RISK AND CAPITAL MANAGEMENT 2017

Disclosure of financial information for SpareBank 1 SR-Bank Group

Contents

INTRODUCTION

Risk and capital management in SpareBank 1 SR-Bank intend to create financial and strategic added value

The purpose of risk and capital management in SpareBank 1 SR-Bank is to create financial and strategic added value through:

- having a good risk culture characterised by high awareness of risk management and the group's value base
- having a good understanding of the risks that generate earnings and losses
- to the greatest extent possible, pricing activities and products in line with underlying risk
- having satisfactory capital adequacy based on the chosen risk profile, while at the same time striving for optimal capital utilisation in the various business areas
- exploiting diversification effects
- avoiding thtat single events should seriously harm the Group's financial position

This document has been prepared to provide the market with the best possible information on SpareBank 1 SR-Bank's risk and capital management. It is also intended to satisfy the stipulated requirements concerning the disclosure of risk information in accordance with the Norwegian Capital Requirements Regulations. This document is updated each year with the exception of information on capital adequacy and the minimum regulatory capital requirements, which is updated quarterly. This information is updated in separate appendices. For information about the Group's remuneration scheme, see Note 22 of the Annual Report 2017.

THE YEAR 2017

SpareBank 1 SR-Bank aims to stimulate growth and development in the region of which the group is a part. A total assessment of the group's financial position indicates that it is well equipped to do so.

The year 2017 has in many ways been a turning point for the economy of the region in which the Group is a part. After a longer period of lower activity in the Norwegian economy, characterised by the oil price fall that started in June 2014, the weak krone rate, low interest rates and change power at the companies have contributed to increased growth rate in the economy. Oil prices have been relatively stable in 2017, and in the Group's market area there was a marked decline in unemployment throughout the year. At the start of 2018, the Business Barometer[1] for Southern and Western Norway show that businesses is overall optimistic and, among other things, expects higher order reserves, better profitability and more employees in 2018. This also applies to companies with high oil exposure, which are the companies most exposed during the downturn.

Credit risk accounts for a significant proportion of the group's risk exposure. SpareBank 1 SR-Bank's credit portfolio is regarded as well-diversified. A clearly defined framework that sets limits on what is financed and on what conditions helps to maintain a robust portfolio.

Loans to retail customers account for 66% of total loans (EAD)[2]. The quality of the retail market portfolio is considered very good and the potential for losses low. Most of the portfolio is secured by mortgages on real estate and the loan-to-value ratio is generally moderate in relation to market value of the collateral.

The corporate market division accounts for 34% of total loans (EAD) and its credit quality is considered good. The concentration risk exposure to major customers and individual industries has been reduced in the last few years, measured in terms of both tier 1 capital and operating profit. The group's largest sectoral concentration is in the area of commercial property, which represents around 15% of the total loan portfolio (EAD). The property portfolio intended for rental consists primarily of long-term leases with financially solid tenants. The vacancy rate is limited and a significant proportion of the portfolio is interest rate-hedged. 7% of the total loan portfolio is related to oil activities. The offshore industry group accounts for the largest proportion of this. Weak economic growth in oil-related offshore in recent years has led to somewhat higher default probability and write-downs in this portfolio than the normalised level in a normal economy. So far, the group has experienced no significant knock-on effects in impairments from oil-related activities to other sectors.

SpareBank 1 SR-Bank delivered a strong result in 2017, with significant income growth, good cost control and lower losses. The group also fulfilled all of its capital requirements as at 31 December 2017. The common equity tier 1 capital ratio increased from 14.7% in 2016 to 15.1% in 2017. The leverage ratio is 7.4%, well above the minimum requirements discussed and recommended internationally. Solid earnings from a robust business model and capital optimisationmeans SpareBank 1 SR-Bank is well positioned to maintain a solid capital base, while ensuring good competitiveness in the years to come.

[1] SpareBank 1 SR-Bank's "Konjunkturbarometer" published January 2018

[2] Including portfolio transferred to SpareBank 1 Boligkreditt AS and SR-Boligkreditt AS

SPAREBANK 1 SR-BANK ASA

SpareBank 1 SR-Bank is currently the leading financial group in the southwest of Norway

SpareBank 1 SR-Bank has been one of the most profitable banks in the Nordic region over the past fifteen to twenty years. The group's market area is Rogaland, Hordaland and the Agder counties, and it has approximately 300,000 customers. There are 1,200 employees.

SpareBank 1 SR-Bank is a financial group with a complete product range in the retail market, corporate market and the public sector.

In addition to banking, the group has expertise in funding, foreign exchange advice, funds management, securities trading, insurance, real estate brokering and financial counselling. The group's head office is in Stavanger.

SpareBank 1 SR-Bank's goal is to be the customer's number one choice in Southern and Western Norway, and to boost growth and development in the region. This is achieved by being closer to people and businesses than the competitors. Being closer to people and businesses means knowing the people, businesses and markets in the region better. SpareBank 1 SR-Bank also wants to ensure it has a sustainable and profitable business model, with innovation, digitisation and cost efficiency as key strategic focus areas in the coming years.

An overview of the companies in the SpareBank 1 SR-Bank group is provided in the figure below.

Figure 1: Fully and partly owned companies in the SpareBank 1 SR-Bank group as of 31 December 2017

Divisions of SpareBank 1 SR-Bank ASA

- **Capital Markets**
  Number of man-years: 26
- **Retail Market**
  Number of man-years: 503
- **Corporate Market**
  Number of man-years: 169
- **Administration & Support**
  Number of man-years: 216

Fully owned companies

- **EiendomsMegler 1**
  Leading real estate broker
  Number of man-years: 199
- **SR-Boligkreditt**
  Covered Bond Funding
  Number of man-years: 1
- **SpareBank 1 SR-Forvaltning**
  Asset management
  Number of man-years: 11
- **FinStart Nordic**
  The company will be a start-up factory for new ideas
  Number of man-years: start-up 1 January 2018
- **SpareBank 1 Regnskapshuset SR**
  Accounting and advisory
  Number of man-years: 93

Partly owned companies

- **BN Bank**
  (23.5%)
  Commercial bank located in Oslo and Trondheim
- **SpareBank 1 Gruppen**
  (19.5%)
  Holding company for the SpareBank 1 - Alliance
- **SpareBank 1 Boligkreditt**
  (8.0%)
  Covered bond company (mortgages)
- **SpareBank 1 Næringskreditt**
  (19.2%)
  Covered bond company (commercial real estate)
- **SpareBank 1 Kredittkort**
  (17.9%)
  Credit card company located in Trondheim
- **SpareBank 1 Betaling***
  (19.7%)
  The company behind mobile payment solution
  *Owner 25% in VIPPS AS

SPAREBANK 1 ALLIANCE

The SpareBank 1 Alliance is one of the largest providers of financial products and services in the Norwegian market.

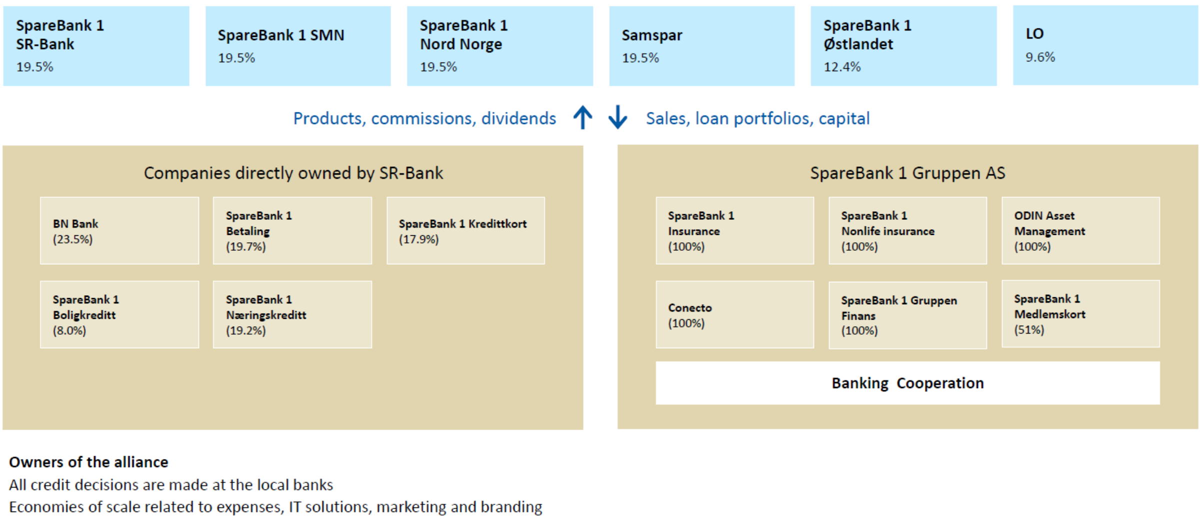
The SpareBank 1 Alliance is a banking and product alliance in which the SpareBank 1 banks in Norway cooperate through the jointly owned holding company SpareBank 1 Gruppen AS.

The independent banks in the alliance are SpareBank 1 SR-Bank, SpareBank 1 SMN, SpareBank 1 Nord-Norge, Sparebanken Østlandet, and Samarbeidende Sparebanker (Samspar). The banks in the SpareBank 1 Alliance distribute financial products from jointly owned companies and collaborate in key areas such as brands, work processes, skills development, IT operations, systems development and purchasing. The SpareBank 1 Alliance has entered into strategic agreements with the Norwegian Federation of Trade Unions (LO) and affiliated trade unions.

The SpareBank 1 Alliance's main goal is to ensure each bank's independence and regional affiliation through strong competitiveness, profitability and financial strength.

The product companies in the SpareBank 1 Alliance are owned by the banks through the holding company SpareBank 1 Gruppen AS. The figure below summarises the ownership structure of the SpareBank 1 Alliance.

Figure 2: SpareBank 1 Alliance as of 31 December 2017



CAPITAL REQUIREMENTS

SpareBank 1 SR-Bank has significantly strengthened its capital adequacy over the past years.

Capital Adequacy Requirements

Financial supervisory authorities regulate financial institutions in order to ensure they assess and handle risk in an effective and sound manner and at the same time are solid and robust enough to withstand fluctuations and shocks in the economy. The capital adequacy Requirements are one way doing this.

The capital adequacy requirements builds on three pillars:

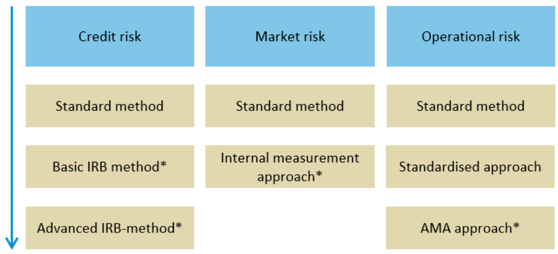
- **Pillar 1**: Quantitative minimum requirements for primary capital.
- **Pillar 2**: Requirements for risk management and internal control, including requirements for internal processes for assessment of risk exposure and capital needs (ICAAP). Under Pillar 2 the supervisory authorities may impose requirements for additional capital if they find that the other requirements do not adequately capture the underlying risk in the institution.
- **Pillar 3**: Requirements for reporting and disclosing financial information. The intention of the pillar is to enable the market to assess the financial institution's risk and capital management.

Primary capital

According to the Norwegian Public Limited Liability Companies Act, all companies must at all times have equity commensurate with the risk and scope of the activities of the company. In Pillar 1, the Capital Requirements Regulations define minimum requirements for the following risk types: credit, market, and operational risk.

The different methods for calculating the minimum primary capital requirements in Pillar 1 are presented in the figure below.

Figure 3: Alternative methods for calculating the minimum primary capital requirements



* The methods require the approval of the Financial Supervisory Authority of Norway

The minimum primary capital requirements (also known as regulatory capital) amount to 8% of weighted balance (the basis for calculation). In principle, there are two different approaches to calculating the minimum primary capital requirements according to the capital adequacy regulations. The first approach is based on standardised rules, while the second one is based on the use of internal models (IRB). Using internal models, the regulatory minimum capital requirement is based on the bank's internal risk evaluations. Consequently, the statutory minimum capital adequacy requirement is more risk sensitive, such that the capital requirement corresponds more closely to the risk in the underlying portfolios or activities.

SpareBank 1 SR-Bank has permission to use internal models for calculating necessary requirements for capital on credit risk in both the retail (IRB mass market) and in the corporate market (advanced IRB method). This entails that internal models are used in calculating the risk parameters probability of default (PD), conversion factor (CF), used in determining exposure at default (EAD), and loss given default (LGD).

With effect from 1 January 2017, the former wholly owned subsidiary SpareBank 1 SR-Finans AS merged into the parent bank SpareBank 1 SR-Bank ASA. The portfolio in SpareBank 1 SR-Finans is primarily constituted bye lease funding, consumer finance and secured car loans. The merged portfolio is reported regulatory according to the standard method while internally using the IRB method.

There are longer-term plans for a transition to the IRB approach for this portfolio.

The IRB system includes all the models, work and decision processes, control mechanisms, IT systems and internal guidelines used in the measurement and management of credit risk. SpareBank 1 SR-Bank's objective with the IRB system is to provide a basis for sound risk management and ensure satisfactory capital adequacy according to the risk the group undertakes. The IRB system affects a substantial part of the group's operations, and since its implementation the system has helped improve the quality of risk management in SpareBank 1 SR-Bank considerably.

The internal measurement methods used for internal risk management are reviewed in the chapter on risk and capital management in SpareBank 1 SR-Bank. Regulatory calculations of risk exposure and capital requirements are calculated using the same systems and models that are used for internal risk management, but with individual differences in models and model parameters. The effect of these differences is illustrated in table 32 in the appendix.

The table below shows the main methods used by SpareBank 1 SR-Bank when calculating the minimum primary capital requirements for credit, market and operational risk.

Table 1: SpareBank 1 SR-Bank's methods for calculating minimum regulatory capital requirements

Type of risk	Portfolio	Regulatory method
Credit risk	States – parent bank	Standard method
	Institutions – parent bank	Standard method
	Housing cooperatives, clubs and associations – parent bank	Standard method
	Enterprises – parent bank	Advanced IRB
	Mass market – parent bank	IRB - Mass market
	Leasing, consumer financing and secured car loans	Standard method
	SpareBank 1 SR-Investering AS – subsidiary	Standard method
	SpareBank 1 SR-Forvaltning AS – subsidiary	Standard method
	Mass market - SpareBank 1 Boligkreditt AS	IRB - Mass market
	Mass market - SR-Boligkreditt AS	IRB - Mass market
	Enterprises – SpareBank 1 Næringskreditt AS	Standard method
	Enterprises – BN Bank AS	Advanced IRB
	Mass market – BN Bank AS	IRB - Mass market
Market risk	Equity risk – parent bank	Standard method
	Debt risk – parent bank	Standard method
	Currency risk – parent bank	Standard method
	Subsidiaries and part-owned companies	Standard method
Operational risk	SpareBank 1 SR-Bank including subsidiaries	Standardised approach
	Other part-owned companies	Standard method

Investments in other financial institutions as of 31 December 2017:

SpareBank 1 Gruppen	19.5 %
Sandnes Sparebank	15.1 %
SpareBank 1 Betaling	19.7 %

The bank differentiates between material assets that exceed 10 % and non-material assets in financial institutions. Investments that exceed 10 % of own common equity tier 1 capital after deductions are deducted from primary capital and the deductions are made in the same class of capital to which the instrument one owns belongs. Investments in common equity tier 1 instruments that are not deductible from primary capital are weighted 250 % in the basis for calculation.

Investments in associated companies as of 31 December 2017:

SpareBank 1 Boligkreditt AS [1)]	9.5 %
SpareBank 1 Næringskreditt AS	19.2 %
BN Bank ASA [1)]	24.2 %
SpareBank 1 Kredittkort AS	17.9 %

1) Including indirect assets

Investments in associated companies are accounted for according to the equity method in the Group and according to the acquisition method in the parent bank. The investments are treated identically for the purposes of determining the capital adequacy ratio except for the Group's investments in SpareBank 1 Boligkreditt AS, SpareBank 1 Næringskreditt AS, BN Bank AS and SpareBank 1 Kredittkort AS. Proportionate consolidation is carried out for the group's capital adequacy.

Combined buffer requirements

Basel III introduces requirements for combined buffer capital that exceed the minimum primary capital requirements. These are the capital conservation buffer, systemic risk buffer, countercyclical buffer and buffer for systemically important institutions.

Capital conservation buffer (2.5%): The requirement for a capital conservation buffer of 2.5% of the bank's basis for calculation remains constant throughout all economic cycles. The purpose of this buffer is to ensure that banks build up capital in economic booms in order to prevent the capital falling below the minimum requirement in periods of recession.

Systemic risk buffer (3%): System risk is defined as the risk that financial instability will result in disruptions in the provision of financial services of a scope that could give significant negative effects for production and employment. The objective of the system risk buffer of 3% is to dampen the negative effects of financial instability.

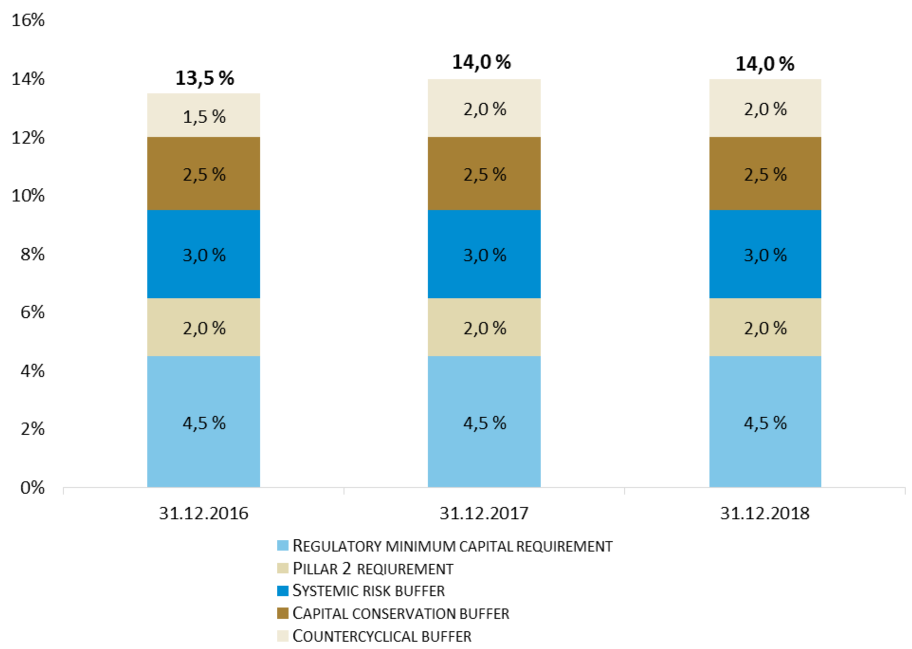
Countercyclical buffer (0-2.5%): The countercyclical capital buffer was set at 2.0% effective from end 2017. The Ministry of Finance sets the level of the countercyclical buffer based on Norges Bank's advice, and the size of the buffer depends on the economic situation. The objective of the countercyclical buffer is to make the institutions even more solid and resistant to lending losses in a future recession and to reduce the risk that banks will reinforce a potential recession by reducing their lending.

Buffer for systemically important institutions (2%): Mortgage companies that are defined as systemically important by the Norwegian authorities will be subject to an extra buffer requirement of 2%. In general, institutions with total assets of at least 10% of mainland Norway's GDP, or at least a 5% share of the market for loans, is defined as systemically important institutions. SpareBank 1 SR-Bank is not defined as systemically important.

Furthermore, the Financial Supervisory Authority of Norway has imposed a Pillar 2 addition of 2% for SpareBank 1 SR-Bank. The objective of the Pillar 2 requirement is to identify capital needs related to risks that are not entirely or at all covered by the capital requirements in Pillar 1.

The figure below shows the regulatory capital adequacy requirements applicable to SpareBank 1 SR-Bank. By the end of 2017, the formal requirement for common equity tier 1 ratio for non-systematically important institutions was 14.0%. SpareBank 1 SR-Bank aims to keep a separate buffer of about 1 percentage point above the minimum requirement of 14.0%.

Figure 4: Regulatory capital adequacy requirements according to Pillar 1 as of 31 December 2017



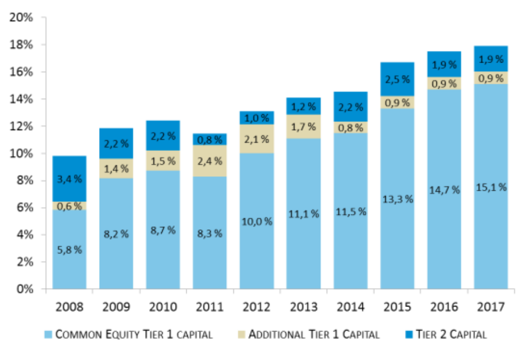
Actual capital adequacy

SpareBank 1 SR-Bank has significantly strengthened its common equity tier 1 capital over the last few years. It has increased from NOK 4.6 billion in 2008 to NOK 18.1 billion in 2017. By the end of 2017, the common equity tier 1 ratio was 15.1% and capital adequacy ratio was 17.9%, compared to 14.7% and 17.5% in 2016 respectively. Included in these calculations is the transition rule (Basel I floor), which says that the capital adequacy determined by using internal models cannot be less than 80% of the capital adequacy determined by the Basel I regulations.

