

SpareBank 1 SMN

# Pillar 3 Report

2024

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## **CONFIRMATION FROM THE EXECUTIVE DIRECTOR OF RISK MANAGEMENT (CRO)**

This document, together with the attached Excel document, is SpareBank 1 SMN's publication of the Group's risk and capital management. The document has been prepared under the requirements of Regulation (EU) 2019/876 of 20 May 2019 (known as CRR2), part 8. The document is owned by the Director of Risk Management (CRO).

It is confirmed that the risk management function at SpareBank 1 SMN is aligned with the Group's strategy, risk profile and complexity. The Director of Risk Management is invited to all meetings of the Board of Directors, has the right to speak at such meetings, and cannot be removed from office without the Board of Directors' approval.

For an assessment of risk areas with the most impact on the Group's business model, and how these risks are managed, the reader is referred to the further description in this document and the attached Excel document.

Ola Neråsen  
Executive director of Risk Management

## **CAPITAL ADEQUACY FRAMEWORK**

In order to ensure that financial institutions are solid and robust to fluctuations and shocks in the economy, financial institutions are subject to regulation, inter alia through requirements on capital adequacy.

The capital adequacy framework is based on three pillars:

**Pillar 1:** Quantitative minimum requirements on own funds and a description of methods used for calculating risk weighted volume and eligible capital.

**Pillar 2:** Requirements on risk management and internal control, including requirements on internal processes for assessing risk exposure and capital need (Internal Capital Adequacy Assessment Process (ICAAP)). The object of the ICAAP is to carry through a structured and documented process for assessment of the Group's risk profile in order to ensure that the Group has sufficient capital to cover the risk associated with the business. Entities are also required to have in place a strategy for maintaining a sufficient level of capital.

Under Pillar 2 supervisory authorities can set requirements for Tier 2 capital if they consider that other capital requirements fail to adequately capture the underlying risk in an institution. The guidance "Finanstilsynet's practices for assessing risk and capital needs", published 18 February 2025, with appendices sets out the methods employed by Finanstilsynet to quantify Pillar 2 requirements for various risk types.

**Pillar 3:** Pillar 3 is a requirement set by the authorities to publish information on capital and risk factors. This document describes risk and capital management at SpareBank 1 SMN and is intended to meet requirements for the disclosure of financial information.

As of 31.12.2024, Norwegian banks are covered by the EU capital adequacy regulations CRR2/CRD5. The discussion below is based on CRR2. On 01.04.2025, CRR3 will come into force for Norwegian banks. The Group will report in accordance with CRR3 from Q2 2025.

### **Pillar 1**

The minimum capital requirement is 8 per cent of risk weighted assets. The minimum capital requirement can be met by up to 2% own funds (Tier 2 capital) and up to 1.5% hybrid capital. SMN aims to meet the minimum requirements through maximum use of hybrid capital and own funds.

Capital adequacy is measured as shown in the figure below.

$$\frac{\text{CET1 capital + hybrid capital + own funds}}{\text{RWA for credit risk, market risk, operational risk and owner risk}} > 8\%$$

The figure below shows the various approaches banks can use to arrive at risk weighted assets.

Credit risk	Market risk	Operational risk
Standardised approach	Standardised approach	Basic indicator approach
IRB foundation approach <sup>)</sup>	IRB approach	Standardised approach
IRB advanced approach <sup>)</sup>		Advanced measurement approach (AMA) <sup>)</sup>

<sup>)</sup> Requires Finanstilsynet's approval

Banks with approval to use an Internal Rating Based Approach for credit risk base their statutory minimum capital requirement for credit risk on their own internal risk assessments. This makes for a more risk sensitive statutory minimum requirement which to a greater extent reflects the risk in the underlying portfolios.

In the case of the IRB Advanced Approach the risk parameters 'probability of default' (PD), 'credit conversion factor' (CF) that are used to establish 'exposure at default' (EAD) and 'loss given default' (LGD) are calculated using the Bank's own models. These parameters are used to calculate the capital requirement.

### Implementing the capital adequacy framework at SpareBank 1 SMN

SpareBank 1 SMN received permission from Finanstilsynet to apply an internal rating based (IRB) approach to credit risk as from 2007. SMN received permission to apply an AIRB approach to its corporate portfolio in February 2015.

The figure below shows the main approaches used by SpareBank 1 SMN to calculate capital requirements and risk weighted assets for credit, market and operational risk respectively.

RISK TYPE	AREA	APPROACH
Credit risk	Sovereigns	Standardised approach
	Institutions	Standardised approach
	Housing cooperatives, clubs and associations	Standardised approach
	Companies – parent bank	Advanced IRB approach
	Retail market – parent bank	Retail IRB approach
	SpareBank 1 SMN Finans Midt-Norge	Standardised approach
	SpareBank 1 Invest	Standardised approach
	SpareBank 1 Markets	Standardised approach
	Retail market – SpareBank 1 Boligkreditt	Retail IRB approach

	Companies – SpareBank 1 Næringskreditt	Standardised approach
	Companies – BN Bank	Advanced IRB approach
	Retail market – BN Bank	Retail IRB approach
<b>Market risk</b>	Equity risk – parent bank	Standardised approach
	Debt risk – parent bank	Standardised approach
	Foreign exchange risk – parent bank	Standardised approach
	Subsidiaries and related companies	Standardised approach
<b>Operational risk</b>	Parent bank	Standardised approach
	Subsidiaries and related companies	Standardised approach
<b>Owner risk</b>	SpareBank 1 Gruppen (insurance)	Solvens II
	Other ownership (not consolidated)	Equity method

### *Combined buffer requirements*

In addition to the minimum own funds requirement of 8%, Norwegian banks are subject to combined buffer requirements to be met by CET1 capital. The buffer requirements are composed as follows, incl. the requirement as of 31.12.2024:

- Requirement of a capital conservation buffer (2.5%)
- Requirement of a systemic risk buffer (4.5%)
- Requirement of a countercyclical buffer (2.5%)
- Requirement of a buffer for systemically important institutions

The requirement of a capital conservation buffer of 2.5% of the Bank's risk weighted assets applies through all economic scenarios and is designed to ensure that the banks build up capital in good times in order to prevent capital falling below the minimum requirement in downturns.

Systemic risk buffer (4.5 per cent): Systemic risk can be defined as the risk of financial instability causing disruption to financial services on a scale that may have substantial negative impacts on production and employment. The systemic risk buffer is designed to dampen the negative effects of financial instability. The systemic risk buffer was last changed from 3% to 4.5% as of 31 December 2020. Since this buffer requirement addresses structural vulnerabilities and other systemic risk in the Norwegian economy, it only applies to banks' exposures in Norway, in contrast to previous buffer requirements which apply to all business activity.

The countercyclical buffer aims to dampen the effects of cyclical variations by requiring institutions to build up extra buffer capital in periods of particularly strong credit growth. The assumption here is that this buffer will not be used for the purpose of fine-tuning macroeconomic management by Norges Bank, the central bank.

The purpose of the countercyclical capital buffer is to render institutions more solid and robust to loan losses in a future slump and to dampen the risk that banks will contribute to intensifying an economic downturn by reducing their lending. 12 months' notice is given of any increase in the countercyclical buffer. A reduction of the countercyclical buffer can be implemented immediately. The countercyclical buffer was lowered to 1.0% with effect from 13 March 2020 in light of the uncertainty surrounding coronavirus. Between June 2021 and 31 March 2023 the countercyclical capital buffer requirement was gradually raised to 2.5%, which is the countercyclical buffer's normal level.

The buffer requirement for systemically important institutions (SIFIs) is 2%. The buffer is designed to reduce the likelihood of difficulties where the wind-down of an institution might involve financial instability and substantial disruptions to the real economy. Institutions defined as systemically important are in all essentials institutions with total assets representing at least 10% of Mainland Norway's GDP or a share of the lending market of at least 5%. SMN is not defined as systemically important as at the end of 2024.

## **Pillar 2 – Assessment of overall capital need and supervisory review**

Pillar 2 imposes requirements on the Bank's process for assessing its total capital in relation to risk profile and a strategy for maintaining its capital level, the Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP covers risk types not covered by Pillar 1, and must be a forward-looking assessment of the Bank's capital need. Finanstilsynet's guidance on "Practices for assessing risk and capital needs" is used as a guide for our work on the ICAAP.

The supervisory authorities are required to review and evaluate the banks' internal assessment of capital need and strategies. The supervisory authorities are also required to monitor and oversee compliance with the capital requirements imposed by them. The supervisory process follows the requirements on the Supervisory Review and Evaluation Process (SREP) and may result in an individual Pillar 2 add-on. Finanstilsynet has published descriptions of the models and methods it uses in its determination of Pillar 2 add-ons.

For SpareBank 1 SMN the current Pillar 2 add-on is 1.7 percentage points. Of this, 1.0 percentage point must be met by CET1 capital, while the remainder can be met by hybrid capital or own funds. Additionally, Finanstilsynet has considered that SpareBank 1 SMN's capital requirements margin should be 1.25 percentage points. SpareBank 1 SMN has also received a provisional Pillar 2 add-on of 0.7% as a result of reduced risk weighting for companies since 2018. The 0.7% add-on will lapse once revised IRB models for the companies portfolio are approved and taken into use. This expresses Finanstilsynet's expectation that revised IRB models make for higher risk weights. This provisional add-on is integrated in financial projections under the ICAAP for the entire forecasting horizon.

Should the Bank breach the combined buffer requirements, a capital plan must be presented to Finanstilsynet within five working days. The Bank can continue in business, but any breach will involve restrictions on the application of the profit for the year.

SpareBank 1 SMN aims for CET1 ratio of 16.3% as of 31.12.24, implying a countercyclical buffer of 2.5% over time. The capital target includes a management buffer of 1.25%. The Bank considers this buffer to be sufficient to capture fluctuations in profit and growth that may impact CET1 capital and risk weighted assets.

At the end of 2024 the CET1 ratio stands at 18.3% and total capital adequacy at 22.8%, compared with 18.8% and 23.0% respectively at the end of 2023.

## **Leverage ratio**

In addition to the requirement on own funds and combined buffer requirements, the banks are also subject to a minimum leverage ratio requirement of 3 per cent in conformance with Article 92(1)(d) of the CRR. Higher, institution-specific, leverage ratio requirements may be imposed on institutions through Pillar 2. The minimum leverage ratio requirement for SpareBank 1 SMN is 3.0%. At the end of 2023 SpareBank 1 SMN's leverage ratio stands at 7.0%.

## **Regulatory liquidity requirements and eligible liabilities**

### *Short-term liquidity requirement (LCR)*

Financial institutions are subject to stringent requirements in terms of maintaining a liquidity buffer sufficient to survive periods of great stress. The LCR (Liquidity Coverage Ratio) imposes strict requirements as to what qualifies as liquid assets. The main eligible items are

cash, government securities and other liquid assets (in this case defined as covered bonds and municipal securities). ‘Stress’ includes both on-balance sheet and off-balance sheet items. The LCR requirement entails that an institution must at all times hold a liquidity reserve of at 100 per cent, i.e. its holding of liquid assets must at least equate to net liquidity outflow in a given stressed period of 30 calendar days.

SpareBank 1 SMN reported an LCR of 183% as at 31.12.2024. The Bank has ample liquidity and access to funding.

#### *Requirement of long-term funding (NSFR)*

In the wake of the financial crisis there has been a growing focus on the maturity of the Bank’s funding. The NSFR is a key performance indicator designed to ensure that the Bank’s asset side of the balance sheet is funded on a sufficiently long-term and stable basis, in this case defined as being funded by liability items with maturities above one year. Available stable funding should be at least as ample as the required stable funding, i.e. the NSFR should be at least 100 per cent.

SpareBank 1 SMN reported an NSFR of 125% as at 31.12.2024. The Bank has stable funding, with a deposit-to-loan ratio 57% and an average maturity of 2.7 years on its borrowings.

#### *Required convertible funds (MREL)*

The MREL requires banks to maintain a minimum level of own funds and eligible liabilities that can be written down or converted equity (bail in) in connection with resolution. A requirement is that parts of the MREL capital consist of senior non-preferred debt. The Bank has issued SNP bonds, both in Norwegian kroner and some in foreign currency. The issued bonds include both callable bonds and bullet bonds. As of 31. December 2024 the Bank has an ample margin in terms of the regulatory requirements pertaining to senior non-preferred liabilities.

### **Pillar 3 – Disclosure requirements**

The reporting requirement under Pillar 3 is set out in the CRR Part 8. The purpose of Pillar 3 is to complement the minimum capital requirements under Pillar 1 and the supervisory review process under Pillar 2. Pillar 3 is designed to promote market discipline through requirements on the disclosure of information that enables the market, including analysts and investors, to assess the institution’s risk management, risk measurement and capital adequacy.

SpareBank 1 SMN publishes supplementary analyses and data on a quarterly basis in “Supplementary Information” as an attachment to its quarterly report.

## **RISK AND CAPITAL MANAGEMENT AT SPAREBANK 1 SMN**

The principles underlying SpareBank 1 SMN’s risk management are laid down in the risk management policy. The Group gives much emphasis to identifying, measuring, managing and monitoring central risks in such a way that the Group progresses in line with its adopted risk profile and strategies.

The bank’s three lines of defence against financial loss or impaired reputation comprise:

1. Prudent risk limits which reduce the probability of a bank-specific event, and a good internal control function which ensures compliance with the limits.
2. The period’s financial result, a buffer to absorb volatility and loss within the adopted risk appetite, and which allows time to make adjustments in business plans/risk profile.
3. Sufficient liquidity and equity capital to manage unexpected events and crises.

Risk management within the Group is intended to support the Group's strategic development and goal attainment. The risk management regime is also designed to ensure financial stability and prudent asset management. This will be achieved through:

- a strong organisation culture featuring high risk-management awareness
- a sound understanding of the risks that drive earnings and risk costs, thereby creating a better basis for decision-making
- striving for an optimal use of capital within the adopted business strategy
- avoiding unexpected negative events which could be seriously detrimental to the group's financial position
- exploiting synergies and diversification effects

The Group's risk is quantified inter alia by calculating expected loss and the need for risk-adjusted capital (economic capital) to meet unexpected losses.

