

Basel II - Pillar 3
Disclosure of market discipline

SpareBank 1 SR-Bank 2007



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1. BASEL II – NEW CAPITAL ADEQUACY REQUIREMENTS

1.1 Introduction to new capital adequacy requirements.

The EU's new directive for capital adequacy was introduced in Norway with effect from 1 January 2007. The new regulations are based on a new capital adequacy standard issued by the Bank for International Settlements (BIS). The object of the new capital adequacy requirements is to strengthen stability in the financial market through:

- More risk-sensitive capital requirements
- Better risk management and control
- Closer supervision
- Increased market information

The new capital adequacy requirements are based on three pillars:

Pillar 1: Minimum capital adequacy requirements

Pillar 2: Assessment of total capital needs and supervisory process

Pillar 3: Market discipline

The following chapters deal with the content of each pillar in more detail.

1.1.1 Pillar 1 – Minimum equity and subordinated capital requirement

The new regulations imply no change in the basic construction of capital adequacy requirements, the minimum is still 8%, but there are some changes in the regulations relating to what can be included as equity and subordinated capital and its composition. The major changes are found in how one calculates capital adequacy requirements for credit risk and the introduction of an explicit capital requirement for operational risk. The current requirements for capital adequacy for market risk are less affected by the new regulations.

The new capital adequacy regulations contain various methods the banks can choose among to calculate the

capital required. The various methods are shown in figure 1.1.1.

For banks that have received approval for applying internal ratings, the Internal Rating Based Approach (IRB) this means that the mandatory minimum capital adequacy requirement for credit risk will be based on the group's internal risk assessments. This makes the mandatory minimum capital adequacy requirement more risk sensitive, so that the capital requirement to a greater extent matches the risk in the underlying portfolios.

When calculating the capital requirement using the Basic IRB approach, the risk parameter Probability of Default (PD) is based on own models, whilst the risk parameters Conversion Factor (CF) used to set exposure at default and Loss Given Default (LGD) are template rules laid down in the Regulations on Capital Requirements.

When calculating the capital requirement using the Advanced IRB approach for the mass market, the risk parameters probability of default (PD), Conversion Factor (CF) used to assess Exposure at Default (EAD), and the Loss Given Default (LGD) are based on own models.

1.1.2 Pillar 2 – Assessment of overall capital requirements and supervisory review.

Pillar 2 is based on two primary principles. Banks should have a process for assessing their overall capital adequacy in relation to risk profile and strategy for maintaining their capital levels. Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if they are not satisfied with the results of this process.

1.1.3 Pillar 3 – Market Discipline.

The purpose of Pillar 3 is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2). Pillar 3 shall encourage market

Credit risk	Market risk	Operational risk
Standard method	Standard method	Basic method
Basis IRB method ¹⁾	Internal rating approach ¹⁾	Template method
Advanced IRB method ¹⁾		AMA-method ¹⁾

Fig. 1.1.1

¹⁾ These methods require the approval of the supervisory authority

discipline by developing a set of disclosure requirements which will allow the market, including analysts and investors to assess the institution's risk profile, the capital adequacy and its management and control. Such disclosures have particular relevance where reliance on internal methodologies gives banks more discretion in assessing capital requirements.

The demands relating to information mean that all institutions are required to publish information on organisational structure, risk management system, reporting channels and how risk control is built up and organised. Furthermore, detailed requirements are made regarding the publication of capital levels and structure and risk exposure, where the latter depends on the assessment methods applied by the bank in Pillar 1. This document is intended to satisfy these requirements.

1.2 Implementation of new capital adequacy requirements in SpareBank 1 SR-Bank.

Figure 1.2. shows the principle methods applied by SpareBank 1 SR-Bank when assessing capital adequacy requirements for credit risk, market risk and operational risk respectively.

SpareBank 1 SR-Bank has received approval from the Financial Supervisory Authority of Norway (Kredittilsynet) to apply the IRB approach for credit risk with effect from 2007.

In the case of the subsidiary SpareBank 1 SR-Finans AS a later transition to the IRB approach is planned and the

portfolio is therefore reported using the standard method until further notice. The company's primary activities are leasing and car loans with vendor's lien. At the end of the year the calculation basis for SpareBank 1 SR-Finans AS was 5.6% of the group's calculation basis for credit risk using the new capital adequacy requirements.

As at 31 December 2007, SpareBank 1 SR-Bank owned 23.6 % of SpareBank 1 Boligkreditt AS, which was established on 18 August 2005. SpareBank 1 Boligkreditt AS operates as a mortgage company under a licence issued by the Financial Supervisory Authority of Norway. Its primary object is to ensure owners stable long-term financing at competitive prices.

That part of SpareBank 1 SR-Bank's mass market portfolio that is transferred to SpareBank 1 Boligkreditt AS is consolidated in SpareBank 1 SR-Bank's capital adequacy reporting. This is because SpareBank 1 SR-Bank owns more than 20% of the company.

SpareBank 1 Boligkreditt AS is in the process of qualifying for using the IRB approach for capital adequacy assessments on the mass market portfolio. Approval to use the IRB approach is expected to be granted sometime during 2009. Until such approval has been granted, SpareBank 1 SR-Bank reports the transferred portfolio according to the standard method. At year-end this amounted to 3.6% of the group's calculation basis for credit risk using the new capital adequacy requirements.

Credit risk	2007	2008
Government	Basel 1 ¹⁾	Standard method ⁴⁾
Institutions	Basel 1 ¹⁾	Standard method ⁴⁾
Enterprises	IRB Basic ²⁾	IRB Basic ²⁾
Mass market	IRB ³⁾	IRB ³⁾
Equity positions	IRB (simple risk-weighted method)	IRB (simple risk-weighted method)
Market risk	Standard method	Standard method
Operational risk	Template method	Template method

Fig. 1.2

- 1) In 2007 a transitional scheme in the new capital regulations was used so that the portfolios were reported according to the previous capital adequacy regulations (Basel I).
- 2) Some small portfolios are reported according to the standard method until further notice (leasing, housing associations, societies and association).
- 3) For the mass market, there is only one IRB method equal to the Advanced IRB method. Some portfolios are reported according to the standard method until further notice (car loans with vendor's lien in SpareBank 1 SR-Finans AS and the portfolio transferred to SpareBank 1 Boligkreditt AS)
- 4) SpareBank 1 SR-Bank has been granted approval for permanent exemption from the IRB method.

2. CONSOLIDATION

The table below shows the difference in consolidation basis when consolidating using accounting rules and in consolidation for capital adequacy purposes.

SpareBank 1 SR-Bank emphasises that all units in the group shall be adequately capitalised at all times. The group's managing bodies have not limited the Board's possibilities of transferring capital between the parent bank and subsidiaries or between subsidiaries other than that which follows from regulations and other mandatory limitations. Nor do the articles of association include any such limitations.

Similarly, the bank and its subsidiaries do not enter into agreements that limit the Board's rights to transfer capital as mentioned. This applies to loan agreements as well as agreements with suppliers and customers.

Against this backdrop there are no limitations on the Board's possibility of transferring capital between the different business units in the parent bank. Transfers of capital between companies are regulated by the ordinary framework legislation for these entities and for

the financial group.

Similarly to investments in subsidiaries the group has a strategic interest in supporting the activities of SpareBank 1 Boligkreditt AS and SpareBank 1 Gruppen AS. Therefore the group is interested in ensuring that no agreements are entered into or resolutions passed or the like that imply a constraint on the parent bank's possibility to transfer capital to these companies should the need arise to achieve satisfactory capital adequacy/financial fitness. The group is not aware of any such limitations except those laid down in the framework legislation and regulations.

The group assumes that it will not be practical to transfer capital from these two companies to the parent banks above and beyond ordinary dividends and applies this assumption in the group's own risk profile. To the best of the group's knowledge there are no constraints in legislations that limit dividend payments from these companies.

Consolidation basis (Amounts in NOK million)

Subsidiaries	No. of shares	Book value	Voting rights	Consolidation method
Companies that are fully consolidated				
SpareBank 1 SR-Finans AS	334 000	265 663	100 %	Acquisition method
Eiendomsmegler 1 SR-Eiendom AS	150	3 000	100 %	Acquisition method
Westbroker Finans AS	100	4 177	100 %	Acquisition method
SR-Investering AS	3 000	133 244	100 %	Acquisition method
SR-Forretningservice AS	1 000	125	100 %	Acquisition method
Vågen Eiendomsforvaltning AS	5 000	19 639	100 %	Acquisition method
SR-Forvaltning ASA	4 000	4 018	67 %	Acquisition method
Total		429 866		

The consolidation method is the same for accounting and capital adequacy purposes.

Investments in associated companies

Investments in associated companies are recorded using the equity method in the group and the acquisition method in the parent bank. Investments are treated in the same manner for capital adequacy purposes except for the group's investment in 23.6% of SpareBank 1 Boligkreditt. In the group's capital adequacy a pro rata consolidation is made.

Investments in joint ventures

The group has a 19.5% stake in SpareBank 1 Gruppen AS. The investment is recorded using the equity method and the book value of the investment is deducted from the capital base and the calculation base for capital adequacy. In SpareBank 1 SR-Bank the investment is recorded using the acquisition method and that part of the investment's book value that exceeds 2% of SpareBank 1 Gruppen's capital base is deducted from the capital base and the calculation base.

Capital base in other financial institutions	Book value
SpareBank 1 Midt-Norge	15
SpareBank 1 Nord-Norge	11
SR-Pensjonskasse (Pension fund)	25
Other financial institutions	26
Total	77

3. RISK AND CAPITAL MANAGEMENT IN SPAREBANK 1 SR-BANK

3.1 Object.

Risk and capital management in SpareBank 1 SR-Bank shall support the group's strategic development and the achievements of its targets and at the same time ensure financial stability and adequate asset management.

