Risk and capital management 2009

SpareBank 1 SR-Bank

SpareBank 1
SR-BANK

RISK AND CAPITAL MANAGEMENT IN SPAREBANK 1 SR-BANK 2009

This document has been prepared in order to provide the market with the best information possible on risk and capital management in SpareBank 1 SR-Bank. It is also intended to cover the requirements placed on the publishing of risk information pursuant to the "Regulation concerning capital requirement".

The Group's information strategy places a focus on extended dialogue with a range of interest groups in which openness, predictability and transparency take central place. The information provided on the Group's development and results shall be correct, relevant and contemporary and shall allow for the Group's different interest groups to keep abreast of information and to generate trust among the investor market.

The core business of the banking industry is to create value by taking conscious and acceptable risks. SpareBank 1 SR-Bank invests considerable resources in the further development of its risk management systems and processes, in line with leading international practice. The company makes extensive use of risk models for its risk management and is happy to confirm that these models have proved robust in the current climate of financial unrest.

Risk and capital management for SpareBank 1 SR-Bank substantiates the Group's strategic development and achievement of goals, while at the same time ensuring financial stability and a justifiable capital management. The bank's total risk exposure has been reduced in 2009 as a result of reinforcements in capital adequacy. In addition, the Group's liquidity risk and credit risk have been diminished.

The unrest on the financial markets has impacted the bank's access to liquidity in 2009. In Norway, the governmental swap arrangement provided improved access to liquidity, thereby reducing the banks' liquidity risk. SpareBank 1 SR-Bank entered swap agreements and gained liquidity corresponding to NOK 7.4 billion in 2009. The swap arrangement therefore contributed to a satisfactory liquidity for the Group throughout the year. At year-end 2009, the Group had surplus liquidity in the form of deposits in Norges Bank and short-term positions in banks and credit institutions equalling NOK 2.2 billion. The Group's buffer capital in the form of liquid assets totals NOK 20.5 billion.

In 2009, the Group made the decision to strengthen its capital adequacy by carrying out share issues of NOK 1.2 billion and issuing perpetual capital securities of NOK 800 million. This capital supply was executed on the private market, without making use of the Norwegian State Finance Fund. Moreover, the Group strengthened its core capital by retaining parts of the result for 2009. Core capital adequacy for the Group thereby saw an increase from 6.4% to 9.6% at year-end 2009, while capital adequacy increased from 9.8% to 11.9%.

Credit risk represents a significant share of the Group's inherent risk. The quality of credit was improved during the last months of 2009 as a result of the upturn in economy and following a significant in-house focus on measures to reduce risk regarding existing customers. The implementation of a restrictive practice for granting loans to new corporate market customers in 2009 also helped strengthen credit quality.

Norway is still experiencing the impact of the economic downturn which started in early 2008, resulting from the global financial crisis. The decline in GDP for mainland Norway at the start of 2010 has now been replaced by a cautious upturn. According to Statistics Norway's "Economic Outlook 2010", the rate of growth is expected to remain moderate in 2010 and Norway will see the end of the recession by year-end 2012.

The economic barometer 2010 for the region of Rogaland indicates that companies have a positive outlook at the start of 2010. Nonetheless, there is a considerable variation in the level of confidence in the future among the different branches. Those companies targeting the domestic market expect to see growth and positive developments while parts of the export industry still suffer from a greater degree of uncertainty.

At the start of 2010, SpareBank 1 SR-Bank is well equipped to contribute towards value creation for the region in which the Group is located.

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1 CAPITAL ADEQUACY REGULATIONS

1.1 Introduction to the capital adequacy regulations

The EU's directive for capital adequacy was introduced in Norway on 1 January 2007. The regulations are based on a standard for capital adequacy calculations compiled by the Bank for International Settlements (BIS). The purpose of the capital adequacy regulations is to reinforce the stability of the financial market by introducing:

- More risk-sensitive capital requirements
- Improved risk management and control
- More thorough inspection
- More information to the market

The capital adequacy regulations are based on three pillars:

Pillar 1: Minimum requirement for subordinated loan capital
Pillar II: The bank's assessment of total risk and capital requirement and individual supervisory review.
Pillar III: Publishing of financial information.
The paragraphs below provide more detailed information on the contents of each pillar.

1.2 Expected amendments to the capital adequacy regulations

On the basis of experience gained from the financial crisis, the Basel Committee published its consultative document, "Strengthening the resilience of the banking sector" on 17 December 2009. The Basel Committee is an international body for central banks with its main objective to provide a forum for cooperation on banking supervisory issues. The Committee was established in 1975 by the central bank directors in the G10 countries.

The restrictions proposed by the Basel Committee are as follows:

- Reinforce the quality of the banks' capital by implementing more stringent requirements on the banks' capacity to absorb losses on a going concern basis. Core capital shall have full capacity to absorb losses while the bank is a going concern and shall principally comprise pure core capital. Deductions shall be made from pure core capital.
- Cover several types of risk, and initially counterpart risk. New regulations for counterpart risk shall provide more definite incentives for central settlement.
- Introduce a requirement for leverage ratio. Minimum requirement for core capital as a share of management capital shall provide a safety net to
- safeguard against risk which is not attended to by models.
- Reduce procyclical models and promote the use of countercyclical buffers. The Basel Committee addresses procyclicality with its proposals to (1) avoiding excessive variation in the minimum requirement, (2) forward-looking provisioning, (3) counteract the downscaling of buffers caused by dividend payments and (4) limit excessive credit growth.
- Introduce global minimum standards for liquidity.
- Potential extra capital requirement for systemically important institutions.

Furthermore, the Basel Committee has proposed quantitative requirements on liquidity. The quantitative requirements are intended to contribute towards banks and financial institutions having sufficient volumes of high-quality liquidity to ensure survival in an acute stress period of 30 days. At the same time, the Committee aims to provide the institutions with an incentive to reduce the gap in maturities between a company's receivables and liabilities. In other words, the objective is for the institutions to aim for more long-term self-financing and to place less trust in short-term forms of financing, including deposit financing.

The Basel Committee plans to present a final set of regulations towards the end of 2010 for implementation towards the end of 2012. However, the Financial Supervisory Authority of Norway is of the opinion that the new regulations should be implemented earlier than 2012.

Moreover, the EU directives, CRD II and CRD III, come into effect from the end of 2010. The main amendments are as follows:

- Revised requirement for the quality of subordinated loan capital by introducing maximum limits for hybrid capital and paramount requirements for the qualities of hybrid and core capital.
- Transparency for the distribution of responsibility between domestic state and host state.
- Reinforcement of the supervision of the institutions' liquidity.
- Reinforcement of the provisions regarding securitisation. Does not apply to covered bonds.
- More stringent requirement on the use of the VaR method (Value at Risk) on the trading portfolio.

SpareBank 1 SR-Bank is of the opinion that the Group currently satisfies the majority of restrictions to the liquidity requirement. However, these restrictions may result in a slight increase in funding costs on the market in general and a slight increase in the number of assets with low return. SpareBank 1 SR-Bank does not expect to be affected by the restrictions to a greater degree than other banks, such that the competitive situation remains unchanged.

2 PILLAR I: MINIMUM REQUIREMENTS FOR SUBORDINATED LOAN CAPITAL

Pillar I describes the different methods for calculating the capital requirement from which the banks can choose. The various methods are displayed in figure 1.

Figure 1: Alternative methods for calculation of minimum requirement for subordinated

Credit risk	Market risk	Operational risk
Standard method	Standard method	Basic method
Basic IRB method *	Internal ratings method *	Standardised method *
Advanced IRB method *		AMA method *

* These methods require the approval of the Financial Supervisory Authority of Norway. Supervisory A

The minimum requirement for subordinated loan capital (hereinafter referred to as regulatory capital) comprises 8% of risk-weighted assets (the calculation base). In principle, there are two different approaches to the calculation of minimum requirement for subordinated loan capital according to the capital adequacy regulations. One approach is based on a standardised method while the other is based on the application of internal ratings.

When applying the internal ratings based approach, the statutory minimum requirement for capital adequacy is based on the bank's internal risk assessments. Consequently, the statutory minimum requirements for capital adequacy are more risk sensitive, such that the capital requirement corresponds more closely with the risk in the underlying portfolios or activities. The use of the internal ratings based approach requires the prior approval of the supervisory authorities.

2.1 Choice of method, SpareBank 1 SR-Bank

Table 1 displays the principal methods utilised by SpareBank 1 SR-Bank when calculating capital requirements for credit, market and operational risk respectively.

Table 1: SpareBank 1 SR-Bank's methods for calculation of minimum requirement for subordinated loan capital.

Type of risk	Portfolio	Regulatory method
Credit risk	States	Standard method
	Institutions	Standard method
	Corporate market	Basic IRB method
	Retail market	Advanced IRB
	SpareBank 1 Boligkreditt AS (retail market)	Advanced IRB
	Other subsidiaries and associates	Standard method
Market risk	Ownership risk	Standard method
	Debt risk	Standard method
	Currency risk	Standard method
Operational risk	SpareBank 1 SR-Bank including subsidiaries	Standardised method
	Associates	Standard method

SpareBank 1 SR-Bank has received approval from the Financial Supervisory Authority of Norway to make use of internal ratings based (IRB) methods for credit risk. The bank has received approval for utilisation of IRB Foundation for enterprises (hereinafter referred to as the corporate market) and IRB (IRB retail) for the mass market (hereinafter referred to as the retail market). This implies that the statutory minimum requirement for capital adequacy for credit risk will be based on the Group's internal risk models.

When estimating capital requirement according to the Basic IRB method for the corporate market, the probability of default (PD) risk parameter is estimated on the basis of internal ratings. The risk parameters conversion factor (CF) used to determine exposure at default (EAD) and loss given default (LGD), are established according to the standardised approach in the capital requirement regulation.

When estimating capital requirement according to the IRB method for mass market (retail market), internal ratings are utilised for the calculation of risk parameters probability of default (PD), conversion factor (CF) used to establish exposure at default and loss given default (LGD).

For the subsidiary SpareBank 1 SR-Finans AS, plans have been prepared for a later transition to the IRB method and the portfolio reports are therefore based on the standardised approach for the time being. The main objective of the company is leasing financing and car financing with seller's chattel mortgage. The calculation base for SR-Finans AS is 4.9% of the total calculation base.

SpareBank 1 SR-Bank owns 33.8% of SpareBank 1 Boligkreditt AS, 23.5% of SpareBank 1 Næringskreditt and 23.5% of BNbank ASA as of 31 December 2009. SpareBank 1 SR-Bank's share of the capital requirement for these companies is consolidated in SpareBank 1 SR-Bank's capital adequacy report, based on the Group's shareholding.

SpareBank 1 SR-Bank owns 19.5% of SpareBank 1 Gruppen. The share of the investment in SpareBank 1 Gruppen's book value which exceeds 2% of SpareBank 1 Gruppen's subordinated loan capital is deducted from subordinated loan capital and the calculation basis. To the extent that the Group has subordinated loan capital in other financial institutions, this is directly deducted from the Group's own subordinated loan capital for the share which exceeds 2% of the recipient financial institution's subordinated loan capital. If the Group has subordinated loan capital in other financial institutions which constitutes less than 2% of the individual financial institution's subordinated loan capital, the total amount of such capital is deducted from the Group's subordinated loan capital for the share which exceeds 10% of the Group's subordinated loan capital.

2.2 Regulatory capital adequacy goals

On the basis of the increased level of uncertainty in the Norwegian and international economies and a general recapitalisation of banks on a global scale, SpareBank 1 SR-Bank made the decision to strengthen its capital adequacy in 2009 by issuing shares of NOK 1.2 billion and issuing perpetual capital securities of NOK 800 million. This capital supply was executed on the retail market, without making use of the Norwegian State Finance Fund.

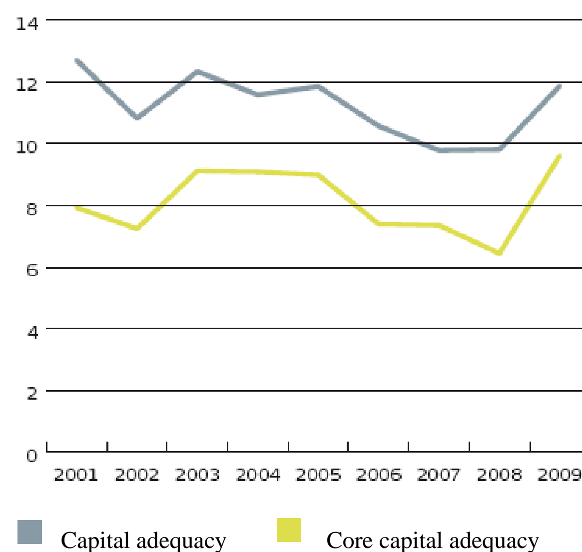
In addition, the Group strengthened its core capital by retaining parts of its result.