Expected loss is the amount which statistically can be expected to be lost in a 12-month period. Risk-adjusted capital is the volume of capital the Group considers it needs to meet the actual risk incurred by the Group. The Board of Directors has decided that the risk-adjusted capital should cover 99.9 per cent of all possible unexpected losses. Statistical methods are employed to compute expected loss and risk-adjusted capital, but the calculation requires expert assessments in some cases. In the case of risk types where no recognised methods of calculating capital needs are available, the Group defines risk management limits that limit loss risk in accordance with the adopted risk appetite.

The Group's overall risk exposure and risk trend are monitored through periodic risk reports to the Administration and the Board of Directors. Overall risk monitoring and reporting are carried out by Risk Management which is independent of the Group's respective business lines.

Return on risk-adjusted capital is one of the key strategic profit measures in the internal management of SpareBank 1 SMN. It entails allocating capital to the business lines based on the estimated risk attending the business concerned, and continuous monitoring of return on capital. Calculation of risk-adjusted capital enables comparison of risk across risk groups and business lines. To this end the Bank has implemented EVA (Economic Value Added) calculations to keep track of the business lines' risk adjusted profitability. Risk is also monitored by measuring positions relative to quantitative risk limits and key portfolio risk limits.

The combined buffer requirement entails that the total regulatory capital need has more than doubled compared with a 99.9% risk-adjusted capital need. In order to ensure the application of the IRB system and the internal profitability management's relevance for accounting profitability purposes, the buffer requirements are also included in the internal risk-adjusted capital. This is done by adjusting all risk-adjusted capital upwards to the same level as the Group's capital target, i.e. from 8% to 16.3%. The selected method means that the relative differences in allocated risk capital remain intact.

### **Risk appetite statement**

SpareBank 1 SMN aims to maintain a moderate risk profile and to employ risk monitoring of such high quality that no single event will seriously impair the Bank's financial position. The framework for determining the Group's risk profile aims to provide a coherent and balanced overview of the risk to which the business is exposed and consists of statements that define the Group's risk appetite in key risk areas. Risk willingness is defined as desired risk exposure/profile based on an earnings and loss perspective. The Bank's risk profile is quantified for all risk groups through a risk appetite framework.



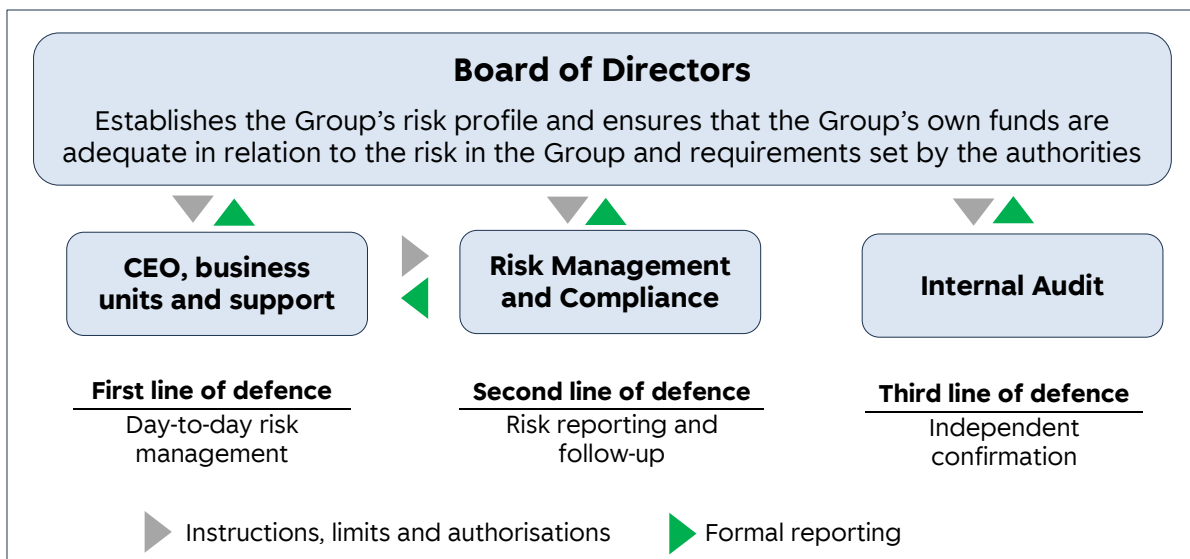
Risk appetite framework	
<i>Risk type</i>	<i>Dimension</i>
Profitability	Return on equity
Capitalisation	CET1 capital adequacy Rating Leverage ratio
Credit risk	Concentration risk for customers, groupings and industries Loss and loss risk Credit quality
Liquidity risk	Deposit-to-loan ratio Survival without access to new funding LCR, NSFR Transfer capacity to SpareBank 1 Boligkreditt
Market risk	Maximum risk as a share of CET1 capital
Owner risk	Capital employed Return on equity
Operational risk	Operational losses and events
Reputational risk	The Bank does not involve itself in business activities which may damage the Bank's reputation.
Compliance risk	Financial loss and sanctions

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

Risk management and control are part of SpareBank 1 SMN's corporate governance as described in the chapter on Corporate Governance in the annual report. The Group's control and management model aims for independence in risk reporting, with due emphasis given to responsibilities and roles in the day-to-day risk management. SpareBank 1 SMN has for several years devoted substantial resources to developing effective risk management processes to identify, measure and manage risk.

In the risk and capital management process, organisation culture is the very foundation on which the other elements build. SpareBank 1 SMN's organisation culture comprises management philosophy, managerial style and the people making up the organisation with their individual qualities such as integrity, values and ethical mindset. A deficient organisation culture cannot be compensated for by imposing other control and governance measures.

The Group attaches importance to a control and management structure that promotes targeted and independent management and control.



The risk management process at SpareBank 1 SMN is divided into the following functions:

- an executive function (including both line (customer responsibility) and Group staff (management/support/control))
- an independent monitoring function (Risk Management and Compliance)
- an independent confirmation function (internal audit function)

This control and management model is designed to ensure independence in decision-making and reporting, and responsibilities and roles in the day-to-day risk management are assigned particular importance. An important principle is that the risk management process is an integral part of the day-to-day business. The risk management and compliance function removes none of the profit centres' responsibility for sound risk management.

An important basis for effective risk management is a strong risk culture that is characterised by a high awareness of risk and risk management throughout the Group. It requires each and every staff member to have a sound understanding of his/her activity and actions, and of the associated risks. The responsibility for risk management is shared between the Board of Directors, the Group Management Team and line management.

The Bank's risk management process is grounded in overall risk management strategies adopted by the Board of Directors and in an assessment of the capital situation that defines risk appetite and capacity for risk exposure.

Further, risk management strategies are adopted for various risk types, as well as strategies for the respective business lines that translate risk appetite and ambitions into concrete targets.

Importance is attached to ensuring that the business and risk management strategies are well matched. Current developments in relation to business goal attainment are reported to the Board of Directors on a monthly basis. This forms the basis for Board of Directors' assessment of the respective units' target attainment.

The Board of Directors receives a quarterly risk and compliance report which enables it to make sure that the activities are being carried out within the risk profile adopted by the Board of Directors.

Further, the internal audit function confirms that the activities are compliant with the framework for internal control that has been established, and that this framework is

appropriate. The Internal Audit meets with the Board of Directors' audit committee ahead of the Board of Directors' consideration to review findings and observations.

The **Board of Directors** of SpareBank 1 SMN is responsible for overseeing that the Group's own funds are adequate to the strategic objectives and adopted risk profile and to requirements set by the authorities. The Board of Directors establishes the overarching objectives related to risk profile and return. The Board of Directors also establishes overall limits, authorisations and guidelines for risk and capital management within the Group, as well as ethical guidelines designed to foster a high ethical standard. The Board of Directors shall moreover ensure that the management sees to an appropriate and efficient risk management process in accordance with laws, regulations, articles of association and principles, and establish preparedness and continuity plans to ensure that operations can continue and that losses are curbed in the event of significant unforeseen events.

The work of the Board of Directors is enshrined in an annual plan which is updated on an annual basis. This ensures that the Board of Directors has sufficient time for, and focus on, central tasks.

The Board of Directors has separate committees for risk management, audit and remuneration. The Risk Committee is a preparatory body for the Board of Directors in matters related to the Group's risk management and internal control, while the Audit Committee prepares matters concerning financial information and the associated internal control. The committees comprise the same four members drawn from the Board of Directors. The Remuneration Committee similarly assists the Board of Directors in its work on the Group CEO's terms and conditions of employment, and as regards the main principles and strategy for compensation to the highest echelon of management in the Group. The Remuneration Committee consists of three members of the Board of Directors.

The **Group CEO** is responsible for risk management. The Group CEO is accordingly responsible for seeing to the implementation of effective risk management systems in the Group, and for the monitoring of risk exposures. The Group CEO is also responsible for delegating authorisations, and for reporting to the Board of Directors.

The **business lines** are responsible for the day-to-day risk management within their respective areas of responsibility, and they must at all times see to it that risk management and risk exposure are in compliance with the limits and overarching management principles established by the Board or the Group CEO.

**Risk Management** is organised independently of the business units and reports directly to the Group CEO. This department is responsible for the Group's risk models and for the further development of effective risk management systems. It is also responsible for independent risk assessment, risk reporting and for overall monitoring of risk.

The **Compliance function** is organised independently of the business units and reports quarterly to the Group CEO and Board of Directors. This function assesses the company's procedures, routines and systems to ensure regulatory compliance, and gives advice on measures that should be implemented to ensure compliance.

**Credit committees.** The Group has a Central Group Credit Committee, a Credit Committee For SMB Clients, and a Credit Committee for Agricultural Clients.

The credit committees are responsible for delivering an independent recommendation to the authorisation holder concerned. The recommendation:

- assesses loan and credit applications, including renewals, in accordance with the existing credit strategy, credit policy, lending regulations and credit processing procedures
- gives particular emphasis to identifying risk related to the individual application and to providing an independent credit risk assessment

- assures that the consequences for the Group of the various risks have been duly clarified

**Credit Support Unit.** This unit takes over dealings with customers who are clearly unable, or are highly likely to become unable, to service their debts unless action is taken beyond ordinary follow-up.

**Credit Watch Committee.** This committee’s main focus is on exposures at risk. The committee deals with exposures defined on a centralised watch list, mainly exposures in excess of NOK 50m.

**Validation Committee.** This committee reviews at least once yearly the validation of the Bank’s IRB models. The committee also considers proposals for implementation of new and further developed versions of the Bank’s IRB models. The committee submits recommendations to the Bank’s Board of Directors, which adopts the final decision.

The **Balance Sheet Committee** is responsible for dealing with matters related to the management of liquidity risk and market risk, including compliance with limits established by the Board of Directors.

The **Risk and Capital Management Committee** is responsible for considering and recommending risk strategies and overarching risk management documents, and proposals for risk limits for the Group’s various risk areas. The committee also considers the stress testing program, capital allocation, ICAAP, ILAAP and recovery plan ahead of consideration by the Board of Directors.

The **Internal Audit** is a tool at the disposal of the Board of Directors and the Administration which oversees that the risk management process is targeted, effective and functions as intended. The Group’s internal audit is carried out by an external provider, thereby assuring the required independence, competence and capacity. The Internal Audit function reports to the Board of Directors. Reports and any recommendations for improvements in the Group’s risk management are reviewed on a continuous basis.

The Internal Audit function reviews regularly, and at least annually, the IRB system, including the models underlying the calculation of risk parameters and the application of and compliance with the capital requirements regulations. KPMG conducts the Group’s internal audit.



## Capital management

SpareBank 1 SMN applies a focused capital management process designed to assure to the greatest possible extent:

- Effective capital procurement and capital application in relation to the Group's strategic objectives and adopted business strategy
- Competitive returns
- Satisfactory capital adequacy in relation to the chosen risk profile
- Competitive terms and good long-term access to capital market funding
- The Group's ability to maintain at minimum its present international ratings
- Utilisation of growth potentials in the Group's defined market area
- That no individual events can seriously impair the Group's financial position

A long-term objective of the adopted business strategy is to ensure that the risk-adjusted capital is as far as possible allocated to those areas that yield the highest risk-adjusted return.

As an integral part of its risk management policy, SpareBank 1 SMN has established a capital allocation process (ICAAP) to ensure that the Bank at all times has sufficient own funds in relation to its chosen risk profile. The process also aims to ensure efficient and effective procurement and application of capital.

The Bank has drawn up a recovery plan for handling the capital and liquidity situation should the Group encounter severe pressure on its CET1 capital adequacy, and in periods of turbulent financial markets. Measurements of KRIs (Key Risk Indicators) are made on a continuous basis in order to capture signals indicating that the Bank is moving towards defined trigger levels. Potential measures are identified and quantified. The bank has also conducted a crisis management and recovery exercise.

The capital management process shall:

- be risk-driven and include all significant types of risk within the Group
- be an integral part of the business strategy, management process and decision-making structure
- be forward-looking and include stress testing
- be based on recognised and appropriate risk measurement methods and procedures
- be regularly reviewed, at least annually, by the Board of Directors

### *Stress tests*

When assessing the group's long-term liquidity and capital needs, stress test process and models are part of the analysis. The intention is to identify factors which may adversely affect the risk picture and capital adequacy. Stress testing covers all significant aspects of the risk picture and includes an assessment of their significance for the Group's financial position.

The stress tests represent factors which could arise from time to time, and which SpareBank 1 SMN should make allowance for in the interest of its operation. The assessment and determination of necessary capital and liquidity forms part of an overall risk assessment, together with an assessment of future growth plans and strategies.

### *Scenarios for stress testing and forecasting*

A set of macro scenarios has been established for use in all forecasting and stress testing in the Group. It is important that the scenarios are as consistent as possible so as to permit the reuse of stress test results in overall stress testing of the Group and to provide the Board of Directors/Management with a consistent picture from the Administration.