This is to be achieved through:

- A strong organisational culture that is characterised by high risk management awareness.
- A good understanding of the risks that drive earnings.
- Striving for an optimal capital application within the adopted business strategy.
- Avoiding individual unexpected events that can seriously impair the group's financial status.
- The exploitation of synergies and diversification effects.

The group has a moderate risk profile. Its goal is at least to maintain its current international credit rating and thus secure good long-term access to funding from the capital markets.

3.2 Risk groups (definitions).

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

Credit risk: the risk of losses that arise as a result of the customer's inability or unwillingness to meet his obligations.

Market risk: the risk of losses due to changes in observable market variables such as interest rates, foreign exchange rates (FX) and securities.

Operational risk: the risk of losses resulting from inadequate or failed internal processes and systems, people or external events.

Liquidity risk: the risk of the group not being able to refinance its liabilities or not being able to finance increases in assets without significant extra costs.

Ownership risk: the risk of SpareBank 1 SR-Bank incurring losses from ownerships in strategically-owned companies and/or the need to provide these companies with new equity. Owned companies are defined as companies in which SpareBank 1 SR-Bank has a significant stake and influence.

Commercial risk: the risk of unexpected fluctuations in revenues and expenses as a result of changes in external circumstances such as the market situation or mandatory regulations.

Reputation risk: the risk of a decline in earnings and access to capital resulting from declining confidence and reputation in the market i.e. customers, counterparts, the stock market and the authorities.

Strategic risk: the risk of losses arising from erroneous strategic decisions.

Compliance risk: the risk of the group having to deal with public sanctions/penalties or financial losses as a result of failure to comply with legislation and regulations.

3.3 Elements in SpareBank 1 SR-Bank's risk and capital management.

The group's risk is quantified, for example, through calculations of the expected losses and need for economic capital to cover unexpected losses. The expected losses and economic capital are calculated for all the main risk groups, and for all the business categories in the group. Expected losses are an indication of the amount of losses that must be statistically expected over the next 12 months. Economic capital describes how much capital the group believes it needs to cover the actual risk the group has assumed. Since it is impossible to fully protect against all losses, the group has stipulated that the economic capital shall cover 99.9 per cent of possible unexpected losses. For ownership risk in SpareBank 1 Gruppen the confidence level is set at 99.5 percent. The calculation of economic capital is based on statistical methods, but the calculation requires the use of qualitative assessments in some cases.

The return on economic capital is one of the most important strategic targets in the internal management of SpareBank 1 SR-Bank. This entails that the business units are allocated capital in accordance with the estimated risk of their activities, and that their return on capital is monitored on an ongoing basis. The calculation of economic capital enables a comparison of risk across risk groups and business units.

In order to ensure an effective and adequate process for risk and capital management the framework is based on 10 elements that reflect the manner in which the Board of Directors and management manage the group:

- Organisation and organisational culture
- Strategic targets
- Risk identification
- Risk analysis
- Stress tests
- Risk strategies

- Capital management (including returns and capital adequacy)
- Reporting and monitoring
- Contingency plans
- Compliance

The following paragraphs deal with these elements in more detail.

3.3.1 Organisation and organisational culture

Organisational culture:

In the risk and capital management process the organisational culture is the very foundation on which the other elements are built. The organisational culture covers management philosophy, management style and the people in the organisation with their individual characteristics such as integrity, basic values and ethical attitudes. SpareBank 1 SR-Bank has established explicit basic values and ethical guidelines that are well communicated and made known throughout the entire organisation.

Organisation:

SpareBank 1 SR-Bank emphasises that independence is an important principle in the group's risk management. Risk management responsibility is therefore divided between various roles in the organisation.

The Board of Directors of SpareBank 1 SR-Bank is responsible for ensuring that the group has a capital base that is adequate based on the adopted risk profile and mandatory requirements. The group's Board adopts the overall goals such as the risk profile, hurdle rates and how the capital is to be distributed among the various business units. The Board also determines the overall limits, authorisations and guidelines for risk management in the group. The Board has adopted an ethical code that contributes to the awareness of and compliance with the ethical standards adopted by the group.

With respect to resolutions by the bank's Board, the boards of the subsidiaries fulfil their duties in the individual companies.

The Chief Executive Officer is responsible for risk management. This means that the CEO is responsible for the implementation of efficient risk management systems in the group and for the monitoring of risk exposure. The CEO is also responsible for delegation of authority and for reporting to the Board.

The Department for Risk Management and Compliance is organised independently of the business units and reports directly to the Chief Executive Officer. The department is responsible for the further development of the framework for risk management, including risk models and risk management systems. Further, the department is responsible for independently following up and reporting on the risk situation and the group's compliance with applicable laws and regulations.

Internal auditing is a tool that is used by the Board and management to monitor whether the risk management process is adequately targeted and effective, and functions as intended. The group's internal audit function is performed by an external public accountant, thus ensuring that the function has the required independence, competence and capacity. The internal audit function reports organisationally to the Board. The internal audit function's reports and recommendations for risk management improvements are reviewed on an ongoing basis in the group.

Internal audit shall regularly and at least once a year audit the IRB system, including models used for reporting risk parameters, application and compliance with the Regulations on capital adequacy.

In addition to the above roles, committees have been established in the risk management area to assist the CEO in his decision-making and follow-up activities.

The Risk and Capital Management Committee carries out the overriding follow-up of the group's risk profile, and the funding and capital adequacy situation. The committee also deals with drafts relating to risk strategies, capital allocations, validation reports and recommends new risk models. The Risk and Capital Management Committee has a broad composition with senior employees from the business units and from risk and capital management.

The credit committees are responsible for making independent recommendations to the authority holder. In their recommendations the credit committees shall evaluate loan and credit applications in accordance with the current credit strategy, credit policy guidelines, loan granting regulations and credit review routines. The credit committees shall place special emphasis on the identification of risk associated with the individual application, and on performing an independent credit risk assessment where the consequences of the various risks to the bank are clarified.

3.3.2 Strategic target

SpareBank 1 SR-Bank revises the strategic target annually. On the basis of the adopted strategic targets a business plan is prepared with in-depth analyses and planned measures aimed at achieving the target. Risk and capital management is based on the group's strategic targets and business plans.

3.3.3 Risk identification

The risk identification process is forward-looking and covers all important risk areas in the group. The process is carried out at least annually and is an integral part of the group's strategy and budget process.

3.3.4 Risk analysis

Thorough risk analyses of identified risks are carried out in order to understand the characteristics of the risks and their causal mechanisms. All significant risks are, to the extent possible, quantified through expected losses and the need for economic capital. Quantification is based on accepted and secure methods and processes for measuring risk. The risk analysis shall also ensure a qualified and structured assessment as well as documentation of the control and management measures that are established.

3.3.5 Stress tests

Stress tests are an important tool for analysing how negative events impact the group's result, its balance sheet and its capital adequacy. SpareBank 1 SR-Bank carries out periodic stress tests on the most critical risk areas such as credit, market and liquidity risks. Stress tests are carried out on individual factors and on scenario analyses where the group is exposed to a range of negative macroeconomic events through a period of at least three years.

3.3.6 Risk strategies

Risk strategies define the risk profile inter alia through expected losses, economic capital and target figures for risk-adjusted returns. The risk strategies are approved by the Board of Directors and are revised at least annually.

3.3.7 Capital management

SpareBank 1 SR-Bank has a deliberate process for capital management that shall ensure, to the extent possible:

- Efficient capital funding and capital application in relation to the group's strategic goals and the adopted business strategy.
- A competitive rate of return.
- Satisfactory capital adequacy based on the adopted risk profile.
- Competitive terms and ample long-term access to funding from the capital markets.
- That, at the very least, the group maintains its current international ratings.
- Exploitation of growth opportunities in the group's defined market area.
- That no single event can seriously impair the group's financial status.

The long-term goal is that the economic capital shall be allocated within the adopted business strategy to the areas that generate the highest risk-adjusted return. SpareBank 1 SR-Bank's goal is to at least maintain its current international credit ratings and thus ensure good long-term access to funding in the capital markets.

SpareBank 1 SR-Bank's capital ratio target is expressed through the targets for the regulatory capital adequacy ratio and the defined goal for protection against the creditor's of legal predecessors. The target for capital adequacy shall ensure that SpareBank 1 SR-Bank has sufficient capital to satisfy the mandatory demands on capital adequacy and the internal target for creditor protection. Protection against the creditor's of legal predecessors is taken care of by the group, for an elected confidence level, shall have equity (including hybrids) that cover the need for economic capital with a one-year time horizon.

On the basis of the strategic targets and the business plan, an annual capital plan is prepared to ensure effective long-term capital management. These projections take into account both likely developments over the next three years and a situation with a serious recession over three years.

On the basis of the analysis of these scenarios the Board considers in general whether the capital adequacy situation is acceptable and adjusted to SpareBank 1 SR-Bank's risk profile and strategic targets.

For situations where there is a risk of the capital adequacy to fall below the critical level, contingency plans have been prepared that illustrate management's strategy and procedures. Contingency plans are updated when the need arises, and at least once a year in connection with the Board's review of the group's strategy for funding from the capital makers.

3.3.8 Reporting and monitoring

One important risk management element is the monitoring of current risk exposure. All managers are responsible for the day-to-day risk management in their respective areas of responsibility, and they shall at all times ensure that the risk exposure is within the limits set by the Board of Directors or the CEO. The group's overriding risk exposure and risk development is monitored through periodic risk reports to the management and the Board. The overriding risk surveillance is carried out by the Department for Risk Management and Compliance which is independent of the group's individual business units.

3.3.9 Contingency plans

The core activity of a bank is to assume risk, and over time this risk may cause the bank large losses, even though it has good risk management systems and processes. Such a situation can put a great deal of pressure on operations, capital adequacy and on the funding situation. SpareBank 1 SR-Bank has prepared contingency plans in order to deal with such a crisis in the best possible manner should one arise.

3.3.10 Compliance

The group strives to have good processes that ensure compliance with current legislation and regulations. The following means are efficient to achieve this:

- Explicit basic values that are clearly communicated throughout and understood by the organisation.
- A process to capture, communicate and implement amendments to law and regulations.
- A process to follow up and report on compliance with legislation and regulations.