The core capital adequacy for the Group was increased from 6.4% to 9.6% at year-end 2009, while capital adequacy increased from 9.8% to 11.9%. For the parent bank, core capital was 11.0% and capital adequacy 13.8% at year-end 2009.

The recapitalisation is in line with the Board's specific target for a core capital adequacy of minimum 9% for the Group, in order to strengthen the capacity to absorb possible losses and secure the potential for future growth.

The figure below illustrates the development in capital adequacy for the period 2001-2009 for the Group.

Figure 2: Development in capital and core capital adequacy for SpareBank 1 SR-Bank 2001-2009.



The requirement for regulatory capital constituted NOK 6.8 billion at year-end 2009 compared with a core capital of NOK 8.1 billion and a net subordinated loan capital of NOK 10.0 billion. The Regulation concerning Capital Requirement stipulates that, during a transitional phase, the requirement for regulatory capital in 2009 cannot be lower than 80% of the minimum requirement, when calculating according to the old regulations (Basel 1 from 2006). It has been decided that the prevailing "floor" shall be sustained in 2010 and 2011. The floor implies that the requirement for regulatory capital as of 31 December 2009 is NOK 264 million higher than what it should have been.

SpareBank 1 SR-Bank places an emphasis on maintaining satisfactory capitalisation over time for all business units within the Group. The Group's control 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. Neither are there any articles of association which impose such limitations.

3 PILLAR II: THE GROUP'S ASSESSMENT OF TOTAL RISK AND CAPITAL REQUIREMENT

Pillar II is based on two main principles. The banks are required to have a process for the assessment of their total subordinated loan capital in relation to risk profile, and a strategy for sustaining their level of capital. The supervisory authorities shall review and evaluate the banks' internal rating of capital requirement and strategies. Furthermore, the supervisory authorities shall monitor and ensure compliance with the capital requirements enforced by the authorities. The supervisory authorities shall implement suitable measures if not satisfied with the results of this process.

With the Group's assessment of total risk and capital requirement, all significant types of risk are quantified by calculating expected loss and the requirement for risk-adjusted capital to cover expected loss. Expected loss is the figure a company expects statistically to lose in a 12-month period. Risk-adjusted capital provides a description of how much capital the Group believes it requires to cover the actual risk assumed.

As it is impossible to protect against all loss, the Group has stipulated that the risk-adjusted capital, in principle, shall cover 99.9% of potential unexpected losses in 2009.

With effect from and including 2010, the Group has adopted an increase in the level of confidence to 99.97% which provides an increase in risk-adjusted capital of approx. 11%.

The calculation of risk-adjusted capital at year-end 2009 covers the following areas:

- Credit risk (including portfolio transferred to SpareBank 1 Boligkreditt AS)
- Market risk
- Operational risk
- Commercial risk
- Ownership risk (SpareBank 1 Gruppen, SpareBank 1 Næringskreditt and Bnbank ASA)
- Reputation risk
- Strategic risk

Risk-adjusted capital for the risk in the subsidiaries, SpareBank 1 SR-Finans AS, Eiendomsmegler 1 SR-Eiendom AS, SpareBank 1 SR-Forvaltning AS, SpareBank 1 SR-Investering AS and SpareBank 1 SR-Fondsforvaltning AS is consolidated under the individual type of risk.

The calculation of risk-adjusted capital is based on an internal ratings approach which, in certain instances, may deviate from the statutory models or the standardised approach. SpareBank 1 SR-Bank is of the opinion that the calculation of risk-adjusted capital provides a more precise illustration of the Group's total risk than the regulatory calculations.

3.1 The purpose of risk and capital management in SpareBank 1 SR-Bank

The core business of the banking industry is to create value by taking conscious and acceptable risks. The Group therefore invests significant resources in the further development of risk management systems and processes in line with leading international practice. Risk and capital management in SpareBank 1 SR-Bank shall support the Group's strategic development and achievement of objectives while ensuring financial stability and sound management of assets. This is to be achieved by:

- A strong organisational culture characterised by high awareness of risk management.
- A good understanding of the risks driving earnings.
- Making every effort to achieve optimal capital employment within the agreed business strategy.
- Preventing unexpected single events from damaging the Group's financial position to a serious extent.
- Making the most of synergy and diversification effects.

3.2 The process of risk and capital management

In order to ensure an efficient and appropriate process of risk and capital management, the framework established is based on a number of elements which reflect the way in which the Board of Directors and management control the Group. The main elements are described in figure 3.

Figure 3: Main elements of SpareBank 1 SR-Bank's risk and capital assessment process

3.2.1 The Group's strategic goals

SpareBank 1 SR-Bank aims to become a larger and more complete corporation as a result of organic growth, innovation and exploitation of strategic opportunities.

SpareBank 1 SR-Bank aims to be the most attractive brand on the financial market for the Group's market areas, and be recognised for:

- Being the leading financial group in the region
- Having satisfied customers who recommend us to others
- Being the market leader in terms of value creation together with customers
- Providing the best services and products related to savings and the pension market
- Being the market leader in attracting, challenging and developing the most skilled employees
- Being one of the most profitable financial institutions in the Nordic countries.

3.2.2 Risk identification and analysis

The risk identification process is based on the Group's strategic goals. This process is forward-looking and covers all significant areas of risk. Thorough analyses are carried out of the risk identified in order to understand the risk characteristics and to assess the impact of the established control and management measures. For those areas where the impact of the established control and management measures does not appear satisfactory, new improvement measures will be implemented. Alternatively, an assessment is carried out as to whether the activities should be eliminated. Measures to reduce probability take precedence over measures to reduce consequences.

3.2.3 Capital allocation

Allocation of risk capital to the individual business segments is an important tool for the management of the business segments' risk profile and activities. Risk capital is defined as the Group's book equity plus perpetual capital securities.

The business units apply each year to the Board of Directors for risk capital and the Board allocates capital to the business units on the basis of the calculated risk for each unit, the estimated risk-adjusted return and the strategic goals.

Risk-adjusted return and general utilisation of the risk capital allocated is monitored on a monthly basis.

3.2.4 Financial projections and stress tests

Two financial projections are made, at a minimum once a year:

- A financial projection of expected development
- A financial projection of a situation involving a severe economic downturn (stress test)

Financial projection of expected development

A projection of the financial developments over the next 5 years is made on the basis of the strategic goals, business plan and expected development in macro economics. The purpose of this projection is to provide an important contribution to the strategic process relating to how macro economics and the strategic goals impact the Group's financial development, measured in relation to return on equity, funding and capital adequacy.

Financial projection of an economic downturn (stress test)

The purpose of a financial projection of an economic downturn is as follows:

- To assess potential losses in different scenarios including major/extreme but plausible shocks.
- To assess the vulnerability of portfolios/activities in the event of major/extreme but plausible shocks.
- To increase understanding of how shock affects the Group's profitability, liquidity and capital adequacy.

- To assess the potential losses based on different strategic possibilities.
- To identify weaknesses in the Group's risk strategies and processes in order to aid the development of measures to reduce risk and the planning of emergency preparedness.

The projections have a time horizon of 5 years and therefore cover a projected economic cycle.

In order to assess the consequences of an economic downturn for SpareBank 1 SR-Bank, the Group places a considerable focus on those areas of the economy which have an impact on financial development. These are primarily the development in demand for credit, the equity market, interest rate market and the development in credit risk. Not only will an economic downturn have an effect on the return from underlying assets, it will also impact the way in which customers save money.

3.2.5 Evaluation and measures

The abovementioned financial projections provide both the Administration and the Board of Directors with a good understanding of risk, allowing them to make the correct strategic decisions while at the same time ensuring a satisfactory risk profile.

On the basis of these analyses, SpareBank 1 SR-Bank makes up capital plans which will allow the bank to achieve a long-term and efficient capital management and ensure a justifiable capital adequacy for the Group, based on risk exposure and strategic goals.

In addition, SpareBank 1 SR-Bank has compiled contingency plans which will allow for the best possible management of potential crises.

The Group's contingency plans comprise:

- Capital adequacy
- Liquidity risk
- Operational risk
-

3.2.6 Reporting and follow-up

Risk reporting and follow-up for the Group form an internal part of the Group's business management and reports to the Board of Directors. Important elements of the Group's business management are to have clear and specific goals for performance and quality of processes, continuous improvements and to attract, develop and challenge the most skilled employees. In this context, a well-balanced target management system is an efficient and powerful tool for follow-up and reporting. In order to ensure a sufficient balance between quality and performance, the ratings card focuses on 4 dimensions: (1) customer/market, (2) internal processes, (3) organisation/competencies and (4) financial development.

Principal risk supervision and reporting are carried out by the department for risk management and compliance which is independent of the different business units. The department reports directly to the CEO.

3.2.7 Organisation and organisational culture

Organisational culture

SpareBank 1 SR-Bank aims to maintain a strong and healthy organisational culture characterised by a high level of awareness of risk management. It is difficult to compensate for an unhealthy organisational culture by introducing other control and management measures. The organisational culture comprises management philosophy and the people in the organisation with their individual qualities such as integrity, value base and ethical attitudes.

SpareBank 1 SR-Bank has established a clearly defined value base which has been clearly communicated and presented throughout the organisation.

"The courage to have an opinion, the strength to create value"

By being

- Long-sighted
- Open and honest

By displaying

- Responsibility and respect
- The willingness and capacity to improve

SpareBank 1 SR-Bank aims to attract, develop and challenge the most skilled employees available. SpareBank 1 SR-Bank dates back 170 years. Over the past 15 years, the Group has created value and results at the top of the spectrum on a Nordic scale. One important reason for SpareBank 1 SR-Bank's success is its clearly defined and long-term focus on values and attitudes as the fundamental pillars of an organisational culture.

Human capital represents the very foundations of the Group. Without skilled employees, the Group would not have products to offer to the market. The Group strongly believes that it can create value for its customers, shareholders and employees by working towards clearly defined result targets and by having a wide range of activities generated by skilled employees with good attitudes and values.

By developing a culture based on value, the Group gains a strategic aid which can represent a competitive edge over time. Below is a description of four factors which illustrate how the Group systematically works towards the development of a healthy organisational culture at all levels within the organisation via recruitment,

development of competencies, incentive schemes, job satisfaction and good reputation.

Focus on ethics and values when recruiting
SpareBank 1 SR-Bank is an attractive place to work. The process towards becoming an employee of the Group is lengthy and maintains a high quality. The majority of vacancies are advertised both in-house and externally. Sound routines and recruitment procedures have been prepared to prevent errors during this process. In addition to thorough interviews, the Group makes use of a variety of tests and recruitment methods which focus on motivation for the position, correct competencies and, last but not least, good attitudes and ethical standards. Before an offer of employment is made, a credit rating of the candidate is carried out and a certificate of good conduct is requested from the police along with feedback from minimum two references. Upon acceptance of the position, the new employee is requested to sign a duty of confidentiality and to confirm understanding of /compliance with the ethical guidelines.

A training program is established for all new employees in groups, covering the Group's history, business concept, strategic goals and a detailed training course in security and ethics. The CEO and members of the corporate management always take part in these training sessions in order to substantiate the contents of the training program. In 2009, a Council on Ethics was established to provide consultation services for practical training in and implementation of the Group's ethical guidelines and for product development and innovation.

Development of competencies for managers and employees
SpareBank 1 SR-Bank defines competencies as "Knowledge, Skills and Attitudes". The term "Knowledge" is further defined as the education and work experience of an individual candidate. The term "Skills" is the way in which an individual makes use of his/her knowledge. The term "Attitudes" reflects an individual's values and conduct on a day to day basis. For new employees, there is a minimum requirement for formal education corresponding to a Bachelor's degree. Internal consultancy schools have been established for the Group's consultants, who make up 2/3 of the Group's human capital.

The consultancy schools are obligatory for all those working in the interface with customers. The focus is on good consultation, best customer process, ethics and attitudes for the Group's consultancy services. For the 350 employees and managers due to complete a new Authorisation Program, ethics is one of six subjects in the theoretical part of the program. For the practical examination, which forms the true basis for a completed authorisation, ethics and consultation represent half of the exam.