In the expectations scenario, Norges Bank's forecasts from the latest Monetary Policy Report are taken as a basis for developments in macroeconomic variables such as interest rates, inflation, unemployment and house prices. In addition, an assessment is made of whether

particular factors in the Bank's market area cause the Bank's expectations scenario to differ from Norway as a whole.

Assumptions for growth and costs are also central to projections. The Internal Governance Department is responsible for maintaining forecasts for growth and costs developments in the expectations scenario.

Risk Management is responsible for the Group's scenarios for serious stress. The scenarios must be serious and not improbable. In addition, recovery and resolution scenarios are created, which are less likely scenarios.

### **Regulatory and economic capital need**

Regulatory capital need is calculated for credit, market and operational risk. Note 5 in the annual report shows regulatory capital need as the "minimum requirement on CET1 capital". This capital need is calculated using the methods described in the chapter entitled "Capital Adequacy Framework". The calculations are either approved by Finanstilsynet or are a direct consequence of the Capital Requirements Regulation (CRR).

Risk weighted assets are then arrived at by multiplying the minimum requirement by 12.5, which is the same as dividing by 8%. The buffer requirement is to be met as a share of risk weighted assets. Hence the buffer requirement is also risk-sensitive. Loans carrying low risk attract a low buffer requirement while high-risk loans attract high buffer requirements.

SpareBank 1 SMN also calculates internal economic capital need. Economic capital is calculated with a view to managing risk without regulatory restrictions. There is nonetheless a high degree of concordance between the calculations to ensure application of the IRB system and the ability to use economic capital to manage accounting profitability. When used in pricing and measuring profitability, economic capital is adjusted upwards to include the buffer requirements.

The most important differences between economic and regulatory capital are:

- Where market risk is concerned, risk is measured based on the instruments' characteristics and not on their valuation under the capital adequacy framework. Hence the valuations are independent of position in the banking or trading portfolio.
- Where credit risk is concerned, the bank utilises applied-for IRB models with regard to economic capital. Currently this involves a forward-looking cashflow model for financing of commercial property.
- Concentration risk, as estimated under Pillar 2, is included in economic capital for credit risk.
- Where owner risk is concerned, underlying risk in affiliates is consolidated into the Group's economic capital. The greatest difference is in the case of the SpareBank 1 Group where underlying insurance risk and market risk are consolidated in economic but not regulatory capital.

### **Governance systems**

The Group has developed an application portfolio of governance systems which has been distributed to all management personnel.

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

Management Information Systems, developed for each division, which include key indicators that are closely linked to the IRB system – such as risk-adjusted return, high-risk share, credit quality and default

The portfolio management system (PorTo), which is the Group’s system for reading and reporting key risk parameters related to lending activity, including:

- Probability of default (PD)
- Loss given default (LGD)
- Exposure at default (EAD)
- Expected loss (EL)
- Unexpected loss (UL)
- Risk weighted assets (RWA)
- Risk adjusted return on risk adjusted capital (RARORAC)

The portfolio management system is user-friendly and flexibly designed. It provides information on various risk parameters and offers filtering capability on various levels and divisions of the portfolio. Historical figures are updated monthly and go back almost 20 years. The system makes it a simple matter for the individual user to export data for use in a variety of analyses in various parts of the portfolio, for example sensitivity analyses and what-if analyses. The user has access to parts of the portfolio where this is required for the task in hand, and can thus follow developments and monitor risk for his/her particular area.

BankKontorRegnskap (BKR)<sup>1</sup> is a governance system for internal accounts. The system is used for budgeting and monthly performance monitoring of all profit centres, thereby providing profit and loss accounting down to office level and for group subsidiaries.

**Reporting**

An important element of effective risk management is monitoring of current risk exposure. All managers are responsible for day-to-day risk management within their area of responsibility, and they are required at all times to see to it that risk exposure is within the limits decided by the Board of Directors or Group CEO.

The Group’s overall risk exposures and risk trend are monitored through periodic risk reports to the Administration and Board of Directors. Overarching risk monitoring and reporting are performed by the Risk Management Department which is independent of the business units in the Group.

Significant reporting to the management team and Board of Directors:

Analysis/report	Recipient/decision-maker		Frequency			Comments
	Board of directors	Group CEO	Yearly	Quarterly	Monthly	
<b>Risk management policy - overarching</b>	x		x			Assessment and adjustment of the Bank’s risk tolerance in various risk areas – credit, market, liquidity and operational risk
<b>Risk strategy – credit, market and liquidity risk</b>	x		x			Assessment and adjustment of detailed targets and limits for credit, market and liquidity risk
<b>ICAAP/ILAAP</b>	x		x			Assures that the Group has a process for

<sup>1</sup> This translates to Bank/Office/Accounts.

						assessing its total own funds in relation to risk profile. ICAAP also helps to determine a prudent target capital ratio and assure a prudent liquidity strategy.
<b>Recovery plans</b>	x		x			The recovery plan is a tool for identifying opportunities to restore financial strength and stability under severe financial stress.
<b>Risk report</b>	x			x		Quarterly reporting of status and expected development of the Group's risk profile. Also confirms compliance with and fulfilment of strategic targets and limits laid down in the Group's risk strategy. Reporting of status in relation to trigger levels in the recovery plan
<b>Report - Compliance</b>	x			x		Reporting of status and development related to the Group's compliance risk
<b>Internal audit reports</b>	x			x		Summary of status and findings on completed internal audit projects
<b>Validation reports</b>	x		x			Overview of quantitative and qualitative validation of the Bank's IRB system
<b>Economic/financial report</b>	x		x	x	x	

## RISK GROUPS

SpareBank 1 SMN identifies and manages risk within the following overarching risk groups:

- **Credit risk:** Risk of loss arising from the customer's inability or unwillingness to honour their obligations.
- **Market risk:** Risk of loss due to changes in observable market variables such as interest rates, exchange rates or securities markets.
- **Operational risk:** Risk of loss due to unsatisfactory or failing internal processes or systems, human error or external events. Operational risk includes legal risk, but not strategic risk or reputational risk.
- **Liquidity risk:** Risk that the Group will be unable to refinance its debt or unable to fund increases in assets.
- **Owner risk:** Risk of loss at subsidiaries, SpareBank 1 Gruppen AS or SpareBank 1 Boligkreditt AS refers to the risk incurred by the individual company in its operations,



as well as the risk of having to supply fresh capital to one or more of these companies.

- **Strategic risk:** Risk of earnings shortfall or failure to generate capital due to changes in framework conditions, poor business decisions, poor implementation of decisions or failure to adjust to changes in business conditions or regulatory framework.
- **Business risk:** Risk of shortfall in earnings and capital supply due to lack of diversification of the business base or lack of sufficient and permanent profitability, for example due to an excessively high cost-income ratio.
- **Reputational risk:** Risk of shortfall in earnings and capital supply due to failing confidence and standing in the market, i.e. among customers, counterparties, equity certificate holders or the authorities.
- **Compliance risk:** Risk of the Group incurring public sanctions or fines, financial loss or reputational impairment as a result of non-compliance with laws and/or regulations, standards or internal policies.

Incorporating ESG risk into steering documents is a continuous process. ESG risk, including climate risk, is regarded as a driver of financial risk and impaired reputation. The Group has a high focus on climate risk.

Climate risk is the risk of economic losses and financial instability arising from physical climate changes and society's response to them. Losses resulting from climate risk will materialise through the other risk groups in the above bullet list, and climate risk is therefore a risk driver and not a risk group in its own right. The Group views climate risk as a material financial risk, and, until such time as climate risk is fully integrated into the traditional risk groups and the Group's corporate governance, climate risk will receive augmented focus in our risk management.

## Credit risk

Credit risk is the risk of loss resulting from the inability or unwillingness of customers or counterparties to honour their commitments to the Group.

The Bank's organisation of and framework for management of credit risk is aligned with the requirements and recommendations of the Financial Institutions Act, the CRR/CRD IV Regulations, the Capital Requirements Regulations and Finanstilsynet's module for management and control of credit risk.

Credit risk arising from the Group's lending activity is the Group's largest risk area. The Group incurs exposure to credit risk through lending and leasing products to retail and corporate customers and through the operations of the Bank's Capital Market and Finance Department.

## Management of credit risk

### *Credit strategy*

Through the annual review of the credit strategy, the board of directors specifies the bank's risk appetite through strategic guidelines and limits for the bank's credit portfolio.

The credit business shall have a strong organizational culture characterized by a high awareness of risk management and high quality in all parts/phases of the credit process. The bank shall finance future cash flows to customers who have the ability and willingness to fulfill their obligations. We shall know our customer, the customer's industry and the customer's local market area. We shall offer understandable products and services to customers with a clear financing structure.

Credit strategic frameworks shall limit concentration risk, so that no single event can seriously damage the group's financial position, by, among other things

- Restricting the size of loans and loss ratio on individual exposures
- Limit the maximum exposure within sectors

Compliance with credit strategy and board-approved limits is monitored continuously by the risk management department and reported quarterly to the board.

### *Credit policy*

The credit policy rules describe limits for, and what is acceptable within, given areas in the credit assessment. In addition to the credit policy rules, a document has been drawn up describing guidelines for lending to corporate clients. These guidelines indicate normative/recommended levels and limits in various areas, in contrast to the credit policy rules where specific authorisations are required in order to diverge from them. The credit policy rules are revised at least once per year and are approved by the CEO, who duly informs the Board of Directors.

### *Authorisations*

The Board of Directors is responsible for the Group's granting of loans and credit, but delegates – subject to certain limits – credit authorisations to the CEO, who within his own authorisations can delegate the credit authorisations to others. The delegated credit authorisations are linked to an exposure's probability of default and collateral value. The authorisations are personal. This means that the credit committees do not have decision-taking authority but make a recommendation to the authorisation holder. For some levels of position the authorisation limit will be reduced by 50% if a recommendation from a credit committee is not available. In general the authorisations are substantial if an exposure's probability of default and loss ratio indicate low risk, whereas authorisations are progressively tightened with increasing risk. The lending regulations are reviewed on an annual basis, and changes are approved by the CEO who duly informs the Board of Directors. However this does not apply to changes in the CEO's credit authorisations or where the changes entail a significant change in risk, since these are approved by the Board of Directors.

### *Credit procedures*

The credit manual regulates in detail all matters related to the Group's lending and exposure monitoring. The credit process provides a closer description of the customer and the purpose of the loan application, and assessments of matters related to:

- Owners and management
- Funding structure
- Observance of credit strategy and credit policy
- Earnings – will the customer have sufficient earnings ahead to service ongoing commitments, interest and instalment payments?
- Absorption – if earnings fail, for how long and by what means can the client meet ongoing commitments, interest payments and principal payments?
- Collateral items and overall risk assessment

### *ESG risk (climate risk)*

The Group has incorporated ESG risk into steering documents, including risk management policy, credit strategy and credit policy. ESG risk, including climate risk, is considered to be a driver of financial risk and risk of impaired reputation.

The Bank's exposure to climate risk has been mapped through qualitative assessments of physical risk and transition risk at industry level, and through ESG scoring requirements for all credit applications above NOK 10m submitted by corporate clients. In addition the Bank has estimated greenhouse gas emissions from its loan customers. The Board of Directors has

adopted a strategy requiring the Bank to be a driver of green transition and is accordingly preparing plans for transition to a low emissions society for all industries of significance to the Bank. The transition plans communicate expectations and requirements to our customers. Strategies and policies are regularly reviewed to ensure that measures to mitigate climate risk in the loan portfolio are adequate in terms of risk appetite. The Bank has in 2024 not employed exclusion of industries or customer groups as a tool to curb climate risk.

### Measurement of credit risk

Credit risk in the portfolio is monitored on an ongoing basis. This is done through monthly reclassifications of each individual customer in which the Bank's IRB-approved risk models are utilised. In addition, the Bank has established early warning systems for early identification of undesired risk build-up at portfolio or single customer level. The Bank monitors and reports breaches of credit strategy and credit policy in matters dealt with by the Group Credit Committee, and the results are reported to each meeting of the Board of Directors.

### *Portfolio management*

The Group performs a monthly reclassifications of all customers whereby updated information of significance for calculating credit risk is obtained and utilised in our credit models. The portfolio management system can thus each month present updated estimates for customers' probability of default, loss ratios and expected losses. Based on this, capital needs and risk-adjusted return are calculated. Both internal and regulatory calculations are included in this reclassification, and are made available to customer officers, managers and the risk management function. Credit risk information concerning individual customers can readily be aggregated at the desired level, for example department, segment, portfolio or bank level.

### *Early warning*

The Group has established a number of processes and reports to enable early identification of changes in credit risk with consequences for defaults and loss ratios. Examples of the Group's early warning process:

- Reporting of brief non-performance (0-90 days)
- Reporting of utilisation of flexi-loan limits and of overdraft facilities
- Reporting of development in and breach of covenants
- Reporting of developments in exposures with forbearance
- Monitoring of announcements (bankruptcies, compulsory winding up orders, mergers, demergers etc)
- Monthly bankruptcy statistics, by industry and region
- Monthly follow-up of changes in capital use and analysis of causes

### *Credit process monitoring*

The Group's systems for monitoring the credit granting process enable ongoing follow-up of the credit quality of, and risk-adjusted return on, new exposures. A credit granting record is downloaded on a monthly basis supplemented with relevant risk and earnings information. The system is well suited to comparisons of quality across the departments and enables an early response if for example individual departments show an undesired development in their ongoing credit practices.

### The risk classification system

In 2007 SpareBank 1 SMN received permission to apply an IRB approach to calculate capital charges on its loans to retail customers and corporates (basic IRB approach). This covers loans by the parent bank. In addition, the part-owned companies Boligkreditt and BN Bank apply the IRB approach to compute their capital charges. As from 2015 SpareBank 1 SMN has permission to apply an advanced IRB approach to loans to corporates. Capital charges on other exposures in the Group are computed using the standardised approach.