The increase in the common equity tier 1 ratio of 0.4 percentage points from 2016 to 2017 is mainly a result of good profitability, low growth and capital efficiency. From January 2018, new accounting rules will be introduced in accordance with IFRS 9. It is expected that the introduction of IFRS 9 will lead to a weakening of core capital adequacy by between 9 and 13 basis points.

The figure below shows the development in capital adequacy in the period 2008-2017.

Figure 5: Capital adequacy



The table below shows SpareBank 1 SR-Bank's fulfilment of the minimum requirements for common equity tier 1 capital, as well as the combined buffer requirements, at the end of 2017.

Table 2: SpareBank 1 SR-Bank fulfilment of the capital adequacy requirements by the end of 2017

	Current rate	31.12.2016	31.12.2015
Risk weighted assets		**120,160**	**116,651**
Common equity tier 1 capital requirement	*4.5%*	5,407	5,249
Buffer requirements			
Capital conservation buffer	*2.5%*	3,004	2,916
Systemic risk buffer	*3.0%*	3,605	3,500
Countercyclical buffer	*2.0%*	2,403	1,750
Total buffer requirements for common equity tier 1		**9,012**	**8,176**
Surplus common equity tier 1 after buffer requirements		3,670	3,728
Capital adequacy		**17.9 %**	**17.5%**
of which core capital		16.0 %	15.6%
of which supplementary capital		1.8 %	1.9%
Common equity tier 1 ratio		15.1 %	14.7%

Leverage ratio

In 2011, the Basel Committee suggested that, in addition to the stricter requirements for primary capital and combined buffer requirements, leverage ratio[3] should be introduced as a supplementary capital target for capital ratio based on the risk weighted basis for calculation. The proposal contained a minimum requirement of 3%. The European Commission has, in line with the Basel Committee's recommendation, proposed the introduction of a 3% minimum requirement from 2018.

In December 2016, the Ministry of Finance set a minimum leverage ratio requirement that must be met from and including 30 June 2017.

The minimum leverage ratio requirement will be 3%. All banks must also have a leverage ratio buffer of at least 2%. Systemically important banks must have an additional leverage ratio buffer of at least 1%.

The minimum leverage ratio requirement for SpareBank 1 SR-Bank is 5.0%. SpareBank 1 SR-Bank had a leverage ratio of 7.4% as at 31 December 2017, and thus well above the minimum requirements discussed and recommended internationally.

[3] Tier 1 capital as a proportion of the exposure target (including off-balance sheet exposure)

RISK AND CAPITAL MANAGEMENT IN SPAREBANK 1 SR-BANK

The core purpose of the banking industry is to create value by assuming deliberate and acceptable risk. SpareBank 1 SR-Bank therefore invests significant resources in the further development of risk management systems and processes that are in line with leading international practice.

Purpose

Risk and capital management in SpareBank 1 SR-bank shall create financial and strategic added value by:

- Having a strong risk culture characterised by a high awareness of risk management and the group's core values
- Having a good understanding of which risks drive earnings and losses
- Ensuring, insofar as it is possible, that activities and products are priced according to the underlying risk
- Having adequate solvency according to the chosen risk profile, as well as striving for optimal capital application within the various business areas
- Exploiting diversification effects
- Avoiding single events seriously harming the group's financial position

Overall risk exposure

SpareBank 1 SR-Bank is exposed to various types of risk, and the most important ones are:

- **Credit risk:** the risk of loss resulting from the customer's or counterparty's inability or unwillingness to fulfil their obligations
- **Market risk:** the risk of loss due to changes in observable market variables such as interest rates, foreign exchange rates and securities markets
- **Operational risk:** the risk of losses due to weak or inadequate internal processes or systems, human error or external incidents
- **Liquidity risk:** the risk that the group is unable to refinance its debt or does not have the ability to fund increases in assets without significant additional costs
- **Ownership risk:** the risk that SpareBank 1 SR-Bank bears if it suffers negative results from stakes in strategically owned companies and/or the needs to inject fresh capital into these companies. Owned companies are defined as companies in which SpareBank 1 SR-Bank has a significant stake and influence
- **Business risk:** the risk of unexpected income and cost variations due to changes in external factors such as market conditions or government regulations
- **Reputation risk:** the risk of a failure in earnings and access to capital because of lack of trust and reputation in the market, i.e. customers, counterparties, stock market and authorities
- **Strategic risk:** the risk of losses due to unsuccessful strategic decisions
- **Compliance risk:** the risk that the group incurs public sanctions/penalties or financial loss as a result of failure to comply with legislation and regulations

One of the ways in which the group's risk is quantified is through the calculation of risk-adjusted capital. Risk-adjusted capital describes how much capital the group believes it needs to cover the risk the group has actually assumed. Since it is impossible to fully protect against all losses, the group has stipulated that the risk-adjusted capital shall cover 99.9% of potential unexpected losses.

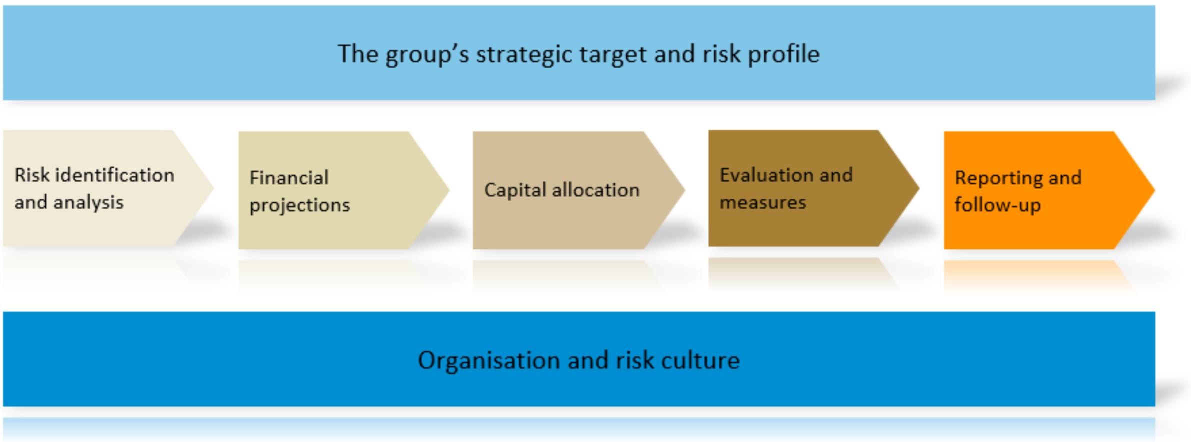
The process of risk and capital management (ICAAP)

The process of risk and capital assessment in SpareBank 1 SR-Bank builds on the following main principles:

- The board is responsible for the process
- The group's own methods and systems are the foundation for the evaluation of whether the risk level and capital requirement are suitable given the group's operations and risk profile
- The process must be embodied in formal documents
- The process must be proportionate in terms of the group's size, risk profile and complexity
- The process must form an integral part of the management process and the decision-making process
- The process must be regularly reviewed
- The process must be risk based
- The process must include all significant aspects of the operations
- The process must be forward looking
- The process must be based on satisfactory methods and procedures for risk measurement
- The results of the process must be reasonable and explainable

To ensure an effective and suitable process, the framework is based on different elements that reflect the manner in which the board and management manage SpareBank 1 SR-Bank. The main elements are described in the figure below.

Figure 6: Main elements in the risk and capital management process in SpareBank 1 SR-Bank



The group's strategic target

The framework for management and control is based on the group's current strategic target.

Defining the risk profile

The board must, at least once a year, adopt the group's risk profile. SpareBank 1 SR-Bank defines its risk profile by first calculating the group's *capacity* to bear risk and secondly calculating its *willingness* to assume risk. Capacity and willingness to bear risk are defined by the group's results, solidity, liquidity and credit quality, and are set for both a normal business cycle and for a serious economic downturn.

The capacity to bear risk describes the maximum risk exposure the group can bear before it is forced into a possible recovery situation and needs to evaluate necessary recovery measures. The willingness to assume risk defines the group's maximum desired risk exposure from the perspective of its earnings and losses, and given the defined risk capacity. The difference between the capacity and willingness to bear risk expresses the group's safety buffer in relation to ending up in a possible recovery situation. The willingness to assume risk should be significantly lower than the capacity to bear risk.

Risk identification and analysis

The process for risk identification is forward-looking and covers all of the group's significant risk areas.

In areas where the effect of the established control and management measures is not considered satisfactory, improvement measures are implemented. Thorough analyses of the identified risks are conducted in order to understand their characteristics and the effect of established control and measurement measures.

Measures that reduce probability shall take precedence over measures that reduce consequences. Up-to-date documentation should be available for all of the important parts of the group's business areas. This documentation should specify the control and management measures that have been established, levels of risk, and references to any instructions, authorities and specifications. An annual risk strategy is prepared each year on the basis of these risk analysis. The strategy specifies acceptable levels of risk and targets for risk-adjusted returns.

Financial projections

Two financial projections are conducted, at least annually:

- Financial projection of expected financial development over the next five years
- Financial projection in a situation involving serious economic downturn over five years

Financial projection of expected financial development

The financial projection of expected financial development is based on SpareBank 1 SR-Bank's prognosis for the current period. This prognosis mirrors the group's strategic target, business plans, capital requirements and expected macroeconomic development over the coming years.

The purpose of the projection is to demonstrate how this will affect the group's financial development, including the return on equity, the funding situation and capital adequacy.

Financial projection of a serious economic downturn (stress test)

The purpose of the financial projection of a serious economic downturn is to:

- evaluate potential losses based on different economic scenarios
- evaluate the vulnerability of portfolios/activities
- increase the understanding of how a shock would affect the group's profitability, liquidity situation and capital adequacy
- evaluate potential losses based on different strategic possibilities
- identify weaknesses in the group's risk strategies and processes to help develop risk mitigation measures and prepare contingency plans

To assess the consequences of an economic downturn, SpareBank 1 SR-Bank largely focuses on those areas of the economy that affect financial development. These are primarily developments in credit demand, the stock market, the interest rate market, and credit risk. In addition to having an impact on the yield of the underlying assets, an economic downturn will also have an impact on customer savings habits.

Capital allocation

Risk-adjusted return is one of the most important strategic result measurements in SpareBank 1 SR-Bank. Risk-adjusted return is based on the calculation of risk-adjusted capital, which describes what level of capital the group must hold in order to cover an unexpected loss within a year. The calculation is made with a confidence level of 99.9%.

This implies that capital is allocated to business areas in accordance with the calculated risk of the operation. Return on capital is continuously monitored.

Evaluation and measures

The abovementioned financial projections provide the executive management team and the board with sufficient understanding of the risk to make proper strategic choices and at the same time ensure that the group has an acceptable risk profile. Based on the analysis, SpareBank 1 SR-Bank develops capital plans to achieve a long-term and effective capital management and ensure that the group's capital adequacy is acceptable, given the risk exposure and strategic targets.

SpareBank 1 SR-Bank has also prepared recovery plans to the extent possible be able to handle emergencies if they nevertheless arise. The recovery plans cover:

- Capital adequacy
- Liquidity risk
- Operational risk

Reporting and follow-up

SpareBank 1 SR-Bank's overall risk exposure and risk trends are reported to the executive management team and the board in periodic risk reports.

The Risk Management Department performs general risk monitoring and reporting and the department is independent of the different business units in the group; the department reports directly to the chief executive.

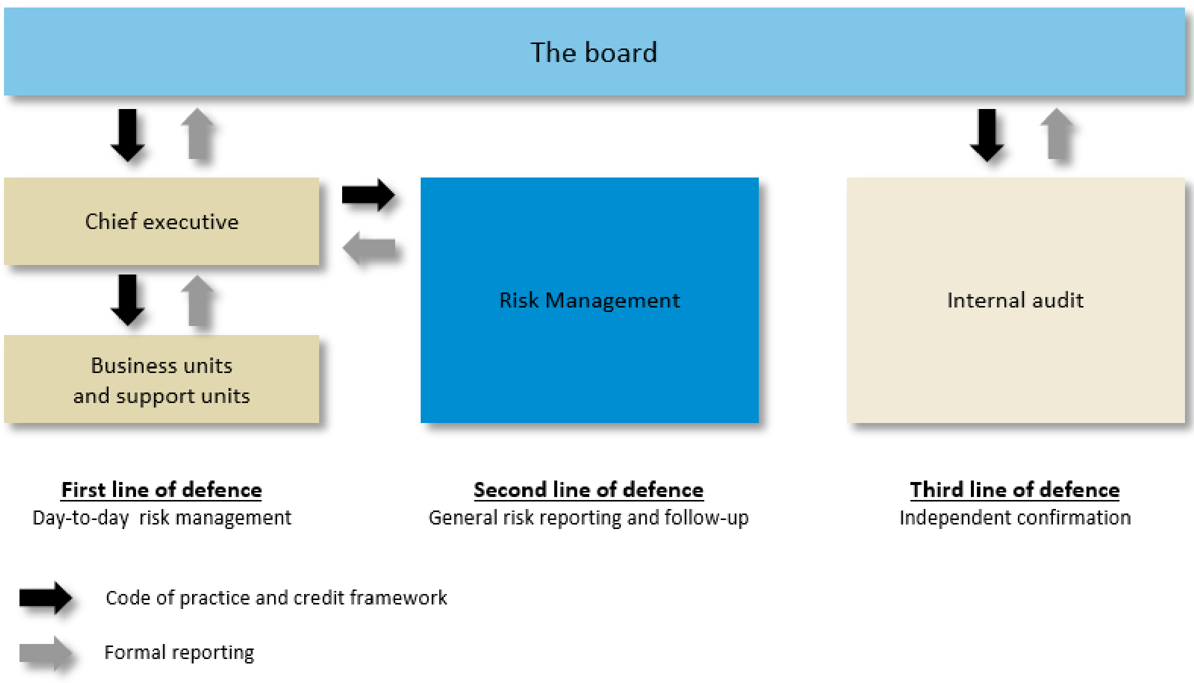
All managers are responsible for the day-to-day risk management within their area of responsibility and must continuously ensure that the risk exposure is within the limits set by the board or chief executive.

Organisation

SpareBank 1 SR-Bank values independence in management and control, and the responsibility is divided between different roles in the organisation. Through the general assembly, the shareholders execute the highest authority in SpareBank 1 SR-Bank.

The group values a control and management structure that encourages targeted and independent management and control

Figure 7: The organisation of risk and capital management



The board of SpareBank 1 SR-Bank bears overall responsibility for the management and organisation of the group, in accordance with laws, statues and regulations. The board is responsible for ensuring that the funds the group administers are managed in a safe and suitable manner. Following this, the board also has an obligation to ensure that accounting and asset management are subject to adequate controls. The members of the board must exhibit sound discretion while exercising its responsibilities and duties.

The board is responsible for ensuring that the group has adequate primary capital given the adopted risk profile and regulatory requirements. The group's board adopts the principal goals such as risk profile, hurdle rates and distribution of capital to the different business units. The board also sets the overarching limits, authorities and guidelines for risk management in the group. The board has adopted a code of conduct that helps to raise awareness and ensure compliance with the ethical standards set for the group.

The boards of the subsidiaries fulfil their duties in the individual companies in line with decisions made by the bank's board. In companies that are wholly owned by SpareBank 1 SR-Bank, a combination in the board that ensures knowledge of industries and good integration with the individual company's business and adjacent segments in SpareBank 1 SR-Bank are sought. Chairman of the individual companies is the one member of the executive management team that has the greatest interface between his or her daily business area and subsidiary's business area. This principle ensures that important issues concerning the group's overall strategy and optimisation throughout the value chain are maintained.

In some companies, up to 40% of the board members are external representatives. This is evaluated in each company, in relation to the balance between the need for external industry skills or ideas versus internal staff who are familiar with the group's overall operations. The group's board has established an audit committee, a remuneration committee and a risk committee. The committees help the board prepare matters for discussion, but decisions are to be made by a gathered board.

The audit committee shall assist the board in carrying out its control tasks and propose measures regarding the bank's framework for managing and control, and the financial reporting.

The remuneration committee shall prepare matters to the board in relation to the board's work relating to the remuneration structures in SpareBank 1 SR-Bank.

*The risk committe*e shall prepare matters for the board regarding the group's overall risk and check that management and control arrangements have been tailored to the risk level and the scale of the business.

The board establishes instructions for the committees.

The chief executive is responsible for the daily management of the group's operations, in line with laws, statutes, authorisations and instructions. Matters that – given the group's situation – are deemed to be of an unusual nature or of great importance to the group are presented to the board. However, the chief executive may decide an issue if authorised to by the board or in cases where the board's decision cannot be waited for without putting the group at a significant disadvantage. The chief executive shall implement the group's strategy and – in collaboration with the board – further develop the strategy. The chief executive reports on the group's operations, position and financial performance to the board every month.

Managers of business areas and support areas are responsible for day-to-day risk management within their area of responsibility and must at all times ensure that the risk management and risk exposure comply with the limits and overarching management principles set by the board or chief executive.

The *Risk Management Department* is independent of the business units and reports directly to the chief executive. The department is responsible for the ongoing development of the framework for risk management, including risk models and risk management systems. The department is also responsible for independently monitoring and reporting risk exposure. The department works closely with the SpareBank 1 Alliance's Centre of Expertise for Credit Models, which is located in SpareBank 1 SR-Bank's headquarters. The Centre of Expertise is responsible for developing and quality assuring credit models in line with leading international practice.

The *Compliance Department* is independent of the business units and reports directly to the chief executive. The department is responsible for ensuring that the group complies with current laws and regulations.

In addition to the abovementioned roles, a number of committees have been established within the area of risk and capital management. The committees assist the chief executive in establishing a basis for making decisions and monitoring.

The Risk and Capital Management Committee is responsible for the overall monitoring of the group's risk profile, funding and capital adequacy situation. The committee also discusses draft versions of risk strategies, capital allocations, validation reports and recommends new risk models. The committee is chaired by the Executive Vice President Risk Management and is broadly composed of executive personnel from the business units, the Accounting and Finance Department and the Risk Management Department.

The *Balance Committee* in SpareBank 1 SR-Bank provides advice on the operative management of the bank's balance sheet within the limits set by the bank's board. The committee's main focus is monitoring and control of the factors that directly and/or indirectly affect the bank's funding capacity.

The credit committees are responsible for making independent recommendations to authority holders. When making their recommendations, the credit committees evaluate loan and credit applications based on the current credit strategy, credit policy guidelines, loan granting regulations, and credit review routines. The credit committees attach special importance to the identification of risk in relation to individual applications and carry out an independent assessment of credit risk, which clarifies the consequences for the bank of the various risks.

A number of independent control bodies have also been established:

The internal audit function ensures that the risk management process is result-oriented, effective and functions as intended. The group's internal audit function has been outsourced, and this ensures that the function has the required independence, competence and capacity. The internal audit function reports to the board. The internal audit function's reports and recommendations on improving the group's risk management are continuously reviewed in the group.

The external auditor's primary task is to assess whether the group's annual financial statements have been prepared in accordance with the applicable laws and regulations. Furthermore, the external auditor must ascertain whether the bank’s asset management is handled properly and subjected to proper scrutiny. The external auditor is elected by the general assembly, based on the recommendations of the Supervisory Board.

Risk culture

Risk culture means values and attitudes that are expressed through risk awareness, actions and ability for organisational learning. A good risk culture constitutes the foundation of good risk management and is a prerequisite for the full benefit of professional policies, procedures and models.

In cooperation with the University of Stavanger, the Group has therefore developed a framework that is used to carry out regular group-wide evaluations of risk culture. The results show that SpareBank 1 SR-Bank has a good risk culture where employees experience a clear organisation that supports and encourages ethical conduct, with a management that acts in accordance with the organisation's ethical guidelines. The results of the measurements provide good discussions in the group and increased awareness and insight into themes that are not usually discussed directly. The fact that such measurements are conducted is therefore considered in itself to make an important contribution to creating a sound risk culture in the organisation.

CREDIT RISK

Credit risk is the risk of loss resulting from the customers or counterparty's inability or unwillingness to fulfil his obligations.

About credit risk

SpareBank 1 SR-Bank is primarily exposed to credit risk through its loan portfolios in the retail and corporate markets. The group is also exposed to credit risk through the liquidity portfolio. This portfolio mainly consists of low risk commercial paper and bonds that qualify for loans from Norges Bank.

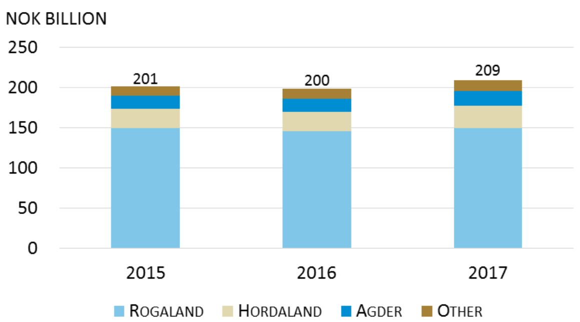
Development in credit risk

In describing credit risk in this paragraph, the following terms are used:

- Probability of default (PD) – the probability for default in a twelve-month period based on a long term outcome[4]
- Exposure at default (EAD) – a calculated size that contains actual exposure and expected exposure for allocated, but not drawn limits at the time of default

The group's primary geographic market areas are Rogaland, Hordaland and Agder. The figure below shows SpareBank 1 SR-Bank's exposure by geographic areas in December 2017. The exposure is shown for the parent bank and includes portfolios transferred to credit institutions. SpareBank 1 SR-Finans has been merged into SpareBank 1 SR-Bank from 1 January 2017 and lending volumes from SR-Finans are included in the figures starting with Q1 2017. This gives rise to a break in the history.

