formal reporting requirement for the liquidity coverage ratio (LCR). On 10 October 2014, the EU Commission published a delegated act, which involves defining a final requirement for the composition of liquidity buffers and a minimum requirement for LCR. Covered bonds now qualify as level 1 assets, assuming a very good credit rating and requirements for a series of loans totalling a minimum of EUR 500 million. The fact that the proportion of covered bonds can now account for up to 70% of the buffer, compared with 40% in previous proposals, results in greater flexibility for portfolio composition. The phasing in of LCR will start on 1 October 2015 with a minimum requirement of 60% and will be fully implemented with 100% by 1 January 2018.

New potential requirements for long-term funding through the minimum requirement net stable funding ratio (NSFR) mean that the Group must adjust its funding strategy such that more of the Group's long-term assets have long-term funding. This will increase the average time to maturity of the Bank's market funding and bring about some structural changes in the Group's overall funding.

The European Banking Authority (EBA) will deliver an 'Impact Assessment' and recommendations about the final definition of NSFR by year-end 2015. By the end of 2015, the EU Commission will also present some bills associated with NSFR.