Incentive systems
The Group has an incentive strategy which mainly emphasises good team performance and a long-term focus related to salary. The incentive strategy mainly comprises three elements, which are fixed salary, bonus and other benefits such as pension and insurance schemes, study grants, subsidised loans and measures to promote health and job satisfaction.

The Group works with five different criteria for individual incentives. These are efforts/performance, customer orientation, quality, competencies and ability/willingness for interaction. Bonus payments are made annually, provided that the Group has achieved its principal goals. The bonus payments are mainly based on team results, but with an option for individual bonus payments which are assumed to cover 20-25% of the best performances in the Group. The Group's bonus scheme has one main principle that the maximum bonus payment is 25% of fixed salary and that the bonus payment can be reduced if the quality of the work is not satisfactory. This has been introduced to discourage employees and managers from taking short-term decisions or poor credit assessments, motivated by external factors and incentive.

Job satisfaction, ethics and reputation
For SpareBank 1 SR-Bank, it is paramount to have employees who comply with the value base established and the Group's ethical guidelines.

The most important factors for a culture based on value are openness and trust between managers and employees. Trust is not something that can be laid down in a strategy but has to be built up with the correct type of conduct. All new managers have to complete an obligatory 2-day course during which ethics and values are central subjects to be discussed. The management training program also focuses on the responsibility of managers to lead the way and provide a good example for correct conduct.

The Group's tertiary performance appraisals indicate a high level of job satisfaction and a high score for issues relating to attitudes and values. The Group works on the hypothesis that a good working environment dominated by openness and trust has a preventative effect on the development of poor attitudes and actions which could damage a good culture and good reputation. The results of the performance appraisals are openly reviewed and discussed by the corporate management, the Board of Directors and the Control Committee at least two times a year.

Organisation

SpareBank 1 SR-Bank focuses on independent management and control, so that responsibility is distributed between various roles within the organisation:

The main tasks of the Supervisory Board are to monitor the Board of Director's management of the company. The Board of Directors has principal responsibility for management and organisation of the Group in line with legislation, articles of association and regulations provided by the Supervisory Board. The Board of Directors is responsible for safe and prudent management of all the funds controlled by the Group. Consequently, the Board of Directors is also obliged to ensure that accounting and capital management are subjected to adequate control. The board members shall exercise proper judgement when executing their responsibility and tasks.

The Board of Directors is responsible for ensuring that the Group has a subordinated loan capital which is justifiable in terms of the risk profile adopted and the

requirements from the authorities. The Group's Board of Directors establishes the principal goals such as risk profile and return on investment and distribution of capital to the different business units. The Board of Directors also establishes the principal frameworks, authorisations and guidelines for risk management within the Group. The Board of Directors has adopted ethical rules which help raise awareness and ensure compliance with the ethical standard established for the Group.

The subsidiaries' Board of Directors perform their tasks for the individual companies in accordance with the resolutions adopted by the bank's Board of Directors. For companies wholly owned by SpareBank 1 SR-Bank, efforts are made to compose the Board of Directors in such a way as to ensure good knowledge of the branch and good integration between the individual company's business and associated business areas in SpareBank 1 SR-Bank. The Chairmen of the Board for the individual companies are the members of the corporate management group with the largest interface between their daily business domain and the business domain of the subsidiary in question. This principle safeguards important factors related to the Group's total strategy and optimisation via the value chain.

Certain companies have a Board of Directors where 40% of the board members are external representatives. The board composition is assessed individually per company in relation to a balance between the need for external expertise of the branch/ideas, and in-house employees who have good knowledge of the Group's total activities.

The CEO is responsible for the daily management of the Group's business, in line with legislation, articles of association, authorisations and instructions. Issues which are of an unusual nature or high importance for the Group are presented to the Board of Directors. However, the CEO has the right to decide on an issue when authorised by the Board of Directors or in cases where waiting for the Board's decision would result in a significant disadvantage for the Group. The CEO shall implement the Group's strategy and cooperate with the Board to further develop this strategy. The CEO reports to the Board on the Group's activities, position and earnings performance on a monthly basis.

The managers of the business and support units are responsible for day-to-day risk management within their area of responsibility and shall constantly ensure that risk management and risk exposure comply with the frameworks and main control principles adopted by the Board of Directors or CEO.

The department of risk management and compliance is organisationally independent of the business units and reports directly to the CEO. The department is responsible for the further development of the framework for risk management including risk models and risk management systems. The department is also responsible for independent follow-up and reporting of risk exposure, and for ensuring that the Group complies with prevailing legislation and regulations. In addition to the CEO, the department comprises three risk managers and two risk analysts.

The department works closely together with SpareBank 1's centre of expertise for credit models, which is located in SpareBank 1 SR-Bank's premises. The centre of expertise is responsible for the development and quality assurance of credit models in line with leading international practice. In addition to managers, the department has 4 risk analysts.

These departments work in close cooperation with organisations such as the academic risk group at the University of Stavanger in order to ensure exchange of experience and development of competencies.

In addition the above-mentioned roles, several committees have been established within the area of risk and capital management and these assist the CEO by providing specifications for decision-making and follow-up.

The risk and capital management committee is responsible for principal follow-up of the Group's risk profile, funding and capital adequacy. The committee also discusses draft versions of risk strategies, capital allocations, validation reports and recommends new risk ratings. The risk and capital management committee is led by the CEO for risk management and compliance and is composed of a broad base of senior employees from the economy/finance department and the risk management and compliance department.

The asset liability committee is a consultation body involved in operative management of the Group's balance sheet within the boundaries authorised by the Board of Directors. This committee plays an important consultative role in the Group's operative management of liquidity risk. The asset liability committee is led by the CFO and is composed of personnel resources from the Group's treasury department, economy/finance department and the department for risk management and compliance.

The credit committees are responsible for providing an independent recommendation regarding power of attorney holders. When making their recommendations, the credit committees evaluate loan and credit applications in accordance with prevailing credit strategy, credit policy, allocation regulations and credit management procedures. The credit committees place a particular emphasis on detecting risk in relation to individual applications and carrying out a separate, independent assessment of credit risk, which charts the consequences of various risks for the Group.

The Group has also established a set of independent regulatory bodies:
The control committee monitors the Group's activities to ensure that they are performed in a justifiable and adequate manner in compliance with legislation and regulations, articles of association, guidelines stipulated by the Supervisory Board and injunctions from the Financial Supervisory Authority of Norway.

The internal audit monitors the risk management process, ensuring that it targets the correct goals, is efficient and functions as intended. The Group's internal audit function is outsourced, thereby providing independence, competency and capacity. In terms of organisation, the

internal audit reports to the Board of Directors. The reports and recommendations of the internal audit regarding improvements to the Group's risk management are reviewed within the Group on a continuous basis.

The main tasks of the external auditor are to assess whether the Group's financial statements are presented in accordance with legislation and regulations. Furthermore, the external auditor shall assess whether the capital management is organised in an adequate manner and with a justifiable level of control. The external auditor is elected by the Supervisory Board.

3.3 Framework for management and control according to type of risk

3.3.1 Credit risk

Credit risk is defined as the risk of loss resulting from customers or counterparties not being able or willing to fulfil their commitments to the Group.

Credit risk management follows the framework for credit approval, follow-up of liabilities and portfolio management. The main elements of this framework can be described as illustrated in figure 4 below.

Figure 4: Framework for credit approval

Credit strategy

The Group's primary market area for credit risk exposure comprises the regions of Rogaland, Agder and Hordaland. The principal credit strategy stipulates that the Group shall have a moderate risk profile, preventing individual events from significantly damaging the Group's financial position.

The credit strategy substantiates the Group's strategic development and achievement of goals by providing:

- A healthy credit environment where clear requirements are made on the knowledge, skills and attitudes of all employees.
- An appropriate process for the giving of credit, where clearly defined requirements are made on quality and compliance with the Group's framework for credit risk management.
- An efficient system for risk management.
- Making every effort to achieve optimal capital allocation within the agreed business strategy.
- To seek an equal risk-adjusted return for all customers over time within the business strategy adopted.
- A diversified portfolio.

The business activities of corporate customers shall have a long-term perspective and customers shall comply with all prevailing legislation and regulations.

The Board of Directors reviews and approves the principal credit strategy every year.
The Group's credit strategy also comprises principal credit strategy frameworks to secure a diversified portfolio and a satisfactory risk profile. These frameworks impose limitations on the probability of default, expected loss, risk-adjusted capital and the amount of total lending exposure permitted for the corporate market. The paragraphs below provide a more detailed description of these frameworks:

- The probability of default describes the share of the lending portfolio (number of customers) which statistically is expected to default over a 12-month period (long-term outcome). For the Group, the risk-weighted probability of default shall not exceed 1.60% in 2010. At the end of 2009, the risk-weighted probability of default was 1.33%.
- Expected loss describes what the Group must statistically expect to lose on its lending portfolio over a 12-month period (long-term outcome). For the Group, expected loss shall not exceed 0.35% of exposure (EAD) in 2010. At the end of 2009, expected loss was 0.23% of exposure (EAD).
- Risk-adjusted capital provides a description of how much capital the Group believes it requires to cover the actual risk assumed based on a specific confidence level. For the Group, risk-adjusted capital in 2010 shall not exceed 3.75% of exposure (EAD) with a confidence level of 99.97%. At the end of 2009, risk-adjusted capital was 3.21% of exposure (EAD) based on a confidence level of 99.9%.
- Lending volume for corporate market portfolio: The lending volume for the corporate market shall not exceed 45% of the Group's total lending (EAD) in 2010. At the end of 2009, the lending volume to the corporate market portfolio was 40% of total lending.

SpareBank 1 SR-Bank's portfolios which have been transferred or are due for transfer to the credit enterprises SpareBank 1 Boligkreditt AS and SpareBank 1 Næringskreditt AS are included in the above-mentioned frameworks.

The principal credit strategy limits are distributed throughout the individual business units. For the corporate market, there are also specific limits for the maximum share of risk-adjusted capital for individual branches, the group of major customers and maximum exposure to customers with high risk. In addition, a maximum limit has been adopted for loss on an individual customer, which cannot exceed NOK 425 million. An individual customer, in this context, also includes commitments for two or more counterparts when the controlling interest or economic association between the two are such that economic difficulties in one party will probably result in payment difficulties for the other party (ies).

The above-mentioned limits have been established in order to ensure a diversified portfolio within the corporate market. The branch leases real estate and this area is allocated the largest limit for risk-adjusted capital among the branches. SpareBank 1 SR-Bank also has its greatest level of exposure in this branch. At year-end 2009, exposure in this branch represents 18% of risk-adjusted capital in the Group and 12% of total lending exposure.

SpareBank 1 SR-Bank makes use of risk-adjusted capital as a measurement parameter for the above-mentioned frameworks, as risk-adjusted capital reflects the actual risk exposure in a significantly better manner than the traditional focus on lending volume.

Commitments with a high risk require considerably more risk-adjusted capital than commitments with a low risk. In summary, the correlation between risk and risk-adjusted capital is as follows:

- Commitments with low risk tie up on average 0.3 times more risk-adjusted capital than commitments with lowest risk.
- Commitments with medium risk tie up on average 3.5 times more risk-adjusted capital than commitments with lowest risk.
- Commitments with high risk tie up on average 6 times more risk-adjusted capital than commitments with lowest risk.
- Commitments with highest risk tie up on average 7.5 times more risk-adjusted capital than commitments with lowest risk.

This implies that the bank can lend significantly higher amounts to customers with low risk than to customers with high risk.

The credit strategy limits are established by the Board of Directors and any deviations from these shall therefore be presented to the Board of Directors for approval. The department for risk management and compliance issues quarterly reports on the development of the credit strategy limits to the Board of Directors.

Credit policy guidelines

The credit policy guidelines stipulate minimum requirements which apply to all types of financing, with the exception of commitments granted as a part of the exercise of particular credit assurance authorisations. In addition to the general credit policy guidelines, a set of more specific credit policy guidelines have been prepared which relate to individual branches or segments which may represent a particular risk.

The credit policy guidelines are revised as a minimum every year and are approved by the CEO, with information submitted to the Board. Any deviations from the credit policy guidelines require explanation and approval at director level.