Figure 8: Exposure (EAD) by geographic market areas

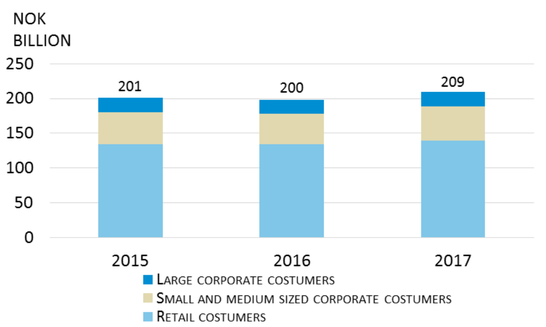


Rogaland is the group's largest market area, with an exposure of NOK 150 billion by December 2017. This amounts to 72% of SpareBank 1 SR-Bank's total loan exposure.

The exposure in Hordaland amounts to NOK 25 billion in 2016. The exposure in Hordaland and Agder is fairly stable and amounted to NOK 28 and 18 billion in 2017, respectively. Exposure outside these market areas is associated with customers who are based in the group's market area.

SpareBank 1 SR-Bank's loan exposure consists of a well-diversified portfolio with both retail and corporate customers. The figure below shows the development in the loan portfolio over the last three years.

Figure 9: Exposure by customer segment

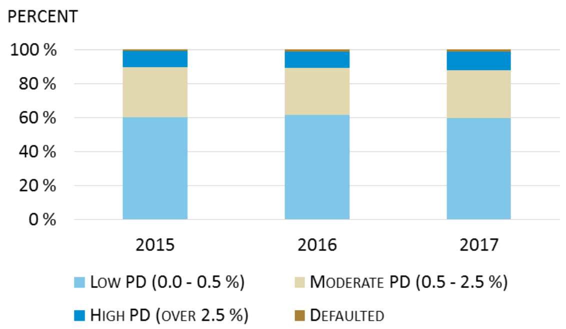


The largest share of the loan exposure in SpareBank 1 SR-Bank is aimed at retail customers, and loans are mainly financed by mortgages on real estate. Exposure to retail customers has increased during the last year, and by the end of 2016 it amounted to NOK 140 billion. 97% of loan exposure in the retail market consists of loans that are smaller than NOK 10 million. Exposure to small and medium sized corporate customers has increased from NOK 44 to 49 billion in 2017. Credit exposure to major customers has been stable last year and amounts to NOK 20 billion by December 2017. Large corporate customers are defined as single customers with exposure (EAD) larger than 250 million kroner.

[4] Long term outcome through a full loss cycle of 25 years

A clearly defined framework that sets limitations on what is financed, and under which conditions, helps to ensure that the portfolio remains robust.

Figure 10: Loan portfolio by probability of default (PD)[5]



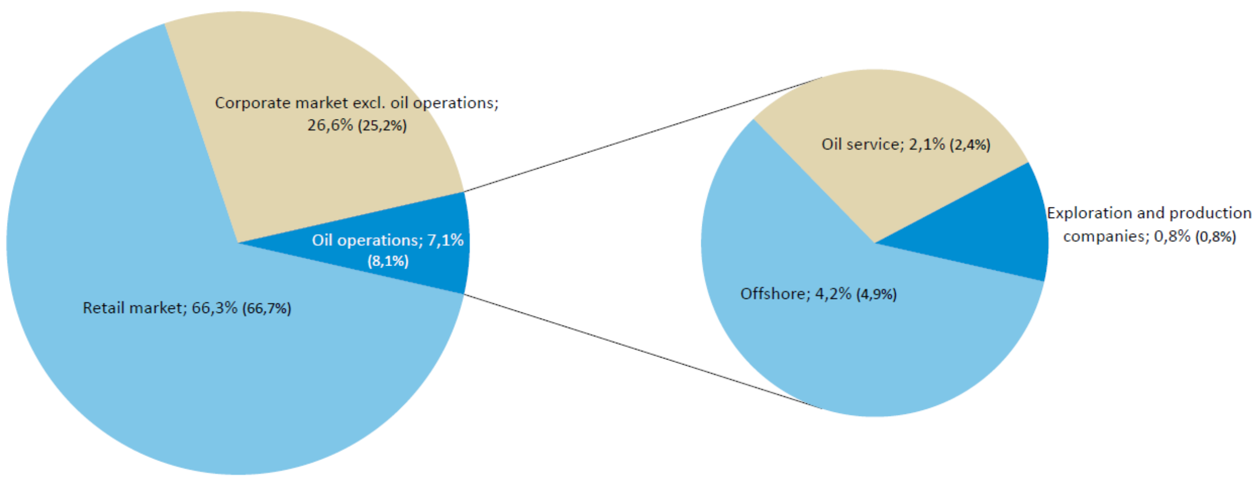
The share of loan exposure on customers with a probability of default (PD) lower than 0.5% amounts to 60% of the total loan portfolio in 2017. These customers are risk classified in the default classes A, B or C. The share of the loan exposure with moderate PD is 28%. These customers are risk classified in the default classes D, E or F.

In SpareBank 1 SR-Bank, there is a significant focus on following up customers with a PD higher than 2.5%. In December 2017, 11% of the loan exposure relates to customers with a PD higher than 2.5%. These customers are risk classified in the default classes G, H or I. Exposure towards customers in default amounts to 1.0% of total loan portfolio in SpareBank 1 SR-Bank in December 2017.

The composition of the portfolio is based on a clearly defined strategy in which the growth and risk profile are managed, for example, through special credit strategy limits for concentration risk. The concentration risk has been significantly reduced in the last few years in line with the risk strategy guidelines set by the board. In particular, there has been a heavy focus on reducing the proportion of commitments with the potential to produce significant losses.

SpareBank 1 SR-Bank has a well-diversified loan portfolio. By December 2017, 7.1% of the total exposure is related to oil activities.

Figure 11: SpareBank 1 SR-Bank's loan exposure by sector



[5] For retail customers, there are different requirements for a long term outcome for probability of default (PD), internal and regulatory. The figure shows the loan portfolio with internal PD estimates

Oil-related activities

Around NOK 15 billion of the portfolio is linked to oil-related activities, including the industry groups: offshore, oil services, and oil and gas. Exposure to oil-related activities accounts for 7.1% of the total loan portfolio, down from 8.1% in 2016.

The offshore industry group accounts for the largest proportion of the loan exposure. The total exposure as at December 2017 was NOK 8.7 billion, equivalent to 4.2% of the group's total exposure. The exposure is primarily to industrial-oriented shipping companies with strong ownership and an integrated organisation. NOK 6.9 billion is financing for offshore service vessels (OSV). This is a well-diversified portfolio of customers with a long history as borrowers in the bank. 2016 and 2017 have been challenging years for this industry, and over the last two years most offshore engagements have been restructured.

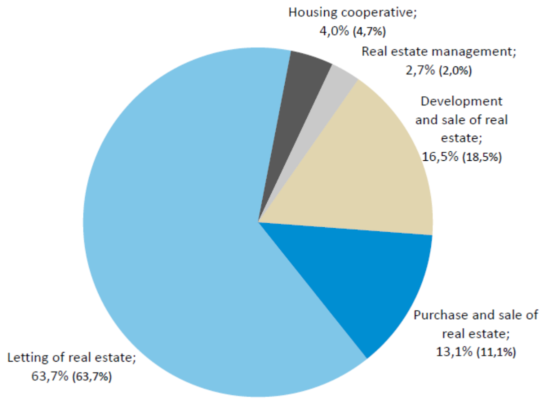
Oil services accounted 2.1% of SpareBank 1 SR-Bank's loan exposure as at December 2017. The exposure primarily consists of financing for operating capital through current and fixed assets, as well as issued guarantees.

The bank's portfolio within oil and gas is limited in size and is primarily linked to reserve-based financing intended for the Norwegian Continental Shelf. The loan exposure accounts for 0.8% of the group's total loan exposure. The volume of loans provided by SpareBank 1 SR-Bank to finance exploration is modest; however, the entire volume is secured by collateral in tax refunds from the Norwegian government. This financing thereby entails no direct oil price risk.

Commercial property

The commercial property portfolio represents the group's greatest concentration in a single sector, and accounts for 14.5% of total loan exposure. The figure below shows how the portfolio of commercial property was distributed as at December 2017:

Figure 12: Lending to commercial real property



This portfolio is characterised by lending to commercial properties with long-term contracts and financially solid tenants. As at December 2016, more than half of the leases had a remaining term to maturity of 5 years or more, and the vacancy rate is limited. A significant proportion of the portfolio is interest rate-hedged. Despite the fact that the market for commercial property leases has been challenging for the last few years in part of the group's market area, with vacancy rates rising slightly and prices falling, there are at this time no signs that this development will have negative consequences for commitments in SpareBank 1 SR-Bank. This is due to the bank having limited exposure to the types of property impacted by the negative trend. The observed falls in prices and vacancy rates in the region largely relate to larger, older buildings with a more peripheral location.

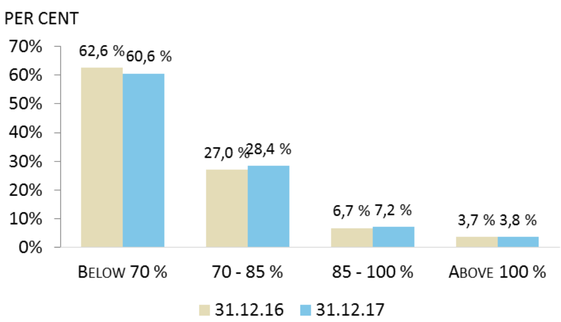
Retail market

The retail market accounts for 66% of the total loan portfolio in SpareBank 1 SR-Bank. The quality of the retail market portfolio is very good with low potential losses. The portfolio generally consists of loans with collateral in real estate. The exposure to other retail customers with collateral in real estate is marginal and accounts for 1.4% of the retail market portfolio. The low risk profile in the portfolio is achieved through selective customer selection and requirements concerning moderate loan-to-value ratio. SpareBank 1 SR-Bank's lending practices comply with the current regulations and there were no significant changes in the bank's lending practices last year.

The figure below illustrates the development of the loan-to-value ratio in the retail market portfolio from 2016 to 2017. The calculation of loan-to-value ratio is based on the collateral's market value and is shown as total-distributed loan-to-value ratio. In the case of total-distributed loan-to-value ratio, the entire relevant loan is allocated to one and the same interval.

The figure shows the proportion of loans with a loan-to-value ratio of less than 85% is stable and high. 89.6% of the loan exposure at year-end 2016 was within 85% of the assessed value of the collateral.

Figure 13: Loan-to-value ratio (LTV) retail market portfolio - total distributed (including portfolio transferred to SpareBank 1 Boligkreditt AS and SR-Boligkreditt AS)



The market value of housing in SpareBank 1 SR-Bank's market area has been weak in recent years. This means that the proportion of loans within 70% of the assessed value of the collateral has decreased slightly since 2016. The proportion of loans with loans below 85 per cent is stable and high. 89.0 % of the lending exposure at the end of 2017 is within 85% of assessed security values.

Managing credit risk

The overall credit strategy establishes that the group shall have a moderate risk profile. The credit risk is managed through limitations for granting credit, follow-up of commitments and portfolio management.

Credit culture

SpareBank 1 SR-Bank is one of the leading players in Norway within managing credit risk. This is achieved through local knowledge about the customer, the use of robust credit models and credit analyses, and by stipulating clear requirements concerning the employees' qualifications and attitudes where the ability to recognise risk and willingness to learn from experience is emphasised.

In credit appraisals, special importance is attached to whether the customer's activities comply with current laws and regulations, whether the customer's activities have a long-term perspective, and whether the customer has both the necessary ability to pay and robust equity given the nature of their activities. The process of granting credit involves a clear division of responsibilities where cooperation should ensure the best possible basis for making decisions, but where actual decisions about credit are made on an individual basis.

The ability to comply with our own guidelines and in this way avoid financing commitments that conflict with these is especially important. There is, therefore, a heavy focus on ensuring the credit staff's active use of, and compliance with, a framework for managing credit risk is in line with best practice in this area. Compliance is also specifically monitored by independent representatives of the corporate risk management team, both through ongoing participation in the various credit committees and through independent reporting from the work of the credit committees.

Credit strategy

The group's primary market areas for risk exposure are Rogaland, the Agder counties and Hordaland. The general credit strategy stipulates that the group shall have a moderate risk profile where no single event shall be capable of seriously harming the group's financial position.

The group's credit strategy consists of general credit strategy limits for ensuring a diversified portfolio and a satisfactory risk profile. This limits the probability of default, expected losses, risk-adjusted capital and how high the total loan exposure can be in the corporate market. Portfolios that have been, or are going to be, transferred from SpareBank 1 SR-Bank to the mortgage companies, SpareBank 1 Boligkreditt AS, SR-Boligkreditt AS and SpareBank 1 Næringskreditt AS, are included in the abovementioned credit strategic framework.

There are also specific limits for the corporate market for the maximum share of risk-adjusted capital for individual sectors, the group of major customers, and maximum exposure to high risk customers, respectively. Specific limits have also been established to limit the maximum loss from a single customer. A single customer in this context includes commitments with one or more counterparties, when specific influence or financial links between the companies imply that financial difficulties in one of the companies is likely to result in payment difficulties for one or more others. The framework has been established to secure a diversified portfolio within the corporate market.

The credit strategic framework has been established by the board and any breaches from it must, therefore, be presented to the board for approval. The Risk Management Department reports on the development of the strategic credit framework to the board every quarter.

Credit political guidelines

The group's credit policy guidelines stipulate minimum requirements that apply to all types of financing, except commitments granted as part of the exercise of special credit hedging authorities. In addition to the general credit policy guidelines, a set of more specific credit policy guidelines related to sectors or segments that can entail a special risk have been prepared. The credit policy guidelines are revised at least once a year, and are approved by the chief executive and reported to the board.

Credit authority regulations

The board is responsible for the group's granting of loans and credit, but delegates the responsibility to the chief executive, within certain limits. The chief executive then delegates these responsibilities within his own authority. Delegated credit authority is linked to a commitment's probability of default and collateral value. The authorities are personal. This means that the credit committees do not have decision-making authority, but make recommendations to the authority holder. If there are no recommendations from credit committee, the authorisation limits will be halved. In general the authorities are ample if a commitment's expected loss and probability of default indicate a low risk, but they will be restricted progressively with increasing risk. The credit authority rules are reviewed annually and changes are approved by the chief executive and reported to the board. However, this does not apply to changes in the chief executive's credit authority as this is approved by the board.

Credit review routines

The credit review routines regulate in detail all factors related to the granting of credit by the group and follow-up of commitments. The credit granting process provides a more detailed description of the customer and the purpose of the loan application, in addition to evaluations of the following:

- Owners and management
- Structure of financing
- Compliance with credit strategy and credit policy
- Whether the customer will have adequate earnings to service the current obligations, interest and instalments
- For how long and in what manner the customer can cover their current obligations, interest and instalments if their earnings fail
- Collateral and overall assessment of risk

Measuring credit risk

Continuous commitment and portfolio monitoring is carried out on existing commitments. . The credit risk is followed up in general by means of the group's portfolio management systems, systems for early notification of key development trends (early warning) and systems for monitoring the quality of the actual credit granting process.

Portfolio management

SpareBank 1 SR-Bank’s risk exposure is monitored via a general portfolio management system. The portfolio management system contains information on the risk at both the aggregate and detailed levels. This makes it possible to conduct efficient monitoring and management of the risk performance of the portfolio. All portfolio information is updated monthly, including updates of the customers' probability of default. The development of risk in the portfolios is followed up with special emphasis on the development of the risk classification (migration), expected losses, risk-adjusted capital and risk-adjusted return. Risk-adjusted capital reflects the actual risk exposure better than what the traditional focus on lending volume does.

Early warning

The group's *early warning* system makes it possible to continuously monitor customers' key risk drivers and acts as an important indicator of potential negative developments in default rates. Its purpose is to detect key trends in development at an early stage.

Some examples of risk drivers are:

- Short-term and repeated default
- Development in limit utilisation
- Development in number of instalment postponements
- Official announcements

Credit process surveillance

The group's systems for monitoring the credit approval process make it possible to monitor credit quality and the risk-adjusted return on new commitments continuously. The system is able to compare quality across departments, and enables early action if, for instance, a department's credit practice is developing in an undesired direction.

Risk classification system

The group utilises credit models for risk classification, risk pricing and portfolio management. The risk classification system is based on the risk parameters as shown in the figure below:

Figure 14: The risk classification system in SpareBank 1 SR-Bank

Probability of default (PD)	The customers are classified in default classes based on the probability of default over a 12 month period, based on a long-term outcome
Exposure at default (EAD)	This is an estimate that indicates the group's exposure to a customer at default
Loss given default (LGD)	This is an estimate of how much the group can potentially lose if the costumer defaults on his obligations
Expected loss (EL)	Describes the loss the group can statistically expect to lose on the loan portfolio during a 12-month period (long-term outcome) in a normal business cycle
Risk-adjusted capital (UL)	Describes how much capital the group needs to reserve as a buffer for future unexpected losses
Risk group	The customer is assigned a risk group based on the risk-adjusted capital on the commitment
Risk pricing	SpareBank 1 SR-Bank is committed to finding the proper price for each risk, and has developed a pricing model that calculates a price given the commitment's risk

1) Probability of default (PD)

Customers are classified in default classes based on the probability of default over a twelve-month period, based on a long-term outcome through a full loss cycle[6].

A commitment is considered to be in default if:

1) A claim has been due for more than 90 days and the amount is over NOK 1,000, or

2) The bank has reason to assume that the debtor is unable to repay (in full) in accordance with his obligations:

- The bank makes write-downs due to impaired creditworthiness.
- The bank sells a claim at a discount as a result of impaired creditworthiness.
- As a result of payment problems by the counterparty the bank grants a postponement of payment or new credit for payment of the instalment, or agrees changes to the interest rate or other terms and conditions of the agreement.
- The counterparty is subject to debt settlement, bankruptcy or public administration proceedings, or voluntary debt negotiations have been initiated.
- The bank assumes due to other reasons that the obligation will not be fulfilled.

The probability of default is calculated on the basis of historical series of data for financial key figures related to earnings and deterioration, as well as on the basis of non-financial criteria such as conduct and age. Nine default classes (A – I) are used to classify the customers according to the probability of default. The group has two additional default classes (J and K) for customers with defaulted and/or written-down commitments.

SpareBank 1 SR-Bank focuses on stable and predictable credit granting and capitalisation over time, and the group therefore develops the models for calculating the probability of default on the basis of a 'Through the Cycle' approach. This also corresponds with the approach behind the rating methods in the most renowned rating companies.

Besides predicting the long-term outcomes of probability of default regardless of the economic situation, the models must also manage to rate the customers based on risk (from the lowest probability of default to the highest probability of default) based on the current economic situation. This is important for predicting which customers may experience problems in the next twelve months. In order to achieve this, the model must also include variables that identify changes in the economic cycles.

SpareBank 1 SR-Bank calculates the long-term outcome for probability of default based on a full loss cycle lasting about twenty-five years, which consist of four periods with a normal economic situation and one period with a sharp economic downturn. Our own, representative historic default data is used as the data basis for the calculation.

Definitions of the individual default classes are shown in the table below. The table also shows the correlation between classification in the largest external ratings agencies and the classification used in SpareBank 1 SR-Bank.

[6] Long term outcome through a full loss cycle, consisting of four periods with normal business cycle and one period with an economic downturn

Table 3: Definition of default classes and the correlation between classification in SpareBank 1 SR-Bank and in the largest external rating agencies

Default class	Lower limit for default	Upper limit for default	Rating scale Moody's	Rating scale Standard & Poor and Fitch
A	0.00%	0.10%	AAA - A-	Aaa - A3
B	0.10%	0.25%	BBB+ - BBB	Baa1 - Baa2
C	0.25%	0.50%	BBB-	Baa3
D	0.50%	0.75%	BB+	Ba1
E	0.75%	1.25%	BB	Ba2
F	1.25%	2.50%	BB-	Ba3
G	2.50%	5.00%	B+	B1
H	5.00%	10.00%	B	B2
I	10.00%	40.00%	B- - CCC/C	B3 - Caa3/C

2) Exposure at default (EAD)

Exposure at default (EAD) is defined as the exposure the bank has to a customer at the time of default. The conversion factor (CF) defines the extent the unutilised credit limit is expected to be drawn on upon default. Unutilised credit in this regard is defined as the remaining disposable limit one year prior to default.

For allocated, but not drawn upon limits for corporate market customers there is a drawing of 100% (1). Granted, but not drawn upon limits for retail market customers have a conversion factor of 1, i.e. 100% drawing upon default is assumed. For the corporate market, approved but not drawn upon facilities are multiplied by a conversion factor that varies between 60-90%, depending on the customer's probability of default. The conversion factor for guarantees is a parameter set by the authorities and is set at 1 for loan guarantees and 0.5 for and other guarantees.