4. REGULATORY CAPITAL - INFORMATION BY RISK GROUP (PILLAR 1)

4.1 Summary

The graph below shows the regulatory minimum requirement for equity and subordinated capital based on Pillar 1 in the new capital adequacy regulation compared to equity and subordinated capital.

Column 1 in the figure shows a minimum requirement for SpareBank 1 SR-Bank of NOK 4.7 billion in primary capital base on the new capital adequacy requirements. At the turn of the year the net capital base aggregated

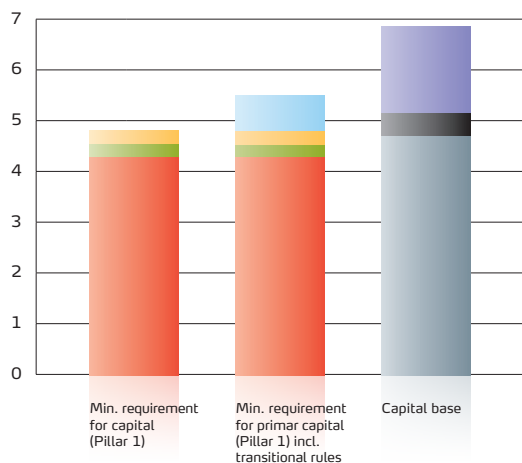
NOK 6.9 billion of which Tier I capital amounted to NOK 5.2 billion.

In the transitional period the regulations specify that the capital base in 2007 cannot be lower than 95 percent of the minimum requirement according to the previous regulations (Basel I) from 2006. The effect of this transitional rule is therefore shown in column 2. In 2008 and 2009 the corresponding limitations are 90 per cent and 80 per cent respectively of the minimum requirement according to the previous regulations (Basel I) from 2006. The introduction of the new regulations has a positive effect on capital adequacy but the full effect will first be seen in 2010.

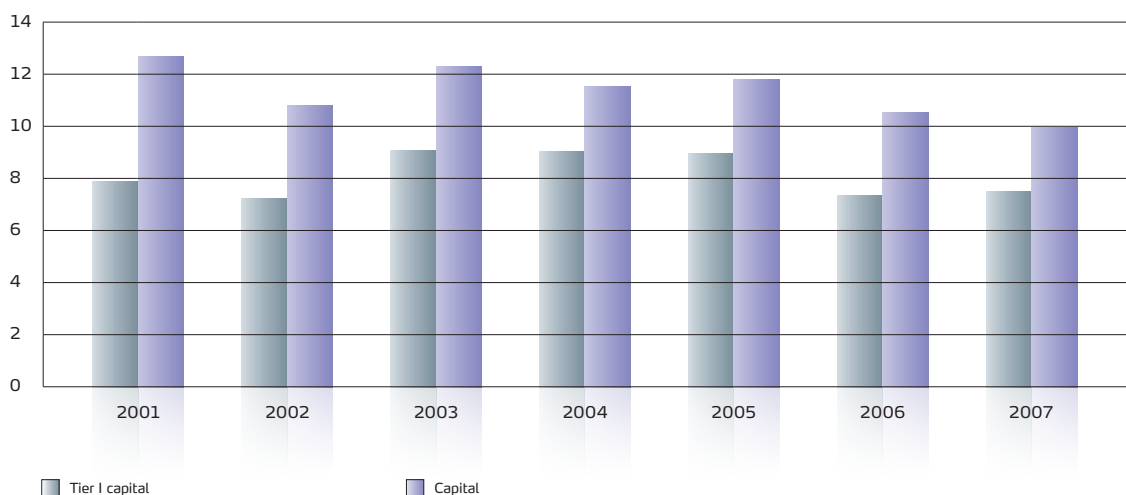
The group's goal is to have a capital adequacy of 11.0 per cent of which Tier I capital adequacy shall be 7.0 per cent. At the end of 2007, the group's capital adequacy was 10.0 per cent and Tier I capital adequacy was 7.5 per cent. In the first quarter of 2008 a new subordinated was raised in the amount of NOK 500 million and at 31 December 2007 this would have strengthened the group's capital adequacy by 0.7 percentage points.

Figure 4.1. shows the development in capital adequacy and Tier I capital adequacy in the period 2001-2007, based on applicable capital adequacy regulations for the year in question.

Amounts in NOK billion



Percentage Fig. 4.1. Development in capital adequacy and Tier 1 capital adequacy during 2001-2007



Capital requirement-Overriding review (Pillar 1)

Review of total capital requirements by type of risk	Capital requirement
Credit risk	4 322
Market risk	230
Operational risk	268
Capital requirements linked to transitional schemes	681
Total minimum capital base requirement	5 501

Capital base

The following provides information on the capital base, including Tier 1 capital and supplementary capital and other additions, deductions and limitations as at 31.12.07.

Group	
Primary capital	1 774
- Own primary capital certificates	-10
Premium reserve	7
Savings bank's reserve	1 970
Endowment fund	124
Equalisation reserve	777
Allocated to dividend	337
Reserve for unrealised gains	139
Other equity	560
Total book equity	5 678
Deferred tax, goodwill and other intangible assets	-26
Reserve for unrealised gains available for sale	-2
Deduction for allocated dividend	-337
50 % of capital base in other financial institutions	-12
50 % of expected losses IRB less loss provisions	-173
50 % capital ratio reserve	-486
Share of non-performing non-amortised estimate deviations	77
Hybrid instruments 1)	448
Total Tier 1 capital	5 167
Supplementary capital beyond Tier 1 capital	
Perpetual subordinated capital 1)	739
Non-perpetual subordinated capital 1)	1 639
50 % of capital base other financial institutions	-12
50 % of expected losses IRB less loss provisions	-173
50 % capital ratio reserve	-486
Total supplementary capital	1 707
Net capital base	6 874

1) Conditions can be seen in the table on next page.

The equity capital value of non-perpetual subordinated capital is reduced by 20 per cent every year in the last five years to the extent that the group has a capital base in other financial institutions this is directly deducted from the group's own capital base to the extent it exceeds 2 per cent of the recipient finance institution's capital base.

If the group has a capital base in other financial institutions that is less than 2 per cent of the individual financial institution's capital base the total of such capital is deducted from the amount that exceeds 10 per cent of the group's capital base. If the group has been ordered to have a 100 per cent capital adequacy on specific assets an amount equivalent to the asset's book value shall be deducted from the capital base and the calculation basis. The calculation basis is weighted according to risk.

Subordinated and hybrid capital

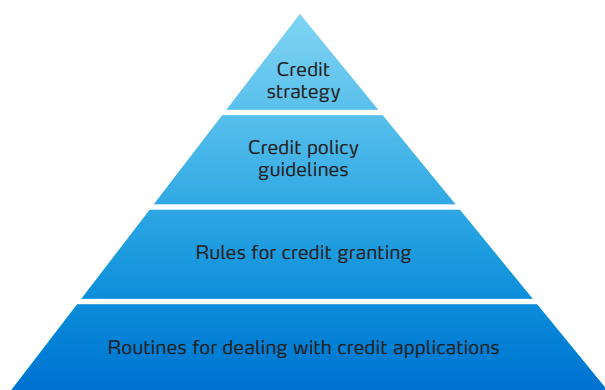
	2007
Non-perpetual:	
Loan 1 (2014 - EUR 65 - 3 month Libor + margin)	517
Loan 2 (2035 - JPY 13 000 - 3 month Libor + margin)	672
Loan 3 (2017 - NOK 450 - 3 month Nibor + margin)	450
Total non-perpetual	1 639
Perpetual:	
Loan 4 (USD 75 - 3 month Libor + margin)	396
Loan 5 (SEK 200 - 3 month Stibor + margin)	172
Loan 6 (NOK 170 - 3 month Nibor + margin)	170
Total perpetual	738
Hybrids:	
Loan 7 (USD 75 - 3 month Libor + margin)	448
Total hybrids	448
Total subordinated capital	2 825

Subordinated and hybrid capital in currencies (USD 150, EUR 65, SEK 200 and JPY 13 000 as at 31.12.2007) are included in the group's currency positions, so that there is no currency risk linked to these loans. Subordinated loan capital of EUR 65 can be redeemed in 2009 while JPY 13 000 and NOK 450 can be redeemed in 2012. Of the 738 in perpetual subordinated loan capital, all is included in supplementary capital as at 31.12.2007. The capitalised cost of raising the loans is reflected in the calculation of amortised cost. Hybrids can account for maximum 15 per cent of Tier I capital. Any excess is considered perpetual subordinated loan capital.

4.2 Credit risk

4.2.1 Management and control

The figure below shows the most important elements in the group's overriding framework for credit management.



Credit risk is managed through the group's overriding credit strategy, strategic credit limitations, credit policies and regulations relating to authority to approve credits. The following deals with the various elements in more detail.

The group's credit strategy is determined at least annually by the Board of Directors. The group's credit strategy is comprised so to measure and capture changes in current risk exposure in the most suitable and effective manner, inter alia expected losses and the need for economic capital. In addition the credit strategy sets special limitations on concentration risk linked to exposure to and risk profile of individual customers, customer groups or industries.

The group's credit policy guidelines are set by the CEO and updated at least annually. The credit policy guidelines comprise concrete principles for granting credits at an overriding level and in relation to specific fields such as property financing, project financing and participation in syndicates. Examples of such principles are demands for equity financing and restrictions on financing activities with a high risk level.

The group's credit granting authority rules. The Board of Directors is responsible for the group's loan and credit approval regulations and these are updated at least once a year. The Board of Directors delegates authority, within certain limits, for the operational responsibility with respect to decisions in loan and credit cases to the CEO. The CEO can himself delegate authority further within the limits of his authority. Delegated authority is personal and is differentiated on the basis of the risk perspective.