The general credit policy guidelines are based on a general requirement of due care related to equity, where it is stipulated that a company shall have a robust equity at all times which is justifiable in relation to the risk and scope of the company's business activities.

In certain instances, the Group is not permitted to assume credit risk. This applies as follows:

- The customer is under impairment.
- The customer has a negative equity.
- Financing of share or financial instruments.
- Financing of intangible assets.
- Security compensates for lack of subordinated loan capital.
- The customer's estimated probability of default exceeds 10%.

For the financing of shares and financial instruments however, the Group allows for credit risk in connection with investments in market-based securities and for industrial contingent acquisitions. The latter also applies to financing of intangible assets.

Credit policy guidelines related to specific segments or branches. Financing of land and development of real estate requires a book equity of minimum 20% for the customer. In addition, the Group differentiates between the degree of financing for various financing purposes according to the following guidelines:

- 80% degree of financing for purchase of developed plots of land.
- 50% degree of financing for purchase of undeveloped plots of land.
- 50% degree of financing for financing of infrastructure.

Financing shall not be granted for the purchase of undeveloped plots of land which, according to the municipal plan, are set aside for other purposes than the customer's expressed purpose.

Financing of development of real estate requires a book equity of minimum 20% for the customer. In addition, there is a minimum requirement for 70% advance sale before discount. In general, the customer's own financing shall always be utilised first for a project.

When financing real estate for lease, the total financing package shall not exceed 11 times the annual gross lease

income, but only if justified by a total assessment of the interest rate level, the duration of the lease contract, the customer's performance factor, the location of the property, the condition of the property and the degree of interest rate hedging.

For maritime financing, only low risk types of tonnage shall be financed. As a main rule, financing shall not be granted to ships older than 25 years. In addition, the Group requires minimum value clauses (MVC) of minimum 125% and insurance coverage of minimum 120% of the loan balance. Requirements are also made on classification company and flag state.

Participation in syndicates is only permitted if the customer, according to the Group's own assessment, can be classified as medium risk or better. Customers must clearly have roots in Norway and the agent bank shall be one of the Norwegian main bank connections and at the same time possess the necessary competencies to manage the commitment.

The guidelines for participation in syndicates also apply to financing abroad, although with an added requirement that SpareBank 1 SR-Bank is one of the Norwegian main bank connections.

For financing of market-based securities, the Group imposes stringent requirements on the degree of financing. The degree of financing is limited to 70% for funds and 50% for shares and equity certificates listed on the Oslo Stock Exchange. The Group, as a main rule, does not finance other market-based securities.

For financing of shipbuilding, a contract is required with a reputable and financially solid shipowner and payment from the shipowner of minimum 20% in the early stages of the project is obligatory. The hull shipyard must be able to provide necessary repayment bonds. The shipyard must also have own liquidity.

Acquisition financing: Acquisition financing is conditional upon a third-party review of all acquired companies and upon approval by the Group of both the acquisition and sales agreements. The loan agreement shall be prepared by an authorised lawyer.

Credit authorisation regulations

The Board of Directors is responsible for the Group's loan and credit commitments, but delegates credit authorisation, within certain limits, to the CEO who in turn can further delegate these within a separate set of authorisations. The delegated credit authorisations are correlated with the expected loss and default probability for the individual positions.

The authorisations are personal. They imply that the credit committees do not have decision-making authority but make a recommendation to the authorisation holder. If there is no recommendation from the credit committee, the authorisation limit is reduced. In general, the authorisations are generous if the expected loss and probability of default for a commitment indicate low risk, while the authorisations are restricted progressively as risk increases.

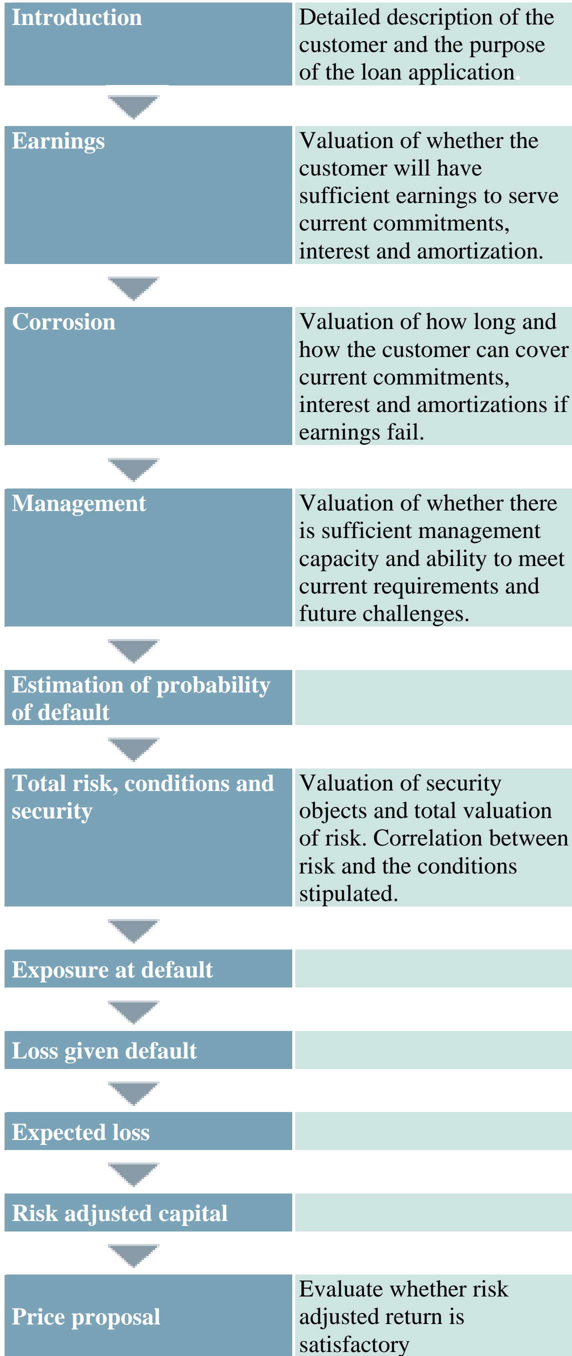
The credit authorisation regulations are reviewed every year and amendments are submitted to the CEO for approval, with information to the Board. This does not apply however to amendments to the CEO's authorisation, as these require Board approval.

Credit processing procedures

The credit processing procedures regulate in detail all factors related to credit allocated by the Group and the follow-up of commitments

The credit award process can be described as illustrated in figure 5 below.

Figure 5: Credit assessment process



For a more detailed description of the credit models and risk classification system, ref. chapter 3.3.1.1.

After a commitment has been entered, the commitment and its portfolio are subject to continuous supervision. In principal, credit risk is monitored by applying the Group's portfolio management systems, systems for early warning of central development trends and systems for monitoring the quality of the actual credit allocation process. The framework for this is illustrated in figure 6 below.

Figure 6: Framework for credit risk follow-up

Portfolio management
Risk exposure for the Group is monitored using a principal portfolio management system. The system comprises a broad range of risk-related information at both aggregate and detailed levels. This allows for an efficient monitoring and management of the portfolio's risk-related development. Monthly updates are made of all portfolio information, including updates of the probability of default for customers. The risk-related development in the portfolios is followed-up with a particular focus on the development of risk classification (migration), expected loss, risk-adjusted capital and risk-adjusted return.

Early Warning
The Group's early warning system allows for continuous follow-up of central risk drivers for customers, which are an important indicator of potential default development. The purpose here is to capture central development trends as early as possible.

Examples of such risk drivers are as follows:

- Short-term and repeated default
- Development in utilisation of facilities - overdraft facilities, building loans and flexi-loans
- Development in the number of amortizations postponements
- Official announcements

Credit process supervision

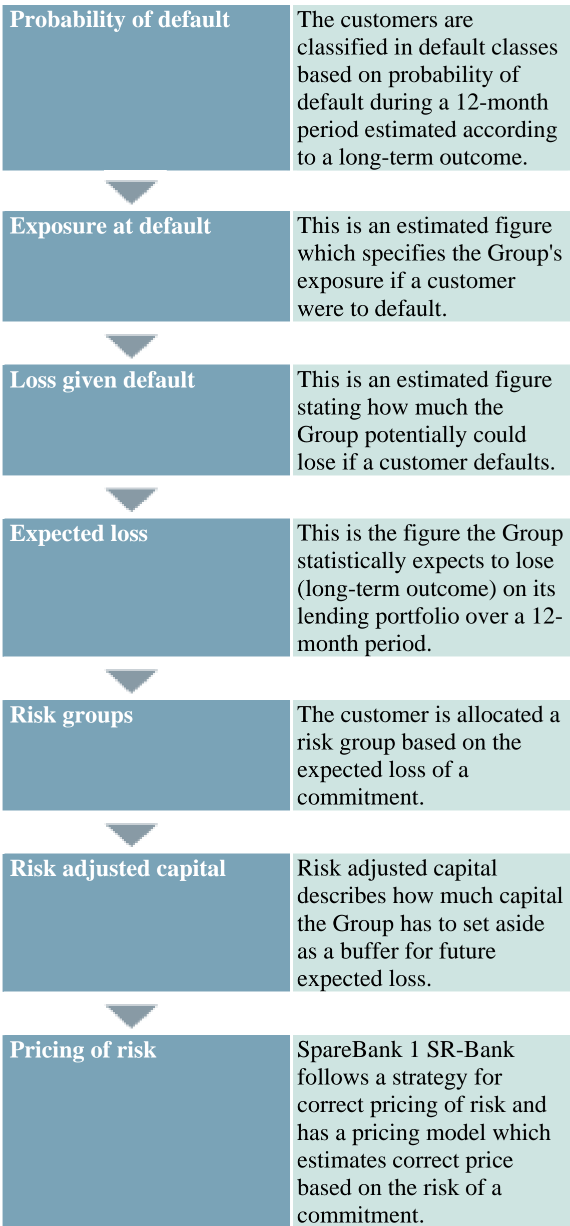
The Group's systems for monitoring the credit allocation process allow for continuous follow-up of credit quality and the risk-adjusted return on new commitments. The system is well suited to interdepartmental comparisons of quality and allows for early action if individual departments experience an undesired development in current credit practice.

For a description of competencies and organisational culture, see chapter 3.2.7.

3.3.1.1 Credit models and the risk classification system

The Group utilises credit models for risk classification, risk rating and portfolio management. The risk classification system is based on the main components as illustrated in figure 7 below:

Figure 7: Risk classification system in SpareBank 1 SR-Bank



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

PD - Probability of Default
The customers are classified into default classes based on the probability of default over a 12-month period based on a long-term outcome.

A commitment is considered as defaulted if:
1. A claim is overdue for payment by more than 90 days and the amount exceeds NOK 1,000, or
2. When the bank has reasons to believe that it is probable the debtor cannot pay back (in full) in accordance with liabilities:

The bank carries out a write-down due to impaired credit worthiness.

- The bank sells a receivable at discount as a result of the impaired credit worthiness.
- Due to payment problems for the counterpart, the bank provides a payment postponement or new credit for payment of the installation, or agrees upon amendments in the interest rate or other terms of the agreement.
- A petition is taken out for debt settlement proceedings, bankruptcy or public administration by the counterpart, or debt arrangement is opened.
- The bank assumes for other reasons that the commitment will not be met.

The probability of default is estimated on the basis of historical series of data for financial key figures, and on the basis of non-financial criteria such as performance and age. In order to group the customers according to probability of default, nine different default classes are used (A-I). The definition of the individual default classes is illustrated in table 2 below.

Table 2: Definition of default classes

Default class	Lower limit for default	Upper limit for default
A	-	0,10%
B	0,10	0,25%
C	0,25	0,50%
D	0,50	0,75%
E	0,75	1,25%
F	1,25	2,50%
G	2,50	5,00%
H	5,00	10,00%
I	10,00	99,99%

The Group has an additional two default classes (J and K) for customers with defaulted and/or impaired positions.

When calculating the probability of default for customers, there are in principal two different approaches utilised on the market.