The risk classification system has been developed in collaboration with the other IRB banks in the SpareBank 1 Alliance, and with support from the SpareBank 1 Alliance’s Centre of Excellence in Credit Risk Modelling (CECRM). The CECRM contributes to the development, management and validation of the IRB models and is a part of SpareBank 1 Utvikling DA. SpareBank 1 Utvikling DA is a jointly owned company responsible for collaborative processes in the banks making up the SpareBank 1 Alliance, where technology, brand-building, competence, shared processes / exploitation of best practice and procurement are at centre stage.

In 2022 the ‘bank package’, including CRR2, was incorporated into Norwegian law. The bank package contains extensive requirements and guidelines for the development, application and validation of IRB models. The Bank’s entire IRB system has in recent years been revised to comply with new requirements and guidelines. In June 2021 an application to use the revised models was delivered to Finanstilsynet. The process remains ongoing.

The group’s risk classification system consists of the following models:

Probability of default PD	The model calculates the probability of a client going into default over the course of the next 12 months
Exposure at default EAD	The model calculates the size of a customer exposure at a future default date
Loss given default LGD	The model calculates how much of the exposure to the customer will be lost if the customer goes into default
Expected loss EL	The model calculates what statistically can be expected to be lost on a customer in the next 12 months based on PD, EAD and LGD
Unexpected loss / capital requirement UL	The model calculates what equity the Bank must hold to cover an expected loss on a customer, calculated as all possible losses within a 99.9% confidence level
Risk class	Customers are assigned to risk classes based on PD
Risk group	Customers are assigned to risk groups based on risk class
Collateral class	Customers are assigned to collateral classes based on collateral cover

**PD**

PD indicates the likelihood of a customer going into default in the next 12 months. The Bank’s definition of default states that a default is present when one or more of the following criteria are met:

- 90 days overdrawn / arrears in excess of NOK 1,000 in the period, and the default exceeds the materiality threshold: Total overdrawn / Total balance sheet exposure > 1%. For corporates the overdrawn amount must exceed 2,000
- Debt composition, voluntary or compulsory; opening of bankruptcy proceedings or notice of public composition with creditors
- Default due to assessment of unlikeliness to pay
- Internally registered bankruptcy, opening of bankruptcy proceedings or notice of bankruptcy
- Confirmation of loss or individually assessed write-down / provision for loss

The Bank employs the PD models when granting loans and for monthly reclassification of customers. The PD models are also used for the purposes of price determination, ongoing reporting and exposure monitoring. Based on calculated PD, each customer is assigned to a risk class and risk group according to the following scale:

PD	Risk class	Risk group	Moody's
< 0.1 %	A	Lowest risk	AAA – A3
0.10% - 0.25%	B	Lowest risk	Baa1 – Baa2
0.25% - 0.50%	C	Lowest risk	Baa3
0.50% - 0.75%	D	Low risk	Ba1
0.75% - 1.25%	E	Low risk	Ba2
1.25% - 2.50%	F	Medium risk	
2.50% - 5.0%	G	Medium risk	Ba2 – B1
5.0% - 10.0%	H	High risk	B1 – B2
10.0 % - 99.9 %	I	Highest risk	B3 – Caa3
Defaulted	J	Defaulted and written down	
Written down	K	Defaulted and written down	

The PD-model behavior is between PIT (Point-in-time) and TTC (Through-the-cycle). That is, the estimates neither fluctuate completely in line with the economic situation and default rate (PIT), nor are they completely independent of economic conditions (TTC). This is because the model uses explanatory variables which in part rapidly capture changes in a customer's financial situation (for example payment defaults registered against him) and other explanatory variables where changes are more sluggish (for example accounting or tax assessment information). As a result the observed default rate (DR) often diverges from the estimated default rate (PD). The observed default rate will typically fluctuate more widely than the estimates.

The PD models' structure and calibration are presented in the table below. Portfolio	Explanatory variables	Method	Uncertainty	History and calibration	Regulatory requirements
<b>Corporate</b>	Accounts Payment history and other behavioural information Line of business Age	The Bank employs a scorecard model based on regression analysis in which historical observations are used to predict the probability of default. The scorecards are divided into seven line-of-business variants (in addition to variants for newly established companies without accounts and companies not obliged to maintain accounting records) to make allowance for the fact that the explanatory variables have differing significance for different lines of business. In addition,	Uncertainty is taken into account through safety margins at the risk class level. Uncertainty is a theme considered in the Bank's periodic validation of the model.	The data underlying estimation and validation are > 10 years. When calibrating level, a method identical to that prescribed by the authorities for residential mortgages is used, but with other parameter	No customers can be assigned a PD lower than 0.03%.

		the calibration can be set at different levels for different lines of business to make allowance for differing historical default levels.		values. By that means the Bank takes account of actual historical default levels when predicting future defaults. The Bank employs up to 7 years' historical data for level calibration purposes, in addition to including a presumed default rate in a severe downturn.	
<b>Retail</b>	Tax assessment information Liquidity and debt Payment history and other behavioural information Length of customership	The Bank employs a scorecard model based on regression analysis, in which historical observations are used to predict the probability of default. The scorecard has two variants: Residential mortgages and Other retail. The explanatory variables are assigned different weights in the two variants. In addition, the calibration can be set at different levels for the two variants.	Uncertainty is taken into account through safety margins at the risk class level. In addition, the method prescribed by the authorities gives a substantial overestimation of the actual default rate. Uncertainty is a theme considered in the Bank's periodic validation of the model.	The data underlying estimation and validation are > 10 years. When calibrating level, a method identical to that prescribed by the authorities is used which takes account of actual historical default levels in the Bank over the last 7 years and a presumed default rate in a severe downturn.	No residential mortgage borrowers can be assigned a PD lower than 0.2%.

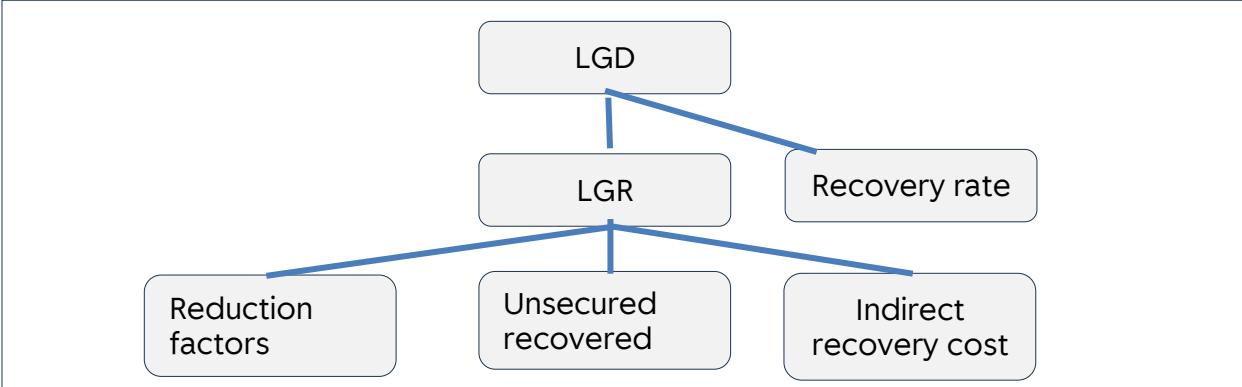
**EAD**

The model calculates what portion of an unutilised credit line will have been drawn down at a future default date. The Bank utilises the EAD model when granting exposures and in the ongoing (monthly) reclassification of its customers.

Portfolio	Explanatory variables	Method	Uncertainty	History and calibration	Regulatory requirements
<b>Corporate</b>	Product Score segment PD	The Bank utilises a model that assigns a conversion factor based on the explanatory variables. The model starts out from a supposition that existing customers will have a lower CF than new customers, public sector customers a lower CF than private companies, and that customers with a low PD will have a lower CF than customers with a high PD.	Uncertainty is taken into account through safety margins	When calibrating level, we have utilised historically observed CF levels, and considered the necessity of a cyclical add-on. In our model, customers are assigned a CF between 40% and 100%.	The level of the CF shall take into account economic contractions. The CF for guarantees is set by the authorities at 100% for loan guarantees and 50% for contractual and other guarantees.
<b>Retail</b>	Product (credit line)	All customers are assigned the same CF: 1		It is checked that historically observed values are below estimated values, and that any cyclical effects are sufficiently taken into account.	

**LGD**

The model estimates how much of the EAD the Bank must take as a loss should the customer go into default. The Bank utilises the LGD model when granting exposures and in the ongoing (monthly) reclassification of its customers. The LGD model consists of several sub-models.



Portfolio	Explanatory variables	Method	Uncertainty	History and calibration	Regulatory requirements
<b>Corporate</b>	Collaterals Customer type Equity ratio EAD	The Bank utilises a structural model which estimates LGD based on sub-models.  Collaterals are the dominant explanatory variable.	Uncertainty is taken into account through safety margins both at sub-model and total-model level.	When calibrating collateral values (reduction factors), customer recovery, recovery of unsecured loans and indirect recovery costs, the Bank utilises its own observations back to 2007, in addition to expert assessments and national and international analyses and statistics. To assure conservative estimates, the Bank has implemented minimum values for LGD.	The Bank is required to include in its LGD estimates a safety margin set by the authorities.
<b>Retail</b>	Collaterals Product				For residential mortgages a floor is set for LGD at portfolio level. This exceeds the Bank's own LGD estimates.

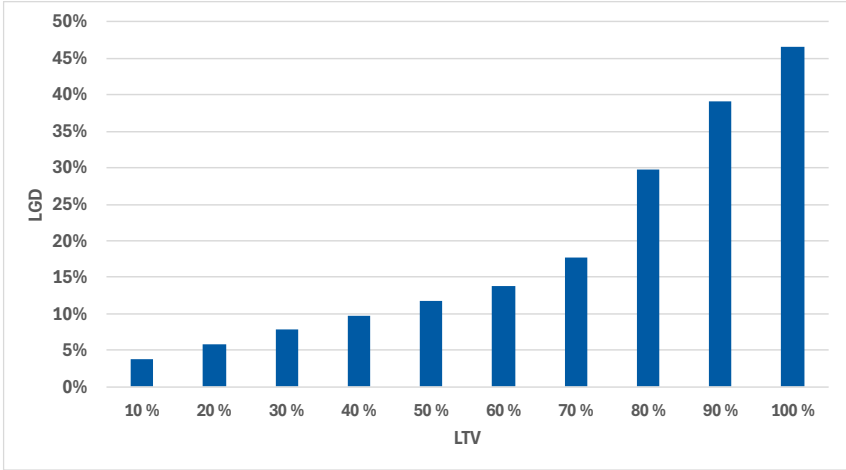
Collaterals are the chief explanatory variable in the LGD model. Having good estimates of the values of collaterals is accordingly crucial to the quality of the LGD model's estimates. Further, the LGD estimate is designed to take account of a future economic contraction, entailing that the current market value cannot be employed as collateral value.

- Good estimates of collateral value are assured through regular updating of market values. To this end various sources are employed, depending on the type of object furnished as security. Valuations are obtained in the case of commercial properties and ships. For residential properties, estimates from national providers of such information are largely utilised, while for most other assets we utilise accounting data. As part of its IRB system the Bank has procedures with regard to how, and how often, the various types of objects are to be valued.
- To ensure that the collateral values accommodate a future economic contraction, the market value is reduced by a reduction factor. This factor is specific to the particular object type and is determined by reference to historical observations of price falls, the Bank's own realisations and expert assessments of potential future falls.

The collaterals' significance for estimated LGD is shown in the figure below. This takes a basis in a loan secured by residential property. Differing loan-to-value ratios (LTVs) give different



LGDs. Whereas LTV utilises the current value of the mortgaged object, LGD utilises a reduced value of the mortgaged object to take account of a possible price fall in a future economic contraction. For residential properties the Bank utilises a reduction factor of 40%. The following graph includes the effect of the LGD floor set by the authorities for residential mortgages, which is in effect in CRR2 but will be repealed upon the introduction of CRR3.



Besides collateral values, the LGD model utilises estimates of probability of customer recovery, of the portion of unsecured EAD that can be recovered and indirect costs of recovery to estimate the loss ratio.

- The probability of customer recovery is the probability that a customer who has gone into default will “return to health” without recourse to restructuring and / or debt forgiveness.
  - For corporate clients the estimate is based on customer type, equity ratio and size of EAD. Clients are assigned a probability of recovery between 0% and 30%.
  - For retail customers the estimate is determined by whether the loan is, or is not, a residential mortgage.
- The portion of unsecured EAD that can be recovered is an estimate of how much of the unsecured EAD can be recovered without realisation of collaterals. All corporate borrowers are assigned the same estimate. The same applies to retail borrowers.
- Indirect costs of recovery are costs that the Bank has incurred that cannot be attributed to specific exposures. All customers (corporate and retail) are assigned the same estimate.

*Expected loss – EL*

Expected loss is calculated by multiplying PD, EAD and LGD.

*Regulatory and economic capital need (RWA/UL)*

Economic capital need (UL) denotes the equity capital needed by the Bank to back each exposure and to cover any loss that may arise within a confidence level of 99.9%. Expected loss that has already been calculated is deducted. This uncertainty regarding the possible loss level varies from one customer to the next, and depends inter alia on type of customer, loan term, collateral cover and stability of servicing ability.

The method used by the Group to calculate capital charges is set out in the CRR for regulatory calculations. The calculation formula for measuring economic capital need that is laid down in the CRR is the same as that used in regulatory calculations of capital requirements/risk weighted assets.

The Group’s capital target corresponds to the overall capital requirement including buffer requirements totalling 16.3%. To ensure consistency between risk measurement and pricing of

capital employed, economic capital is adjusted upwards such that the overall economic capital need corresponds to the regulatory capital need. This entails that regulatory buffer requirements are also implemented in the internal economic models.

### *Risk pricing*

All credits in SpareBank 1 SMN's portfolio are assigned a recommended minimum price upon being granted such that higher risk entails a higher price. The main elements included in this assessment are the customer's overall net interest income, other incomes, expected losses, estimated operating expenses, capital lock-in and the Bank's required rate of return. Expected loss, operating expenses and capital lock-in will all be affected by the assessed risk posed by the customer/exposure. The risk assessments are based in the same main components as in the Group's risk classification system as regards assessment of debt servicing ability and collateral cover. It is the profit centres' responsibility to offer their customers prices that contribute to the fulfilment of the Group's profitability and risk objectives.