The group's routines for dealing with credit applications are set by the responsible Executive Vice President and are regularly revised. The routines for dealing with credit applications regulates in detail the group's granting of credits.

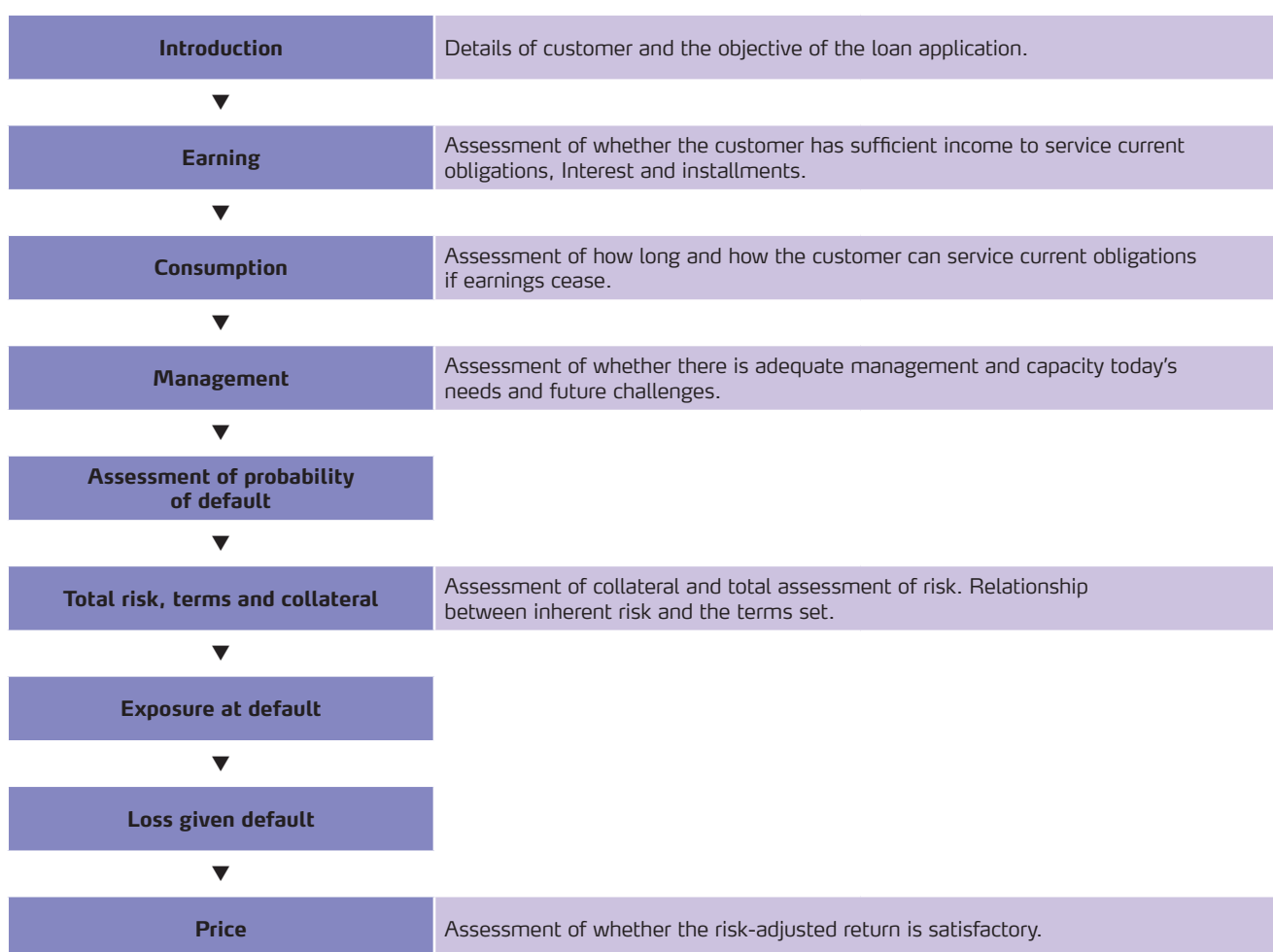
The group's risk exposure is monitored with the help of the group's portfolio management system. This system provides information that allows an effective follow-up of the risk profile and management of the portfolio. SpareBank 1 SR-Bank carry out a monthly updating of the portfolio information with the help of internal and external customer data. The risk-related development in the portfolio is followed up with special emphasis on developments in risk classification (migration), expected losses, economic capital, risk-adjusted return and capital adequacy.

The Department for Risk Management and Compliance carries out an independent review of risk follow-up and reporting of the overall risk exposure to management and the Board.

SpareBank 1 SR-Bank carries out periodic stress tests on credit risk. Stress tests are an important tool for analysing how negative events impact on the group's profit, balance sheet and capital adequacy. Stress tests are carried out on individual factors and on scenario analyses where the group is exposed to a range of negative macroeconomic events through a period of at least three years.

4.2.2 Model description and application

The figure below describes the group's overriding credit assessment concept.



The risk models underlying the risk classification system in the credit process are based on statistical calculations and are undergoing continual development and testing. The models are mostly based on three prime components:

The Probability of Default (PD): The customers are classified in default classes based on the probability of the customer defaulting on his obligations during the course of a 12 month period. The probability of default is calculated as a long-term average that represents the probability of default over a business cycle. The probability of default is calculated inter alia on the basis of historic data series.

Nine default classes (A - I) are used to classify the customers according to the probability of default. In addition, the group has two default classes (J and K) for customers with defaulted and/or written down commitments.

A commitment is considered defaulted on when one of the following criteria is met:

- A claim is more than 90 days overdue and the amount is in excess of NOK 1 000 or
- When the bank has reasons for assuming that it is probable the debtor will not be able to (fully) repay in accordance with his obligations.

Expected exposure at default (EAD): This is an estimation of how large the expected exposure will be if a customer defaults. The calculation is based on the customer's total exposure including approved but undrawn facilities and guarantees.

Loss given default (LGD): This is an assessment of how much the group can potentially lose if a customer defaults on his obligations.

For the mass market the assessment takes into account the value of the collateral provided and the costs the group will have to collect a defaulted commitment. The group sets a realisation value for the collateral provided on the basis of own experience over time and in such a manner that these conservatively reflect the estimated realisation value in a cyclical downturn.

When calculating the minimum regulatory capital for the corporate market (governments, institutions and enterprises) factors set by the authorities are applied.

SpareBank 1 SR-Bank is concerned on pricing the risk, and therefore measures the risk-adjusted return in connection with the granting and following up of credits. The risk-pricing model uses the same prime components as the group's risk classification system and these components form the basis for calculating the return on economic capital from each individual commitment.

The group is constantly developing and testing the risk management system to ensure its high quality over time. This work can be split into three main segments:

- **Quantitative validation:** The quantitative validation ensures that the quality of the bank's estimates for probability of default, conversion factor (for use when setting exposure at default) and loss given default ratio is satisfactory. Various types of analysis are carried out that look in detail at the models' ability to rank commitments (discrimination ability), the ability to set the right level of risk parameters and the stability of the models' estimates.
- **Qualitative validation:** The review shall show that the IRB system is well integrated in the organisation and that it represents a major element in the group's risk management and decision making. The IRB system covers all models, work and decision-making processes, control mechanisms, IT-systems and internal guidelines and routines that are used to measure and manage credit risk.
- **Compliance with the Regulation relating to Capital Adequacy:** The review shall ensure that the group complies with the Regulation relating to Capital Adequacy.

4.2.3 Portfolio information

The following tables show the bank's commitments in relation to credit risk.



Credit risk - credit risk, defaults and declines in value in general

The total commitment (defined as loans to customers + Guarantees + Undrawn credit lines) in the Group after possible write-downs and without consideration to collateral and the average size during the period, split into types of commitment.

Type of commitment	Commitment as of 31.12.07	Average committed amount in 2007
Enterprises	52 155	47 278
Mass market	59 114	56 570
Gross commitments to customers	111 269	103 848
Individual write-downs	-98	-103
Write-downs on groups of loans	-131	-131
Write-downs guarantees	-7	-6
Net commitment to customers	111 033	103 608
Governments (Norges Bank)	2 401	1 512
Institutions	3 357	1 764
Total amount committed	116 791	106 884

Committed amounts for each type of commitment by significant geographic region before deduction for write-downs.

Type of commitment	Rogaland	Agder-counties	Hordaland	Other	Total
Gross loans to customers	69 732	7 864	3 861	6 633	88 090
Unutilised credit lines	14 332	1 188	1 412	1 226	18 158
Guarantees	3 996	604	174	247	5 021
Total gross commitments to customers	88 060	9 656	5 447	8 106	111 269

Committed amount for each commitment type by significant industries before deductions for write-downs.

Type of commitment	Loans	Undrawn credits	Guarantees	Total
Agriculture/forestry	2 389	490	8	2 887
Fishing/fish farming	640	252	19	911
Petroleum/mining	2 497	717	266	3 480
Industry	2 993	1 399	1 465	5 857
Power and water supplies/building and construction	1 845	1 039	1 666	4 550
Retail, hotels and restaurants	2 216	507	324	3 047
International shipping, pipe transport, other transport	3 749	1 427	167	5 343
Property management	15 917	2 601	649	19 167
Services	4 211	831	285	5 327
Public service and financial services	655	813	118	1 586
Undistributed (additional value fixed interest loans)	-117	117	0	0
Total enterprises	36 995	10 193	4 967	52 155
Mass market	51 095	7 965	54	59 114
Total gross commitments to customers	88 090	18 158	5 021	111 269

Credit risk - credit risk, defaults and declines in value in general - contd.

Committed amounts by type of commitment and by remaining term.

Type of commitment	On demand	<1 year	1-5 years	More than 5 years	Total
Gross loans to customers	34 423	5 954	9 165	38 548	88 090
Guarantees	0	942	811	3 268	5 021
Unutilised credit facilities	18 158	0	0	0	18 158
Total gross loans to customers	52 581	6 896	9 976	41 816	111 269
Governments (Norges Bank)	2 401	0	0	0	2 401
Institutions	53	3 248	56	0	3 357

Credit and impairment risk by significant industries.