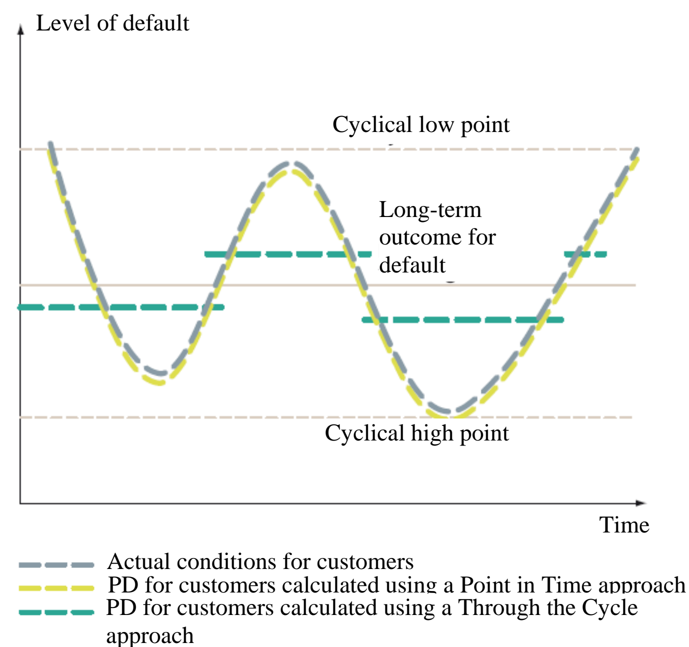
The first approach is a "Point in Time" approach which calculates the probability of default for the next 12 months based on the prevailing business trends. The level of default will then be almost correct for each year. This approach is well suited for calculating default in the short term, but will however be less suited for long-term planning.

An excessive focus on short-term probability of default may result in an unpredictable credit allocation and pricing for customers.

If the probability of default varies significantly over time, the bank's capital requirement will also vary at a relatively high rate with the economic cycles in such a way that it is low in an economic upturn and high in a downturn. In such a case, the capital requirement will have a procyclical effect and will contribute to an increase in the economic fluctuations in society.

The second approach utilised is a "Through the Cycle" approach which expresses the long-term 12-month probability of default (long-term outcome). With such an approach, the default will be somewhat underestimated during economic downturns and correspondingly over estimated during economic upturns. The level of default will however be practically correct over time and the capital requirement for the banks will vary less throughout an economic cycle.

Figure 8 below illustrates the differences between the two approaches:

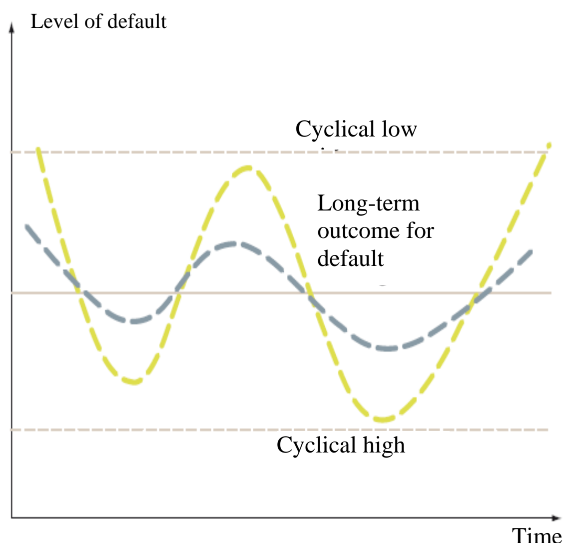


The extent to which economic cycle sensitivity affects the probability of default relies on the importance given to choices among different risk variables in the models for calculating probability of default. Typically, a model which places significant emphasis on short-term liquidity and behavioural data will be more sensitive to economic cycles than a model which emphasises accounting data such as profitability and debt ratio over time.

SpareBank1 SR-Bank places an emphasis on stable and predictable credit allocation and capitalisation over time, and the Group therefore develops models for calculating probability of default based on a Through the Cycle approach. This corresponds with the approach on which the rating methods of the most highly recognised rating companies is based. In addition to predicting the long-term outcome of probability of default, irrespective of economic cycle, the models must also be able to rank the customers according to risk (from lowest PD to highest PD) based on the prevailing business trends. It is important for the banks to be able to predict which customers are most likely to experience problems over the next 12 months. In order to achieve this, the model must also contain variables which capture changes in economic cycles.

In practice therefore, SpareBank 1 SR-Bank's models for calculation of probability of default are a midway point between Point in Time approach and Through the Cycle approach. The calculated probability of default will therefore fluctuate less than actual default throughout an economic cycle. The ratio between the fluctuations in estimated default and actual default are illustrated in figure 9 below.

Figure 9: Ratio between estimated default and actual default



An analysis based on simulation and experience of the financial crisis shows that the estimated probability of default will most probably vary between 30% and 40% of the fluctuations in actual default as a result of different business trends.

The capital requirement is arrived at on the basis of factors such as the estimated probability of default. The fluctuations in estimated probability of default therefore imply that the capital requirement will also vary over time.

As a result, the core capital adequacy will most probably vary by +/- 0.5 percentage points throughout a normal economic cycle.

It was previously reported that the probability of default shall predict long-term outcome. Long-term outcome can be calculated in a variety of ways.

Experience from both Norway and other countries indicates that default varies significantly throughout economic cycles. Default varies in line with economic cycles such that default is high when the GDP is relatively low and default is low when the GDP is relatively high. During special trading conditions, default may be very high. One example of this can be taken from the Norwegian economy in the early 1990s when the GDP was low at the same time as a high interest rate. At that time, there was a very high degree of default. This also applies to years of economic downturn such as 2002 and 2003, 2008 and 2009.

Analyses indicate that the distribution of default over time is concentrated around relatively low levels of default while the distribution has a "heavy tail end" following several years of extremely high default. The distribution of default is therefore not symmetrical around an average, as with normal distribution. For non-symmetrical distributions, there will be a difference between the normal measurements at the centre (average and median) in a distribution. For a non-symmetrical distribution, the heavy tail end may have such an impact on the average that the median in many contexts is the best measurement of the most normal outcome. SpareBank 1 SR-Bank has therefore chosen to utilise historical median as the basis for calibration of long-term outcome.

EAD - Exposure at Default
The conversion factor (CF) defines the size of an unutilised credit facility which is expected to be utilised upon default. For guarantees and allocated but not utilised facilities for corporate market customers, a utilisation ratio of 75% is assumed (0.75). For allocated but not utilised facilities for retail market customers, a utilisation ratio of 100% is assumed (1).

LGD - Loss Given Default
Loss given default describes how much the Group potentially could lose if the customer defaults on commitments. The valuation takes into account the value of underlying securities and the costs to be met by the Group when collecting the defaulted position. The Group establishes the realisation value for securities provided on the basis of own experience over time and so that these reflect the assumed realisation value, based on a conservative valuation, in an economic downturn.

SpareBank 1 SR-Bank takes into consideration the main types of securities as illustrated in table 3 below:

It is not permitted to take pledge against deposits from retail market customers who meet the definition of consumer in the Financial Contracts Act.

On the retail market, the market value of real estate is established either by utilising the estate agent valuation/appraised value, value estimates from Eiendomsverdi (applies to residential properties) or, by exception, own assessment. Eiendomsverdi is an information and analysis tool which provides access to

estimated market values for properties in Norway. Value estimates from Eiendomsverdi may be utilised in accordance with internal procedures if the property is located on a successful house market and if there is little uncertainty as to the value estimate. Own assessment may only be utilised if the conditions for such have been met. The valuation on which all own assessments are based must be approved by a separate customer consultant. The realisation value of real estate is established by starting with the market value and reducing this by 20% for residential properties and 40% for plots of land and holiday properties. On the retail market, securities in other objects than property are utilised to a limited degree.

Table 3: Main types of securities

Type of security	Retail market	Corporate market
Real estate	X	X
Motor vehicles	X	X
Leisure boats	X	
Securities	X	X
Guarantees	X	X
Operating assets		X
Ships		X
Construction machinery		X
Inventory		X
Agricultural movables		X
Accounts receivable		X
Deposits		X

In the corporate market, the lease value method is the primary method for calculating security value of commercial properties. The market value is calculated by multiplying net lease income with an interest rate which reflects risk-free positions and general risk premium. On the basis of the estimated market value, the realisation value is established as between 60% and 80%, depending on the condition of the building and its purpose. Specialised industrial buildings with limited alternative utilisation potential are allocated a realisation value of maximum 25% of market value.

Other pledgevalues are estimated in accordance with established internal procedures. The realisation value of the securities provided is established by starting with the market value and reducing this by a factor which varies according to the qualities of the security object, constituting minimum 20%. Securities in the form of negative pledges and unlisted securities are not allocated any security-related realisation value, while sureties can be allocated a realisation value if certain conditions are met.

Seven classes (1-7) are utilised to classify degree of loss given default. The definition of the individual default classes is illustrated in table 4 below.

Table 4: Definition of loss given default (security classes)

Class	Lower limit for LGD	Upper limit for LGD	Corresponds to security cover (realisation value)
1	-	0,08%	Over 120%
2	-	0,08%	Over 100 %
3	0,08%	13,62%	Over 80%
4	13,62%	27,23%	Over 60%
5	27,23%	40,85%	Over 40%
6	40,85%	54,46%	Over 20%
7	54,46%	68,08%	Up to 20%

EL - Expected Loss
Expected loss describes the figure the Group statistically expects to lose on its lending portfolio over a 12-month period (long-term outcome). Expected loss is calculated by multiplying by probability of default, exposure at default and expected loss respectively.

Risk groups
A commitment is allocated to a risk group, from lowest to highest risk group, based on the expected loss for a commitment. The risk groups are defined in table 5 below.

Table 5: Definition of risk groups

	Expected loss	
Risk group	Lower limit	Upper limit
Lowest	0%	0.0125%
Low	0.0125%	0.50%
Medium	0.50%	2.00%
High	2.00%	2.40%
Highest	2.40%	99.99%

Risk-adjusted capital (UL - Unexpected loss)
Numerous factors have an impact on the Group's losses on lending and credit. Expected loss is based on figures which are uncertain. The degree of uncertainty is mainly related to the qualities of the commitment. The level of uncertainty is relatively low for commitments with sufficient securities to borrowers who have good debt servicing capacity while the level of uncertainty is relatively high for commitments with little security and for customers with unstable debt servicing capacity. In order to encompass the entire range of risk, unexpected loss is calculated for all commitments. By totalling the unexpected loss for all commitments, the Group can estimate how much the Group could lose in excess of expected loss. This estimate takes into account the assumption that not all customers will generate a loss simultaneously. A correlation between the customers of 0.2 is therefore applied to include this in the calculation.

In other words, risk-adjusted capital provides a description of how much capital the Group believes it requires to cover the actual risk assumed. As it is impossible to protect against all loss, the Group has stipulated that the risk-adjusted capital shall cover all

possible unexpected loss based on a specific level of confidence.

Pricing of risk
SpareBank 1 SR-Bank has a strict policy for correct pricing of risk. This implies that commitments with high risk are allocated higher prices than commitments with low risk. However, the general level of risk pricing will also depend on the Group's principal targets for return and factors relating to competition.

SpareBank 1 SR-Bank therefore makes use of models to calculate the correct risk price which should be utilised, for example to include expected loss and return on risk-adjusted capital in the price. The risk pricing model is based on the same main components as in the Group's risk classification system.

The model is based on a standard "RARORAC" model (Risk Adjusted Return on Risk Adjusted Capital) for the measurement of risk adjusted return.

The pricing model is principally utilised when granting and renewing loans in order to calculate the customer's price and to measure and monitor profitability.

3.3.1.2 Validation of the credit models

The Group continuously carries out further development and testing of its risk management system and process to ensure that it maintains a high quality over time.

Responsibility and roles

The Board of Directors is responsible for assessment and decision-making regarding:

- The risk parameters (PD, EAD and LGD) and ensuring that these maintain a sufficient level of quality and provide reliable calculations of risk level and capital requirement.
- The risk management system and process and for ensuring that this is fully integrated in the organisation and forms a central part of the bank's risk management and decision-making.
- Ensuring compliance with the Regulation concerning capital requirement.

The results of the validation work are presented to the Board of Directors at least once a year or more frequently if required by special conditions.

The CEO is responsible for making recommendations to the Board regarding the above-mentioned elements, on the basis of the assessments made by the risk and capital management committee.

The risk and capital management committee is responsible for:

- Preparing plans and the scope of the validation work.
- Evaluating whether the result of the validation work is sufficient to allow a conclusion that the risk parameters have a satisfactory level of quality, including that they are based on reasonable assumptions and a solid base of data which is representative for the bank's exposure.
- Whether sufficient processes and routines are established for non-conformance management, including adjustment of the credit models.
- Recommending amendments to the risk management system or process.