3) Loss given default

Loss given default describes how much the group could potentially lose if the customer defaults on their obligations. The model presents estimates that predict the degree of loss in an economic downturn. The valuation takes in account the value of underlying securities, the degree of recovery of unsecured loans, the degree of recovery before realisation and the costs the group has in recovering defaulted commitments.

Seven classes are used (1–7) for classifying commitments in relation to loss given default. Definitions of these classes are illustrated in the table below.

Table 4: Definition of loss given default (collateral class)

LGD class	LGD interval
1	Until 10%
2	<10%, 20%]
3	<20%, 30%]
4	<30%, 40%]
5	<40%, 50%]
6	<50%, 60%]
7	Over 60%

4) Expected loss (EL)

Expected loss describes the loss the group can statistically expect to experience on the loan portfolio during a twelve-month period, based on a long-term outcome through a full loss cycle. Expected losses are calculated based on the probability of default, exposure at default and loss given default.

5) Risk-adjusted capital (UL)

There are many factors that affect the group's losses on loans and credits. The expected loss is based on uncertain magnitudes, where the uncertainty is largely related to the characteristics of the commitments. On well-secured loans, the uncertainty is limited, while the uncertainty is relatively large with less well-secured loans and with customers with an unstable ability to fulfil their obligations.

To take account of this uncertainty, a value for unexpected loss, or risk-adjusted capital, (UL) is calculated on all commitments. In this regard, SpareBank 1 SR-Bank uses the reference model for unexpected loss as set out in the Capital Requirements Regulations. The sum of unexpected losses for all commitments provides an estimate of how much the group could lose in excess of the expected loss.

Risk-adjusted capital describes how much capital the group believes it needs to cover the actual risk that the group has assumed. As it is impossible to fully protect against all losses, the group has stipulated that the risk-adjusted capital must cover all possible unexpected losses based on a stipulated confidence level of 99.9%.

A commitment is risk classified in a risk group from lowest to highest risk, depending on the risk-adjusted capital. The risk groups are defined as shown in the table below.

Table 5: Definition of risk groups

RISK-ADJUSTED CAPITAL (UL)% OF EAD		
RISK GROUP	**Lower limit**	**Upper limit**
LOWEST	0.0%	1.6%
LOW	1.6%	4.0%
MEDIUM	4.0%	8.0%
HIGH	8.0%	12.0%
HIGHEST	12.0%	99.99%

6) Risk pricing –RARORAC (Risk Adjusted Return on Risk Adjusted Capital)

SpareBank 1 SR-Bank focuses on pricing risk correctly. This means that high risk commitments are priced higher than low risk commitments. The general level of risk pricing will, however, also depend on the group's general return targets and an assessment of the competition situation. SpareBank 1 SR-Bank therefore uses models that calculate the correct risk price that should be taken into consideration when pricing the expected losses and return on risk-adjusted capital. The risk pricing model uses the same main components as in the groups risk classification system as the basis. The model is based on a standard risk adjusted return on risk adjusted capital (RARORAC) model for measuring risk-adjusted return.

The pricing model is primarily used for granting and renewing credit, as well as calculating the customer's price and measuring and monitoring profitability.

Collateral and other risk mitigation measures

SpareBank 1 SR-Bank uses collateral to reduce the credit risk in each commitment. For corporations, different types of conditions and terms are also specified in most credit agreements. Use of terms gives the bank assurance that the company keeps proper levels of liquidity and equity, or that the company is in compliance with applicable laws and regulations related to its services.

In the retail market, the collateral is primarily real estate (housing). Several different types of collateral are accepted in the corporate market. This is shown in the table below.

Table 6: Main types of collateral

Type of collateral	Retail market	Corporate market
Real property	X	X
Land	X	X
Securities	X	X
Guarantees	X	X
Machinery and plant		X
Vessels		X
Motor vehicles/construction machines		X
Inventories		X
Agricultural chattels		X
Trade receivables		X
Deposits	X	X

The group establishes the realisation value of posted collateral on the basis of statistical data over time, as well as expert evaluations in cases where the statistical date is insufficient. The realisation value is set to give a conservative evaluation that reflects presumed realisation value in an economic downturn.

Monetary claims in the form of deposit accounts with credit institutions may be pledged for the benefit of the credit institution. In consumer relations such pledge must be established by a written contract, and the pledge may only cover deposits that are in a unique account created in connection with the agreement.

In the retail market the market value of real estate is stipulated either by utilising the purchase price according to the contract, a broker valuation/appraisal or value estimates from Eiendomsverdi (applies only to residential properties. Eiendomsverdi is an information and analysis tool that provides access to an estimated market value for properties in Norway. Value estimates from Eiendomsverdi may be utilised in accordance with internal procedures if the property is located in a well-functioning residential market and if there is little uncertainty with regard to the value estimate. The realisation value on real estate is established on the basis of the market value of the property and reduces this value by a reduction factor that depends on the type of property. In the retail market, assets other than real property are used as collateral to a limited extent.

In the corporate market, the value of commercial properties is calculated using the yield method, where the value is the present value of the expected cash flow to the property. Yield reflects the return an investor can demand when investing in a property, and is affected by factors such as the property's location and nature, duration of the lease, tenants' solidity, regulatory risks, and the anticipated long-term, risk-free interest rate. The realisation value of the collateral is determined based on the market value, which is reduced by a factor that varies with the property's characteristics.

The reduction factors for all types of collateral are set on the basis of the fall in value that must be expected in a sharp economic downturn.

Validation

The group continuously develops and tests the risk management system and the credit granting process to ensure that it is of high quality over time. The work is summarised in an annual validation report that provides a basis for the board of SpareBank 1 SR-Bank to determine whether or not the risk management system (IRB system) is well integrated within the organisation and whether it calculates the level of risk and capital requirements satisfactorily.

The IRB system is described in the chapter on capital requirements.

The aim of the validation process is to ensure that:

- The IRB system is customised to the portfolios on which it is used
- The assumptions the IRB system builds on are reasonable
- The IRB system measures what it is meant to measure
- The IRB system is well integrated in the organisation, and that it is a central part of the risk management and decision making in the bank
- SpareBank 1 SR-Bank complies with the Capital Requirement Regulations

The validation process can be divided into four main areas:

Quantitative validation: Quantitative validation is intended to ensure that the estimates used for the probability of default, exposure at default and loss given default are always of adequately good quality.

Qualitative validation: The quantitative validation is supplemented by more qualitative assessments in the form of meetings with the bank's own expert group and with customer advisers. Using qualitative measuring methods ensures all processes, control mechanisms, and routines are fully validated and it also contributes valuable input in relation to further developing the current models. Qualitative validation also provides supplementary information in those cases where the capture of statistical data is limited.

Application: Verification should show whether the system for managing and measuring credit risk is well integrated in the organisation, and if it represents a key part of the group's risk management and decision-making.

Compliance with the Capital Requirements Regulations: The review is intended to ensure that SpareBank 1 SR-Bank complies with the Capital Requirements Regulations.

The table below shows the models used by SpareBank 1 SR-Bank in the regulatory IRB reporting, as of end 2016.

Table 7: Risk models used in regulatory reporting, 2017

Commitment category	Segment	PD model	EAD model	LGD model
Mass Market (Retail Market) Housing	Mortgage customers with internal history of behaviour	RM score card A	CF = 1	LGD RM
Mass Market (Retail Market) Other	Other retail customers with internal history of behaviour	RM score card B	KF = 1	LGD RM
Businesses (Corporate Market)	Companies that have delivered public accounting	CM sector 1-7	EAD CM	LGD CM
	Companies that do not provide public accounting	Stencil core	EAD CM	LGD CM
	Newly established companies	Stencil score	EAD CM	LGD CM

SpareBank 1 SR-Bank is continuously striving to refine its IRB system and focuses heavily on the development of models. New models are initially used in internal risk management in order to acquire sufficient experience and data to conduct a validation. If its use and validation provide satisfactory results, an application for regulatory use of the model will be submitted. The table below provides an overview over models that so far are only being used in internal risk management.

Table 8: PD models used in the internal risk management

Commitment category	Segment	PD model
Mass Market (Retail Market)	New retail customers without internal history of behaviour	RM New customers
Businesses (Corporate Market, CM)	Commercial properties for rent	PD Property leasing
	Large corporate customers	Rating based PD model
	Companies that do not provide public accounting	CM Sector 8
	Newly established companies	CM Sector 9

In the validation, the different models are assessed on the basis of four criteria: data quality, ranking ability, level and stability in the estimates.

Data quality

The models used for estimating probability of default (PD), exposure at default (EAD), and loss given default (LGD) were developed on the basis of data from the period 1994-2012 from the banks in the SpareBank 1 Alliance.

The data is subject to thorough, continuous quality assurance and an annual validation process is conducted to ensure that it is representative of the current portfolio in SpareBank 1 SR-Bank. Validating the data also shows that it complies with the requirements concerning data that are stipulated in the Capital Requirements Regulations. Proper safety margins have been established where deemed necessary due to the uncertainty in the data.

Discrimination power

The model's ability to rank the customers is primarily measured by means of the area under curve (AUC) method.

The discrimination power of the model that estimates the customers' PD expresses the model's actually ability to rank the customers from the highest actual PD to the lowest PD.

The discrimination power of the model that estimates EAD will show the degree to which the model actually manages to rank the customers from those with the highest conversion factor (CF) to the lowest CF. Validation of the model for corporate customers is conducted annually. Exposure on retail market customers has a fixed conversion factor of one for all customers.

The discrimination power of the model for calculating LGD is validated by analysing estimated and actual losses in the various LGD classes, measured by median, unweighted and weighted average.

The extent to which the model is able to differentiate between customers with the highest expected losses (EL) and the lowest EL in relation to geographic exposure is also validated.

Level

In the Capital Requirements Regulations it is assumed that estimated PD will predict long-term outcome through a full loss cycle. This means that the level of default will be overestimated in booms and normal economic situations, while in periods of serious recession the level of defaults will be underestimated. An assessment is made of whether the difference between actual level of default and estimated level of default is justifiable, given the economic situation. Stress tests are conducted in order to show that the economic properties of the model satisfy the requirements of the Capital Requirements Regulations.

For CF and LGD, the Capital Requirements Regulations assume that model estimates can predict the framework utilisation (CF) and losses in the event of serious economic downturns. This means that the conversion factor and loss estimates must always be higher than actually observed values in normal economic situations. Each element in the LGD model, including recovery, the reduction factors used for collateral values, proportion of unsecured exposure recovered, and unsecured exposure and recovery costs, undergoes validation.

The level of expected loss (EL) is assessed against the level of actual costs recognised in the accounts, both on an overall level and by geographic area. As with the estimated PD, EL should predict long-term outcome through a full business cycle.

Furthermore, stress tests are conducted on all parameters in order to validate that the estimates are in compliance with the Capital Requirements Regulations.

Stability in the estimates

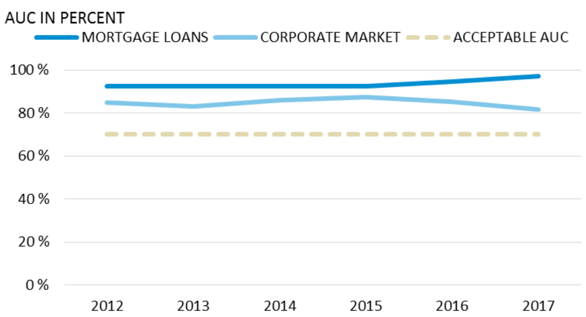
Every risk parameter is validated in order to establish their stability over time, independent of the economic situation. In validating the PD model, the validation is conducted by analysing migration over a twelve-month period, and over time.

Comparison of risk parameters and actual outcome

In this paragraph, an outtake of the validation results for the PD, EAD and LGD models in SpareBank 1 SR-Bank is presented. The work on validation for 2016 was ongoing at the time of publication of Pillar 3 for 2017. The EAD and LGD validation has, therefore, not been updated with numbers for 2017. More detailed information on risk parameters with actual outcome is provided in the appendix.

PD models

Figure 15: Discrimination power PD models



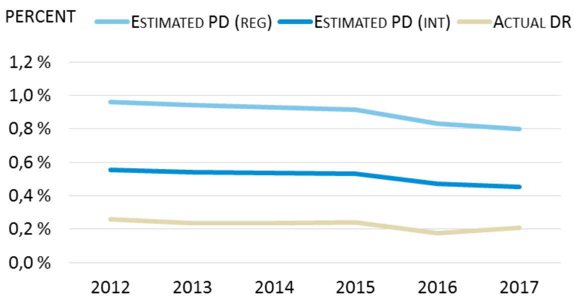
The PD model on mortgage loans has a very high and stable ranking ability, which means that the model is capable of ranking the customers from the ones with highest to lowest actual probability of default. Validation on different segments also demonstrates its good ranking ability. The PD model for corporate customers has a high and stable ranking ability for the portfolio as a whole, while its ranking ability may be somewhat lower for validation in different sub-portfolios. This applies to larger customers and certain types of sector. This is why specific PD models have been developed for these segments, as shown in table 8.

In 2014, the Norwegian FSA passed a new methodology for regulatory calculation of probability of default (PD) and loss given default (LGD) for mortgage loans. The new methodology for calculating the probability of default includes four periods of a normal business cycle and one period with an economic downturn. The level of default in the economic downturn has to be fixed ad 3.5% each year, regardless of the underlying portfolio quality and loss history. Furthermore, a safety margin is attributed to the PD estimates to prevent a level of PD below 0.2%. SpareBank 1 SR-Bank has taken the regulation into account and implemented new, regulatory levels for PD and LGD.

However, SpareBank 1 SR-Bank finds that the new methodology for regulatory calculation of probability of default in an economic downturn significantly overestimates the risk in the underlying portfolio. This entails an overestimation of the PD through a full loss cycle. Internally, SpareBank 1 SR-Bank uses lower PD estimates that reflect the underlying risk in the portfolio to a greater degree. Using the internal estimates provides more risk sensitive risk weightings and better encourages sound risk management.

In section 11-2 (1) in the Capital Requirements Regulations it is assumed that the probability of default (PD) should predict a long-term outcome through a full loss cycle. This means that the PD estimates must be relatively stable over time, as well as through a business cycle. The figure below shows the average estimated probability of default (PD), both internally and regulatory, compared with the average actual default rate in the years 2012-2017. Unweighted values are used. EAD weighted values are presented in the appendix.

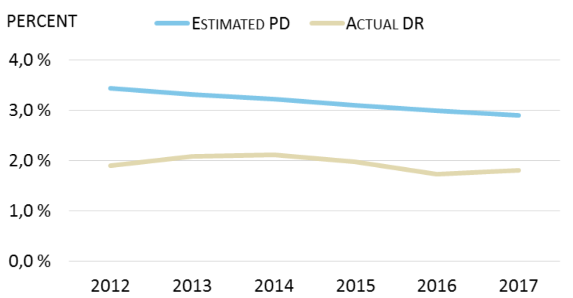
Figure 16: Comparison of unweighted estimated PD with actual DR – mortgage loans (regulatory and internal)



The figure shows that actual default (DR) is significantly lower than both the internally and regulatory estimated default (PD) over the whole period. In compliance with applicable regulations, the regulatory estimate is a significant overestimation of the default rate.

For corporations, the internal and regulatory calibrations are consistent with each other. The figure below shows the average unweighted estimated and actual default rate for the corporate portfolio.

Figure 17: Comparison of unweighted estimated PD and actual DR – corporate market



As the figure shows, estimated probability of default (PD) is significantly higher than actual default (DR) over the entire period. The observations are from a period with a normal business cycle until 2015 and moderate economic downturn in 2016 and 2017 for parts of the economy. The PD-level is in line with the desired cyclical properties of the model.

Every customer with a credit exposure in SpareBank 1 SR-Bank is risk classified at least annually by updating accounting or tax assessment data. Furthermore, the customers are scored monthly, based on information on internal and external behaviour. The figures below show the annual migration of the retail and corporate customers, respectively. Migration is the proportion of customers who change default class during a twelve-month period.

Figure 18: Annual migration – mortgage loans

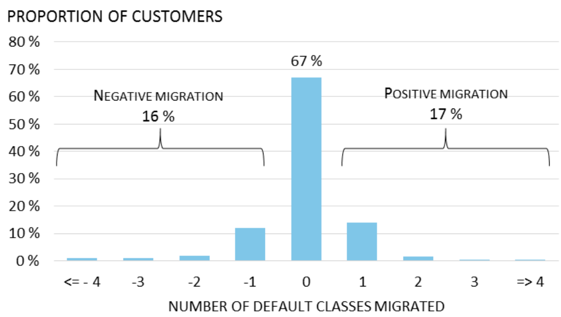
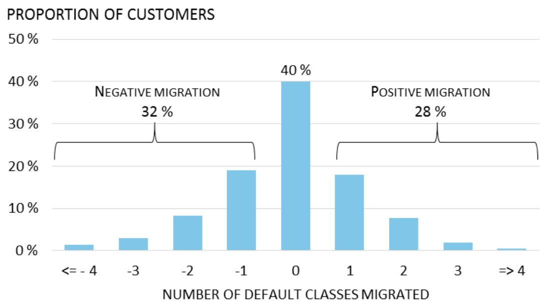


Figure 19: Annual migration - corporate market

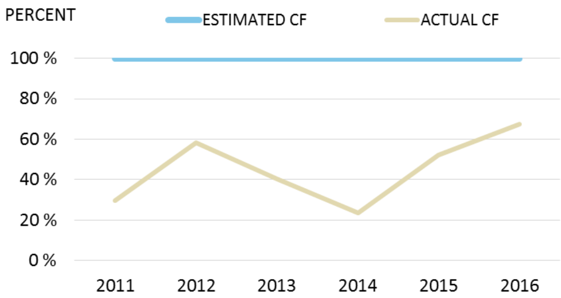


Stability in the PD estimates is the leading indicator of a model's cyclical properties. The figures above show that the proportion of stable customers in 2017 was 67 per cent for mortgage loans and 40 per cent for the corporate market. For corporate market customers, the proportion of negative migration is higher than the percentage of positive migration, while for mortgage customers, the proportion of negative and positive migration is the same. This is because the mortgage portfolio in SpareBank 1 SR-Bank was not affected by the increase in unemployment rates due to the fall in oil price. Mortgage rates have also been low during the period, which in sum indicates that the period may be referred to as normal economic activity. Corporate customers have been more affected by the oil price drop and the associated weakened financial framework conditions. The negative migration in 2017 is mainly due to weaker financial performance in 2015 and 2016, which has an impact on PD when loading accounts.

EAD models

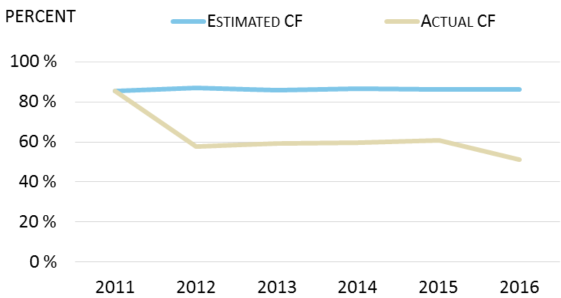
A validation of whether the model estimates can predict the utilisation of limits (CF) in an economic downturn is conducted. This entails that there should be a sufficient margin between estimated and actual values in a normal business cycle. Validation of EAD for 2017 was under preparation by publishing Pilar 3, and the figures below show the estimated and actual conversion factor for mortgage loans and the corporate market, respectively, for the period 2011-2016.

Figure 20: Comparison of estimated and actual conversion factor (CF) – mortgage loans (limit loans)



For all of the mortgage loan customers, the conversion factor is a fixed parameter. In the period with a normal business cycle, actual conversion factor is significantly lower than the estimate.

Figure 21: Comparison of estimated and actual conversion factor (CF) – corporate market



A separate model has been developed for the corporate market that estimates conversion factors based on risk classification and type of commitment. Average estimated conversion factor is 86% and higher than average actual conversion factor at 58%.

LGD models

The new methodology for regulatory calculation of loss given default (LGD) for mortgage loans entails a minimum LGD of 20%, regardless of the underlying quality in the portfolio or historic losses. Internally, SpareBank 1 SR-Bank's own estimates for degree of loss based on internal data with empirical evidence and that is representative of the bank's portfolio are used.

For the corporate market, the internal and regulatory estimates for LGD are consistent with each other. The figures below show the comparison of estimated and actual loss rate on defaulted customers, both in the retail and corporate markets. The loss rate is measured in per cent and weighted relative to the exposure (EAD) on the defaulted commitments.

The Norwegian FSA published in Rundskriv 9/2016 a new minimum discount rate of 9 percent for discounting payments and costs related to defaulted loans. SpareBank 1 SR-Bank has used historically lending rates to corporate clients drawn from Statistics Norway (SSB) as the basis for discount rates. SpareBank 1 SR-Bank implemented the new discount rate in 2017, with retroactive effect for previous observations. This means that the calculated realized LGD deviates from previous years' reporting. The figures below show the estimated and actual loss ratio in the period 2011 – 2016.