SpareBank 1 SMN has a pricing model that takes account of these elements and calculates return in relation to required rate of return / EVA (Economic Value Added). The Bank also monitors the profitability of each customer by compiling and analysing historical data on a monthly basis. The same elements as those described above are included in the profitability assessments.

### **Collaterals and other risk-mitigating measures**

SpareBank 1 SMN makes use of collateral to reduce credit risk in each individual exposure. For corporates, use is made various types of covenants in credit agreements in cases where this is appropriate. Use of covenants gives the Bank assurance that the company concerned will hold prudent levels of, for example, liquidity and equity, or that the company will abide by applicable laws and regulations that govern its business.

For personal customers, collateral is mainly real property (residential). Corporate borrowings are secured against various types of collateral.

The Group determines the realisation value of furnished collaterals against the background of statistical data over time, and expert assessments in cases where statistical data are not sufficiently reliable. Realisation values are fixed so as to reflect, on a conservative assessment, the presumed realisation value in an economic contraction.

In the personal market the market value of real property is determined either by using the purchase sum shown in the contract, a broker's estimate or valuation estimates from Eiendomsværdi (residential property only). Eiendomsværdi is a company offering an information and analysis tool providing access to estimated market values of properties in Norway.

In the corporate market collateral values of commercial properties are calculated using the yield method or broker's estimate, where available. Under the yield method, market value is calculated as the present value of expected net cash flows from the property. Yield reflects the return an investor would demand when investing in the property and is influenced inter alia by factors such as the property's location and type, duration of leases, tenants' financial position, regulatory risk and the expected long-term risk-free interest rate. The yield matrix is revised regularly and is intended to be more conservative than brokers' estimates.

The realisation value of the collaterals furnished is determined by reducing the market value by a factor that varies with the collateral object's characteristics. The reduction factors for all types of collateral are determined with reference to value falls to be expected in a severe economic downturn.

## Validation of credit risk models

It is important that validation of the credit risk models is done with a sufficient degree of independence. In this context independence means independence of the units that develop the credit risk models from those that validate the same models. This is to ensure that validation is objective and that there can be no suspicion of incentives to embellish the validation results.

CDR 2022/439 from the European Banking Authority (EBA) provides further clarification on the requirement of independence of the validation function. Two central roles are presented:

- The Credit Risk Control Unit (CRCU)  
This unit has responsibility for developing credit models and monitoring their performance
- Validation function  
This unit has responsibility for the validation of models and for their use.

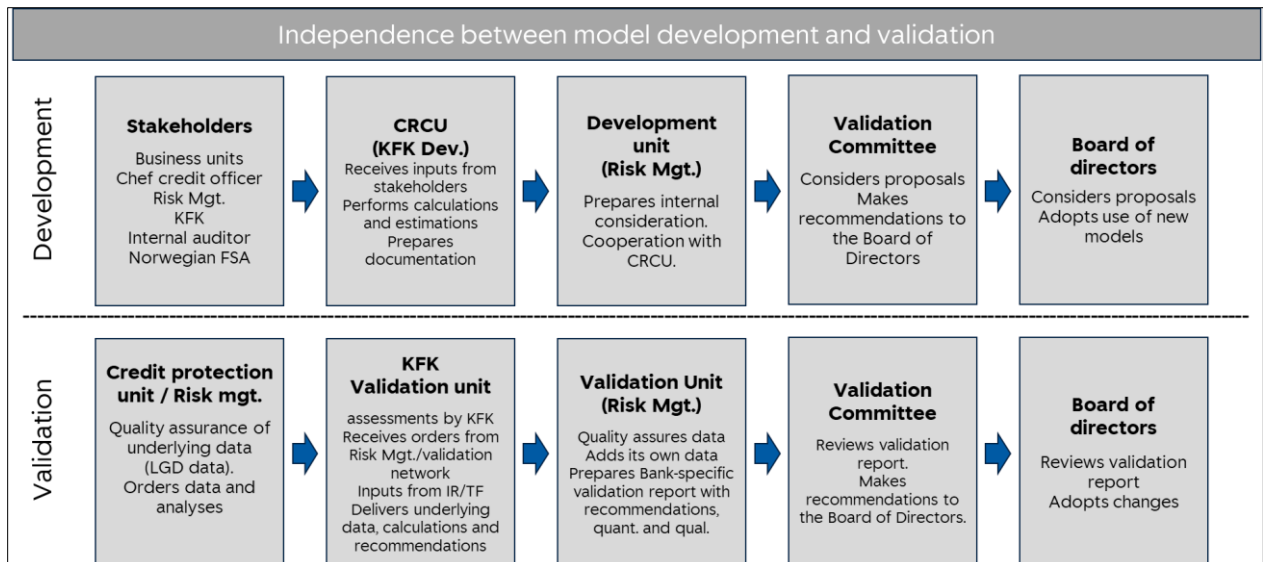
Thus the validation function is responsible for validation of the credit models and for their use. At SpareBank 1 SMN this is taken care of by Risk Management, which is responsible for both qualitative and quantitative validation as well as for the preparation of validation reports to the Validation Committee, the Management and the Board of Directors. The employees in Risk Management who contribute to the model development process are not the same people who perform validation.

Data and analyses/assessments are obtained from units through the work done on validation. Where qualitative validation is concerned, assessments and checks carried out by the line units are obtained. In the case of quantitative validation, inputs from the Bank's own Credit Analysis Department, the Alliance's validation network and the Alliance's Centre of Excellence in Credit Risk Modelling (KFK) are utilised.

- The Credit Analysis Department contributes its competence in sector-specific assessments, typically commercial property and offshore.
- The Alliance's validation network exchanges experience and proposals for improvement of the validation process. In addition, the validation network draws up joint orders for data and analyses from the KFK. Hence the KFK is an important contributor of data, analyses and inputs to the work of validation.
- In addition to contributing data and analyses, the KFK also makes recommendations for changes to models and estimates when they consider this necessary.

Based on inputs from these units, and its own analyses and assessments, Risk Management performs the Bank's independent validation of credit models and their use.

The independence (and interaction) between the units responsible for the Bank's development and validation of the credit models is shown in the figure below.



The validation of the Bank’s IRB models is important for ensuring that the models’ estimates are in line with the de facto risk to which the Bank is exposed. Validation therefore represents an important quality assurance of the Bank’s IRB system. The IRB system is checked both by means of quantitative and qualitative validation in keeping with the CRR EBA/GL/2016/17, CDR 2022/439 and EBA/GL/2016/07.

Qualitative validation is a process that ensures that the models are geared to the Bank’s portfolios and that they constitute a central component of the Bank’s risk management and decision taking. The IRB system also comprises those models, working processes and decision processes, control mechanisms, IT systems, and internal policies and procedures that are linked to the classification and quantification of credit risk using IRB models.

Quantitative validation is described in the table below.

	<b>Suitability and stability</b>	<b>Ranking ability</b>	<b>Level</b>
<b>PD</b>	Validation examines whether the population to which the model is applied is identical to the model’s estimation basis. This is done both through statistical tests and qualitative assessments of the underlying data and changes in the customer base.	We test the models’ ability to distinguish between customers going into default and customers not going into default. To this end the Bank uses both simple migration matrices and statistical analyses.	Through the validation process we check that the estimated level is sufficiently high measured against actual observations of the default rate. To define what is a sufficiently high level, we utilise up to seven years’ default history, and also make allowance for the presumed default rate in an economic contraction.
<b>EAD (CF)</b>	We make a qualitative assessment of whether the model is geared to the customer base. Observations that represent noise affecting what we want to measure are removed.	In contrast to probability of default (PD), the credit conversion factor (CF) does not have a binary outcome (default or non-default). Therefore, when assessing the ranking ability of the EAD model, we look at whether the model manages to distinguish between	Through the validation process we check that the estimated level is sufficiently high measured against actual observations.

		customers with a high CF and those with a low CF.	
<b>LGD</b>	We make a qualitative assessment of whether the model is geared to the customer base. Observations that represent noise affecting what we want to measure are removed.	The assessment of the LGD model's ranking ability uses the same approach as the EAD model. We assess whether the LGD model manages to distinguish between default customers with a high loss ratio and those with a low loss ratio.	The assessment of whether the LGD model's estimates are sufficiently high must take into account the fact that estimated LGD has to be calibrated to an economic contraction. This makes the assessment of estimates under normal economic conditions challenging. Estimated values are measured against the Bank's historically observed values and assumed levels in an economic contraction.

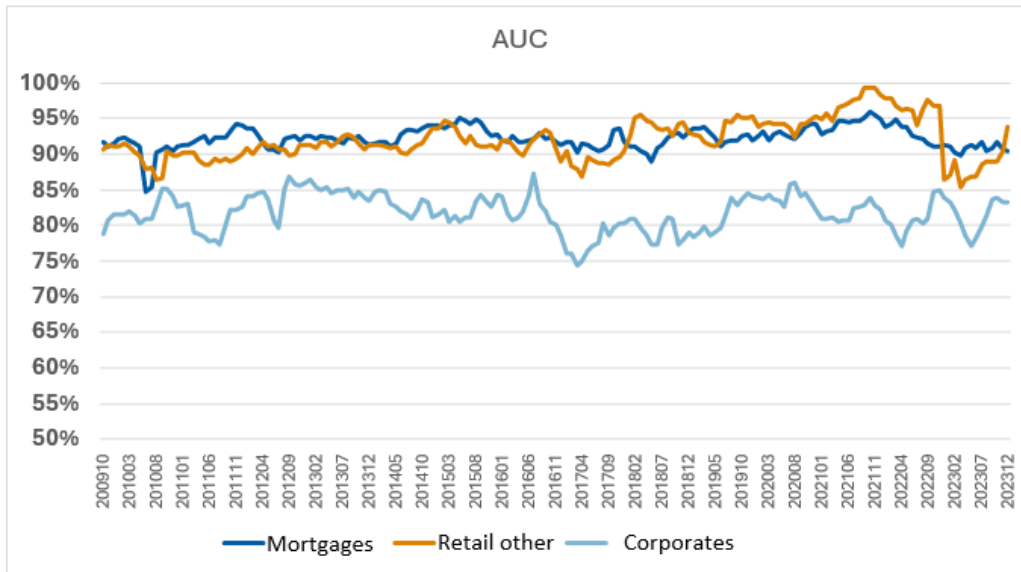
In the sections below, we present an excerpt from the 2023 validation, as the validation report for 2024 is not yet available.

## PD

Ranking ability is an important characteristic of a PD model. We measure the models' ranking ability by means of a method termed AUC. A model's calculated AUC enables us to classify the model's ranking ability according to the following scale.

<b>AUC</b>	<b>Ranking ability</b>
<b>0%-50%</b>	None
<b>50%-70%</b>	Low
<b>70%-80%</b>	Acceptable (minimum requirement)
<b>80%-90%</b>	High
<b>90%-100%</b>	Very high

The PD model's ranking ability for, respectively, residential mortgages and corporates is shown below. The underlying data include loans sold to the captive mortgage companies Boligkreditt and Næringskreditt. The drop in AUC for the corporate model in 2017 is attributable to some clients in oil-related business which, owing to the oil price fall and substantially lower activity, moved from low estimated risk to exposures subject to write-down in a short space of time. Apart from these observations, our models have shown a high ranking ability.



The table below shows the historical development of estimated (PD) and the observed default rate (DR) for, respectively, residential mortgages, other retail loans and corporates in the parent bank. The estimated default rate has exceeded the observed default rate for all years in the measurement period.

<b>Period</b>	<b>Corporates, normal scoring</b>		<b>Residential mortgages</b>		<b>Other retail loans</b>	
	<i>Estimated</i>	<i>Actual</i>	<i>Estimated</i>	<i>Actual</i>	<i>Estimated</i>	<i>Actual</i>
2008	3,79 %	3,44 %	1,04 %	0,53 %	3,99 %	1,66 %
2009	3,50 %	3,35 %	1,14 %	0,40 %	4,16 %	1,40 %
2010	3,94 %	2,84 %	1,10 %	0,31 %	4,16 %	1,44 %
2011	3,56 %	2,00 %	1,07 %	0,34 %	3,83 %	1,50 %
2012	3,46 %	1,88 %	0,98 %	0,33 %	3,52 %	1,23 %
2013	3,25 %	2,16 %	0,93 %	0,28 %	3,38 %	1,42 %
2014	2,92 %	2,16 %	0,95 %	0,29 %	3,06 %	1,28 %
2015	2,65 %	1,41 %	0,92 %	0,22 %	2,67 %	0,96 %
2016	2,60 %	1,60 %	0,90 %	0,22 %	2,33 %	0,66 %
2017	2,67 %	1,80 %	0,88 %	0,21 %	2,17 %	0,47 %
2018	2,62 %	1,58 %	0,86 %	0,23 %	2,13 %	0,76 %
2019	2,57 %	1,73 %	0,88 %	0,28 %	1,84 %	0,46 %
2020	2,57 %	2,03 %	0,94 %	0,29 %	1,82 %	0,92 %
2021	2,53 %	1,52 %	0,83 %	0,19 %	1,59 %	0,26 %
2022	2,27 %	1,23 %	0,76 %	0,25 %	1,53 %	0,26 %
2023	2,47 %	1,62 %	0,74 %	0,30 %	1,43 %	0,52 %
<b>Average</b>	<b>2,96 %</b>	<b>2,02 %</b>	<b>0,93 %</b>	<b>0,29 %</b>	<b>2,72 %</b>	<b>0,95 %</b>

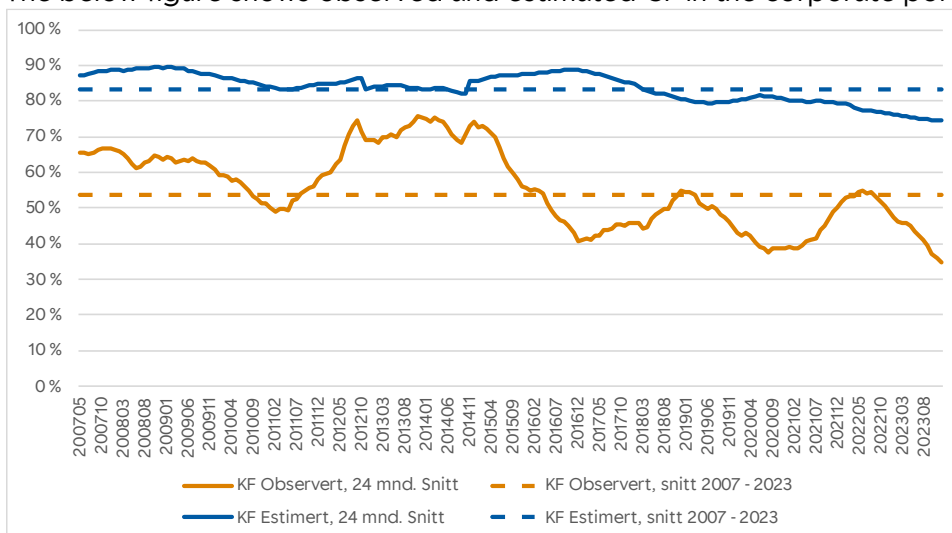
Estimated PD and observed default rate (DR) in the above table are averages based on number of exposures and are not volume weighted. Estimated PD expresses the estimated probability of default for exposures not in default at the start of the measuring period.