Industry	Total committed amount			Changes in value recorded in P&L during the period
	Commitments with decline in value	Commitments past due date	Changes in value and write-downs	
Agriculture/forestry	6	3	0	-4
Fishing/fish farming	2	0	1	-2
Petroleum/mining	0	0	0	0
Industry	447	3	32	26
Power and water supplies/building and construction	12	1	1	-2
Retail, hotels and restaurants	21	4	10	-1
International shipping, pipe transport and other transport	21	0	5	-2
Property management	15	1	8	3
Services	11	10	11	7
Public services and financial institutions	0	0	0	0
Total enterprises	535	22	68	25
Mass market	112	70	37	-15
Total enterprises	647	92	105	10

Actual losses per risk class in the period.

Risk class	2007	2006
A	0	0
B	0	0
C	0	0
D	0	0
E	0	0
F	0	0
G	0	0
H	0	0
I	0	0
J	5	12
K	19	4
Total	24	16

Credit risk - credit risk, defaults and declines in value in general - contd.

Separate specification of the total committed amount with impairment in value and defaulted commitments by significant geographic areas, including total changes in value and write-downs:

Geographic area	Total committed amount		Total changes in value and write-downs
	Commitments with value impairment	Defaulted commitments	
Rogaland	163	62	50
Agder-counties	468	14	47
Hordaland	5	7	1
Other	11	9	7
Total	484	30	55

Reconciliation of changes in value and write-downs for commitments with an impairment in value.

Type of change in value and write-down	Opening balance at 01.01.2007	Amounts recorded against write-downs	Amounts allocated to or reversed from expected losses	Closing balance at 31.12.2007
Individual write-downs	107	67	58	98
Write-downs on groups of loans	131	0	0	131
Specified loss provisions on guarantees	4	0	3	7
Total	242	67	61	236

Credit risk - credit risk, defaults and declines in value in general - contd.

Distribution by risk class where the IRB method is used.

Commitment category	Risk class	Total EAD	Total undrawn limit	Average risk-weight	Average LGD	Average CF
Enterprises	A	657	391	0,41	0,45	0,98
	B	18 527	4 771	0,73	0,45	0,97
	C	9 145	1 178	0,94	0,45	0,98
	D	6 247	920	1,10	0,45	0,98
	E	1 380	173	1,31	0,45	0,98
	F	849	80	1,43	0,45	0,99
	G	312	28	1,79	0,45	0,99
	H	345	45	2,02	0,45	1,00
	I	136	11	2,17	0,45	0,99
	J	9	0	0,00	0,45	1,00
	K	59	12	0,00	0,45	0,96
Total enterprises		37 665	7 608			
Mass market	A	6 149	1 910	0,01	0,09	1,00
	B	24 299	3 153	0,07	0,10	1,00
	C	14 646	1 323	0,12	0,10	1,00
	D	9 059	601	0,20	0,12	1,00
	E	2 114	96	0,33	0,15	1,00
	F	1 389	61	0,49	0,17	1,00
	G	867	33	0,56	0,16	1,00
	H	360	10	0,79	0,19	1,00
	I	605	10	0,77	0,16	1,00
	J	12	0	0,18	0,09	1,00
	K	109	0	0,57	0,31	1,00
Total mass market		59 609	7 196			

Comparison of risk parameters with actual outcome

The table below shows the average estimated and actual default (non adjusted) in the portfolio in the period 2005-2007. The volume adjusted default during the period is substantially lower for estimated as well as for actual default.

Portfolio	Estimated default	Actual default
Mass market (property)	1,1 %	0,3 %
Other mass market	3,1 %	1,9 %
Enterprises	2,9 %	1,2 %

The table shows that the actual default (non adjusted) was significantly lower than the estimated default for the period. This is because the default estimates are calibrated to a default level that should represent the

default level through a trade cycle. The period 2005-2007 represents years with low default levels as it was a period of strong economic growth.

The table below shows estimated and actual loss given default.

Portfolio	Estimated loss degree	Actual loss degree
Mass market housing	9,3 %	6,5 %
Other mass market	45,0 %	33,3 %

When validating the model for loss given default a realisation period is necessary. The validation is therefore linked to the period 2000-2005.

The conversion factor for expected exposure on default is set at 1 for down payment loans and frame loans. In the case of frame loans this means that the exposure at default is set at the loan's ceiling.

The analysis shows that actual default on the housing portfolio has been 6.5 per cent compared to 9.3 per cent estimated. The other mass market actual default is 33.3 per cent compared to an estimated 45.0 per cent.

Total amount committed and share that is secured by liens divided according to commitment category.

Commitment category	Committed amount	Of which secured by mortgage on real estate ¹⁾	Of which secured by other liens ¹⁾	Of which unsecured ¹⁾
Mass market				
Commitments with mortgage on real estate	48 811	100 %	0 %	0 %
Mass market SME	2 965	52 %	35 %	13 %
Other mass market commitments	7 850	78 % ²⁾	6 %	16 %
Total	59 626			

¹⁾ Share of total commitment with such security compared to total commitment for relative commitment category.

²⁾ A commitment to a mass market customer where the realisation value of the home is considered less than 30% of the customer's loan is not categorised as a commitment with real estate but as other mass market.

SpareBank 1 SR-Bank has no liens that result in a reduction in the committed amount. For enterprises consideration is not given to collateral in LGD assessments. The LGD factors laid down by the authorities are used. For that reason no such list has been presented in the above table.

Total EAD per sub-category for specialised lending under the template method.

	Project financing	Object financing	Commodity financing	Income-generating property	Total EAD for specialised lending
EAD	2 826	4 282	747	17 929	25 785

The actual change in values of the individual commitment categories and development since earlier periods (IRB):

Commitment category	Value 31.12.2007	Change in value in 2006 (in %)	Value 31.12.2006	Change in value in 2006 (in %)	Value 31.12.2005
Mass market commitments	59 626	5,0 %	56 769	20,2 %	47 242
-of which mass market SME	2 965	9,5 %	2 708	8,7 %	2 491
-of which mass market private individuals property	55 323	5,0 %	52 692	21,8 %	43 262
-of which mass market private individuals other	1 338	-2,3 %	1 369	-8,1 %	1 489
Enterprises	14 965	6,1 %	14 098	84,3 %	7 649
Specialised lending	26 474	37,6 %	19 234	60,1 %	12 010
Total	101 065	12,2 %	90 101	34,7 %	66 901

Figures for 2006 og 2005 are based on parallel reporting for these years.

4.2.4 Minimum equity and subordinated capital requirement

Minimum capital base requirement by commitment category and sub-categories.

Category	Sub-category	Comment	Commitment	Commitment EAD	Minimum credit base requirement Consolidated
Enterprise	Large enterprises		3 852	3 640	303
	Other enterprises		11 113	10 793	733
	Specialised lending		26 474	25 785	1 860
Mass markets	Mass market SME		2 965	2 962	31
	Mass market private individuals - property		55 323	55 313	559
	Mass market private individuals - other		1 338	1 334	47
Equity positions	Standard method (simple risk-weighted method)	Unlisted	5	5	1
		Listed	326	326	76
		Other	258	258	76
Minimum requirement credit risk IRB			101 654	100 416	3 686
Governments			2 531		0
Institutions			3 938		63
Enterprises			4 365		255
Mass market			4 382		202
Other assets			2 476		198
Minimum requirement standard method			17 692		718
Intangible assets					26
Deductions					-108
Total minimum capital base requirement for credit risk					4 322

4.3 Market risk

4.3.1 Management and control

The market risk is measured and monitored continually on the basis of limits adopted by the Board. The Department for Risk Management and Compliance is responsible for the continual, independent monitoring of the group's market risk. The limits are reviewed and renewed at least once a year. The limits are set on the basis of stress tests and scenario analyses of negative market movements. The purpose of such analyses is to analyse where SpareBank 1 SR-Bank can incur major market risk-related losses if all credit facilities are fully utilised and market movements are extreme. In a normal situation, all credit facilities will not be utilised. In addition, stop-loss limits have been set on exposure in the currency and interest rate instrument markets.

The interest rate risk for all interest positions can be expressed by looking at the change in the value of interest rate instruments in the event of a 1 per cent change in interest rates. The group uses analyses that show the effect of the aforementioned interest rate change for various maturity intervals, and there are separate limits for interest rate exposure within the individual intervals. The interest rate commitment terms for the group's

instruments are mostly short, and the group's interest rate risk is moderate.

The group measures currency risk based on net positions in each individual currency. The limits for currency risk are expressed by limits for the maximum aggregate currency position and maximum position in individual currencies. The group's currency risk is well within the limits laid down in the regulation and is considered to be low.

The value of a security depends on factors that are specific for the individual issuer and on general market movements. The group's exposure to this type of risk is regulated through limits set for the maximum investments in the various portfolios.

The group's general exposure to market risk is moderate.

The table below illustrates the effect on the result of one stress test carried out in connection with the annual review of the group's market risk limits.

Main frame	Market shock	Estimated effect on result in NOK millions
Currency	10 % change	15.0
Interest rate instruments	1 % parallel shift	30.0
Index linked bonds	20 % fall in value	10.0
Shares	30 % fall in value	87.0
Own account property syndicates	50 % fall in value	12.5
Completion of property syndicates	40 % fall in value	80.0
Bonds	2 % fall in value	170.0
Guarantees	30 % fall in value	30.0

In the internal follow up and assessment of market risk SpareBank 1 SR-Bank also makes use of a model based on Value at Risk (VaR) principle. The VaR model is an important tool in connection with internal limits mana-

gement and with capital allocations. The model is still undergoing tests and development and is not yet being used in the day-to-day management of market risk.

4.3.2 Portfolio information

Equity positions outside of the trading portfolio.

Information on investment by object (shareholding stakes outside the trading portfolio).