Figure 22: Comparison of estimated and actual weighted LGD for defaulted loans – mortgage loans (internal and regulatory)

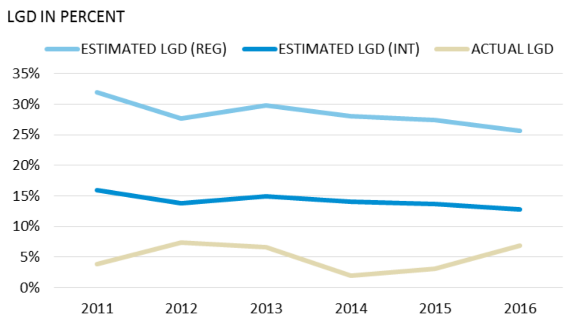
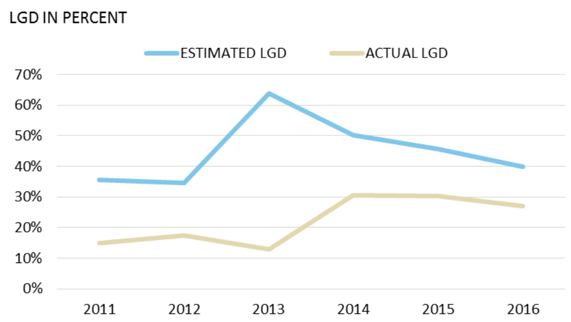


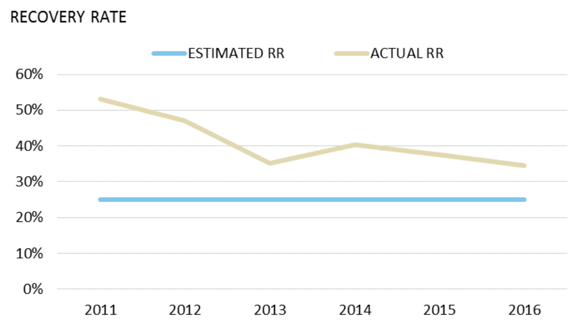
Figure 23: Comparison of estimated an actual weighted LGD for defaulted loans – corporate market



The figures show that actual loss rate is lower than estimated loss rate, for both mortgage loans and the corporate market. Few defaults mean the loss rate of a single customer has the potential to have a large impact on the actual loss rate. This is especially seen in cases with corporate customers.

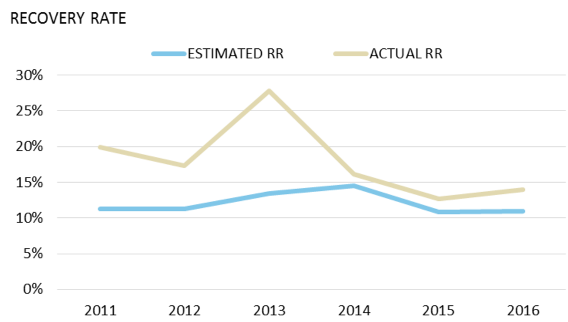
There are two possible outcomes of a default; either the commitment ends with loss with realisation of collateral, or the exposure is recovered. Recovery rate is defined as the proportion of defaulted customers who are recovered during a 12-month period, thus not going to realisation. SpareBank 1 SR-Bank uses a fixed recovery rate of 25 percent for mortgage loans when calculating loss given default. For corporate customers a recovery rate model calculates the estimated recovery rate. The figures below show the estimated and actual observed recovery degree respectively mortgage portfolio and the corporate portfolio.

Figure 24: Comparison of estimated and actual recovery rate (RR) – mortgage loans



Actual observed recovery rate is 41% on average and higher than estimated recovery rate in the years 2011-2016.

Figure 25: Comparison of estimated and actual recovery rate (RR) – corporate market



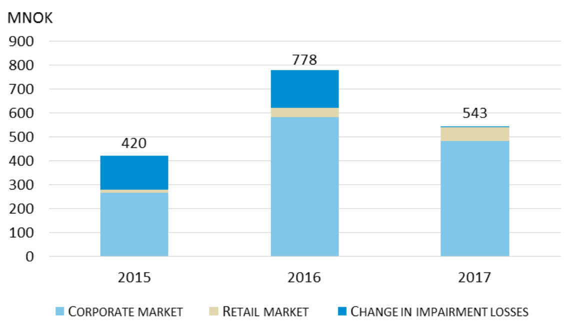
Actual observed recovery rate for the corporate market is on average slightly higher than the level of estimated recovery rate in the years 2011-2016.

Default and impairment

SpareBank 1 SR-Bank continuously evaluates the quality of the credit portfolio, both on an overall level and on a customer level. Customers in default in the form of an overdraft or arrears are monitored and followed up at an early stage. This ensures that any necessary measures are implemented quickly.

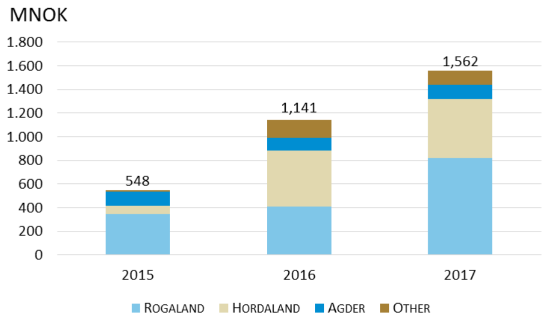
The identification of need for impairment is conducted in line with the 'Regulation on the accounting treatment of loans and guarantees to financial institutions'. A commitment or a group of commitments is defined as experiencing a loss in value if there is objective evidence of an event that reduces the commitment's future cash flow. If such objective evidence exists, the loss on the commitment is calculated as the difference between the carrying value and the present value of estimated future cash flows, discounted by the effective interest rate.

Figure 26: Development in impairment losses



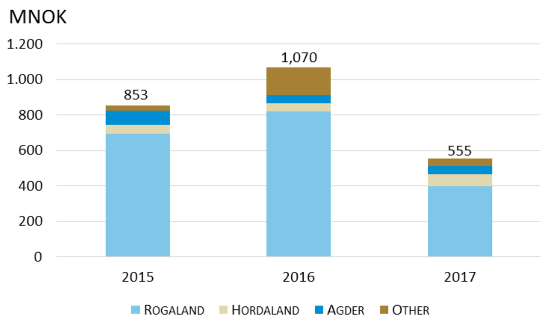
Impairment losses totalled NOK 543 million in 2017, a decrease of NOK 235 million compared with 2016. Impairments in 2017 are still higher than the average in an economic cycle, reflecting that some customers in the oil industry are still experiencing demanding markets. Closely monitoring customers and preventive measures are important tools in maintaining good credit quality, and help to keep impairment losses at a moderate level.

Figure 27: Development in doubtful commitments by geographical area



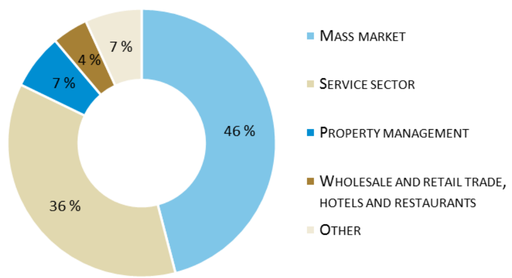
Doubtful commitments includes defaults below 90 days, both with and without individual write-downs. Doubtful commitments have been increasing over the past three years and amounted to NOK 1.56 billion in 2017.

Figure 28: Development in non-performing commitments by geographic area



Non-performing commitments includes defaults with a duration longer than 90 days, both with and without individual write-downs. Total non-performing commitments are significantly reduced in 2017 to NOK 555 million. A total of 46% of non-performing commitments in 2017 is categorised as mass market.

Figure 29: Defaulted commitments in 2017, by standard sector definitions (percentage of total commitment size in default)



Risk-weighted balance for credit risk

Total risk-weighted balance for credit risk was NOK 103.1 billion at the end of 2017, measured by the IRB method and the standard method.

Table 9: Risk weighted balance for credit risk, by commitment categories and sub-categories

		Commitments 31.12.2017	**Commitments EAD 31.12.2017**	**Risk weighted assets Consolidated 31.12.2017**	Risk weighted assets Consolidated 31.12.2016
Enterprises	Specialised enterprises*	36 734	35 022	21 916	19 471
	SME enterprises	26 904	24 350	19 220	17 231
	Other enterprises	9 887	7 996	6 868	6 785
Mass market	Mass market SME	5 924	5 921	1 303	1 194
	Commitments with mortgage on real estate	131 570	131 561	27 026	25 899
	Other mass market commitments	4 603	4 593	1 942	2 027
Risk weighted assets credit risk - IRB		**210,641**	**215 622**	**78 275**	72 607
Governments		6,280		51	68
Local and regional governments, public authorities		3,350		140	333
Institutions		13,176		1,865	2,169
Enterprises		14,531		9,474	7,446
Mass market		9,764		3,884	4,564
Covered bonds		26,858		2,686	1,817
Equity positions		2,312		5,036	4,850
Other assets		2,131		1,678	1,826
Risk weighted assets credit risk - standard method		**78,402**		**24,813**	**23,073**
Total risk weighted assets credit risk				**103,088**	**95,680**

*SpareBank 1 SR-Bank has found that the current categorization of enterprises means that the bank has a share of specialized enterprises which are significantly higher than other comparable banks. If an enterprise is categorized as specialized or not has under current regulations no effect on the capital requirement. The bank's current categorization of specialised enterprises is exclusively made on the basis of the entity's business code, without involving an explicit assessment of whether the terms of the Capital Requirements § 9-1 third paragraph are met. If one or more of the conditions are not met, the commitment cannot be categorised as a specialised enterprise. The Bank has therefore initiated a work to bring categorisation in the direction of current market practices and provisions of the regulations. New categorization will be implemented together with adaptations to the new Basel Standard.

MARKET RISK

Market risk is a collective term that comprises the risk of loss due to changes in market prices. Securities risk, currency risk, interest rate risk, spread risk, risk associated with own holdings and/or use of equity in syndicates, as well as guarantees for the full subscription of offerings are included in market risk.

About market risk

Risk strategy

Market risk in SpareBank 1 SR-Bank primarily relates to the group's investments in securities, including equities and bonds. Furthermore, the group is somewhat exposed to market risk through trading activities in interest rate and currency markets, as well as from activities that underpin ordinary funding and lending activities. The group's exposure to market risk is deemed moderate.

The risk strategy and the associated specification of the necessary risk limits, reporting procedures and authorities must be reviewed and approved by the group's board at least once a year.

Authorities, guidelines and routines

The limits set by the board relating to SpareBank 1 SR-Bank Markets and Treasury are delegated by the chief executive to named people.

SpareBank 1 SR-Bank Markets' guidelines and routines are well described in SJEKK, the bank's system for process and routine descriptions. SJEKK continuously updates the processing steps and routines so that the last valid version is always available. Compliance with the routines by the people involved in managing and controlling market risk is satisfactory.

The group's market risk is measured and monitored based on fixed limits. The responsibility for continuous position reconciliation and measurement of the group's market risk exposure lies with the middle office in SpareBank 1 SR-Bank Markets. The risk manager for market and funding risk is responsible for maintaining continuous control of risk measurements and independent risk reporting, both internally and externally.

Market risk, including spread risk for bonds and securities

Price risk is the risk of losses that arise following changes in the value of the group's commercial paper, bonds and equity instruments. The risk associated with a fall in value for the bond portfolios, including both systematic and unsystematic, is quantified by calculations based on the Financial Supervisory Authority of Norway's stress test model for insurance companies. The method is generally based on Solvency II (the QIS5 specifications).

The liquidity portfolio's total holding amounts to NOK 31.7 billion[7]. The portfolio in SpareBank 1 SR-Bank Markets amounts to NOK 0.3 billion. The table below provides an overview of exposure by asset class.

Table 10: Fair value of the bond portfolio (NOK million)

Sub-portfolio	4th Qtr. 2017	3rd Qtr. 2017	2nd Qtr. 2017	1st Qtr. 2017
Treasury	**31,678**	**29,326**	**28,153**	**21,778**
Norwegian state/municipality	500	758	666	296
OMF/Covered Bond	22,955	20,085	19,173	14,182
Foreign guarantees	8,205	8,435	8,265	7,251
Norwegian bank/finance	18	49	49	48
SR-Bank Markets	**343**	**312**	**313**	**310**
Norwegian bank/finance	90	99	102	101
Industry/other	253	212	211	209

Risk-adjusted capital associated with other market risk is measured and followed-up in accordance with the Value-at-Risk (VaR) principle. The VaR model covers the group's interest rate and currency

[7] Of which NOK 3.2 billion is measured at amortized cost and is therefore not exposed to market risk.

risk, as well as the securities risk associated with the group's investments in equities, units and other equity investments.

Market risk is reported under credit and counterparty risk in accordance with the standard method.

Bond portfolio

Risk profile and portfolio performance

The group has two different portfolios consisting of bonds and commercial paper – the liquidity portfolio and trading portfolio, respectively. The respective portfolios are governed by separate management mandates.

Liquidity portfolio (managed by Treasury)

The liquidity portfolio consists of interest-bearing securities that either satisfies the requirements for depositing with Norges Bank, the LCR regulations or uncommitted credit facilities, as well as exposure on companies within the SpareBank 1 alliance. The size of the portfolio will always depend on the group's balance sheet and thereby the need for liquid assets. At the end of the fourth quarter of 2017, the value of the combined liquidity portfolio totals NOK 31.7 billion.

In accordance with the group's internal guidelines, securities that do not satisfy the aforementioned requirements entail a credit risk governed by special processing rules.

Trading portfolio

The trading portfolio consists of financially oriented investments in interest-bearing securities[8]. The current limit for such investments is NOK 1 billion. All investments in the trading portfolio that do not satisfy the criteria for uncommitted credit lines stipulated by the board of directors shall be subject to ordinary credit processing. At the end of the fourth quarter of 2017 the trading portfolio includes investments in 32 companies valued at NOK 343 million.

The trading portfolio does not have any structured bonds (CDOs, etc.) or other types of financial instruments.

The tables below provide a summary of SpareBank 1 SR-Bank's exposure to bonds in the different portfolios:

Table 11: Securities exposure, bonds and securities

Risk classes for bonds and commercial paper – total

Risk category	Rating	Market value NOK million	Total %
Very low risk	AAA, AA+, AA and AA-	31,644	98.9 %
Low risk	A+, A and A-	0	0.0 %
Moderate risk	BBB+, BBB and BBB-	77	0.2 %
High risk	BB+, BB and BB-	187	0.6 %
Very high risk	B+ and lower	96	0.3 %
Total		**32,005**	**100.0 %**

Risk classes – Treasury

Risk category	Rating	Market value NOK million	Treasury %
Very low risk	AAA, AA+, AA and AA-	31,644	99.9 %
Low risk	A+, A and A-	0	0.0 %
Moderate risk	BBB+, BBB and BBB-	18	0.1 %
High risk	BB+, BB and BB-	0	0 %
Very high risk	B+ and lower	0	0 %
Total		**31,663**	**100.0 %**

Risk classes – SpareBank 1 SR-Bank Markets

Risk category	Rating	Market value NOK mill	Trading %
Very low risk	AAA, AA+, AA and AA-	0	0 %
Low risk	A+, A and A-	0	0 %
Moderate risk	BBB+, BBB and BBB-	59	17.2 %
High risk	BB+, BB and BB-	187	54.7 %
Very high risk	B+ and lower	96	28.1 %
Total		**343**	**100.0 %**

[8] Includes hybrid capital (mutual fund bonds), classified as equity

Interest rate risk

Interest rate risk arises because the group's assets and liabilities can be subject to different fixed rate periods. Interest rate instrument trading must always comply with the adopted limits and authorities. The group's limits define quantitative targets for the maximum potential loss. The commercial risk is quantified and monitored continuously.

The group's general limits for interest rate risk define the maximum loss from a 1 percentage point change in interest rates. The maximum loss following a 1 percentage change in interest rates totals NOK 85 million with NOK 35 million of the total balance in SpareBank 1 SR-Bank Markets and NOK 50 million of the total balance in Treasury.

The total currency position cannot exceed the interest rate risk limit in NOK.

Table 12: Sub-limits within the different maturity bonds

Maturity bond	Limit SR-Bank Markets	Treasury limit
0 – 3 months	NOK 20 million	NOK 50 million
3 – 6 months	NOK 20 million	NOK 50 million
6 – 9 months	NOK 10 million	NOK 50 million
9 months – 1 year	NOK 10 million	NOK 50 million
1 year – 18 months	NOK 10 million	NOK 20 million
18 – 24 months	NOK 15 million	NOK 15 million
Each year (1-10)	NOK 30 million	NOK 15 million
10 years or more	NOK 30 million	NOK 10 million

The table below shows the total interest rate risk by the end of the last four quarters.

Table 13: Effect on earnings of a positive parallel shift in the yield curve of one percentage point (NOK million)

Interest rate risk	0-6 months	6-12 months	1-5 years	> 5 years	Total
4th Qtr. 2017	-11	-0	-13	2	**-22**
3rd Qtr. 2017	-23	7	-7	4	**-20**
2nd Qtr. 2017	-26	8	-4	1	**-21**
1st Qtr. 2017	-13	7	-5	1	**-9**

Foreign exchange risk

Currency rate risk is the risk of loss due to fluctuations in foreign exchange rates. The group measures currency risk of net positions in the different currencies in which the group is exposed. The group has prepared limits for the net exposure to each individual currency, and limits for the aggregate net currency exposure. The overnight price risk for spot trading in foreign currencies shall not exceed NOK 100 million for each individual currency, and NOK 175 million in aggregate.

The table below shows the net foreign currency exposure including financial derivatives at the end of the last four quarters.

Table 14: Foreign currency exposure including financial derivatives (NOK million)

Currency	4th Qtr. 2017	3rd Qtr. 2017	2nd Qtr. 2017	1st Qtr. 2017
EUR	-31	-70	-93	-99
USD	0	0	0	0
CHF	-0	-2	-7	-9
GBP	0	0	0	0
SEK	3	-9	-6	-41
Other	-36	-56	-51	-21

Securities risk, shares[9]

Shares, units and other equity interests are classified within the categories of fair value and available for sale. Securities that can be measured reliably and are reported internally at fair value are classified as fair value through profit and loss. Other shares are classified as available for sale.

The table below provides a summary of the group's shareholdings at the end of the last four quarters.

Table 15: The group's share portfolio at fair value at the end of the year (NOK million)

Balance sheet classification	4th Qtr. 2017	3rd Qtr. 2017	2nd Qtr. 2017	1st Qtr. 2017
Shares, units etc.	627	562	529	622
Available for sale	0	0	22	22

[9] Does not include hybrid capital (mutual fund bonds) classified as equity

OPERATIONAL RISK

Operational risk is the risk of loss due to weak or inadequate internal processes or systems, human errors or external incidents[10].

Management of operational risk

SpareBank 1 SR-Bank aims to have a moderate risk profile for operational risk with a good balance of trust and control that ensures efficiency, while not exposing the Group to unnecessary risk. This is achieved through a good risk culture in the organisation, continuous learning from unwanted incidents and the development of leading methods for identifying and quantifying risk.

Risk strategy and limits on operational risk exposure are set annually and approved by the board. The individual managers are responsible of ensuring that the unit they lead is subject to adequate management and control given the limits, and that operational risk is managed in accordance with the strategy and guidelines defined for SpareBank 1 SR-Bank. The Risk Management Department is responsible for supporting and challenging the risk owners, and for ensuring that the group has a good framework for the identification, reporting and follow-up of operational risk.

Measuring operational risk

SpareBank 1 SR-Bank calculates and keeps regulatory capital related to operational risk in accordance with the standardised approach. However, as this method is based on historical income and does not take business-specific factors and established controls into account, it is deemed to provide an inadequate indication of the actual exposure to operational risk. In order to gain insight into what actually drives operational risk within business processes and thereby measure risk exposure, a total review of the group's operational risk exposure is conducted at least annually. In this process, potential risk scenarios and their associated probabilities and consequences are analysed with extensive involvement by business process owners and technical experts. The resulting estimated exposure to operational risk is input in the group's management accounts in order to calculate the business unit's risk-adjusted return. Thus, any measure carried out to reduce the estimated operational risk exposure, will translate into improved risk-adjusted return for relevant business units. This encourages active risk management.

The group's insurance arrangements have a major impact on the potential financial consequences of operational risks. For all identified risks with a potential financial consequence of more than NOK 10 million, an individual assessment of expected insurance coverage is conducted.

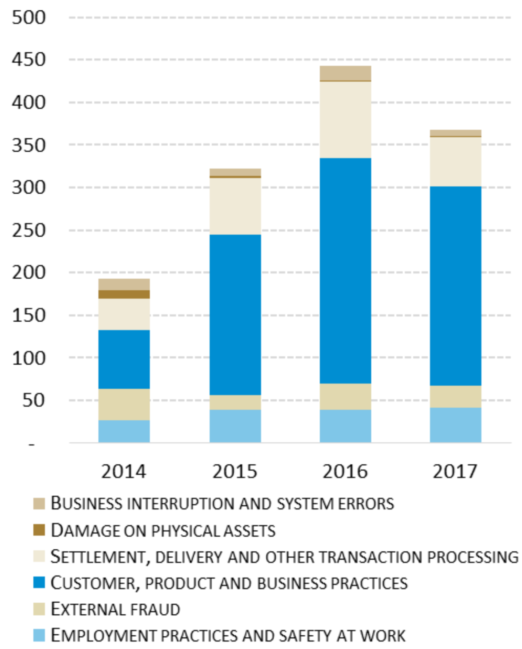
Development in operational risk

Through periodic mapping and updating of the risk picture, SpareBank 1 SR-Bank has identified operational risks with significant loss potential over the past five years. As a result, targeted risk mitigation actions have been implemented which have kept the overall level of potential loss at a stable level. This is achieved through targeted measures against risk drivers, in order to reduce the probability of identified risks to occur, as well as measures to reduce the consequences if they do. Implemented measures are mainly related to changes in procedures, stricter amount limits, improvement of system controls and targeted collection of additional insurances.