An exposure to a personal customer where the realisation value of the dwelling is assessed to be below 30% of the customer's loan is categorised not as an exposure secured on real property, but as "other retail market."

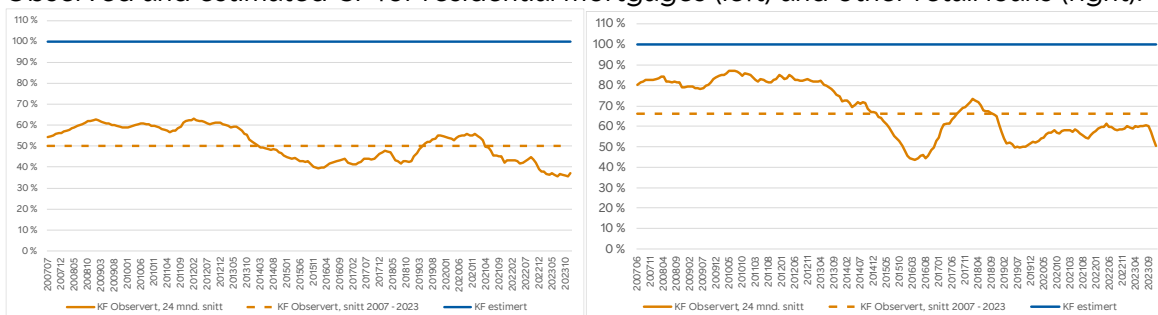
## EAD

Due to the small number of observations each month, observed CF fluctuates widely. We have therefore opted to look at a 24-month moving average of the observations and measure them against the estimates. For the residential mortgage portfolio we see a considerable overestimation. For corporates the observations show greater fluctuation and have at times exceeded the estimates. Thus far we have not considered it necessary to revise the estimates. The observations in the graphs refer to the parent bank.

The below figure shows observed and estimated CF in the corporate portfolio.



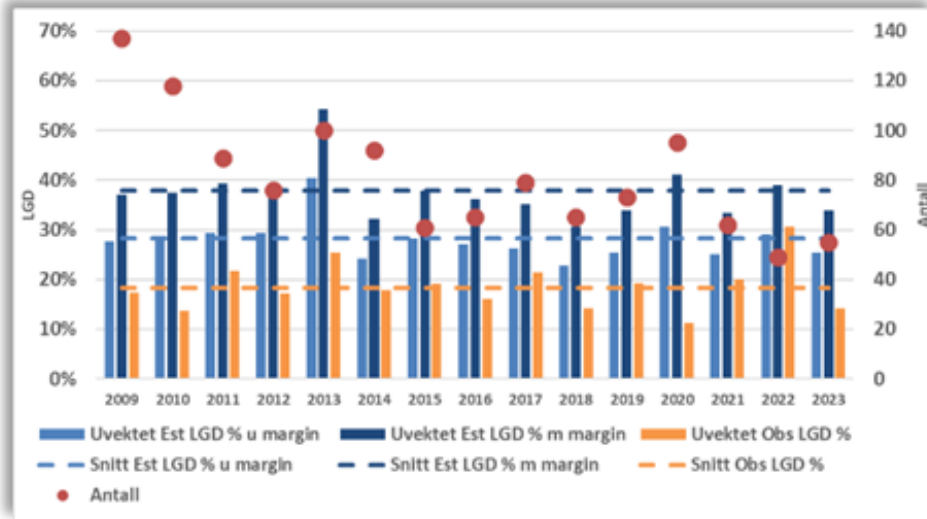
Observed and estimated CF for residential mortgages (left) and other retail loans (right).



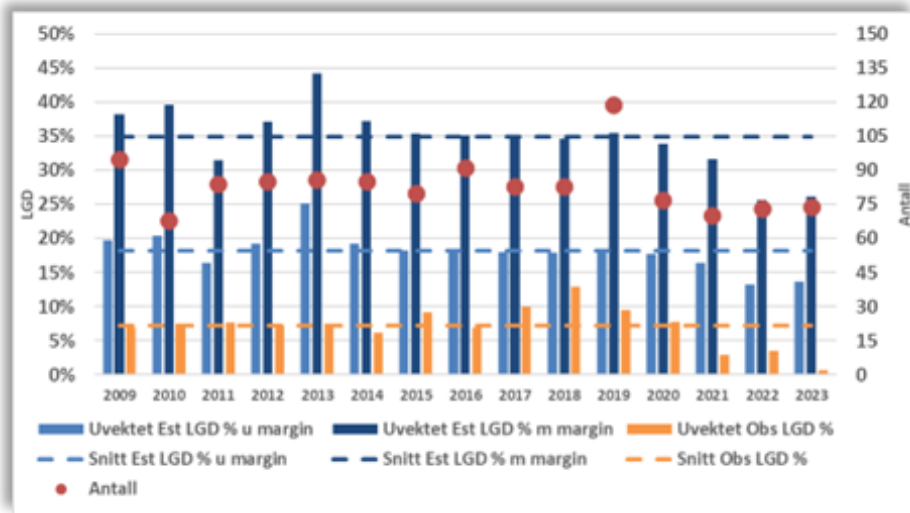
## LGD

In the graphs below, observations to end-2023 refer to the parent bank. Our validation shows that the estimates have substantial safety margins relative to observed values. In our assessment the assessments are also conservative if an economic contraction taken into consideration.

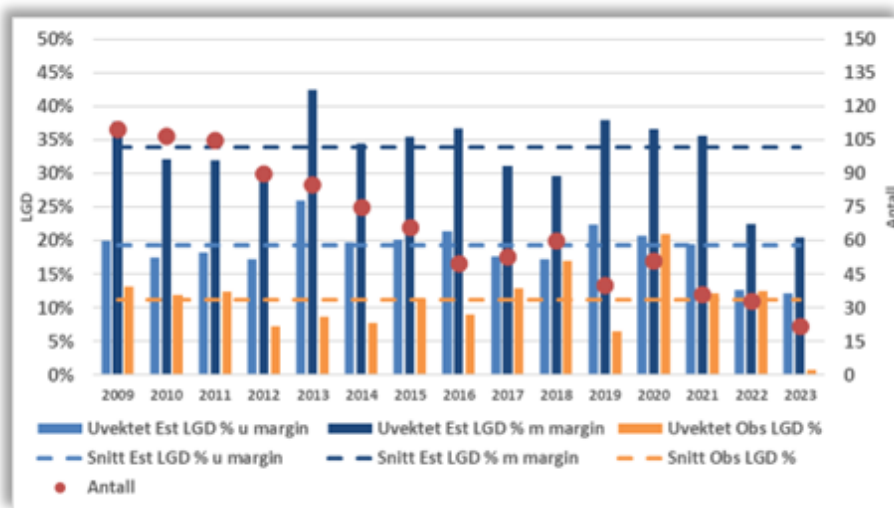
The below figure shows the selection of corporates > 20,000, exc. oil-related activity



The below figure shows the selection of residential mortgages > NOK 1m.



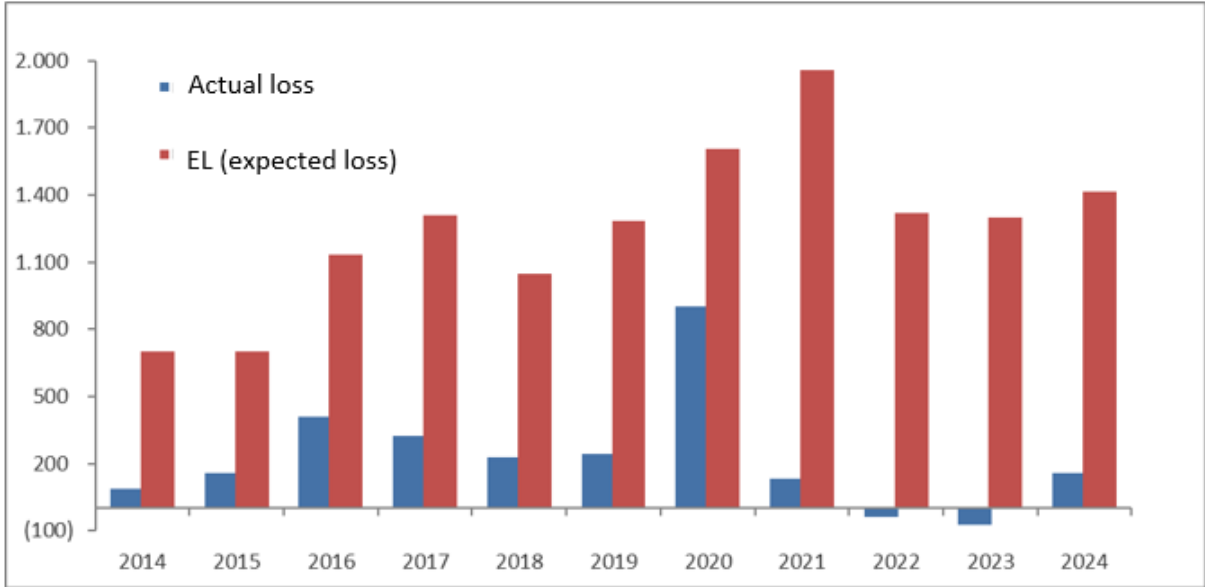
The below figure shows the selection of residential mortgages < NOK 1m.





### EL (expected loss)

The graphs below show regulatory EL for the parent bank at the start of the year against observed book losses in per cent of EAD at year-end. Wide margins are evident between estimated and observed EL values. Regulatory EL is included in the EL deduction when calculating CET1 capital. If EL is larger than the overall write-downs, the difference is deducted directly from CET1 capital.



### Losses and write-downs

The Bank rescors its loan portfolio monthly. Customers showing objective evidence of loss due to payment default, impaired creditworthiness or other objective criteria are subject to individual assessment and calculation of loss. Should the Bank’s calculations show that the present value of the discounted cash flow based on the effective interest rate at the time of estimation is below the book value of the loan, the loan is assigned to stage 3 and a write-down is performed for the calculated loss. A high degree of discretionary judgement is required in order to assess evidence of loss, and the estimation of amounts and timing of future cash flows with a view to determining a calculated loss is affected by this judgement. Changes in these factors could affect the size of the provision for loss. In cases where collateral values are tied to specific objects or industries that are in crisis, collateral will have to be realised in illiquid markets, and in such cases assessment of collateral values may be encumbered with considerable uncertainty.

For loans in stage 1 and 2 a calculation is made of the expected credit loss using the bank’s loss model based on estimates of probability of default (PD) and loss given default (LGD), as well as exposure (EAD). The bank uses the same PD model as in IRB, but with unbiased calibration, i.e. without safety margins, as a basis for assessment of increased credit risk. The PD estimate represents a 12-month probability.

Write-downs for exposures in stage 1 will be calculation of one-year’s expected loss, while for exposures in stage 2, loss is calculated over lifetime.

The most important input factors in the bank’s loss model that contribute to significant changes in the loss estimate and are subject to a high degree of discretionary judgement are the following:

- Use of forward-looking information and projection of macroeconomic variables for multiple scenarios on a probability-weighted basis.
- Establishing what constitutes a significant increase in credit risk for a loan.

### *Use of forward-looking information*

Measurement of expected credit loss for each stage requires both information on events and current conditions as well as expected events and future economic conditions. Estimation and use of forward-looking information requires a high degree of discretionary judgement. Each macroeconomic scenario that is utilised includes a projection for a five-year period. For engagements where the credit risk is assessed to have increased significantly since approval (stage 2), loss estimates for the period after year 5 are based on year 5 in terms of the level of PD and LGD.

Our estimate of expected credit loss at stage 1 and 2 is a probability-weighted average of three scenarios: Base Case, Best Case and Worst Case. The model that computes model write-downs is based on two macro variables – interest rate level (three-month NIBOR) and unemployment (Statistics Norway's Labour Force Survey, AKU). The assumptions in the baseline scenario are based on the assumptions in Norges Bank's Monetary Policy Report 4/24. Updated macro assumptions this quarter have had a small positive effect on the level of write-downs due to a lower interest rate path in the base scenario and increased estimates for price increases on housing, as per updated estimates from Norges Bank. The downside scenario features high interest rates and high unemployment, which are largely based on Finanstilsynet's stress test reported in Financial Outlook, June 2023. The upside scenario features low interest rates and low unemployment.