The department for risk management and compliance is responsible for the preparation and quality assurance of the grounds for decision-making applied by the risk and capital management committee. This applies to both the quantitative validation and validation of application.

SpareBank 1's centre of excellence for credit models is responsible for the execution of the quantitative validation for SpareBank 1 SR-Bank.

Scope of validation
Validation work can be divided into two main areas:

Quantitative validation: The quantitative validation shall ensure that the estimates applied for probability of default, exposure at default and loss given default maintain a sufficient level of quality. Analyses are performed to assess the capacity of the rating models to rank the customers according to risk (discrimination capacity) and the capacity to establish the correct level of risk parameters. In addition, the stability of the model estimates and the models' sensitivity to economic cycles are analysed. The quantitative validation will, in certain circumstances, be supplemented by more qualitative valuations if the scope of statistical data is limited.

Application: A re-examination is carried out to assess whether the system for management and measurement of credit risk is fully integrated into the organisation and that it makes up a central part of the Group's risk management and decision-making process.

The chapters below describe the results of SpareBank 1 SR-Bank's validation of the two main areas.

Validation results
a) Ranking capacity - probability of default (PD).
Analysis of the models' discrimination capacity (ranking capacity) indicates the level to which the model for calculation of PD actually manages to rank the customers from those with highest PD to the customers with lowest PD.

The scoring models' capacity to rank customers is primarily measured by applying an internationally recognised method known as the AUC method (Area Under Curve). The AUC method allows comparison of information from statistic measurements made over a period of time. AUC is very useful for the comparison of different default models in order to identify which models have the best capacity for ranking customers.

Due to limited grounds for estimates, there will always be a certain amount of statistic uncertainty related to the results. This is because SpareBank 1 SR-Bank can only measure the ranking capacity of the scoring models for

customers in the SpareBank 1 alliance, and not all customers in Norway. Subsequently, the level of uncertainty will also be higher at bank level than at alliance level.

SpareBank 1 SR-Bank makes use of the following assessment criteria for ranking capacity:

0% < AUC < 50%	No ranking capacity
50% < AUC < 70%	Weak
70% < AUC < 80%	Acceptable (minimum requirement)
80% < AUC < 90%	Very good
90% < AUC < 100%	Exceptional

Figures 10 and 11 below illustrate the ranking capacity for the scoring models for retail customers in the period 2007 to 2009, divided into customers with loans secured against property and other customers. The analysis illustrates the ranking capacity for the customers in SpareBank 1 SR-Bank and for all the customers in the SpareBank 1 alliance in total.

Figure 10: Customers with loans secured against property

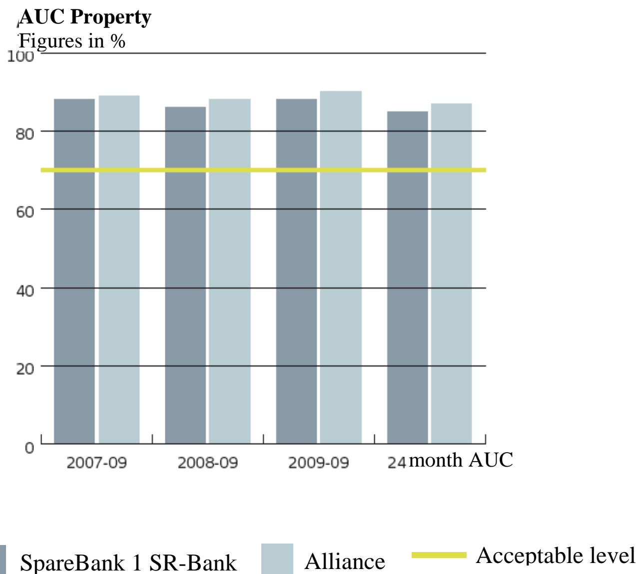
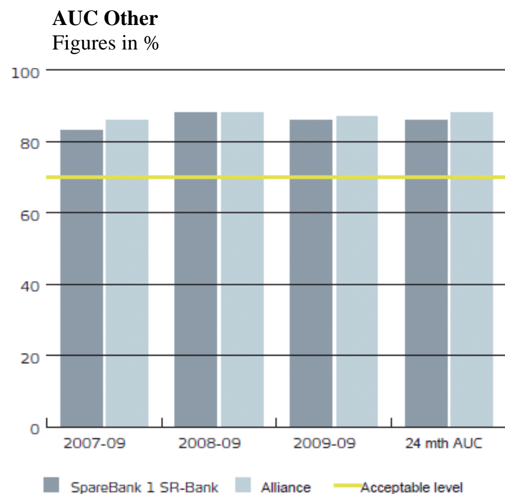


Figure 11: Other customers

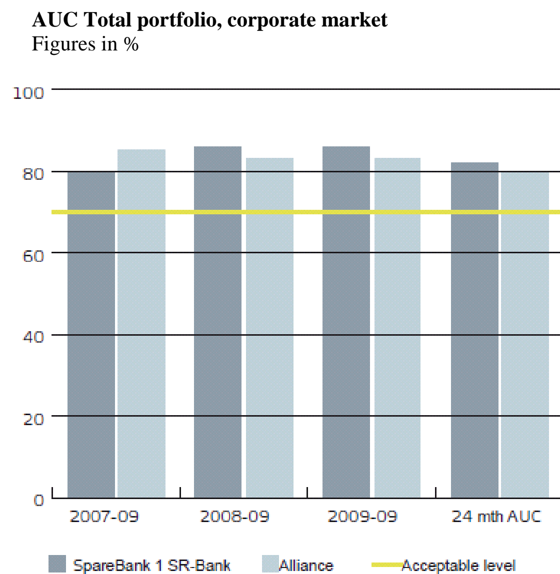


The figures indicate that SpareBank 1's scoring models for calculation of the customers' probability of default have an extremely good ranking capacity. This implies that the models have a high capacity for distinguishing between customers with high risk and customers with low risk. This applies to both customers with loans secured against property and for other customers. The ranking capacity is very good for both SpareBank 1 SR-Bank's customers alone and for all customers in the SpareBank 1 alliance.

The analysis also illustrates that ranking capacity has remained stable over time and was reliable during the financial crisis.

Figure 12 below illustrates the scoring models' ranking capacity for corporate customers in the period 2007 to 2009. The analysis illustrates ranking capacity for both customers in SpareBank 1 SR-Bank and for the SpareBank 1 alliance.

Figure 12: Ranking capacity corporate customers



The validation results indicate that SpareBank 1's scoring model for calculation of the customers' probability of default has an extremely good ranking capacity at both bank and alliance level. The analysis also illustrates that ranking capacity has remained stable over time and was reliable during the financial crisis.

b) Stability in probability of default estimates (PD). Previously in this document, it was stated that SpareBank 1 SR-Bank has a target for calculation of probability of default which forecasts long-term outcome. This implies that estimated probability of default for customers should be relatively stable throughout an economic cycle. However, it is natural to expect a somewhat higher level

of migration (change in default classification) in connection with sudden changes in cyclical trends.

Figures 13 and 14 illustrate migration of retail market customers over the past 12 months as of June 2007 to December 2009 divided between customers with loans secured against property and other customers. There is migration in the figure for a customer if the class of default is changed in the space of one year.

Figure 13 on the next page illustrates that migration has been very stable during the period for customers with loans secured against property. At the end of 2009, the graph indicates that 51% of customers have remained in the same default class over the past 12 months. At the same time, 26% of customers migrated to a better default class, while 23% migrated to a poorer default class. This is in line with the figures as of June 2007. The financial crisis has therefore not resulted in an increased level of migration in the portfolio.

Figure 14 indicates that migration has been relatively stable during the period for other retail customers. At the end of 2009, the figure indicates that 51% of customers have remained in the same default class over the past 12 months. At the same time, 25% of customers migrated to a better default class, while 24% migrated to a poorer default class.

However, the figure indicates an increased level of migration when comparing with the status as of June 2007. At that time, 32% of customers had a positive migration over the past 12 months compared with 25% at the end of 2009. The ratio of negative migration as of June 2007 was 20% compared with 24% at the end of 2009.

The financial crisis has therefore resulted in a minor increase in negative migration for the portfolio. This concurs with previous experience which indicates that there is a higher degree of volatility in default for loans to retail customers without security against property than to customers with loans secured against property.

A more detailed analysis also shows that approx. 60% of retail customers who migrate, only migrate by one class of default.

Negative migration is mainly due to internal or external ranking for customers. Positive migration mainly occurs when customers achieve an improvement in ranking history over time.

Figure 15 shows the migration of corporate customers over the past 12 months as of June 2007 to December 2009.

Figure 15 indicates that the financial crisis has resulted in an increase in negative migration on the corporate portfolio. During the period, the ratio of customers who have not changed class of default saw an increase from 35% to 40%. At the end of 2009, 35% of customers had had a negative migration over the past 12 months compared with 16% as of June 2007. The positive migration fell from 49% to 24% by year-end 2009.

Figure 13: Migration for customers with loans secured against property

Figures in %

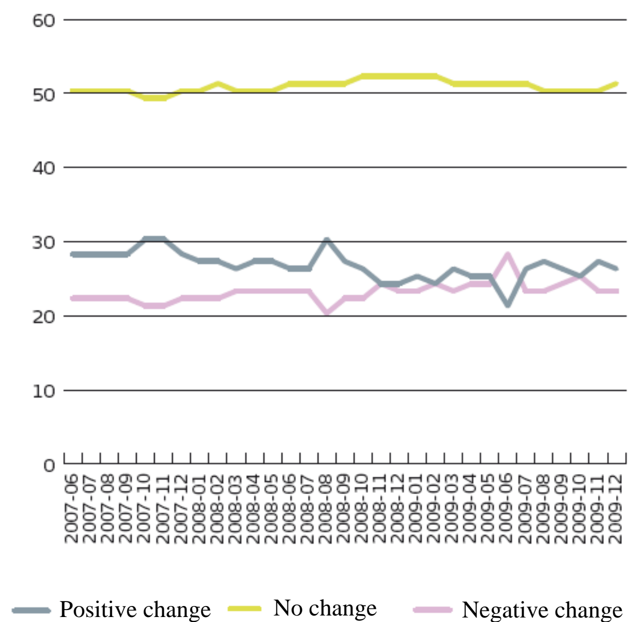


Figure 14: Migration for other retail customers

Figures in %

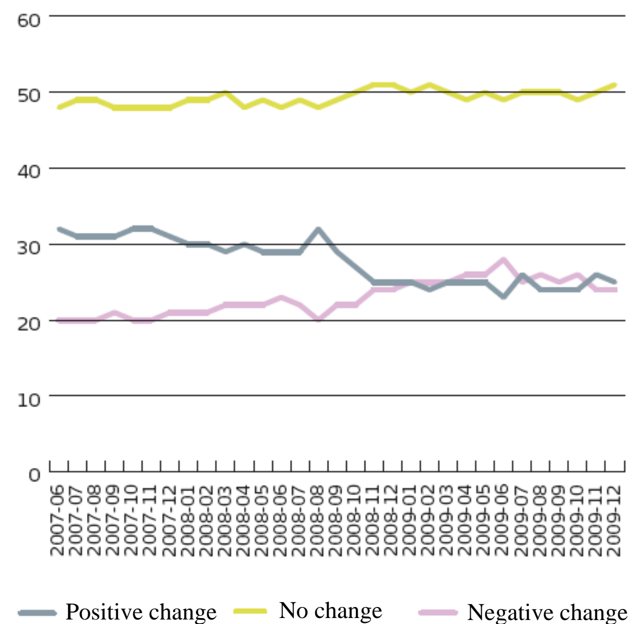
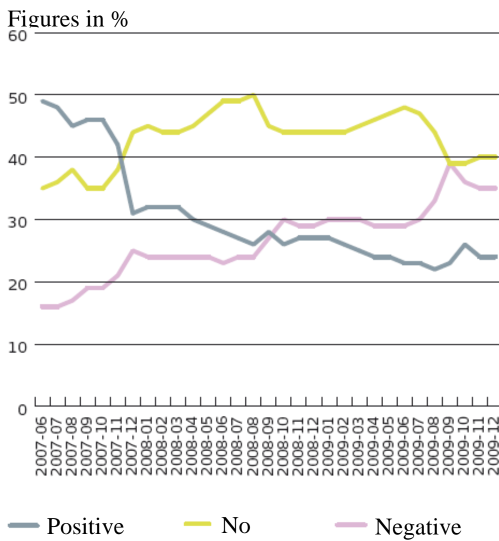


Figure 15: Migration for corporate customers



Furthermore, the analysis indicates that 60% of customers who migrate, only migrate by one default class. Migration is mainly attributed to a change in score for the variables of income and liquidity.

c) Accuracy of probability of default (PD). The analysis of the accuracy of probability of default shows the level to which the estimated degrees of default concur with the actual degree of default over time (long-term outcome). Actual default is the number of customers which are in default or have defaulted over a 12-month period. In other words, customers with minor loans are allocated less weight than customers with major loans. Customers with minor loans are historically over-represented in default statistics.