Object	Investments	Amount
Financial investments at fair value through P&L	Oslo Børs	5
	Kverneland	4
	Sparebanken Vest	3
	Austevoll Seafood	3
	Grieg Seafood	0
	Roxar	13
	Viking Venture II	4
	SR Feeder	1
	Proserv	7
	Borea Opportunity II	1
	Marin Vekst II	5
	Hitec Vision Private Equity III	40
	Optimarin	5
	RPT Gass	4
	Progressus	2
	FishEx	1
	Mikro A	3
	Marin Forvaltning	0
	Hitec Vision Private Equity IV	21
Other financial investments	18	
Total at fair value through P&L		140
Strategic investments at fair value through P&L	Blå Holding	127
Strategic investments available for sale	Other strategic investments	4
Total		271

Shares and parts are classified either at fair value through P&L or available for sale. Changes in fair value from opening balance are recorded as income from financial investments.

Review of book value and fair value, gains and losses.

Type of investment	Book value	Fair value	Total realised gains or losses 2007	Unrealised gains or losses in 2007	Amount included in Tier 1 capital or supplementary
Financial investments at fair value through P&L	140	140	25	27	0
Strategic investments at fair value through P&L	127	127	0	0	0
Strategic investments available for sale	4	4	1	0	2
Total	271	271	26	27	2

Review of type and value of listed shares, unlisted shares in diversified portfolios and other commitments:

Type	Value
Unlisted	233
Listed	29
Other	9
Total	271

Review of counterpart risk for derivatives etc.

Type of derivative	Nom. Value	Fair value	Amount committed	Min. requirement for capital base ¹⁾
FX Forwards	3 729	16	3	0
FX Swaps	12 154	188	130	10
FX Options	72	1	0	0
FX Instruments in trading portfolio	15 955	205	133	10
Interest rate swaps	35 496	514	219	18
Non-standard contracts	45	4	0	0
Interest rate instruments in trading portfolio	35 541	518	219	18
Interest rate swaps	8 704	174	45	4
Interest rate instruments outside of trading portfolio	8 704	174	45	4
Credit derivatives	0	0	0	0
Total	60 200	897	397	32

¹⁾ The minimum requirement for capital base is entirely calculated according to the standard model

4.3.3 Minimum equity and subordinated capital requirement

The minimum capital base requirement for market risk, including position risk, counterpart risk, settlement risk, currency risk and commodity risk.

Minimum requirement	Consolidated
Position risk	196
- Of which equity instruments	38
- Of which debt instruments	158
Counterpart risk (derivatives in the trading portfolio)	32
- Of which derivatives in the trading portfolio	28
- Of which derivatives outside of the trading portfolio	4
Currency risk	2
Total	230

4.4 Operational risk

4.4.1 Management and control

The risk strategy for operational risk is determined at least annually by the Board of Directors. The risk strategy sets the framework for expected losses and economic capital. The group's risk management and monitoring shall be so efficient at all times that no single event caused by operational risk shall be able to seriously harm the group's financial position.

The process of identifying, quantifying and managing operational risk includes the use of external and internal data, expert evaluations and an evaluation of the framework. Scenario analyses and statistical models are used to estimate the group's operational risk exposure. The group's risk-reducing measures include routine and process descriptions, division of work, electronic and manual controls, insurance, outsourcing and contingency and catastrophe plans. Preventive measures shall be given priority ahead of consequence-reducing measures.

An annual confirmation of risk management is arranged where senior staff members report upwards up in the organisation on to what extent risk management has been implemented in accordance with the adopted risk strategy, policy and established control and manage-

ment measures. Managerial confirmation is also a tool for regular identification of problem areas and gives group management a better understanding of the positive aspects and the weaknesses inherent in the management of risk. This ensures that management is better able to allocate resources to the right improvement measures.

The group has a database for registering undesirable events. All operational events that can potentially result in losses or where losses have already been incurred shall be registered in the database and improvement measures shall be considered and implemented if this is found to be appropriate. The group is constantly working on improving the reporting structure so that, as far as possible, one can manage to register all significant events that might occur.

In line with the group's risk management ambitions SpareBank 1 SR-Bank took the initiative to establish an R&D project in the field of operational risk in association with the SpareBank 1 Alliance, DnB NOR and the University of Stavanger. The object of this project is to establish Norway as the central European point for managing and measuring operational risk in banking and finance. The project will also develop a tool for managing operational risk that qualifies for use of advanced methods for calculating the mandatory minimum capital adequacy requirements for operational risk.

4.4.2 Minimum equity and subordinated capital requirement

Minimum capital base requirement for operational risk using the template method:

Business area	Consolidated	EiendomsMegler 1	SR-Finans	SR-Forvaltning
Banking services for mass market customers	172	23	0	4
Banking services for corporate customers	72	0	8	0
Payment and settlement services	24	0	0	0
Total	268	23	8	4

The minimum capital base requirement for operational risk is calculated in a percentage of the average revenue from each business area over the last three years. Banking services for the mass market 12%, banking services for the corporate market 15% and other services 18%.

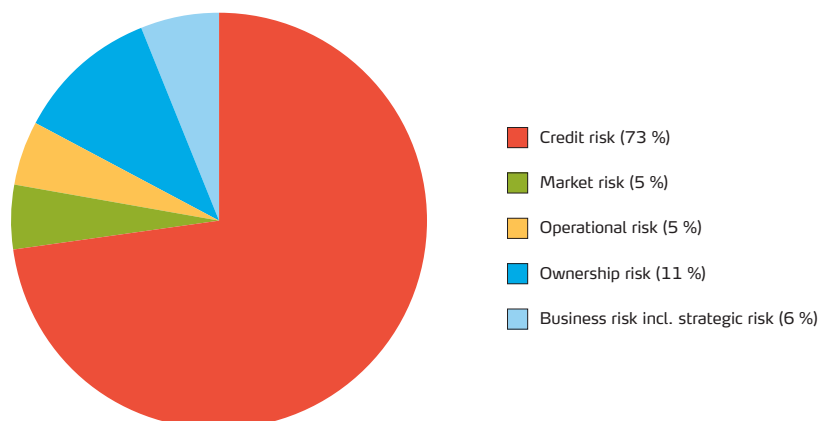
5. ECONOMIC CAPITAL (PILLAR 2)

5.1 Summary

Economic capital describes how much capital the group believe is needed to cover the actual risk the group has assumed. Since it is impossible to fully protect against all losses, the group has stipulated that the economic capital shall cover 99.9 per cent of possible unexpected losses on a one-year horizon. For SpareBank 1 Gruppen, however, ownership risk as been given a confidence level of 99.5 percent. The calculation of economic

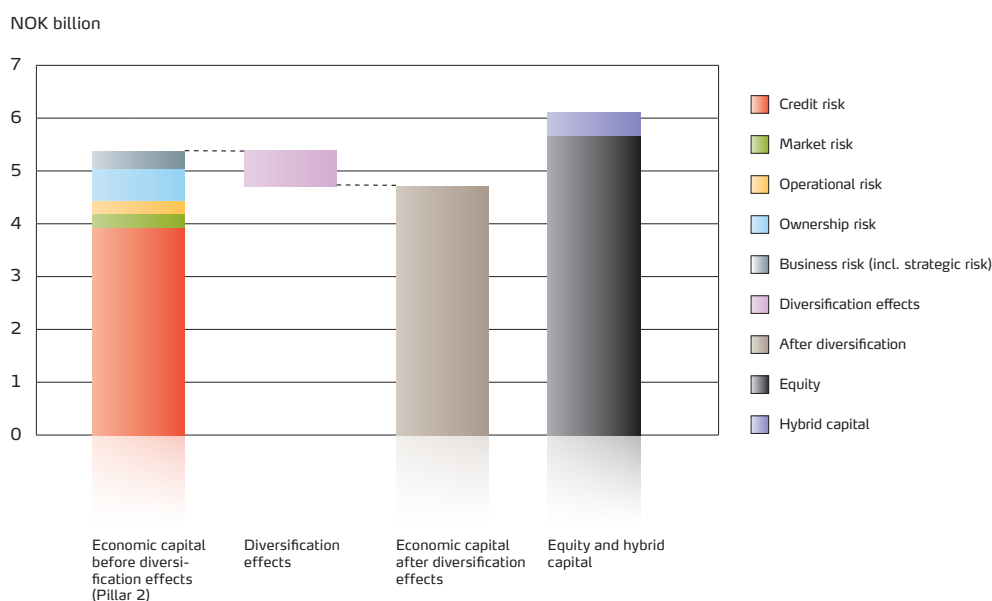
capital is based on statistical methods, but the calculation requires the use of qualitative assessments in some cases.

The diagram below shows the distribution of economic capital in the various risk groups based on the risk exposure at 31 December 2007. At the year-end economic capital was calculated for credit, market, operational, ownership and business risk (including strategic risk).



The table below shows economic capital at 31 December 2007. In addition, a comparison has been made of

the need for economic capital against actual equity and hybrid capital at 31 December 2007.



The total need for economic capital at 31 December 2007 is calculated to NOK 5.4 billion before diversification effects. When diversification effects between risk groups are taken into account the need for economic capital is calculated to NOK 4.7 billion. The diversification effects show the risk-reducing effect the group achieves from working in a number of risk areas that are not expected to result in unexpected losses at the same time.

Available equity including hybrid equity aggregated NOK 6.1 billion at the turn of the year.

In the following chapters SpareBank 1 SR-Bank reports in more detail on the framework and management of the risk types that are not covered by the minimum equity requirement (Pillar 1), and describe in more detail the calculation of economic capital for credit, market and operational risks where this deviates from the regulatory calculations.

5.2 Credit risk

5.2.1 Management and control

The management and control of the credit risk is described in detail in chapter 4.2.1.

5.2.2 Model description and application

By and large the group's makes use of the same models and approaches for calculating economic capital as it does for calculating the minimum capital base requirement. There are, however, some differences. When calculating economic capital for credit risk for the corporate market (governments, institutions and enterprises) the loss-given-default (LGD) risk parameter is based on internal models. SpareBank 1 SR-Bank's internal estimates of LGD are lower than those set by the authorities' template values.