Unwanted incidents that occur in the group are registered and followed up in order to avoid repetition. It is important that as many of the incidents that occur as possible are registered since they provide valuable input for risk evaluations and provide a basis for continuous operational learning and improvement. The figure below shows the number of registered incidents in 2014 through 2017.

[10] Legal risk is included in operational risk, but not strategic risk and reputation risk, which are assessed separately.

Figure 30: Registered, undesired incidents by Basel categories



The number of registered incidents has increased from 2014, mainly due to upgraded system support from 2015 and improved reporting culture. The number of registered events in 2017, however, is somewhat lower than in 2016. This reduction is mainly due to fewer events related to settlement, delivery and other transaction processing. Most of the registered incidents is still related to customers, products and business practices. The total loss from registered unwanted incidents in 2017 amounted to NOK 5 million, compared with NOK 8 million in 2016.

Risk-weighted balance for operational risk

Risk-weighted balance for operational risk is calculated as a percentage of average income for each business area over the past three years. Banking services for the mass market are weighted 12%, banking services for the business market 15% and other services are weighted 18%.

The table below shows the risk-weighted balance for operational risk in 2017 and 2016. The SpareBank 1 SR-Bank group uses the standardised approach for calculating risk-weighted balance for operational risk. Other companies use the basic approach.

Table 16: Risk-weighted balance for operational risk according to the standardised approach

2017	Konsolidert	Boligkreditt	Næringskreditt	BN Bank	SpareBank 1 Kredittkort*
Banking services for mass market customers	3,759				
Banking services for corporate customers	3,406				
Payment and settlement services	-245				
Proportion of operational risk consolidated	510	70	52	256	132
Totalt	**7,430**	**70**	**52**	**256**	**132**

2016	Konsolidert	Boligkreditt	Næringskreditt	BN Bank	SpareBank 1 Kredittkort*
Banking services for mass market customers	3,894				
Banking services for corporate customers	3,049				
Payment and settlement services	-302				
Proportion of operational risk consolidated	413	101	51	261	
Totalt	**7,054**	**101**	**51**	**261**	

*SpareBank 1 Kredittkort is consolidated as of Q1 2017.

LIQUIDITY RISK

Liquidity risk is the risk that the group is unable to refinance its debt or is unable to finance an increase in assets.

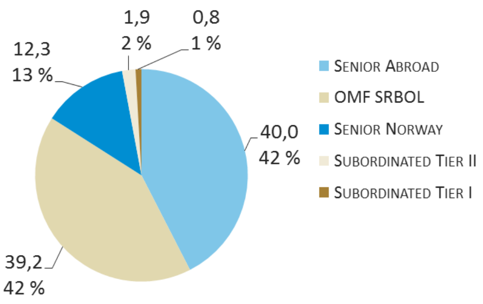
About liquidity risk

The bank's framework for managing liquidity risk shall reflect the bank's risk profile. Liquidity risk shall be low.

Management and measurement of liquidity risk

Liquidity risk is managed and measured by means of several measurement methods, as no method alone can be used to quantity this type of risk. The methods include limits for the maximum refunding need for various maturities, key balance sheet figures, survivability targets in a normal situation, assuming the capital markets are closed and the short-term liquidity measure LCR. Furthermore, internal stress tests are conducted to determine the bank's ability to survive under various scenarios, including a serious bank or market specific crisis. The results of the stress tests are included in the information on which the group's liquidity strategy and recovery plan[11] for a liquidity crisis are based.

Figure 31: Composition of the group's securities borrowing as of 31 December 2017 (NOK billion and percent)



The liquidity reserve is NOK 32.3 billion, and the group has an additional NOK 19.7 billion representing mortgage loans that have been prepared in the WEB client (loans ready to be transferred to the mortgage companies). The liquidity situation for SpareBank 1 SR-Bank is satisfactory.

The liquidity buffer indicates a survival period of 32 months at the end of 2017 without access to external funding[12]. During the next twelve months, debt corresponding to NOK 10.9 billion will be refinanced.

Deposits from customers represent the group's most important source of funding. For the group as a whole, the volume of deposits increased by NOK 9.5 billion (11.0%) to 95.4 billion in 2017. The deposit coverage ratio has increased from 47.1% in 2016 to 51.0% in 2017.

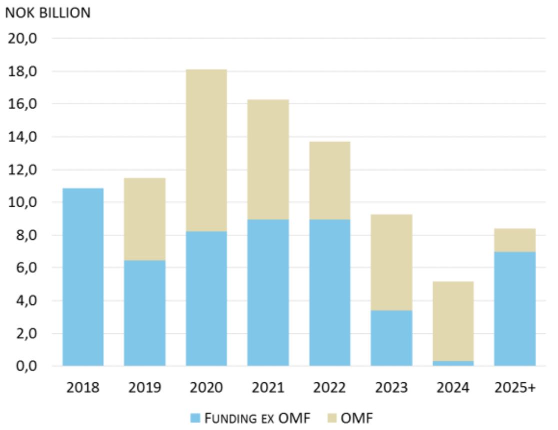
SR-Boligkreditt AS is a wholly owned subsidiary, established in the second quarter of 2015. The aim of the company is to buy mortgages from SpareBank 1 SR-Bank, which is financed by issuing covered bonds. Through SR-Boligkreditt AS, SpareBank 1 SR-Bank can diversify and optimise its funding. Mortgage loans transferred to SR-Boligkreditt AS amounted to NOK 40.8 billion by the end of 2017, while mortgage loans transferred to SpareBank 1 Boligkreditt AS amounted to NOK 14.1 billion. Transferred balance to the mortgage companies accounts for about 45% of the gross mortgage loan balance and around 30% of the total gross lending. Loans in SpareBank 1 Næringskreditt AS total approximately NOK 0.5 billion.

The figure below illustrates the maturity structure for the funding portfolio at the end of 2017[13].

[11] The group recovery plan also serves as the group's contingency plan, cf. regulations on prudent liquidity management § 6
[12] Assuming unchanged lending and deposit volumes

[13] Excluding SpareBank 1 Boligkreditt and Næringskreditt

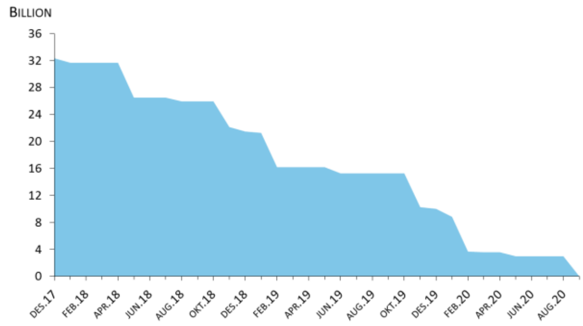
Figure 32: The funding portfolio's maturity structure as of 31 December 2016



The average remaining term to maturity in the portfolio of senior bond funding was 3.5 years[14] at the end of 2017.

A sensitivity analysis that measures the group's ability to survive in the event of closed capital markets is prepared on a monthly basis. The primary objective of the analysis is to measure whether the funding risk is in accordance with the definition of targets for liquidity management, which specify that SpareBank 1 SR-Bank must be able to survive for a minimum twelve months without external access to liquidity in a normal situation. The analysis is based on different scenarios. In the basis scenario, the growth in net funding needs is set at zero, i.e. the relationship between deposits and loans are kept constant.

Figure 33: Sensitivity analysis of the funding risk – basis scenario



As the basis scenario assumes that access to external funding is unavailable, new lending can only be funded by instalments from and the maturity of the existing loan portfolios. In such a situation, the group's liquidity buffer ensures the ability to survive to the end of February 2020. The liquidity buffer consists of cash and very secure interest-bearing securities. The group's liquidity target, LCR (liquidity coverage ratio), was 168% at the end of 2017.

[14] Based on «first call»

OWNERSHIP RISK

Ownership risk is the risk that SpareBank 1 SR-Bank will incur a negative result from stakes in strategically owned companies and/or need to inject fresh capital into these companies. Owned companies are defined as companies in which SpareBank 1 SR-Bank has a significant stake and influence.

Management of ownership risk

SpareBank 1 SR-Bank heavily focuses on management and control in companies in which the bank has full or partial ownership. In companies that are part-owned, either through direct ownership by SpareBank 1 SR-Bank or indirectly through ownership of 19.5% of SpareBank 1 Gruppen, SpareBank 1 SR-Bank, as the largest bank in the alliance, is represented as a board member in all companies of significant importance.

All follow-up of ownership interests is performed under the group's chief financial officer. All reporting from the individual companies and questions regarding capital increases etc. are reported here. A good supply of information is assured through active participation in the board of directors of a number of the part-owned companies, which safeguards SpareBank 1 SR-Bank's ownership interests. In cases of importance to SpareBank 1 SR-Bank’s other operations, the individual board chairman/member will submit the matter for a plenary discussion by the group’s executive management team.

The group’s board stipulates risk limits and the allocation of equity to the individual companies annually. This is based on a framework for the assessment of risk.

About ownership risk

The ownership risk varies from company to company, depending on the company's operations and the inherent risk, as well as SpareBank 1 SR-Bank's stake. The figure below shows the Bank's wholly owned and partly owned companies as at 31 December 2017.

Figure 34: Wholly and partly owned companies as at 31 December 2017

Divisions of SpareBank 1 SR-Bank ASA	Fully owned companies		Partly owned companies	
Capital Markets Number of man-years: 26	**EiendomsMegler 1** Leading real estate broker Number of man-years: 199	**SR-Boligkreditt** Covered Bond Funding Number of man-years: 1	**BN Bank** (23.5%) Commercial bank located in Oslo and Trondheim	**SpareBank 1 Gruppen** (19.5%) Holding company for the SpareBank 1 - Alliance
Retail Market Number of man-years: 503	**SpareBank 1 SR-Forvaltning** Asset management Number of man-years: 11	**FinStart Nordic** The company will be a start-up factory for new ideas Number of man-years: start-up 1 January 2018	**SpareBank 1 Boligkreditt** (8.0%) Covered bond company (mortgages)	**SpareBank 1 Næringskreditt** (19.2%) Covered bond company (commercial real estate)
Corporate Market Number of man-years: 169	**SpareBank 1 Regnskapshuset SR** Accounting and advisory Number of man-years: 93		**SpareBank 1 Kredittkort** (17.9%) Credit card company located in Trondheim	**SpareBank 1 Betaling*** (19.7%) The company behind mobile payment solution *Owner 25% in VIPPS AS
Administration & Support Number of man-years: 216				

BUSINESS RISK

Business risk is the risk of unexpected fluctuations in incomes and costs resulting from changes in external circumstances, such as the market situation or government regulation.

The group has developed a well-diversified income base over a long period of time, and this means that any reduction in the individual product groups or customer segments will not have significant consequences over time.

Over time, the group has developed cost-effective operations in combination with a continuous development of competence and expansion of the operations with regard to the range of products and geography. SpareBank 1 SR-Bank has systematically focused on the value chain philosophy and development of products and services for several years.

REPUTATION RISK

Reputation risk is the risk of a failure in earnings and access to capital due to a lack of trust and damage to reputation in the market, i.e. in relation to customers, counterparties, stock markets and authorities.

The group has established an information department that is represented in the group’s executive management team. Dedicated employees are responsible for handling all communications in social media, and information management is included in the group’s contingency plan, which is distributed to all employees.

SpareBank 1 SR-Bank has also implemented an internal process for identifying and evaluating the group's overall reputation risk situation. A full review and survey of the reputation risks to which the group is exposed are conducted regularly and at least semi-annually. Changes in the risk situation are also registered.

Reputation risk is identified and sorted according to:

- Direct management cost (firefighting)
- Impact on departure of existing customers
- Impact on influx of new customers
- Potential for the Group's concessions may come under consideration and thus indirectly affect market value and financing capacity
- If certain events would result in revealing attitudes and actions that deviate significantly from the Group communicated values

The group continuously monitors its reputation, both through day-to-day media monitoring and evaluation, as well as continuously monitoring discussions in different social channels. The continuous day-to-day evaluations are carried out as objectively as possible. Members of the group’s executive management team and other key personnel receive daily media reports.

STRATEGIC RISK

Strategic risk is the risk of loss due to failed strategic decisions.

SpareBank 1 SR-Bank annually conducts a strategy process that involves the board of directors, key personnel, departments and subsidiaries. The result of this process is a strategic presentation of goals for the following three years, with an associated business plan and plan of action. The business plan clearly shows the priorities the group has made for the period based on scenarios and the competition and market situation. The business plan and plan of action are more detailed for the next year.

The group's executive management team conducts monthly and four-monthly evaluations of the group's achievements and strategic direction. The evaluation also assesses relevant new initiatives and measures that must be implemented based on changes in assumptions or the market situation. Strategic work is therefore flexible in its approach and can safeguard both short-term and long-term goals.

COMPLIANCE RISK

Compliance risk is the risk that the group incurs public sanctions/penalties or financial loss due to failure to comply with legislation and regulations.

The compliance function at SpareBank 1 SR-Bank is an independent function that ensures that the laws, regulations, standards and recommendations that regulate our operations, and are laid down by government agencies or other institutions or associations, are implemented and complied with.

Compliance policy

The group's compliance policy is adopted by the board and describes the main principles for responsibility and organisation. The group stresses the importance of good processes to ensure compliance with the current laws and regulations. Effective tools for achieving this include:

- Clear values that are clearly communicated and understood throughout the organisation.
- A process that detects, communicates, and implements changes in legislation and regulations.
- A process to monitor and report compliance with legislation and regulations.

Management of compliance risk

SpareBank 1 SR-Bank is managed through the compliance framework as set out in the Bank's compliance policy, which ensures that the Group does not incur public sanctions / fines or financial losses due to non-implementation and compliance with laws and regulations. The Group's compliance policy is adopted by the Board and describes the main principles of responsibility and organisation.

SpareBank 1 SR-Bank is commited to having good processes to ensure compliance with applicable laws and regulations. Focus areas are ongoing follow-up of compliance with applicable regulations, and ensuring that the Group has the best adaptation to future regulatory changes.

The group's compliance function is performed by the Compliance Department, which is organised independently of the business units. The department bears overall responsibility for the framework, follow-up and reporting in the area of compliance. Subsidiaries and the investment firm have designated compliance managers when this is required. The designated compliance manager for the group's investment firm is responsible for ensuring that the bank's activities relating to the provision of investment services always comply with the regulations for securities trading.

The group's managers have an operational responsibility for practical implementation and compliance with laws and regulations. All employees are responsible for ensuring that they comply and understand the laws and regulations on a day-to-day basis.

ABBREVIATIONS AND DEFINITIONS

An explanation of abbreviations used in Pillar 3 is given in the table below.

Abbreviation	Explanation
IRB	Internal Rating Based
PD	Probability of Default
DR	Default Rate
EAD	Exposure at Default
CF	Conversion Factor (proportion of unutilised credit facility which is expected to have been drawn upon default)
LGD	Loss Given Default
RM	Retail market
CM	Corporate Market

A commitment is considered to be in default if:

- A claim is overdue by more than 90 days and the amount is over NOK 1,000, or
- When the bank has reason to believe that there is a chance that the debtor is unable to (fully) repay according to their obligations:
  - The bank makes an impairment attributable to poorer creditworthiness
  - The bank claims a loss due to poorer creditworthiness
  - Due to payment problems with the counterpart, the bank grants a postponement of payment or new credit to payment by term, or comes to an agreement of changes in the interest rate or other conditions
  - An opening of debt negotiations, bankruptcy or public administration with the counterparty is requested, or voluntary debt negotiations have been initiated
  - For any other reasons, the bank presumes that the obligations will not be fulfilled

OVERVIEW OVER FIGURES

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APPENDIX

Consolidation basis

Table 17: Consolidation basis (amounts in NOK 1,000)

Subsidiaries As at 31/12/2017	Number of shares	Book value	Voting rights	Consolidation method
Wholly consolidated companies				
EiendomsMegler 1 SR-Eiendom AS	150	97,205	100 %	Acquisition method
FinStart Nordic AS *	4,700	224,225	100 %	Acquisition method
SR-Forvaltning AS	6,000	29,018	100 %	Acquisition method
Regnskapshuset SR AS	9,000	80,125	100 %	Acquisition method
Rygir Industrier AS konsern	90,000	164,382	100 %	Acquisition method
Finansparken Bjergsted AS	8,000	258,016	100 %	Acquisition method
SR-Boligkreditt AS	4,000,000	4,000,150	100 %	Acquisition method
Total		**4,853,121**		

Subsidiaries As at 31/12/2016	Number of shares	Book value	Voting rights	Consolidation method
Wholly consolidated companies				
SpareBank 1 SR-Finans AS	334,000	883,228	100 %	Acquisition method
EiendomsMegler 1 SR-Eiendom AS	150	97,205	100 %	Acquisition method
SR-Investering AS	3,500	164,225	100 %	Acquisition method
SR-Forvaltning AS	6,000	29,018	100 %	Acquisition method
Regnskapshuset SR AS	8,000	70,125	100 %	Acquisition method
Rygir Industrier AS konsern	90,000	186,246	100 %	Acquisition method
Finansparken Bjergsted AS	8,000	258,016	100 %	Acquisition method
SR-Boligkreditt AS	3,025,000	2,025,150	100 %	Acquisition method
Total		**3,713,213**		

* SR-Investering AS has changed its name to FinStart Nordic AS in 2017.

Method of consolidation is the same for accounting purposes and capital adequacy purposes.

Subsidiaries using the standard method

	31/12/2017	31/12/2016	
Amounts in NOK million	**SR-Forvaltning**	SpareBank 1 SR-Finans	SR-Forvaltning
Net regulatory capital	**19**	1,078	17
Minimum regulatory capital requirements	**83**	6,553	71
Capital ratio %	**23.29**	16.45	24.71

Subsidiaries using the IRB method

	31/12/2017	**31/12/2016**
Amounts in NOK million	**SR-Boligkreditt**	
Net regulatory capital	**3,934**	1,974
Minimum regulatory capital requirements	**16,925**	12,089
Capital ratio %	**23.24**	16.33

Investments in associated companies and joint ventures

Investments in associated companies are accounted for according to the equity method in the group and according to the acquisition method in the parent bank. The investments are treated identically for the purposes of determining the capital adequacy ratio except for the group's investments in SpareBank 1 Boligkreditt AS, SpareBank 1 Næringskreditt AS, BN Bank AS and SpareBank 1 Kredittkort AS. Proportionate consolidation is carried out for the group's capital adequacy.

Investments in joint ventures are recognised in the group using the equity method and in accordance with the acquisition method in the parent bank. The investments were treated equally for capital adequacy purposes.

Table 18: Investments in associated companies and joint ventures

Amounts in NOK 1,000	**Ownership percentage 1) 31/12/2017**	**Capital requirements 2) 31/12/2017**	**Capital adequacy percentage 31/12/2017**	Ownership percentage 1) 31/12/2016	Capital requirements2) 31/12/2016	Capital adequacy percentage 31/12/2016
SpareBank 1 Boligkreditt AS 1)	9.5	7,093	16.68	15.3	11,241	16.52
SpareBank 1 Næringskreditt AS	19.2	1,971	22.87	21.9	2,482	20.67
BN Bank ASA 1)	24.2	3,247	29.57	24.2	3,317	28.88
SpareBank 1 Kredittkort AS	17.9	894	24.30			

1) Including indirect assets
2) SpareBank 1 SR-Bank's share

SpareBank 1 Boligkreditt AS and BN Bank AS use the IRB approach in its capital adequacy reporting. SpareBank 1 Næringskreditt AS uses the standard approach for reporting capital adequacy.

SpareBank 1 SR-Bank places an emphasis on maintaining adequate capitalisation at all times for all business units within the group. The group's governing bodies have not imposed any limitations on the board of directors' authorisation to transfer capital between the parent bank and its subsidiaries and from subsidiary to subsidiary with the exception of regulatory and other statutory limitations. In addition, there are no provisions in the Articles of Association that impose any such restrictions.

For the same reason, the bank and its subsidiaries do not enter into agreements that impose limitations on the board of directors' right to transfer capital as mentioned above. This applies to funding loan agreements and agreements with suppliers and customers. Accordingly, no restrictions have been placed on the board's opportunity to transfer capital between the various business units in the parent bank either. Moreover, the transfer of capital between the companies will be regulated by ordinary legislation for these companies and for the financial group as a whole. As for investment in subsidiaries, the group has a strategic interest in supporting the activities of SpareBank 1 Boligkreditt AS and SpareBank 1 Gruppen AS. In this connection the group is concerned about no agreements being entered into or decisions etc. made that entail a restriction of the owner banks' opportunity to transfer capital to these companies if this should be necessary in order to achieve satisfactory capital adequacy or financial strength. The group is not aware of any such constraints with the exception of those imposed by legislation and the regulation. The group assumes that the transfer of capital from these two companies to the owner banks will not be practical, with the exception of ordinary dividend payments, and it has based the group's own risk profile on this assumption. As far as the group knows, there are no private legal impediments that restrict dividend distributions from these companies.