Figures 16 and 17 below illustrate the accuracy of default level for retail customers in the period 2007 to 2009, divided into customers with loans secured against property and other customers.

Figure 16 illustrates that the estimated default for retail customers with loans secured against property in 2009 was calculated as 0.69% while the actual default was 0.33%. This is practically in line with the total figures for 2007-2009. There has been a considerable over-estimation of default for the period. SpareBank 1 SR-Bank expects that the long-term outcome (median) will most probably be between 0.6 and 0.7%.

Figure 16: Accuracy of default level for retail customers with loans secured against property.

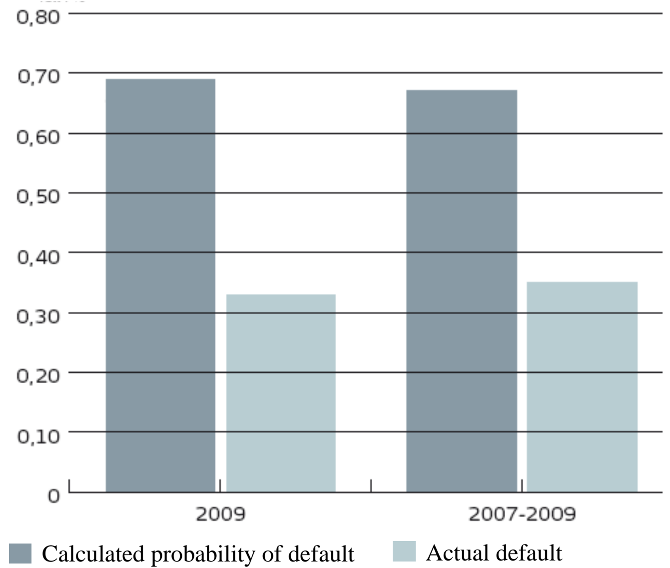


Figure 17 illustrates that the estimated default for other retail customers in 2009 was calculated as 2.6% while the actual default was 2.7%. In the period from 2007 to 2009, estimated default was 2.3% which was also the actual default for the period

SpareBank 1 SR-Bank expects that the long-term outcome (median) will most probably be between 3.0 and 4.0%. This implies a general under-estimation of default in relation to long-term outcome. On this background, SpareBank 1 SR-Bank aims to make an upward adjustment of the default estimates for long-term outcome in 2010. The adjustment will have only a minor impact on the size of risk-adjusted capital.

Figure 17: Accuracy in default level for other retail customers

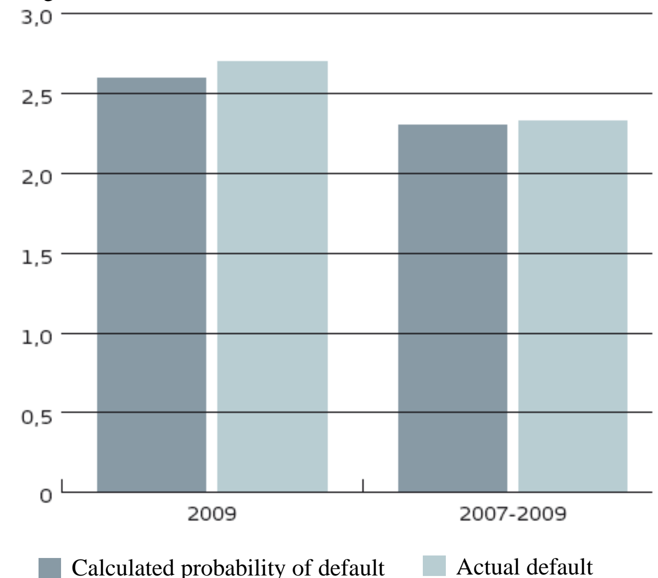


Figure 18 below illustrates the level of accuracy in default level for corporate customers in the period 2007-2009.

Figure 18: Accuracy of default level for corporate customers

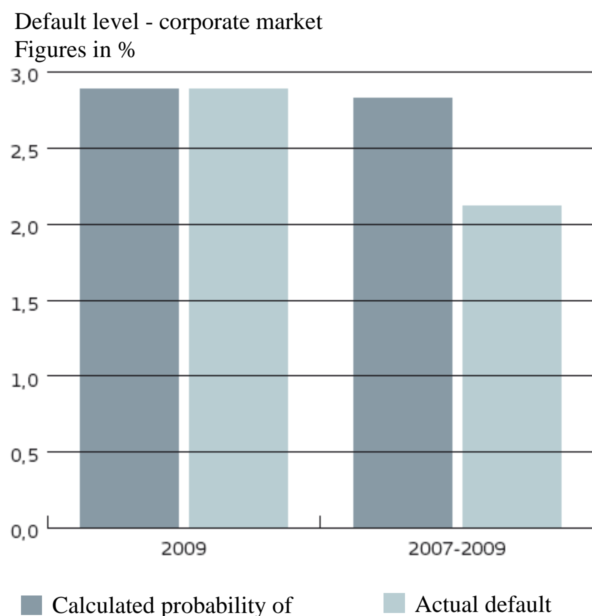


Figure 18 indicates that estimated default for corporate customers was calculated as 2.9% in 2009, which was also the actual level. In the period from 2007 to 2009, estimated default was 2.8% compared with the actual default of 2.1%.

Actual default for corporate customers in 2009 is expected to exceed the projected long-term outcome for SpareBank 1 SR-Bank. According to statistics from Statistics Norway, the growth in GDP for mainland Norway was lower than the trend growth rate in both 2008 and 2009. This implies that the Norwegian economy has been in an economic downturn over the past 2 years. For the first time in 20 years, 2009 saw a decline in GDP in terms of fixed prices. According to Norges Bank's monetary policy report, the Norwegian economy remains in an economic downturn as the GDP level is lower than potential GDP. Capacity utilisation is low and the so-called production gap is negative.

SpareBank 1 SR-Bank expects that the long-term outcome (median) will most probably be between 2.0 and 2.5%. This represents a general over-estimation of default in relation to long-term outcome, and SpareBank 1 SR-Bank has therefore carried out a downward adjustment of the default estimates for long-term outcome as of January 2010. The adjustment resulted in a requirement for risk-adjusted capital of 7.8% or approx. NOK 300 million for the corporate market division.

Accuracy of CF factor (EAD)
The conversion factor (CF) defines the size of an unutilised credit facility which is expected to be utilised upon default. If the conversion factor (CF) is stipulated as 1, exposure at default (EAD) is equal to full utilisation of the credit facility.

For the retail market, the CF factor for credit facilities has been conservatively stipulated as 100% (1.0). The validation results indicate that the actual conversion factor is significantly lower.

For the corporate market, the CF factor for drawing rights including guarantees for loan programs has been conservatively stipulated as 75% (0.75). The validation results indicate that the actual conversion factor is lower.

Accuracy of loss given default (LGD)
This analysis indicates the degree to which the estimated loss given default corresponds with the actual loss given default. While SpareBank 1 SR-Bank makes use of long-term outcome for the calculation of probability of default, the Group utilises so-called downturn estimates to calculate loss given default. This implies that estimated loss given default shall forecast loss given default during an economic downturn.

When calculating loss given default for the retail market, the market value for securities was adjusted as a main rule down by minimum 20% in order to reflect the projected realisation value during periods of economic decline.

Figure 19 illustrates estimated and actual loss given default for defaulted commitments in SpareBank 1 SR-Bank for the period from 2000 to September 2009, divided between defaulted retailmarket commitments with security against property and other defaulted commitments. As validation of loss given default requires a certain period for clarification, the results from the previous year's validation will contain the best estimate of loss for defaulted and non settled commitments.

The analysis indicates that, for defaulted commitments with security against property, the actual loss given default is 3.3% compared with an estimated loss given default of 6.9% for the period. For other defaulted commitments, the actual loss given default is 31.2% compared with an estimated loss given default of 46.0%. This analysis therefore indicates a general over-estimation of the actual loss given default for customers with security against property and for other customers.

The loss data period is from 2000 to 2009, when house prices on average saw an increase of 10% per year. A sensitivity analysis indicates that actual loss given default on defaulted commitments with security against property would have increased to 7% if there had been a fall in house prices of 20% during the period.

Figure 19: Loss given default, defaulted retail market commitments

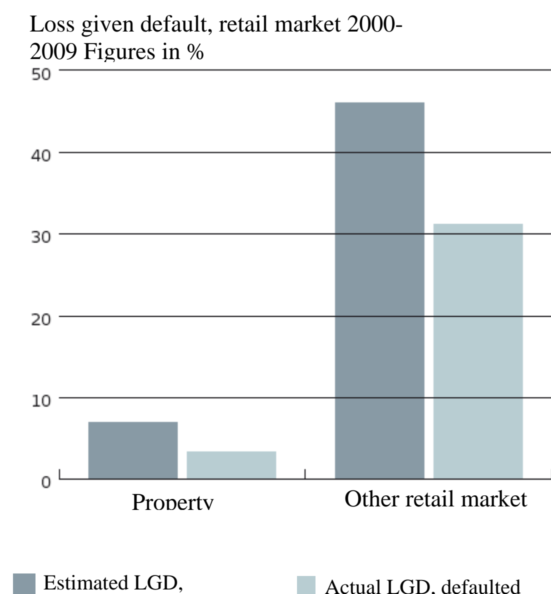
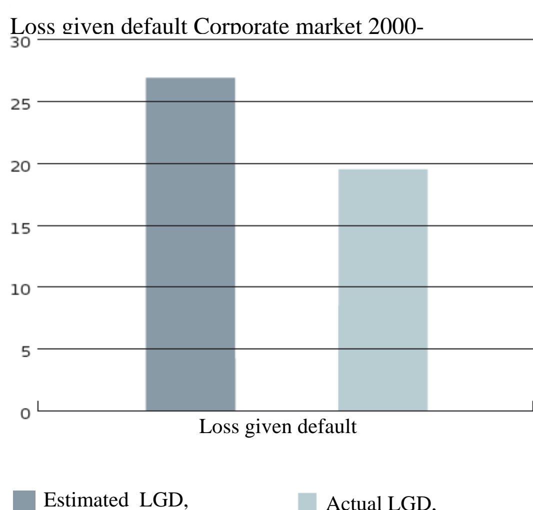


Figure 20 displays estimated and actual loss given default for defaulted commitments in the corporate market for SpareBank 1 SR-Bank from 2004 to 2009. As validation of loss given default requires a certain period of time for clarification, the results from last year's validation will also contain the best estimate of loss for defaulted and non-settled commitments.

The analysis indicates that the actual loss given default for defaulted commitments is 19.5% compared with the estimate of 26.9%. The period for the loss data is from 2004 to 2009 which were mainly years of high economic activity, while the estimated loss given default shall forecast loss given default during periods of economic downturn. This principally explains the deviation between estimated and actual loss given default.

Application of the risk management system
Validation for 2009 indicates that the system for management and measurement of credit risk is fully integrated into the organisation and that it makes up a central part of the Group's risk management and decision-making process.

Figure 20: Loss given default, defaulted corporate market



3.3.2 Market risk

Market risk is defined as the risk of loss due to changes in observable market variables, such as interest rates, currency exchange rates and security prices.

Market risk in SpareBank 1 SR-Bank is mainly related to the Group's long-term investments in securities. In addition, the Group has a certain exposure to market risk from trading activities on the interest rate and currency markets and from activities which support ordinary funding and lending activities. The Group's exposure to market risk is moderate.

The Group's market risk is measured and monitored on the basis of conservative limits which are renewed and approved by the Board of Directors at least once a year. The size of these limits is stipulated on the basis of stress tests and analyses of negative market trends.