The group sets the realisation values of collateral on the basis of own experience over time and in such a manner that these, on a conservative evaluation reflect the expected realisation value in a cyclical downturn.

Calculations of the minimum capital base requirement do not take into consideration the concentration risk inherent in the portfolio. Concentration risk is defined as the risk that arises from concentrating exposure to a single customer, trade, geographic area or commitments where the collateral lodged has similar risk characteristics. SpareBank 1 SR-Bank calculates the economic capital so as to take this type of risk into account.

5.2.3 Economic capital

Economic capital for credit risk is included in the group's process for assessing economic capital in accordance with Pillar 2.

5.3 Market risk

5.3.1 Management and control

Management and control of market risk is described in more detail in chapter 4.3.1

5.3.2 Model description and application

The group reports regulatory capital (Pillar 1) in accordance with the standard method for market risk. Economic capital is calculated on the Value at Risk (VaR) principle. Economic capital is calculated for interest rate, currency and securities risks for Sparebank 1 SR-Bank and the calculation of economic capital is therefore an important tool in connection with the internal framework management and capital allocation. The model is still undergoing tests and further development and is thus not used in the day-to-day management of market risk.

Calculations of economic capital deviate not only model-wise, but also to some extent portfolio-wise from the regulatory assessments of capital. This is because the internal estimations of economic capital include interest rate risk outside of the trading portfolio, which is not subject to the standardised method's minimum equity requirements.

Risk activities linked to currency, interest rate and securities trading shall always be within the adopted limits, powers and credit lines granted to counterparties.

SpareBank 1 SR-Bank's interest rate risk is moderate and the bank assumes to a very limited extent interest rate risk linked to trading activities. Income from these activities shall primarily be in the form of customer margins. This is to achieve the greatest possible stability and security in revenues. In the current follow up of the group's risk we do not therefore differentiate between interest rate risk in or outside of the trading portfolio. Pursuant to chapter 4.2.2 internal management and control of interest rate risk is based on the interest costs' sensitivity to interest rate changes. The table below sums up the group's interest rate risk measured as net interest rate costs' sensitivity to parallel interest rate changes of 1 per cent (100 basis points).

Sensitivity on net interest rate cost in NOK million	31.12.2007
NOK	8
EUR	2
USD	2

5.3.3 Economic capital

Economic capital for market risk is included in the group's process for evaluating economic capital pursuant to Pillar 2.

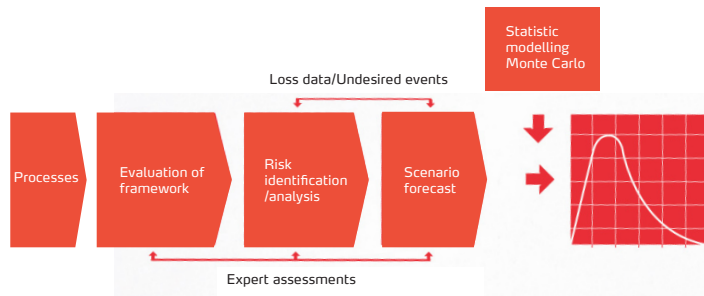
5.4 Operational risk

5.4.1 Management and control

Management and control of operation risk is described in detail in chapter 4.4.1.

5.4.2 Model description and application

The figure below shows the group's process for identifying, quantifying and managing operational risk. This process includes the use of external and internal data, expert assessments, quantification and management of the framework. Scenario analyses and statistical models are used to calculate the group's exposure to operational risk.



5.4.3 Economic capital

Economic capital for operational risk is included in the group’s process for assessing economic capital pursuant to Pillar 2.

external access to liquidity. The stress test is based on a series of different scenarios under the assumption that available facilities are fully drawn down and this represents a worst case simulation of the group’s net refinancing needs in a crisis situation.

5.5 Liquidity risk

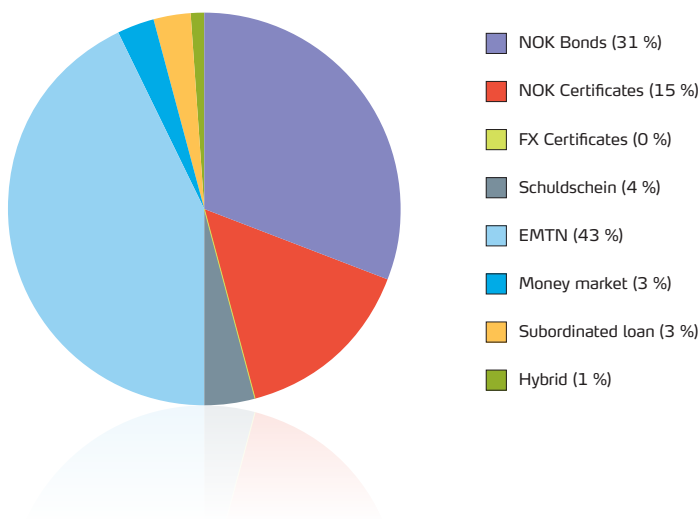
5.5.1 Management and control

Management of the group’s funding structure is based on the group’s overriding liquidity strategy, which is reviewed and adopted by the Board at least once a year. The liquidity strategy reflects the group’s moderate risk profile. The group has prepared a contingency plan for dealing with the liquidity situation in periods with unrest in the financial markets. SpareBank 1 SR-Bank has also developed a stress test model that analyses the group’s vulnerability as regards liquidity in periods without

The group’s currency/finance area (SR-Markets) is responsible for liquidity management, while the Department for Risk Management and Compliance monitors and reports on the utilisation of limits in accordance with the liquidity strategy. The liquidity risk is reduced by borrowing in several markets, using a range of funding sources, instruments and maturity dates.

5.5.2 Diversification and maturity information

The figures below show the diversification of the group’s funding sources and markets as at 31.12.2007.

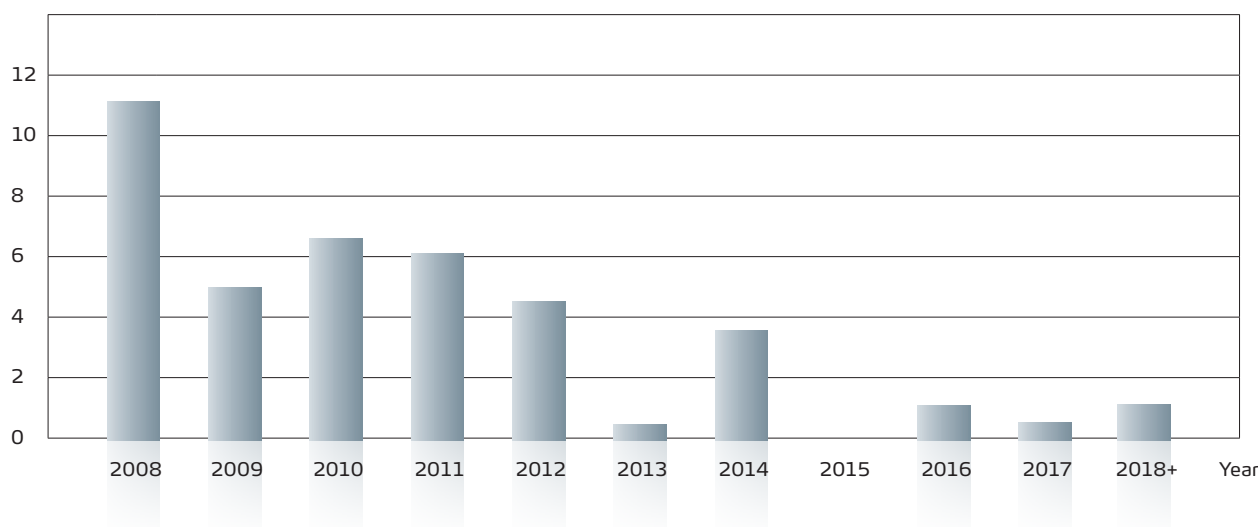


Funding through the Euro Medium Term Notes (EMTN) programme accounts for 43 per cent of the group's total funding. This group comprises both open and private loans. This segment has increased significantly as the corresponding figure for 2006 was 37 per cent. The main reason for this is that the group arranged two large open loans in the European market in 2007.

In 2007 the group obtained 53 per cent of its funding from international markets, while the corresponding figure in 2006 was 58 per cent. Hence, the share of funding obtained in Norway rose from 42 per cent to 47 per cent during the course of 2007. Deposits from customers are the group's most important source of funding. The deposit-to-loan ratio was 57 per cent at the end of 2007, compared to 55 per cent at the end of 2006.

Despite the unrest in the financial markets, the group's liquidity as at 31 December 2007 was satisfactory. The group increased its liquid assets through bonds deposited with Norges Bank during the year. In 2007, legislation governing bonds with pre-emptive rights was passed. Through the partly-owned company SpareBank 1 Boligkreditt AS the group reduced its liquidity risk significantly. In 2007, the group transferred approximately NOK 5 billion in housing loans, and this had a corresponding positive impact on liquidity. Actual surplus liquidity at year-end amounted to NOK 3.5 billion. Of the group's aggregate funding portfolio of NOK 41.5 billion at 31 December 2007, 27 per cent or NOK 11.2 billion is to be refinanced in 2008. The figure below illustrates the funding portfolio's maturity structure from the year 2007. There is an even distribution between international and domestic funding sources.

NOK billion - Maturity structure SpareBank 1 SR-Bank



5.5.3 Method used to calculate economic capital

The rating level, composition of external funding distributed by source and maturity date and access to the capital markets will be of importance to the bank's ability to deal with the liquidity situation at all times. The risk of an inability to refinance debt is managed through the group's overriding liquidity strategy and contingency plan. Economic capital is calculated for the risk of the group assuming additional costs in connection with refinancing in periods when the capital markets are turbulent.