Calculation of the Group's overall model write-downs is based on calculations of expected credit loss (ECL) for each of five portfolios below. For each portfolio, separate assumptions are defined with regard to how the macro variables 'interest rate' and 'unemployment' impact PD and LGD. The relationships between the macro variables are developed using of regression analysis and simulation, while the relationships between the macro variables and LGD are based largely on expert assessments and discretionary judgement. The five portfolios are:

- Residential mortgages
- Other retail loans
- Agriculture
- Industries with large balance sheets / high long-term debt ratios (real estate, shipping, offshore, aquaculture, fishery)
- Industries with smaller balance sheets / low long-term debt ratios (other industries)

The criteria for classification in stage 2 ("significantly increased credit risk since approval") have not been changed in the period. The customers in building and construction industry (including industries closely linked to the building and construction sector) and some fishery segments are generally considered to have acquired significantly increased credit risk since loan approval and customers in this industry are accordingly classified to stage 2 or 3.

ECL as at 31 December 2024 is calculated as a combination of 80 per cent expected scenario, 10 per cent downside scenario and 10 per cent upside scenario (80/10/10 pct).

### *Determination of a significant increase in credit risk:*

The assessment of what constitutes a significant increase in credit risk requires a large degree of discretionary judgement. Movements between stage 1 and stage 2 are based on whether the instrument's credit risk on the balance sheet date has increased significantly relative to the date of first-time recognition. This assessment is done with a basis in the instrument's economic 12-month PD, and not expected losses.

The assessment is done for each individual instrument. Our assessment is performed at least quarterly, based on three factors:

1. The bank uses both absolute and relative changes in PD as criteria for removal to stage 2. A change of more than 150% in PD is considered to be a significant change in credit risk. In addition, the PD must at minimum be more than 0.6 percentage points.
2. An additional quantitative assessment is made based on whether the exposure has a significantly increased credit risk if it is subject to special monitoring or forbearance
3. In addition, customers with payments between 30-90 days overdue will in all cases be moved to stage 2.

If any of the above factors indicate that a significant increase in credit risk has occurred, the instrument is moved from stage 1 to stage 2.

### **Counterparty risk**

Counterparty risk in derivatives trading is managed through ISDA and CSA contracts set up with financial institutions that are the bank's largest counterparties. ISDA contracts regulate settlements between financial counterparties. CSA contracts limit maximum exposure through market evaluation of the portfolio and margin calls when the change in portfolio value exceeds the maximum agreed limit or minimum transfer amount. The bank will continue to enter CSA contracts with financial counterparties to manage counterparty risk. See the 2024 annual report for a further description of these contracts.

Counterparty risk for customers is hedged through use of cash depots or other collateral which, at all times, have to exceed the market value of the customer's portfolio. Specific procedures have been established for calling for further collateral or to close positions if market values exceed 80 per cent of the collateral.

### **Market risk**

Market risk is a generic term for the risk of loss and reduction of future incomes as a result of changes in rates or prices of financial instruments. Market risk arises at SpareBank 1 SMN mainly in connection with the bank's investments in bonds, CDs and shares, including lending/borrowing in currencies other than NOK and differences in interest rate agreements on the group's interest-bearing assets and liabilities. SpareBank 1 has outsourced customer trading in fixed income and foreign currency instruments to SpareBank 1 Markets. This customer activity, and SpareBank 1 Markets' use of the bank's balance sheet, also affect the bank's market risk.

Market risk is managed through limits for investments in shares, bonds and positions in the fixed income and currency markets. The Bank's strategy for market risk lays the basis for management reporting, control and follow-up of compliance with limits and guidelines. The bank limits market risk through the active use of hedging instruments. Uncovered market risk shall be managed within assigned risk limits.

Limits are reviewed at least once a year and adopted yearly by the bank's Board of Directors. Compliance with the limits is monitored by Risk Management, and exposures relative to the adopted limits are reported quarterly to the Board of Directors.

Interest rate risk is the risk of loss due to changes in interest rates in financial markets. The risk on all interest rate positions can be viewed in terms of the change in value of interest rate instruments resulting from a rate change of 1 percentage point across the entire interest rate curve on all balance sheet items. The Group utilises analyses showing the effect of this change for various maturity bands, with separate limits applying to interest rate exposure within each maturity band and across all maturity bands as a whole, including EVE and NII (metrics) for interest rate risk in the banking book. Interest rate lock-ins on the group's instruments are essentially short, and the Group's interest rate risk is low to moderate.

Spread risk is the risk of loss as a result of changes in market value/fair value of bonds due to general changes in credit spreads. The bond portfolio is managed based on an evaluation of the individual issuers. In addition, the bank has a separate limit for overall spread risk and for

the business lines. The bank calculates spread risk based on Finanstilsynet's module for market and credit risk. The loss potential for the individual credit exposure is calculated with a basis in rating and duration.

Exchange rate risk is the risk of loss resulting from exchange rate movements. The Group measures exchange rate risk on the basis of net positions in the various currencies. Limits on exchange rate risk are expressed in terms of limits for the maximum aggregate foreign exchange position in individual currencies.

Equity risk is the risk of loss on positions as a result of changes in share prices. Limits are set for the various portfolios as well as limits for total equity risk. Shares in subsidiaries and shares included in a consolidated or strategic position are not taken into account.

#### Calculation of capital need

The Group reports regulatory capital (Pillar 1) using the standardised approach for market risk. Pillar 2 capital requirements related to market risk are calculated based on the Norwegian Financial Supervisory Authority's guidance from December 2024.

Economic capital is calculated for interest rate, exchange rate and securities risk incurred by SpareBank 1 SMN. The calculation is based on stress tests which incorporate a scenario of major market disruption. Measurement of economic capital is an important tool with a view to internal budget setting and capital allocation.

### Liquidity risk

Liquidity risk is the risk that the Group will be unable to refinance its debt or unable to finance increases in its assets.

The Bank's most important source of finance is customer deposits. At end-2024 the Group's ratio of deposits to loans was 57 per cent, including loans sold to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt (group figures).

The Bank reduces its liquidity risk by diversifying funding across a variety of markets, funding sources, maturities and instruments, and by employing long-term funding. Excessive concentration of maturities heightens vulnerability with regard to refinancing. The Group seeks to mitigate such risk by applying defined limits. The maturity structure of capital market funding is shown in the table below:

[NOK billion]	2025	2026	2027	2028	2029-->
Funding maturity	8,0	12,4	7,0	10,8	11,6

Next eight quarters [NOK billion]	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26	Q3 26	Q4 26
Funding maturity	0,0	1,0	0,3	6,8	0,9	0,0	6,8	4,6

The Bank's Finance Division is responsible for the Group's financing and liquidity management. Compliance with limits is monitored by Risk Management which reports monthly to the Board of Directors, but breached limits can be reported on an ongoing basis. The Group manages its liquidity on an overall basis by assigning responsibility for funding both the bank and the subsidiaries to the finance division.

Governance is based in the group's overall liquidity strategy which is reviewed and adopted by the board at least once each year. The liquidity strategy reflects the group's moderate risk profile. As a part of the strategy, emergency plans have been drawn up both for the Group and the SpareBank 1 Alliance to handle the liquidity situation in periods of turbulent capital markets. These take into account periods of both bank-specific and system-related crisis scenarios as well as a combination of the two.

The Bank maintains a holding of liquid assets sufficient to cover a minimum of 12 months' ordinary operation and pay loan obligations without access to external funding, including to withstand a house price fall of 30 per cent. The Bank shall in addition have an adequate liquidity buffer consisting of assets that meet the LCR requirements, and which in volume at all times ensures that the Bank is above the minimum requirement. Access to funding has been satisfactory in 2024.

Government requirements and investor's preferences will pull in the direction of green investments ahead. The Group has issued green bonds worth NOK 24bn and its objective is to increase the share of loans that qualify for green bonds.

The Group's liquidity situation as of 31 December 2024 is considered satisfactory.

### **Operational risk**

Operational risk is the risk of loss as a result of unsatisfactory or failing internal processes, systems, human error or external events. Examples of the foregoing include errors on the part of employees, flaws in products, processes or systems, or losses inflicted on the Bank by external factors such as fraud, fire or natural damage.

Operational risk is a risk category that captures the bulk of costs associated with quality failings in the Bank's ongoing business.

SpareBank 1 SMN has established a policy specifically for the management of operational risk. The policy guides the Bank's overarching stance on the management of operational risk and is designed to ensure that such risk is managed in an effective and appropriate manner. Operational risk has to be low, and risk management must ensure that the risk of undesired loss is reduced. A number of measures to achieve this are in place, and a description follows of activities that are key to the management of operational risk.

Identification, management and control of operational risk are an integral aspect of managerial responsibility at all levels in SpareBank 1 SMN. Managers' most important aids in this respect are professional insight and managerial expertise along with action plans, control procedures and good monitoring systems. A systematic focus on risk assessment also promotes knowledge and awareness of improvements needed in the particular entity. Any flaws found are reported to appropriate levels of the organisation.

SpareBank 1 SMN attaches importance to clear authorisation structures, good descriptions of procedures and well defined responsibilities in supply contracts between the respective departments as elements of a framework for handling operational risk.

The Board of Directors is kept abreast of the operational risk position through quarterly risk reports, and the annual internal control confirmation. This confirmation encompasses managers of market and specialist areas who report on how risk management in their respective area of responsibility has been performed. The confirmation needs to be sufficiently comprehensive to enable the Group CEO and Board of Directors to take a position on whether the risk management framework has been properly attended to. In addition the Board of Directors receives each year from the internal auditor an independent assessment of the Group's risk and of whether the internal control system functions in an appropriate and satisfactory manner.

A GRC (Governance, Risk and Compliance) system is used in the effort to ensure continuous improvement across all SpareBank 1 SMN's activities. This system provides a better structure and monitoring of risk, events and areas in need of improvement. Together with the reporting carried out, this system constitutes an important experience base with respect to operational risk. All operational events which could potentially entail loss, or where losses have arisen, are recorded in this base. Improvement measures are considered and set in train where appropriate.

A broad-based insurance programme is in place designed to capture significant portions of losses incurred as a result of major events and disasters. Liability and crime insurances have been taken out, along with property and contents insurances, with a view to such events. Several types of personal insurance have also been taken out. These highly cost-effective policies are primarily intended to cover major loss events.

Undesired events recorded in 2024 show the highest proportion of loss events to be in the category *Settlement, delivery and other transaction processing*. The proportion of losses is highest in the loss category *external fraud* where customer fraud predominates. The loss level and number of payments related to customer fraud are on the increase.

The figure below shows the distribution of actual operational losses at SpareBank 1 SMN broken down on various intervals in the period 2019 to 2024. The figure shows the bulk of operational loss events to be small, with about 55 per cent of loss events involving amounts below NOK 10,000.



**Method**

The capital charge for operational risk can be calculated using the basic indicator approach, the standardised approach or the advanced measurement approach.

*Basic indicator approach*

The basic indicator approach can in principle be used by all undertakings. The calculation base under this approach is 15 per cent of average income over the last three years multiplied by 12.5 as at the end of the financial year.

*Standardised approach*

Use of the standardised approach imposes certain requirement on the undertaking’s management and control of operational risk, and switching to this approach must be notified to Finanstilsynet. The capital charge is calculated with a basis in income distributed on eight business lines with differing percentage rates applied in the calculation.

### *Advanced measurement approach (AMA)*

The calculation base under the AMA approach is determined based on expected and unexpected loss, and the AMA system aims to capture all material risk factors of significance for the probability distribution of loss estimates. The AMA system builds on internal data, external data, scenario analyses and factors associated with the business. Use of the advanced approach requires Finanstilsynet's permission.

### **Applied approach**

The parent bank uses the standardised approach when calculating capital need for operational risk, whereas the basic indicator approach is applied to subsidiaries.

Stress tests are performed to assess whether sufficient capital is held for operational risk. A basis is taken in material operational risks and the likely frequency and financial consequence of various events are quantified. This is a part of the ICAAP process and may bring to light a need for further capital, both with a view to internal governance (economic) and to regulatory Pillar 2 capital needs.

### **Compliance risk**

Compliance risk is the risk of failure to comply with the rules regulating the business. Non-compliance may result in SpareBank 1 SMN's incurrence of public sanctions, financial loss or loss of reputation.

### **Management and measurement of compliance risk**

SpareBank 1 SMN's compliance policy is adopted by the Board of Directors and describes main principles governing responsibilities and organisation. Low compliance risk is aimed for across the Group.

The Group shall comply with applicable rules for the business that is carried on. The compliance function lays the basis for effective identification of any risk of non-compliance with relevant external requirements, and gives advice on risk-mitigating measures. The compliance function's approach to its control activities is moreover risk-based. Compliance with rules and regulations is monitored and tested by means of a structured and well defined monitoring programme.

The responsible manager reports to the Group CEO and the Board of Directors on a quarterly basis.

The Group's managers are operatively responsible for ensuring that all activities within their units are carried on in accordance with applicable rules and are required to document this on an ongoing basis. Managers shall see to it that employees have the necessary knowledge and competence to carry out their tasks within the bounds of applicable rules. All staff are responsible for everyday compliance.

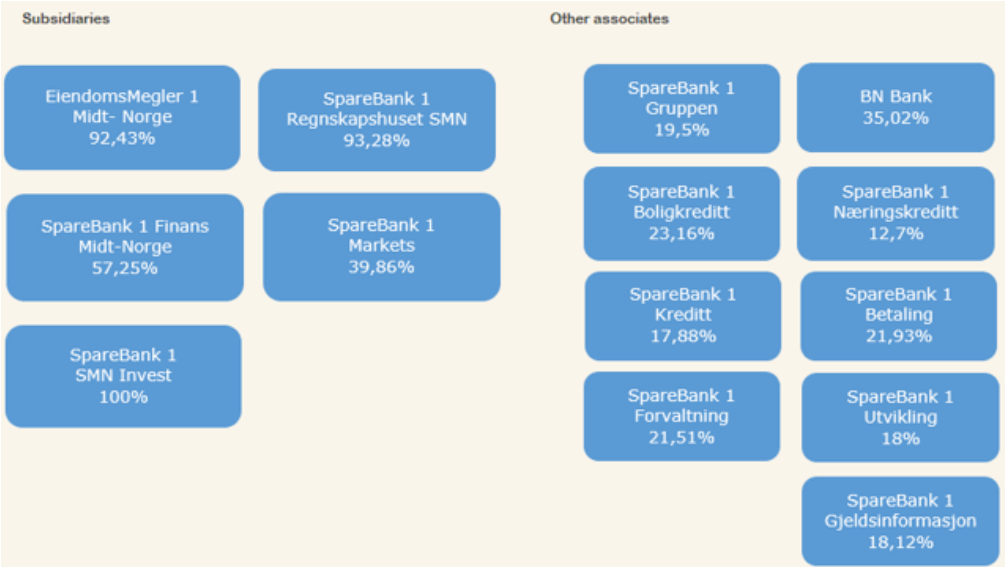
Business lines, support functions and subsidiaries are required to promote compliance when operationalising the compliance policy adopted by the Board of Directors and when addressing identified compliance risks.