Regulatory capital

The bank differentiates between material assets >10% and non-material assets in financial institutions. Investments that exceed 10% of own common equity tier 1 capital after deductions are deducted from primary capital and the deductions are made in the same class of capital to which the instrument one owns belongs. Investments in common equity tier 1 instruments that are not deductible from primary capital are weighted 250% in the basis for calculation.

Table 19: Regulatory capital in other financial institutions

Amounts in NOK million	**Ownership percentage 31/12/2017**	**Book value 31/12/2017**	Ownership percentage 31/12/2016	Book value 31/12/2016
SpareBank 1 Gruppen	19.5 %	1,677	19.5 %	1,585
Sparebanken Hedmark [2]			1.6 %	126
Sandnes Sparebank	15.1 %	191	15.1 %	140
SpareBank 1 Kredittkort [1]			18.1 %	210
SpareBank 1 Betaling	19.7 %	63	19.7 %	19
Visa		60		33
Other financial institutions		102		44
Total		**2,093**		2,157

[1] SpareBank 1 Kredittkort is consolidated as of Q1 2017.

[2] Sparebanken Hedmark is sold in Q2 2017.

Table 20: Regulatory capital

Regulatory capital, including core capital and supplementary capital, as well as relevant supplements, deductions and limitations.

Total minimum common equity Tier 1 capital ratio requirement, including countercyclical capital buffer and Pilar 2 premiums, was 14.0% per 31/12/2017 for SpareBank 1 SR Bank. The common equity Tier capital requirement consists of the common capital requirement of 4.5%, conservation buffer of 2.5%, systemic risk buffer of 3.0% and countercyclical buffer of 2.0%. In addition, the Norwegian FSA has established an individual Pillar 2 requirement of 2.0%.

Group (Amounts in NOK million)	**31/12/2017**	31/12/2016
Share capital	**6,394**	6,394
Share premium reserve	**1,587**	1,587
Allocated dividend	**1,087**	575
Fund for unrealised gains	**43**	52
Hybrid capital	**150**	-
Other equity	**10,628**	9,680
Total recorded equity	**19,889**	18,288
Core (Tier 1) capital		
Deferred tax, goodwill and other intangible assets	**-116**	-94
Deduction for allocated dividend	**-1,087**	-575
Deduction in expected losses IRB less loss provisions	**-337**	-263
Hybrid capital not to be included in core (Tier 1) capital	**-150**	
Deduction for investments in other financial institutions	**-72**	-163
Value adjustments due to the requirements for prudent valuation	**-38**	-50
Total core (Tier 1) capital	**18,089**	17,143
Hybrid capital	**392**	-
Hybrid Tier 1 bond [1]	**797**	1,084
Total core (Tier 1) capital	**19,278**	18,227
Supplementary (Tier 2) capital in excess of core (Tier 1) capital		
Non-perpetual subordinated capital	**2,254**	2,276
Deduction for investments in other financial institutions	**-43**	-60
Total supplementary (Tier 2) capital	**2,211**	2,216
Net regulatory capital	**21,489**	20,443

[1)] Terms and conditions are presented in the table "Subordinated loan capital and hybrid Tier 1 bonds"

Risk weighted assets	**31/12/2017**	31/12/2016
Credit risk and counterparty credit risk	**103,088**	95,680
Credit value adjustment risk (CVA)	**933**	701
Operational risk	**7,430**	7,054
Capital adequacy requirements related to transitional arrangements	**8,709**	13,216
Risk weighted assets	**120,160**	116,651
Common equity Tier 1 capital requirement 4.5 %	**5,407**	5,249
Buffer requirements		
Capital conservation buffer 2.5 %	**3,004**	2,916
Systemic risk buffer 3 %	**3,605**	3,500
Countercyclical buffer 1 %	**2,403**	1,750
Combined buffer requirement	**9,012**	8,166
Surplus CET1	**3,670**	3,728
Capital adequacy	**17.88 %**	17.52 %
Of which core capital	**16.04 %**	15.63 %
Of which supplementary capital	**1.84 %**	1.90 %
Common equity tier 1 ratio	**15.05 %**	14.70 %
Unweighted Tier 1 capital	**7.37 %**	7.28 %

Subordinated loan capital and hybrid tier 1 bonds

Subordinated loan capital and hybrid Tier 1 bonds (hybrids) in foreign currencies are included in the Group's total currency position so that there is no currency risk associated with the loans. Of a total of NOK 2 764 million in subordinated loan capital, NOK 794 million counts as core (Tier 1) capital and NOK 1 897 million as non-perpetual subordinated capital. Capitalised costs associated with borrowing are reflected in the calculation of amortised cost.

Table 21: Subordinated loan capital and hybrid tier 1 bonds

Principal	Terms	Maturity	First maturity Date	2017	2016
Non-perpetual					
NOK 300	3 month Nibor + 1.45 % p.a.	2029	2024	**300**	
NOK 625	3 month Nibor + 1.52 % p.a.	2028	**-**	**625**	
NOK 500	3 month Nibor + 1.80 % p.a.	2023	2018	**499**	499
EUR 50	6 month Euribor + 1.725 % p.a.	2030	2030	**492**	465
NOK 825	3 month Nibor + 2.75 % p.a.	2022	2017	**-**	825
Sum tidsbegrenset				**1,916**	1,789
Hybrid tier 1 bonds					
NOK 684	9.35 % p.a. until 09/12/2019, then 3 month Nibor + 5.75 % p.a.		2019	**723**	732
NOK 116	3 month Nibor + 4.75 % p.a. til 09/12/2019, then Nibor + 5.75 % p.a.		2019	**116**	116
Total hybrids				**839**	848
Accrued interest				**9**	9
Total subordinated loan capital				**2,764**	2,646

Commitments by geographic area

Commitment amount is defined as gross lending to customers + guarantees + unutilised credit in the group, prior to deductions for write-downs and without regard to potential collateral.

Table 22: Commitment amount for each type of commitment, divided into geographic areas before deductions for write-downs.

2017	**Gross loans**	**Unutilised credit**	**Guarantees**	**Total**
Rogaland	117,331	15,250	5,997	138,578
Agder	15,848	2,088	822	18,758
Hordaland	26,651	3,608	1,517	31,776
Other	12,724	1,766	784	15,274
Total gross commitments, customers	**172,554**	**22,712**	**9,120**	**204,386**

2016	Gross loans	Unutilised credit	Guarantees	Total
Rogaland	109,307	14,587	6,820	130,714
Agder	13,985	1,866	873	16,724
Hordaland	24,118	3,219	1,505	28,842
Other	10,228	1,365	637	12,230
Total gross commitments, customers	**157,638**	**21,037**	**9,835**	**188,510**

Commitments by type of commitment

Table 23: Total commitment size, by type of commitment (amount in NOK million)

2017	**Commitment amount**	**Average commitment amount**
Enterprises	87,052	86,239
Mass market	117,334	110,209
Gross commitments, customers	**204,386**	**196,448**
Individual write-downs	-639	-615
Write-downs for groups of loans	-678	-677
Write-down of guarantees	-13	-9
Net commitments, customers	**203,056**	**195,148**
Governments (Norges Bank)	207	548
Institutions	1,608	2,971
Total commitment amount	**204,871**	**198,667**

2016	**Commitment amount**	**Average commitment amount**
Enterprises	85,426	87,757
Mass market	103,084	99,493
Gross commitments, customers	**188,510**	**187,250**
Individual write-downs	-590	-295
Write-downs for groups of loans	-676	-338
Write-down of guarantees	-5	-3
Net commitments, customers	**187,239**	**178,392**
Governments (Norges Bank)	889	445
Institutions	4,334	2,167
Total commitment amount	**192,462**	**182,164**

Commitments by customer groups

The total commitment amount, defined as gross lending to customers + guarantees + unutilised credit in the group, after any write-down and without taking account of any security pledged.

Table 24: Commitment amount for each type of commitment, broken down by sectors before deductions for write-downs

2017	**Gross loans**	**Unutilised credit and guarantees**	**Total**
Agriculture/forestry	4,833	2,660	7,493
Fisheries/fish farming	860	574	1,434
Mining operations and extraction	4,876	4,951	9,827
Industry	3,632	168	3,800
Power and water supply/building and construction	3,666	2,919	6,585
Wholesale and retail trade, hotels and restaurants	2,984	1,432	4,416
Overseas shipping, pipeline transport and other transport	10,015	2,181	12,196
Property management	27,041	345	27,386
Service sector	8,428	2,064	10,492
Public sector and financial services	1,869	1,554	3,423
Net group accounts currency	(399)	399	0
Not allocated (added value fixed interest lending)	450	(450)	0
Total for enterprises	**68,255**	**18,797**	**87,052**
Mass market	104,299	13,035	117,334
Total gross commitments, customers	**172,554**	**31,832**	**204,386**

2016	Gross loans	Unutilised credit and guarantees	Total
Agriculture/forestry	4,549	2,544	7,093
Fisheries/fish farming	755	145	900
Mining operations and extraction	4,780	329	5,109
Industry	2,914	1,620	4,534
Power and water supply/building and construction	3,533	1,794	5,327
Wholesale and retail trade, hotels and restaurants	2,885	1,711	4,596
Overseas shipping, pipeline transport and other transport	9,766	276	10,042
Property management	27,269	6,086	33,355
Service sector	8,441	2,193	10,634
Public sector and financial services	1,898	1,939	3,837
Net group accounts currency	(741)	741	0
Not allocated (added value fixed interest lending)	419	(419)	0
Total for enterprises	**66,467**	**18,959**	**85,426**
Mass market	91,171	11,913	103,084
Total gross commitments, customers	**157,638**	**30,872**	**188,510**

Commitment broken down by remaining maturity

The total commitment amount, defined as gross lending to customers + guarantees + unutilised credit in the group, after any write-down and without taking account of any security pledged.

Table 25: Commitment amount for each type of commitment broken down by remaining maturity

2017	**Upon request**	**< 1 year**	**1–5 years**	**More than 5 years**	**Total**
Gross loans	19,763	10,077	36,608	106,106	172,554
Unutilised credit	22,712				22,712
Guarantees	83	2,391	5,419	1,227	9,120
Total gross commitments, customers	**42,558**	**12,468**	**42,027**	**107,333**	**204,386**
Governments (Norges Bank)	194	13	-	-	207
Institutions	0	730	860	18	1,608

2016	**Upon request**	**< 1 year**	**1–5 years**	**More than 5 years**	**Total**
Gross loans	49,766	6,517	23,254	78,101	157,638
Unutilised credit	21,037				21,037
Guarantees	39	2,092	6,194	1,510	9,835
Total gross commitments, customers	**70,842**	**8,609**	**29,448**	**79,611**	**188,510**
Governments (Norges Bank)	889	-	-	-	889
Institutions	802	3,532	-	-	4,334

Defaulted and doubtful commitments broken down by customer group

Doubtful commitments are defined as commitments that are not defaulted, but where the customer's financial position indicates a probability of loss in the future. A commitment is deemed to be in default if a claim is overdue by more than 90 days and the defaulted amount exceeds NOK 1,000, or when the bank has reason to believe that it is likely that the debtor will be unable to repay according to its obligations to the bank. Defaulted commitments are risk classified in the default classes J and K. Commitments with individual write-downs are risk classified in default class K.

Table 26: Defaulted and doubtful commitments by customer groups

31/12/2017	**Total commitment amount**			
Amounts in NOK million	**Doubtful**	**In default**	**Individual write-downs**	**Value changes recognised during the period**
Agriculture/forestry	10	7	4	4
Fisheries/fish farming	0	0	0	0
Mining operations and extraction	0	0	0	0
Industry	89	9	28	1
Power and water supply/building and construction	5	14	7	-3
Wholesale and retail trade, hotels and restaurants	50	24	30	15
Overseas shipping, pipeline transport and other transport	745	8	318	188
Property management	233	37	89	33
Service sector	351	201	89	251
Public sector and financial services	0	0	0	0
Total for enterprises	**1,483**	**300**	**565**	**489**
Transferred from write-downs on groups of loans	0	0	0	0
Mass market	79	255	87	54
Total	**1,562**	**555**	**652**	**543**

31/12/2016	**Total commitment amount**			
Amounts in NOK million	**Doubtful**	**In default**	**Individual write-downs**	**Value changes recognised during the period**
Agriculture/forestry	13	5	8	4
Fisheries/fish farming	0	0	0	0
Mining operations and extraction	0	0	0	0
Industry	48	1	15	10
Power and water supply/building and construction	43	23	26	21
Wholesale and retail trade, hotels and restaurants	55	17	25	5
Overseas shipping, pipeline transport and other transport	581	139	212	195
Property management	257	81	92	29
Service sector	79	600	150	322
Public sector and financial services	0	0	0	0
Total for enterprises	**1,076**	**866**	**528**	**586**
Transferred from write-downs on groups of loans	0	0	0	158
Mass market	65	204	62	34
Total	**1,141**	**1,070**	**590**	**778**

Actual losses by default class

Table 27: Actual losses for each default class during the period (amounts in NOK million)

	2017	2016
A (0.00–0.10 %)	**0**	0
B (0.10–0.25 %)	**0**	0
C (0.25–0.50 %)	**0**	0
D (0.50–0.75 %)	**0**	0
E (0.75–1.25 %)	**0**	0
F (1.25–2.50 %)	**0**	0
G (2.50–5.00 %)	**0**	0
H (5.00–10.00 %)	**0**	0
I (10.00 –)	**0**	0
J	**0**	0
K	**543**	**778**
Total	**543**	778

Defaulted and doubtful commitments by geographic area

Table 28: Separate specification of the total commitment amount with impairment and defaulted commitments divided into geographic areas, including total changes in value and write-downs

	Total commitment amount		**Individual write-downs**
2017	**Doubtful**	**In default**	
Rogaland	818	398	264
Agder	121	44	48
Hordaland	501	69	214
Other	122	44	113
Total	**1,562**	**555**	**639**

	Total commitment amount		**Individual write-downs**
2016	**Doubtful**	**In default**	
Rogaland	409	820	285
Agder	104	44	54
Hordaland	475	47	110
Other	153	159	141
Total	**1,141**	**1,070**	**590**

Write-downs on loans

Table 29: Reconciliation of changes in changes in value and write-downs respectively for commitments with impairment

2017	**Opening balance**	**Write-down amount recognised**	**Amount set aside for or reversed from estimated losses**	**Closing balance**
Individual write-downs	590	152	201	639
Write-downs on groups of loans	676		2	678
Specified provisions for losses, guarantees	5		8	13
Total	**1,271**	**152**	**211**	**1,330**

2016	**Opening balance**	**Write-down amount recognised**	**Amount set aside for or reversed from estimated losses**	**Closing balance**
Individual write-downs	315	192	467	590
Write-downs on groups of loans	518		158	676
Specified provisions for losses, guarantees	3		2	5
Total	**836**	**192**	**627**	**1,271**

Exposure of portfolios in which the IRB approach is used

Table 30: Distribution by risk classes in which the IRB approach is used (amounts in NOK million)

2017	Default class	Total EAD	Total unutilised facility	Average risk weight	Average loss given default	Average conversion factor
SME enterprises						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	355	38	33.4 %	31.6 %	96.0 %
	C	3,944	545	38.7 %	29.3 %	90.5 %
	D	2,770	707	48.8 %	31.7 %	88.4 %
	E	3,548	844	60.4 %	31.3 %	92.4 %
	F	4,757	932	73.9 %	34.7 %	93.2 %
	G	5,324	868	107.7 %	40.7 %	87.2 %
	H	1,610	455	129.6 %	42.5 %	84.3 %
	I	969	118	188.5 %	43.3 %	96.6 %
	J	17	3	15.2 %	73.7 %	85.3 %
	K	1,055	150	86.5 %	0.0 %	99.6 %
Total SME enterprises		**24,348**	**4,662**	**78.9 %**		**90.5 %**
Specialised enterprises						
	A	105	9	10.8 %	18.5 %	93.8 %
	B	1,144	259	25.4 %	28.7 %	87.0 %
	C	3,722	188	37.2 %	28.7 %	98.5 %
	D	5,355	274	46.4 %	28.4 %	97.0 %
	E	9,119	1,015	50.3 %	26.9 %	90.4 %
	F	5,941	567	64.1 %	30.3 %	97.7 %
	G	6,844	835	88.8 %	33.5 %	97.8 %
	H	1,495	148	103.5 %	34.6 %	98.5 %
	I	887	22	153.9 %	37.6 %	98.2 %
	J	81	0	10.7 %	48.6 %	99.9 %
	K	329	5	106.5 %	7.3 %	99.3 %
Total specialised enterprises		**35,022**	**3,321**	**62.6 %**		**95.3 %**
Other enterprises						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	34	0	29.9 %	0.0 %	100.0 %
	C	252	14	24.8 %	1.1 %	99.4 %
	D	204	106	63.4 %	23.1 %	73.8 %
	E	2,460	453	70.7 %	6.0 %	88.2 %
	F	2,703	980	79.7 %	11.1 %	74.5 %
	G	1,784	244	112.2 %	5.0 %	88.2 %
	H	285	195	205.4 %	41.8 %	60.1 %
	I	130	100	142.9 %	22.9 %	48.8 %
	J	0	0	0.0 %	0.0 %	0.0 %
	K	143	0	0.0 %	0.0 %	0.0 %
Total other enterprises		**7,996**	**2,092**	**85.9 %**		**80.9 %**
SME mass market with mortgage on real estate						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	1,917	603	7.4 %	17.1 %	99.9 %
	C	1,574	121	12.9 %	19.7 %	100.0 %
	D	794	15	21.3 %	22.3 %	100.0 %
	E	703	7	28.4 %	21.9 %	99.9 %
	F	498	5	39.6 %	21.6 %	100.0 %
	G	146	1	60.2 %	21.9 %	99.9 %
	H	111	1	89.4 %	21.8 %	99.8 %

	I	150	0	120.6 %	21.0 %	99.9 %
	J	11	0	3.5 %	14.5 %	99.2 %
	K	18	0	123.4 %	32.4 %	100.0 %
Total SME mass market, real estate		**5,921**	**753**	**22.0 %**		**99.9 %**
Mass market with mortgage on real estate						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	41,461	11,726	7.3 %	16.8 %	100.0 %
	C	35,339	1,417	14.0 %	21.2 %	100.0 %
	D	23,709	177	22.3 %	23.3 %	100.0 %
	E	19,134	62	30.9 %	24.2 %	100.0 %
	F	7,228	19	43.4 %	24.0 %	100.0 %
	G	1,613	7	69.5 %	24.4 %	100.0 %
	H	1,132	8	96.1 %	23.5 %	100.0 %
	I	1,589	1	132.9 %	23.3 %	100.0 %
	J	182	0	40.6 %	23.2 %	100.0 %
	K	173	1	168.5 %	22.1 %	100.0 %
Total mass market, real estate		**131,561**	**13,419**	**20.5 %**		**100.0 %**
Other mass market	A	0	0	0.0 %	0.0 %	0.0 %
	B	879	448	21.6 %	48.9 %	99.7 %
	C	1,231	291	31.6 %	49.5 %	99.8 %
	D	926	84	42.7 %	50.2 %	99.8 %
	E	765	34	52.7 %	50.1 %	99.7 %
	F	453	49	64.0 %	49.9 %	99.9 %
	G	139	4	76.1 %	50.8 %	99.8 %
	H	56	2	80.4 %	49.2 %	99.7 %
	I	104	2	115.4 %	49.7 %	99.7 %
	J	9	0	0.1 %	49.9 %	100.0 %
	K	30	0	11.8 %	84.6 %	99.9 %
Total other mass market		**4,593**	**913**	**42.3 %**		**99.8 %**

2016	**Default class**	**Total EAD**	**Total unutilised facility**	**Average risk weight**	**Average loss given default**	**Average conversion factor**
SME enterprises						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	509	50	23.2 %	25.2 %	95.6 %
	C	3,029	805	37.9 %	31.0 %	81.5 %
	D	2,920	778	43.9 %	27.2 %	93.3 %
	E	4,492	699	52.7 %	26.9 %	93.1 %
	F	5,494	1,155	66.7 %	31.1 %	95.3 %
	G	5,565	838	84.5 %	32.1 %	85.3 %
	H	1,424	163	124.7 %	39.1 %	88.4 %
	I	464	65	176.7 %	44.7 %	94.5 %
	J	7	1	9.9 %	64.4 %	91.9 %
	K	746	16	181.7 %	0.0 %	98.9 %
Total SME enterprises		**24,650**	**4,571**	**69.9 %**		**90.1 %**
Specialised enterprises						
	A	9	0	15.8 %	20.8 %	100.0 %
	B	1,292	271	23.9 %	29.6 %	87.7 %
	C	4,519	132	36.8 %	24.2 %	99.6 %
	D	4,478	233	41.6 %	26.8 %	96.6 %
	E	6,189	580	53.8 %	27.5 %	90.6 %
	F	7,175	644	62.7 %	28.2 %	97.5 %
	G	4,526	585	80.6 %	33.1 %	96.3 %
	H	2,746	223	96.8 %	31.5 %	98.4 %
	I	624	83	138.8 %	36.3 %	93.7 %