5.5.4 Economic capital

The model and the related assumptions for calculating economic capital for liquidity risk are being tested and recalibrated and economic capital for liquidity risk is therefore not currently included in SpareBank 1 SR-Bank's external process for calculating economic capital pursuant to Pillar 2.

5.6 Ownership risk

5.6.1 Management and control

Sparebank 1 SR-Bank primarily assumes ownership risk through its stakes in SpareBank 1 Gruppen and SpareBank 1 Boligkreditt AS.

The SpareBank 1 banks manage the alliance co-operation and development of the product companies through the jointly-owned holding company SpareBank 1 Gruppen AS. SpareBank 1 Gruppen AS is owned by SpareBank 1 SR-Bank, SpareBank 1 Nord-Norge, SpareBank 1 Midt-Norge, Sparebanken Hedmark, Samarbeidende Sparebanker AS (20 savings banks in Eastern and North-western Norway), and the Norwegian Confederation of Trade Unions (LO) and affiliated trade unions. SpareBank 1 SR-Bank owns 19.5 percent of SpareBank 1 Gruppen.

SpareBank 1 Gruppen also has administrative responsibility for bank cooperation in the SpareBank 1 Alliance in which technology, brands, competence, common processes/application of best practice and procurement are key elements. The alliance is also engaged in development work through three expertise centres for Learning (in Tromsø), for Payments (in Trondheim) and for Credit models (in Stavanger).

The chief executive officers of the stake holding banks, SpareBank 1 SR-Bank, SpareBank 1 Midt-Norge, Sparebank 1 Nord-Norge, Sparebanken Hedmark and Samarbeidende Sparebanker AS make up the board of directors by virtue of their ownerships. The owners' chief executives also form the board for the Alliance.

SpareBank 1 Boligkreditt AS operates as a mortgage company under a licence issued by Kredittilsynet (The Financial Supervisory Authority of Norway). It is owned by savings banks that are part of the SpareBank 1 Alliance. The mortgage company was established on 18 August 2005. The individual savings bank's stake in SpareBank 1 Boligkreditt AS is based on the share of loans transferred from the parent banks. At 31 December 2007 SpareBank 1 SR-Bank's ownership share was 23.63 per cent and SpareBank 1 SR-Bank has a seat on its Board of Directors and is represented in its Board of Representative and General Meetings.

5.6.2 Method for calculating economic capital

SpareBank 1 SR-Bank calculates economic capital for ownership risk in SpareBank 1 Gruppen on the basis of

SpareBank 1 Gruppen's own capital assessment process and evaluation of economic capital.

Economic capital for ownership risk in SpareBank 1 Boligkreditt is dealt with and reported as a credit risk. This company is not considered to entail any ownership risk above and beyond the credit risk.

5.6.3 Economic capital

Economic capital for ownership risk is included in the group's process for assessing economic capital pursuant to Pillar 2.

5.7 Business risk

5.7.1 Management and control

The business risk is managed through analyses of inter alia external market situations and possible changes in framework conditions. The group is engaged in developing a well diversified income base so that possible impairments in individual product groups or customer segments will not have significant consequences.

SpareBank 1 SR-Bank is well positioned to meet future challenges. Over many years the group has shown that it has ability and a will to reorganise. Over time it has developed cost-effective operations combined with a continual raising of the level of competence and an expansion of the operations as far as the range of products and geography goes. Over several years SpareBank 1 SR-Bank has systematically emphasised the value chain in developing its products and services.

5.7.2 Method for calculating economic capital

The calculation of economic capital is based on the volatility in SpareBank 1 SR-Bank's revenues and expenses. Volatility is calculated on the basis of elements such as possible changes in customer behaviour as a result of a serious recession, changes in the competitive situation or product innovation.

5.7.3 Economic capital

Economic capital for business risk is included in the group's process for assessing economic capital pursuant to Pillar 2.

5.8 Reputation risk

5.8.1 Management and control

SpareBank 1 SR-Bank has established an overriding communication strategy that ensures that information is distributed internally and externally in a manner that support the bank's basic values, goals and vision.

SpareBank 1 SR-Bank has implemented a process for identifying and assessing the group's reputation risk at least once a year. All reputation risks are assessed against inherent risks and established control and management measures. Improvement measures are introduced as needs arise.

5.8.2 Method for calculating economic capital

SpareBank 1 SR-Bank has developed its own methodology for calculating economic capital for reputation risk. The method for calculating economic capital is based on scenario analyses using Monte Carlo simulations.

5.8.3 Economic capital

The model with related assumptions for calculating economic capital for reputation risk is being tested and calibrated and economic capital for reputation risk is not, therefore, currently included in SpareBank 1 SR-Bank's external process for assessing economic capital pursuant to Pillar 2.

5.9 Strategic risk

5.9.1 Management and control

SpareBank 1 SR-Bank has an annual strategy process that involves the Board, management and the business segments. A major element in the strategy process is the evaluation of the group's strengths and weaknesses, and threats and opportunities. This work culminates in strategic goals for the next 3 years, together with a related business plan.

Group management makes monthly and quarterly evaluations of the group's achievements and its strategic direction. The Board follows up the strategic direction and the strategic risk periodically.

5.9.2 Method for calculating economic capital

SpareBank 1 SR-Bank calculates economic capital based on a risk analysis of the group's strategic risk with related scenario analyses.

5.9.3 Economic capital

Economic capital for strategic risk is included in the group's process for assessing economic capital pursuant to Pillar 2.

5.10 Compliance risk

5.10.1 Management and control

The group shall have an effective process that ensures compliance with current legislation/regulations, industry standards and internal guidelines so that financial losses or sanctions are not imposed on the group as a result of a failure to comply. This shall be done through:

- Unambiguous basic values that are clearly communicated and understood throughout the organisation.
- An effective process that captures, communicates and implements amendments to laws and regulations.
- An effective process for following up and reporting compliance with laws and regulations.

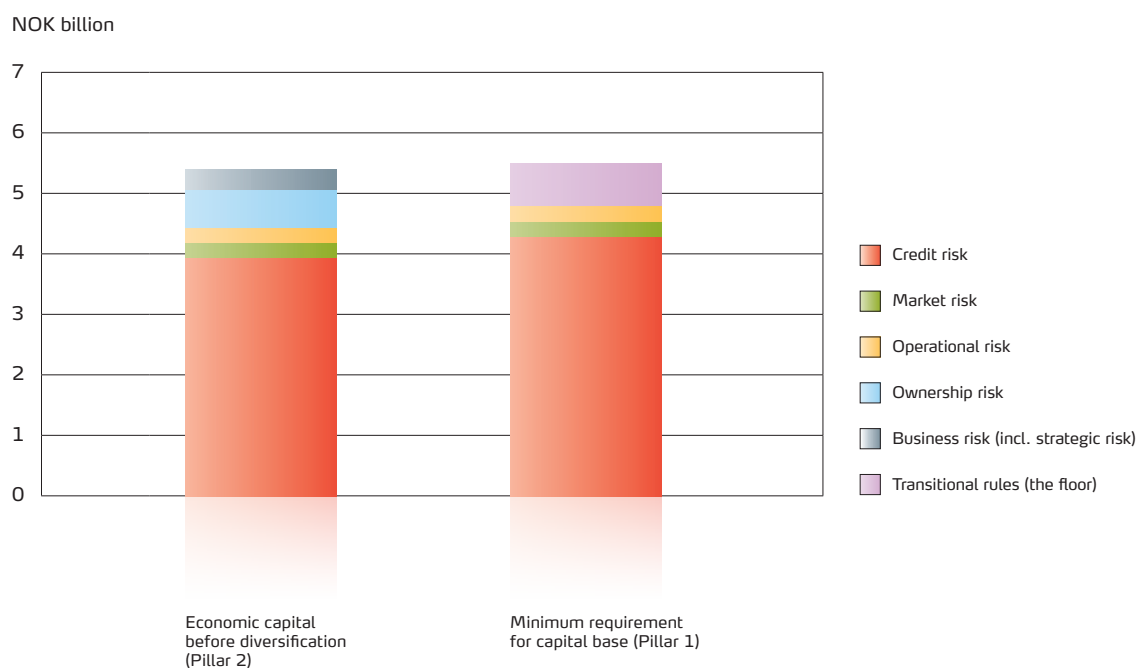
5.10.2 Economic capital

SpareBank 1 SR-Bank does not calculate economic capital for compliance risk.

6. COMPARISON OF REGULATORY AND ECONOMIC CAPITAL ADEQUACY

The graph below compares the minimum requirements for capital base (Pillar 1) and the need for economic

capital (Pillar 2). The main reasons for the differences between these are also reported.



The main differences between economic capital (Pillar 2) before diversification effects of NOK 5.4 billion and the minimum requirement for capital base (Pillar 1) of NOK 4.8 billion (transitional rules) are mainly due to:

- **Credit risk:**

LGD: When calculating economic capital for credit risk for governments, institutions and enterprises the LGD risk parameter is calculated on the basis of internal models, while the calculation of minimum capital base is template set pursuant to the Regulation on Capital Adequacy.

The group sets a realisation value for the collateral provided on the basis of own experience over time and in such a manner that these conservatively reflect the estimated realisation value in a cyclical downturn. SpareBank 1 SR-Bank's internal estimates of LGD are considerably lower than the values set by the authorities' template method.

Concentration risk: Economic capital takes into account concentration risk.

- **Ownership risk SpareBank 1 Gruppen:**

Economic capital (Pillar 2) is calculated for the ownership risk in SpareBank 1 Gruppen equivalent to NOK 0.6 billion. In connection with the calculation of the minimum capital base requirement (Pillar 1) 50 per cent of this ownership item is deducted from Tier I capital and 50 per cent from supplementary capital and is thus not directly reflected in the minimum capital base requirements.

- **Business risk (including strategic risk):**

Economic capital (Pillar 2) is calculated for business risk (including strategic risk) while this is not a separate type of risk when calculating the minimum capital base requirements.