### **Owner risk**

Owner risk is defined as the risk incurred by SpareBank 1 SMN's subsidiaries or affiliates through their operations as well as the risk that it will need to supply them with capital to meet regulatory requirements, investors' expectations or internal guidelines. Owner risk includes business practices which impair the assets of SpareBank 1 SMN as owner, including failure to attain a required rate of return on capital employed.

Owner risk is managed through periodic company reporting and participation in companies' board meetings. The policy on owner risk sets out principles for ownership and financing, including the Group CEO's authorisations to participate in stock issues.

As at 31.12.2024 the most important ownerships were as shown in the figure below:



The SpareBank 1 Group is a jointly-owned holding company for the SpareBank 1 banks which are in turn direct owners of Fremtind Forsikring, SpareBank 1 Forsikring, SB1 Factoring, Kredinor and Spleis. SpareBank 1 SMN's exposure to insurance risk is through the SpareBank 1 Group.

SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt operate as captive mortgage companies under licence granted by Finanstilsynet for the purpose of providing their owner banks with access to finance via the covered bond market. These companies are owned by savings banks making up the SpareBank 1 Alliance. Each savings bank's stake in the two companies is based on its share of transferred loans. At the end of 2024 SpareBank 1 SMN's direct stake in SpareBank 1 Boligkreditt was 23.16%. Its stake in SpareBank 1 Næringskreditt was 12.7%. SpareBank 1 SMN is represented on, respectively, the Board of Directors, Supervisory Board, and General Meeting of both companies.

**Calculation of capital need**

Subsidiaries are fully consolidated into SpareBank 1 SMN's capital adequacy for the Group.

The capital requirements for BN Bank, SpareBank 1 Boligkreditt, SpareBank 1 Næringskreditt and SpareBank 1 Kreditt are consolidated on a proportional basis. The owner interest in the SpareBank 1 Group is deducted at 100% from the Group's CET1 capital for that portion which exceeds 10% of the Group's CET1 capital. That portion of the holding which is not deducted from the CET1 capital is assigned a risk weight of 250%.

With respect to further internal capital need and need for Pillar 2 capital, SpareBank 1 SMN takes a basis in the companies' own capital assessment processes and assessments of economic capital. The Group makes its own assessments of affiliated companies' capital needs as and when required.

In the assessment of economic capital, underlying risk is consolidated on a proportional basis in the case of all affiliates, including the SpareBank 1 Group.



## **Business risk**

### **Definition**

Business risk is the risk of unexpected income and cost fluctuations arising from external factors such as cyclical fluctuations, customer behaviour, competitors or changes in the regulatory framework.

### **Management and control**

Business risk is managed through strategic analyses of external market situations and possible changes in framework conditions. The Group is concerned to develop a well-diversified income base so that any failure in individual product groups or customer segments will not have significant consequences.

SpareBank 1 SMN is well placed to meet new challenges. The Group has for many years demonstrated a considerable ability and will to adapt. The Group has over time developed cost-effective operations combined with continuous competence enhancement and business expansion in terms of product range and geographical reach. SpareBank 1 SMN has for several years systematically prioritised value chain thinking in its development of products and services.

### **Assessment of capital need**

Assessment of capital need takes a basis in the volatility of that portion of SpareBank 1 SMN's revenues and expenses to which capital is not allocated through other risk categories. Volatility is calculated against a background of elements such as possible changes in customer behaviour prompted by a severe economic setback, change in the competitive situation, or product innovation. Volatility is assessed against loss-absorbing capacity afforded by ongoing operations, i.e. net profit.

Economic capital for business risk is viewed in context with strategic risk.

## **Strategic risk**

### **Definition**

Strategic risk is the risk of loss resulting from failed strategic ventures.

### **Management and control**

SpareBank 1 SMN runs each year a strategy process involving the Board of Directors, Management Team and the divisions. A key aspect of the strategy process is to evaluate the Group's strengths, weaknesses, threats faced and potentials. The process culminates with a strategic vision for the next three years with an associated business plan.

The Group Management Team conducts a monthly and quarterly evaluation of the Group's performance and strategic direction. A periodic review of strategic ventures and the strategic risk picture is also conducted by the Strategy and Budget Management Department under the auspices of the Board of Directors.

### **Assessment of capital need**

Regulatory Pillar 1 capital is not held for strategic risk. SpareBank 1 SMN assesses the need for capital based risk analysis of the Group's strategic risk picture on a continuous basis and in connection with Pillar 2.

## **Reputational risk**

Reputational risk is the risk of a shortfall in future earnings and capital access resulting from loss of market confidence.

The Group has defined a risk appetite which states that the Bank shall not become involved in business activities which may impair the Bank's reputation.

Capital is not held for reputational risk.

# ECONOMIC CAPITAL

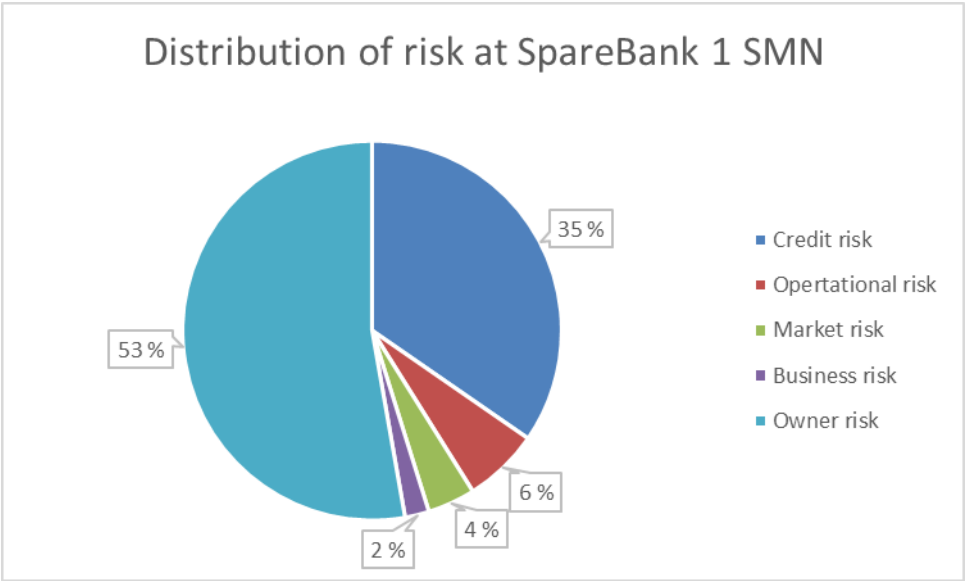
Economic capital describes how much capital the Group considers it needs in order to cover the actual risk it has incurred. The Group has determined that economic capital should cover 99.9 per cent of possible unexpected losses over a one-year horizon. However, in the SpareBank 1 Group a confidence level of 99.5 per cent is employed which is in keeping with requirements of the Solvency II framework. This means in practice that the following analysis refers to the 8% capital requirement of the internal calculation base (RWA).

Statistical methods are employed to compute economic capital, but the calculation nonetheless requires qualitative assessments in some cases.

Regulatory buffer requirements are not taken into account in this analysis. This is done to give a clearer picture of the size of the real buffer between assessed capital need and available total capital. In the internal capital management the capital need is adjusted upwards to the capital target, i.e. including the buffer requirements.

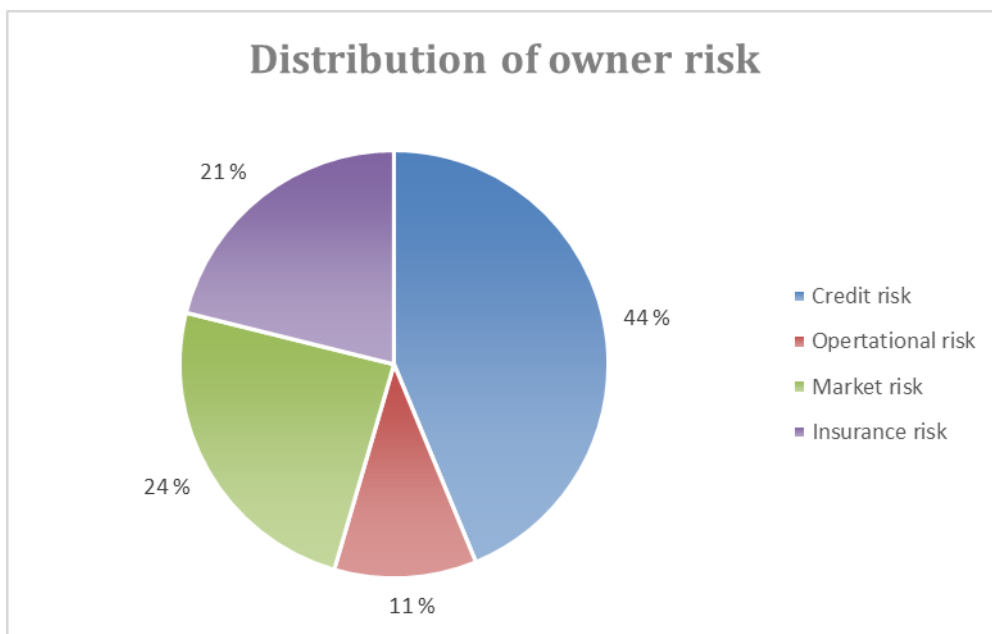
The figure below shows the distribution of economic capital on the various risk groups for the parent bank SpareBank 1 SMN, with a basis in risk exposure as at 31.12.24. Here, economic capital is calculated for credit, market, operational, owner and business risk (including strategic risk).

The calculations are done with a basis in internal risk assessments, and include self-assessed Pillar 2 add-ons for material risk.

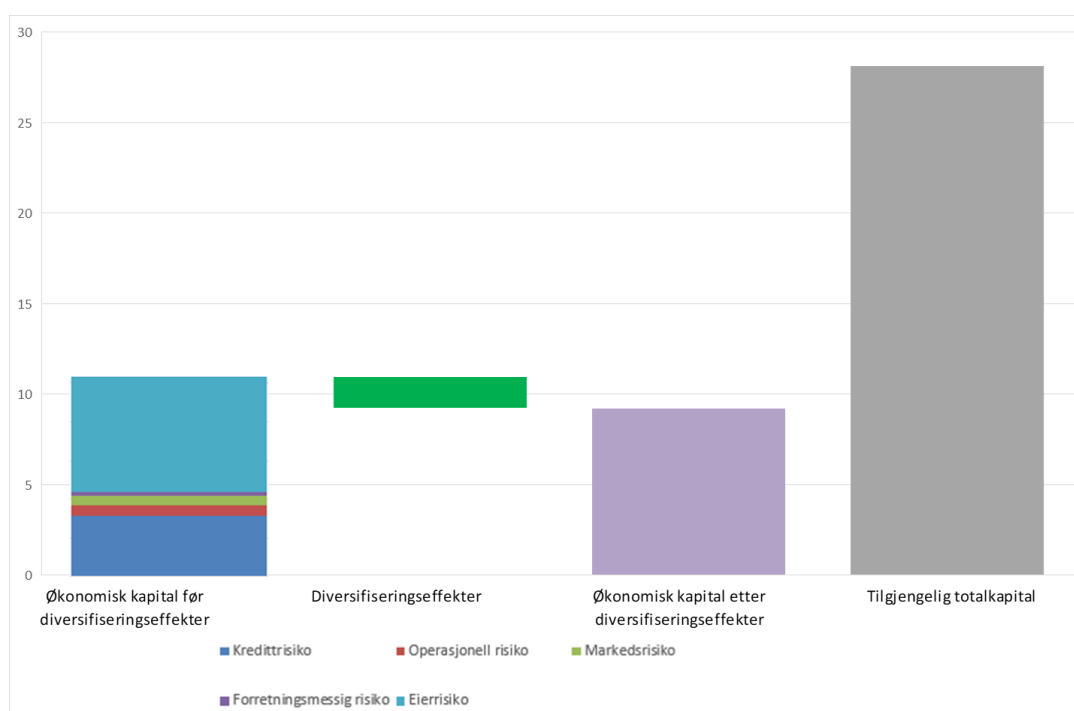


Owner risk accounts for a significant portion of capital employed at SpareBank 1 SMN. In the figure below owner risk is distributed on the various risk groups. Credit risk constitutes the bulk of the risk exposure. The parent bank in SpareBank 1 SMN is indirectly exposed to credit risk via SpareBank 1 Finans Midt-Norge, BN Bank, SpareBank 1 Boligkreditt, SpareBank 1 Næringskreditt and SpareBank 1 Kreditt.

In addition, market risk constitutes a significant risk. This is in the main exposures present in SMN Invest, SpareBank 1 Markets and the SpareBank 1 Group.



The figure below compares economic capital need with available total capital as at 31.12.24. Here, available total capital is equity capital adjusted for goodwill and hybrid capital.



The total need for economic capital as at 31.12.24 is calculated at NOK 11bn before diversification effects. When account is taken of diversification effects between the risk groups, the need for economic capital is calculated at NOK 9.3bn. The diversification effect shows the risk-mitigating effect the Group achieves by incorporating further risk areas which cannot be assumed to entail unexpected losses simultaneously. A significant portion of the diversification effects is related to activities in the insurance business.

Available loss-absorbing capital including hybrid capital amounted to NOK 28.1bn at year-end, which is more than three times the estimated capital need. This shows that the Group has substantial buffer capital. Even a serious financial crisis should be manageable given the Group's three lines of defence against loss.