	J	69	0	69.8 %	15.6 %	99.8 %
	K	548	119	107.5 %	8.9 %	82.3 %
Total specialised enterprises		**32,176**	**2,871**	**60.5 %**		**95.4 %**
Other enterprises						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	10	0	13.8 %	0.0 %	100.0 %
	C	141	99	47.7 %	25.5 %	64.5 %
	D	1,461	963	42.3 %	12.7 %	88.8 %
	E	1,848	348	60.9 %	5.5 %	88.8 %
	F	3,441	864	80.3 %	7.6 %	76.8 %
	G	1,117	408	120.0 %	15.6 %	76.3 %
	H	615	38	105.9 %	2.4 %	98.5 %
	I	141	57	115.6 %	8.7 %	38.2 %
	J	41	0	0.0 %	0.0 %	0.0 %
	K	374	0	0.0 %	0.0 %	0.0 %
Total other enterprises		**9,188**	**2,776**	**73.8 %**		**81.3 %**
SME mass market with mortgage on real estate						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	1,780	571	7.2 %	16.7 %	99.9 %
	C	1,545	129	13.5 %	21.5 %	100.0 %
	D	770	16	21.6 %	24.0 %	100.0 %
	E	736	7	30.4 %	24.4 %	100.0 %
	F	391	6	40.7 %	23.0 %	100.0 %
	G	92	1	55.6 %	21.2 %	99.9 %
	H	75	1	94.0 %	23.2 %	99.9 %
	I	152	1	116.9 %	22.2 %	100.0 %
	J	8	0	11.7 %	13.1 %	100.0 %
	K	13	0	65.9 %	52.8 %	100.0 %
Total SME mass market, real estate		**5,562**	**731**	**21.5 %**		**100.0 %**
Mass market with mortgage on real estate						
	A	0	0	0.0 %	0.0 %	0.0 %
	B	37,907	11,047	7.1 %	16.2 %	100.0 %
	C	33,393	1,807	13.1 %	19.9 %	100.0 %
	D	22,702	267	20.8 %	21.9 %	100.0 %
	E	20,563	86	29.6 %	23.2 %	100.0 %
	F	8,290	27	41.9 %	23.4 %	100.0 %
	G	1,969	6	59.0 %	22.3 %	100.0 %
	H	1,211	11	86.5 %	21.5 %	100.0 %
	I	1,626	5	126.8 %	22.3 %	100.0 %
	J	186	0	34.5 %	24.4 %	100.0 %
	K	161	5	149.0 %	26.4 %	100.0 %
Total mass market, real estate		**128,007**	**13,261**	**20.2 %**		**100.0 %**
Other mass market	A	0	0	0.0 %	0.0 %	0.0 %
	B	703	364	21.4 %	48.4 %	99.8 %
	C	1,202	286	31.3 %	49.3 %	99.8 %
	D	953	90	43.0 %	50.4 %	99.9 %
	E	1,022	55	53.2 %	50.3 %	99.9 %
	F	434	20	65.3 %	50.4 %	99.9 %
	G	178	4	74.7 %	49.8 %	99.9 %
	H	59	2	82.5 %	50.3 %	99.7 %
	I	72	2	111.2 %	49.4 %	99.4 %
	J	8	0	0.2 %	50.6 %	99.8 %
	K	28	0	6.6 %	88.2 %	100.0 %
Total other mass market		**4,660**	**823**	**43.5 %**		**99.9 %**

Regulatory requirements for IRB models on mortgage loans

SpareBank 1 SR-Bank uses different levels of PD regulatory and internally for real estate. Regulatory level of PD is in accordance with the Financial Supervisory Authority of Norway's circular of 8/2014 Requirements for IRB models on mortgage loans: 'Long-term average PD', according to the Capital Adequacy Regulations section 11-2, shall at least equal a weighted average of PD during a recession at 3.5% and the institution's own estimates for PD in normal years, with a 20% weight on the former. Furthermore, a safety margin is to be attributed to the PD estimates, so that a single commitment will not have a PD lower than 0.2%. Regulatory level for minimum estimated LGD on mortgage loans is set to 20% in the circular. SpareBank 1 SR-Bank has taken the requirements into effect, and has implemented new, regulatory levels for PD and LGD.

Internal, long-term outcome for PD is calculated using the same methodology as with regulatory levels, but with own estimates PD levels in a recession. Internally, the PD model is also calibrated against the most conservative option of weighted and unweighted default. For the mass market, this is weighted default, both for the mass market with mortgages on real estate and other commitments. Internal level on estimated LGD follows from the IRB approved LGD model, without use of a minimum floor. In other words, the internal and regulatory calculations are conducted by using the same systems and models, but with somewhat different parameters. SpareBank 1 SR-Bank also uses different levels of PD regulatory and internally for the rest of the mass-market segment. The effects of these differences are seen in the tables below.

Table 31: Risk parameters internal vs. regulatory

	Calibration level (unweighted)	Conversion factor	Estimate for loss given default*
Mass market with mortgage on real estate	**PD**	**EAD**	**LGD**
Internal	0.70%	100%	10.0%
Regulatory	0.96%	100%	23.1%

	Calibration level (unweighted)	Conversion factor	Estimate for loss given default*
Other mass market	**PD**	**EAD**	**LGD**
Internal	2.80%	100%	39.2%
Regulatory	3.66%	100%	49.5%

* Level of estimated loss given default (LGD) is applies for the entire portfolio

For the corporate market, regulatory and internal estimates are identical. All tables presented in the report show regulatory estimates, unless stated otherwise.

Comparison of the risk parameters with the actual outcomes

The tables below show the average estimated and actual default for the portfolio for the period from 2007 to 2017. Estimated default (PD) is based on the long-term outcome for the probability of default through a full loss cycle. The default percentage is defined as the total number of customers who are, or have been, in default within a twelve-month period, seen in relation with the total number of customers in the portfolio. This means that a customer in default with a small loan commitment is weighted just as much as a customer in default with a large loan commitment.

Table 32: IRB level of default – PD models (unweighted)

Mass market with mortgage on real estate

Year	Predicted	Observed
2007	0.79 %	0.41 %
2008	0.79 %	0.41 %
2009	0.88 %	0.43 %
2010	1.07 %	0.42 %
2011	1.05 %	0.32 %
2012	0.96 %	0.26 %
2013	0.94 %	0.24 %
2014	0.93 %	0.24 %
2015	0.92 %	0.24 %
2016	0.83 %	0.18 %
2017	0.80 %	0.21 %
Average	*0.91 %*	*0.30 %*

Other mass market

Year	Predicted	Observed
2007	3.92 %	2.26 %
2008	3.64 %	2.00 %
2009	3.91 %	2.58 %
2010	4.29 %	2.66 %
2011	3.78 %	1.91 %
2012	3.38 %	1.43 %
2013	3.12 %	1.57 %
2014	3.01 %	1.53 %
2015	2.76 %	1.32 %
2016	2.39 %	0.84 %
2017	2.18 %	1.01 %
Average	*3.31 %*	*1.74 %*

Enterprises

Year	Predicted	Observed
2007	2.93 %	1.68 %
2008	2.92 %	1.78 %
2009	2.99 %	2.82 %
2010	3.38 %	2.71 %
2011	3.65 %	2.40 %
2012	3.44 %	1.90 %
2013	3.32 %	2.09 %
2014	3.22 %	2.12 %
2015	3.10 %	1.98 %
2016	3.00 %	1.73 %
2017	2.90 %	1.80 %
Average	*3.17 %*	*2.09 %*

Table 33: IRB default level - PD by default class (unweighted)

Mass market with mortgage on real estate	Predicted 2017	Observed 2017	Predicted 2007-2017	Observed 2007-2017
A	0.00 %	0.00 %	0.00 %	0.00 %
B	0.20 %	0.00 %	0.21 %	0.02 %
C	0.36 %	0.01 %	0.36 %	0.07 %
D	0.61 %	0.02 %	0.61 %	0.11 %
E	0.94 %	0.11 %	0.95 %	0.25 %
F	1.64 %	0.33 %	1.67 %	0.58 %
G	3.52 %	1.33 %	3.49 %	1.42 %
H	7.09 %	2.65 %	7.01 %	3.05 %
I	22.90 %	12.16 %	22.02 %	10.67 %
Total mass market with mortgage on real estate	**0.80 %**	**0.21 %**	**0.91 %**	**0.30 %**

Other mass market	Predicted 2017	Observed 2017	Predicted 2007-2017	Observed 2007-2017
A	0.00 %	0.00 %	0.00 %	0.00 %
B	0.00 %	0.00 %	0.24 %	0.00 %
C	0.41 %	0.01 %	0.41 %	0.03 %
D	0.61 %	0.12 %	0.62 %	0.08 %
E	0.96 %	0.11 %	0.97 %	0.23 %
F	1.73 %	0.98 %	1.77 %	0.77 %
G	3.45 %	1.90 %	3.49 %	1.81 %
H	6.96 %	4.95 %	6.94 %	3.76 %
I	23.26 %	12.34 %	22.20 %	13.31 %
Total other mass market	**2.18 %**	**1.01 %**	**3.31 %**	**1.74 %**

Enterprises	Predicted 2017	Observed 2017	Predicted 2007-2017	Observed 2007-2017
A	0.08 %	0.00 %	0.08 %	0.00 %
B	0.22 %	0.20 %	0.22 %	0.02 %
C	0.37 %	0.32 %	0.37 %	0.11 %
D	0.62 %	0.14 %	0.62 %	0.27 %
E	0.98 %	0.40 %	0.97 %	0.60 %
F	1.77 %	1.61 %	1.77 %	1.13 %
G	3.52 %	1.98 %	3.55 %	2.20 %
H	7.04 %	3.42 %	7.04 %	3.84 %
I	15.71 %	10.81 %	16.06 %	12.41 %
Total enterprises	**2.90 %**	**1.80 %**	**3.17 %**	**2.09 %**

Weighted IRB default is defined as the total commitment that is or has been in default, compared to the total exposure (EAD). Thus, weighted default takes the size of the loan commitment into account. The table below shows the average estimated and actual weighted default for the portfolio for the period from 2007 to 2017.

Table 34: IRB default level – PD model (EAD-weighted)

Mass market with mortgage on real estate

Year	Predicted	Observed
2007	0.94 %	0.49 %
2008	0.94 %	0.54 %
2009	1.08 %	0.61 %
2010	1.31 %	0.61 %
2011	1.27 %	0.48 %
2012	1.13 %	0.38 %
2013	1.08 %	0.28 %
2014	1.08 %	0.38 %
2015	1.07 %	0.27 %
2016	0.94 %	0.24 %
2017	0.89 %	0.22 %
Average	*1.07 %*	*0.41 %*

Other mass market

Year	Predicted	Observed
2007	3.44 %	1.64 %
2008	3.11 %	0.95 %
2009	3.57 %	3.90 %
2010	4.10 %	1.27 %
2011	4.09 %	1.11 %
2012	3.72 %	0.96 %
2013	3.41 %	0.80 %
2014	3.38 %	1.22 %
2015	2.92 %	1.01 %
2016	2.89 %	0.47 %
2017	2.66 %	1.04 %
Average	*3.39 %*	*1.31 %*

Enterprises

Year	Predicted	Observed
2007	2.30 %	1.78 %
2008	2.60 %	2.73 %
2009	2.66 %	3.43 %
2010	2.91 %	1.40 %
2011	2.94 %	1.25 %
2012	2.65 %	1.71 %
2013	2.63 %	1.28 %
2014	2.38 %	1.74 %
2015	2.20 %	0.82 %
2016	2.09 %	1.64 %
2017	2.12 %	1.46 %
Average	*2.50 %*	*1.75 %*

Validation of LGDD for 2017 was under preparation on publication of Pilar 3, and the tables below show the estimated and actual loss of defaulted loans for the 2007-2016 period. The Capital Requirements Regulations require that the estimated loss given default represents economic downturns. The Norwegian FSA published in Rundskriv 9/2016 a new minimum discount rate of 9 percent for discounting payments and costs related to defaulted loans. SpareBank 1 SR-Bank implemented the new discount rate in 2017 with a retrospective effect on previous year's calculations of actual loss.

Table 35: IRB loss given default for defaulted loans – LGD (unweighted)

Portfolio	Predicted LGD 2016	Observed LGD 2016	Predicted LGD 2007-2016	Observed LGD 2007-2016
Mass market with mortgage on real estate	24.2 %	7.1 %	27.0 %	9.8 %
Other mass market	0.0 %	0.0 %	19.9 %	2.6 %
Enterprises	47.6 %	29.6 %	52.3 %	29.7 %

Internally estimated unweighted LGD for mass market with mortgage on real estate (without regulatory minimums) is 12.1% in 2016 and 13.4% in the years 2007-2016.

Table 36: IRB loss given default for defaulted loans – LGD (EAD-weighted)

Portfolio	Predicted LGD 2016	Observed LGD 2016	Predicted LGD 2007-2016	Observed LGD 2007-2016
Mass market with mortgage on real estate	25.6 %	6.8 %	28.9 %	5.1 %
Other mass market	0.0 %	0.0 %	17.3 %	2.8 %
Enterprises	39.9 %	27.0 %	46.4 %	18.4 %

Internally estimated EAD-weighted LGD for mass market with mortgage on real estate (without regulatory minimums) is 12.8% in 2016 and 14.4% in the years 2007-2016.

Expected loss describes the loss the group can statistically expect to experience on the loan portfolio during a twelve-month period, based on a long-term outcome through a full loss cycle. Expected losses are calculated based on the probability of default, exposure at default and loss given default. The table below shows the average expected loss and actual net recognised losses for total mass market and enterprises for the last three years.

Table 37: IRB expected losses (EL) compared to actual net recognised losses

Mass market in total

Year	Predicted	Observed
2015	0.22 %	0.01 %
2016	0.28 %	0.02 %
2017	0.26 %	0.04 %

Enterprises

Year	Predicted	Observed
2015	0.95 %	0.36 %
2016	1.11 %	0.78 %
2017	1.38 %	0.68 %

Total commitment amount and share secured by mortgage (IRB)

Table 38: Total commitment amount (in NOK million) and percentage secured by mortgage, broken down by commitment categories (IRB)

Commitment category	**2017** Commitment amount	**2017** Of which secured by mortgage on real estate [1]	2016 Commitment amount	2016 Of which secured by mortgage on real estate [1]
Enterprises				
Specialised enterprises	36,734	55 %	33,738	53 %
SME enterprises	26,904	17 %	27,353	18 %
Other enterprises	9,887	6 %	11,308	5 %
Mass market				
Mass market with mortgage on real estate	131,570	88 %	128,013	87 %
SME mass market with mortgage on real estate	5,924	85 %	5,563	85 %
Other mass market	4,603	4 % [2]	4,666	3 % [2]
Total	**215,622**		210,641	

[1] Percentage of total commitment with such security in relation to total commitment for the relevant commitment category
[2] A commitment for a mass market customer in which the realisation value of the home is deemed to be less than 30% of the customer's commitment is not classified as a commitment with real estate, but as other mass market.

SpareBank 1 SR-Bank has no pledged security that results in a reduced commitment amount.

Actual value changes

Table 39: The actual changes in value for the individual commitment category and development from previous periods (IRB)

Amounts in NOK million	**Value 31/12/2017**	**Change in value in 2017 (%)**	**Value 31/12/2016**	**Change in value in 2016 (%)**
Mass market commitments	**142,097**	**2.8 %**	**138.242**	1.7 %
– of which mass market SME	**5,924**	**6.5 %**	**5.563**	-3.1 %
– of which commitments with mortgage on real estate	**131,570**	**2.8 %**	**128.013**	0.0 %
– of which other mass market commitments	**4,603**	**-1.4 %**	**4.666**	125.3 %
Specialist lending	**36,734**	**8.9 %**	**33.738**	-11.3 %
SME enterprises	**26.904**	**-1.6 %**	**27.353**	-0,9 %
Other enterprises	**9,887**	**-12.6 %**	**11.308**	-4.0 %
Total	**215.622**	**2.4 %**	**210.641**	**-1,3 %**

Amounts in NOK million	**Value 31/12/2015**	**Change in value in 2015 (%)**	**Value 31/12/2014**
Mass market commitments	135,879	7.1 %	126.872
– of which mass market SME	5,739	-1.1 %	5.804
– of which commitments with mortgage on real estate	128,069	7.5 %	119.170
– of which other mass market commitments	2,071	9.1 %	1.898
Specialist lending	38,057	-5.3 %	40.193
SME enterprises	27.604	4.3 %	26,459
Other enterprises	11,775	14.7 %	10.264
Total	**213.315**	**20.3 %**	**177,329**

Investments

Shares and other interests are either classified at fair value through profit and loss or as available for sale. Changes in fair value after the opening balance are recognised as income from financial investments.

Table 40: Investments (equity positions outside the trading portfolio) by purpose

	Investments	31/12/2017	31/12/2016
Financial investments at fair value through profit and loss			
	HitecVision Asset Solutions LP	37	32
	SR-PE-Feeder III KS	24	19
	Optimarin AS	24	24
	Monner AS	23	0
	Hitec Vision Private Equity IV LP	15	10
	Offshore Merchant Partners Asset Yield Fund LP	14	7
	SR PE Feeder IV AS	13	9
	Energy Ventures IV LP	12	9
	Øvrige finansielle investeringer	47	51
Total financial investments at fair value through profit and loss		**209**	161
Strategic investments at fair value through profit and loss			
	SpareBank 1 Østlandet*	0	127
	SpareBank 1 Markets	20	0
Total strategic investments at fair value through profit and loss		**20**	127
Strategic investments available for sale	Visa Norge IFS	60	33
	Other strategic investments	2	2
Total strategic investments available for sale		**62**	35
Total		**291**	323

* The shares in SpareBank 1 Østlandet (formerly SpareBanken Hedmark) were sold in June 2017.

Shares and other interests are either classified at fair value through profit and loss or as available for sale. Changes in fair value after the opening balance are recognised as income from financial investments.

Table 41: Overview of book value and fair value, gains and losses (amount in NOK millions)

2017	**Book value**	**Fair value**	**Total realised gains or losses**	**Unrealised gains or losses**	**Amount included in core capital or supplementary capital**
Financial investments at fair value through profit and loss	209	209	-15	-18	0
Strategic investments at fair value through profit and loss	20	20	19	-17	-17
Strategic investments available for sale	62	62	0	60	60
Total	**291**	**291**	**4**	**25**	**43**

2016	**Book value**	**Fair value**	**Total realised gains or losses**	**Unrealised gains or losses**	**Amount included in core capital or supplementary capital**
Financial investments at fair value through profit and loss	161	161	0	-39	0
Strategic investments at fair value through profit and loss*	127	127	0	19	19
Strategic investments available for sale	35	35	62	0	33
Total	**323**	**323**	**62**	**-20**	**52**

* Bank 1 Oslo is sold to Sparebanken Hedmark in Q2 2016 and was reported as "Discontinued operations" as per 31/12/2015.

Table 42: Summary of type and value of listed shares, unlisted shares in diversified portfolios and other commitments

Amounts in NOK million	**Value 2017**	Value 2016
Unlisted	**229**	288
Traded on an exchange	**0**	0
Other	**62**	35
Total	**291**	323

Table 43: Summary of counterparty risk for derivatives etc. outside the trading portfolio

Amounts in NOK million	**Nominal value**	**Risk weighted assets 2017 [1)]**	Risk weighted assets 2016 [1)]
Interest rate and currency instruments	206,949	1,655	1,854
Credit value adjustment risk (CVA)		933	701
Total financial derivatives	**206,949**	**2,588**	2,555

[1)] The risk-weighted balance sheet is calculated using the standard method.

Interest rate risk

Interest rate risk arises because the group's assets and liabilities may be subject to different fixed rate periods. Interest rate instrument trading must at all times comply with the adopted limits and authorities. The group's limits define quantitative targets for the maximum potential loss. The commercial risk is quantified and monitored continuously.

The group's general limits for interest rate risk define the maximum loss from a one percentage point change in interest rates. The maximum loss following a one percentage point change in interest rates totals NOK 85 million with NOK 35 million of the total balance in Trading and NOK 50 million of the total balance in Treasury.

Table 44: The effect on earnings of a positive parallel shift in the yield curve of one percentage point at the end of the last two years if all financial instruments were measured at fair value (amounts in NOK million)

	31/12/2017	31/12/2016
Certificates and bonds	**-45**	-28
Fixed-rate loans to customers	**-16**	-21
Other loans and deposits	**-83**	-86
Debt due to issue of securities	**121**	127
Other	**1**	-3
Total interest-rate risk	**-22**	-11
Maturity		
0 - 3 months	**-11**	-6
3 - 6 months	**0**	-4
6 - 9 months	**-3**	13
9 - 12 months	**2**	5
12 - 18 months	**-1**	-6
18 - 24 months	**-2**	0
2 - 10 yr	**-7**	-13
10 yr +	**0**	0
Total interest-rate risk	**-22**	-11
Currency		
NOK	**17**	-2
EUR	**-27**	-4
USD	**-11**	-6
CHF	**-1**	3
Øvrige	**0**	-2
Total interest-rate risk	**-22**	-11

Other appendices

The tables presented in this chapter are also available in a separate appendix (excel), which is updated quarterly. In addition, the appendix contains the following tables:

- The most important agreement terms and conditions for capital instruments (sheet 28)
- Composition of primary capital (sheet 29)
- Relationship between primary capital in the financial statements and the primary capital that is calculated for capital adequacy purposes (sheet 30)
- Calculation of unweighted tier 1 capital ratio (leverage ratio) (sheet 31)
- Public disclosure of information about SpareBank 1 SR-Banks compliance with the requirements for countercyclical capital buffer (sheet 32)

SpareBank 1 SR-BANK