Interest rate risk is the risk of loss incurred due to changes in interest rates. The Group's interest rate risk is regulated by limits established for maximum value change resulting from a change in interest rate of 1%. Maximum loss in total shall not exceed NOK 30 million on the Norwegian krone balance sheet, and within a maturity limit (0-3 months, 3-6 months, 6-12 months, 1-2 years etc.) maximum loss shall not exceed NOK 15 million. Maximum net loss related to interest rate risk on the foreign currency balance sheet is NOK 8 million. The maximum interest rate risk for individual currencies is NOK 5 million. Interest rate terms for the Group's instruments are mainly short-term and the Group's interest rate risk is low.

Currency risk is the risk of loss caused by changes in foreign exchange rates. The Group measures currency risk based on net positions in the different currencies in which the Group has exposure. Currency risk is regulated by nominal limits for maximum aggregate currency position and maximum position within individual currencies. The overnight foreign exchange risk for currency as net must not exceed NOK 100 million per individual currency and NOK 125 million on aggregate. The scope of the Group's trading activities in currency is modest and currency risk is considered to be moderate.

Exchange risk related to securities is the risk of loss caused by changes in the value of the Group's bonds, certificates and equity instruments. When quantifying risk related to impairment of the liquidity portfolio, SpareBank 1 SR-Bank distinguishes between systematic risk (market risk) and non-systematic risk (default risk). Default risk connected with the above-mentioned portfolio is quantified as credit risk. Of the total reserves on the liquidity portfolio corresponding to NOK 22.5 billion, bonds classified as "held to maturity" total NOK 11.9 billion. Investments which are classified as "hold to maturity" are recognised according to amortised cost and are therefore not exposed to market risk in terms of accounting. The Group's risk exposure in terms of this kind of security risk is regulated by limits for maximum investments in the different portfolios.

Risk adjusted capital connected to market risk is measured and monitored according to the Value at Risk

(VaR) principle. The VaR model covers the Group's interest rate and currency risk on and outside the trading balance sheet and the security risk connected with the Group's investments in current assets and long-term shareholdings.

The VaR model does not cover general spread risk (systematic risk) connected with the Group's investments in bonds and certificates. General spread risk is the risk of a decline in the market value of securities caused by a general increase in the credit spreads. The model utilised to quantify risk adjusted capital for general spread risk has been taken from the Financial Supervisory Authority's module for market and credit risk in insurance.

The models used to calculate risk adjusted capital for market risk provide an important tool in connection with the Group's allocation of capital, but they are not utilised for daily management of market risk.

The department for risk management and compliance is responsible for current and independent supervision of the Group's market risk.

3.3.3 Operational risk

Operational risk is the risk of loss resulting from insufficient or defective internal processes or systems, human error or extreme events.

Analyses of former national and international bankruptcies and financial scandals show that these are often triggered by operational risk. SpareBank 1 SR-Bank therefore aims to be one of the leading banks in the Nordic countries in terms of measurement and management of operational risk.

SpareBank 1 SR-Bank has financed two positions at the University of Stavanger (UoS) related to operational risk; one professorship and one adjunct professorship and also makes considerable contributions to Master degree education related to risk management as a whole. Moreover, SpareBank 1 SR-Bank took the initiative to form a major research project related to operational risk in cooperation with organisations such as UoS, the SpareBank 1 alliance, DnB NOR, the Research Council of Norway and the Financial Supervisory Authority of Norway. The purpose of the project is to establish Norway and the banks as a European centre of expertise on the management of operational risk. The project aims to achieve its goals by carrying out research, education and transfer of experience from the research community for risk analysis at UoS. This research community is renowned as one of the world leaders within its field.

SpareBank 1 SR-Bank's framework for management of operational risk is based on factors such as CoSo, an internationally recognised framework for risk management.

The main elements in the framework for management of operational risk are illustrated in figure 21 below.

Figure 21: Framework for management of operational risk

Risk analyses
A risk assessment and analysis of all significant business and support processes in the Group are carried out as a minimum once a year in order to identify operational risks. Each risk is assessed to judge the quality of the control and management measurements established and the calculation of expected loss and unexpected loss (risk adjusted capital) over time. Scenario analyses and statistic models are utilised to calculate risk exposure. Finally, an overall assessment is performed to judge whether the risk profile is acceptable or if further measures are required.

The risk assessments and analyses take the form of workshops, attended by those responsible for processes and professional experts with a high level of knowledge and experience. In-house bank data and historical data from former incidents, both national and international, also represent important input to these workshops. The reviews are managed by the department for risk management and compliance.

The Group has established its own quality assurance procedures and model to be applied prior to the launch of new products and implementation of new activities. Their purpose is to ensure that new activities and products have been subjected to sufficient risk assessment prior to implementation or launch. Key areas which are assessed include profitability, complexity both internally and in relation to the customer, system solutions and security, and whether the Group is exposed to new types of risk. There is also a legal assessment to ensure compliance with licences, legislation and regulations.

Furthermore, a separate approval committee has been established for new products. This committee carries out a total risk assessment on the basis of the completed analysis.

Management confirmation, risk management
Every year, the Group carries out a confirmation of the quality of risk management during which senior

employees report and confirm the degree of risk management carried out in accordance with the adopted risk strategy, policy and established control and management measures. The senior employees also carry out an assessment of whether the management and control measures established function adequately. They also report the highest risks based on own assessment.

The senior employees make an assessment of the level of competencies within critical individual areas and an assessment of the quality and organisational culture within their own areas of responsibility.

This confirmation is a tool to help identify problem areas and to provide the corporate management with a higher understanding of the quality of risk management within the organisation.

Reporting of undesired incidents
The Group has its own database for reporting and monitoring of undesired incidents. All significant operational incidents which could potentially result in loss or where loss has occurred shall be registered in the Group's database. Undesired incidents are monitored and improvement measures shall be assessed and implemented where suitable. The Group works continuously on a process of improvement to the reporting culture, aiming to secure information on all significant incidents which occur.

Based on the results from risk analyses, management confirmation of risk management and reporting of undesired incidents, measures to reduce risk are implemented where necessary. The Group policy is to give precedence to measures which reduce probability before measures to reduce consequences. Important measures which are utilised actively to reduce risk are preventative analyses, development of competencies, distribution of work, system checks, documentation of routines, re-examination, outsourcing and insurance. The insurance schemes are established to cover loss as a result of fire, operational interruptions and serious crime.

In addition, contingency plans have been prepared which describe how to manage crises in the Group. The purpose of these plans is to limit the negative impact of such events. The Group's contingency plans cover areas such as security and ICT (information and communication technology). The contingency plans for security comprise preparedness for physical damage caused by natural catastrophe, water damage, long-term power cuts etc. Furthermore, the plans comprise areas such as pandemics, terrorist acts, corruption and the like.

The ICT contingency plan describes how the Group is to manage unexpected system failures as a result of hacking, server problems or other technical problems and how to protect critical services and systems against the negative consequences of errors or accidents. In addition, the plan describes how to secure continuation of operations in such an event.

If a catastrophe or incident were to occur, the transfer of experience and lessons learned will help reduce the probability of reoccurrence.

The plans are tested regularly and evaluated and updated in accordance with the test results.

The risk strategy for operational risk is stipulated at least once a year by the Board of Directors. The risk strategy provides the limits for expected loss and risk-adjusted capital.

Follow-up and reporting
The Group has an efficient risk management and monitoring system to provide optimal prevention of events generated by operational risk from severely damaging the Group's financial position. The individual business units, areas of responsibility and processes are responsible for daily follow-up and monitoring of operational risk. The department for risk management and compliance is responsible for current and independent supervision of the Group's operational risk.

For a description of competencies and organisational culture, see chapter 3.2.7.

3.3.4 Liquidity risk

Liquidity risk is the risk that the Group is not able to refinance its liabilities or does not have the capacity to finance increases in assets.

The rating level, composition of the funding portfolio and access to the capital markets will all be of significance for the Group's capacity to manage the prevailing liquidity situation at all times. Management of the Group's financial structure is based on an overall liquidity strategy that is assessed and approved by the Board of Directors at least annually. As part of its liquidity strategy for 2009, the Group decided to change the formulation of its goal for liquidity management towards a more conservative approach. The change requires, among other things, a resolution to increase the Group's portfolio of liquid assets which qualify for access to borrowing from Norges Bank. A larger liquidity buffer will increase the Group's capacity to survive periods without external access to financing. The liquidity strategy shall reflect the bank's conservative risk profile and contribute to the achievement of the Group's strategic goals. The following goals apply to the Group's liquidity management:

"SpareBank 1 SR-Bank shall in a normal situation survive for minimum 12 months without external access to liquidity. Furthermore, the Group shall be able to survive in a "medium stress situation" for minimum 6 months without external access to liquidity."

Liquidity management is based on conservative frameworks and reflects the moderate risk profile adopted by the Group. The Group's lending is mainly financed by customer deposits and long-term security debt. The liquidity risk is limited in that the security debt is distributed over a number of markets, sources of funding, instruments and maturities.

The Group's treasury department is responsible for liquidity management, while the department for risk management and compliance monitors and reports the application of limits in relation to the liquidity strategy.

The Group has prepared a contingeny plan for the management of the liquidity situation during periods of turbulent financial markets. The contingency plan defines areas of responsibility and determines specific crisis measures for involved employees in SpareBank 1 SR-Bank. The purpose of the contingency plan is to allow the Board of Directors and corporate management to carry out necessary measures based on a correct and sufficient information base.

The main elements of the contingency plan include:

- Identification and assessment of the level of a liquidity crisis.
- Obligation to report and reporting lines for certain levels of preparedness.
- Distribution of responsibility for certain levels of preparedness.
- Detailed work plan for certain levels of preparedness (measures for replacing the loss of cash flow).

SpareBank 1 SR-Bank's contigency plan includes three different levels of preparedness:

- Level 1: There is a risk that the Group may suffer a liquidity crisis.
- Level 2: A liquidity crisis has a certain impact on the Group.
- Level 3: A liquidity crisis has a major impact on the Group.

The contingency plan is part of the Group's liquidity strategy and is updated as required, although at least once a year.

As a supplement to the contingency plan, SpareBank 1 SR-Bank has also developed a stress test model which analyses the Group's liquidity-related vulnerability during periods without external access to liquidity. The stress test takes its starting point in a number of different scenarios which assume full application of limits and thereby represents a worst case simulation of the Group's net refinancing requirement during a crisis. All scenarios are such that they would require implementation of the Group's contingency plans.

The premises for the stress test scenarios are an immediate crisis requiring full application of the limits for liquidity risk. In these scenarios, the authorities do not offer any packages or the like. The Group makes use of three test points for each scenario: 30, 180 and 360 days.

Scenario 1 - medium internal crisis: The Group experiences a fall in customer confidence in the market. With a reduction in investor and customer confidence in SpareBank 1 SR-Bank, it will become problematic to refinance existing funding instalments and not least to finance new lending. A significant decline in access to both short and long-term funding is to be expected. A drop in confidence among customers results in a notable reduction in deposits. In the main, customer deposits of over NOK 2 million are affected, but a reduction in deposits of under NOK 2 million must also be expected

Scenario 2 - major internal crisis: The Group experiences a significant fall in customer confidence the market. The market is perplexed about the consequences for the Group. With the imminent loss of investor and customer confidence in SpareBank 1 SR-Bank, it will only be possible to refinance minor shares of the funding instalments. It should be expected that access to both short and long-term funding will practically disappear. Large numbers of customers will withdraw their deposits and conditions may resemble what can be referred to as a bank run. This affects all types of deposits.

Scenario 3 - medium market crisis: There is a drop in market confidence in Norwegian banks and in inter-bank confidence. The banking industry in general suffers loss on its lending portfolio and has negative return on bond and equity investments. The outlook for future earnings in the banks is low and both investor and customer confidence to the banking industry in general is weakened. A number of banks experience problems in refinancing existing funding instalments and not least in financing new loans. A significant decline in access to both short and long-term funding is to be expected. A drop in confidence among customers results in a notable reduction in deposits. In principal, this will affect customer deposits of over NOK 2 million as customers prefer to spread their deposits over several banks. However, it is also to be expected that deposits under NOK 2 million will disappear.

Scenario 4 - major market crisis: There is a significant drop in confidence in Norwegian banks on the market in general and in interbank confidence. The authorities, rating agencies, brokers etc. have published negative comments on the condition of the banking industry. The banking industry in general suffers major loss on its lending portfolio and has a very negative return on their bond and equity investments. The bank has negative earnings and in general has lost both investor and customer confidence. It is probable that one or more banks technically go bankrupt. As a result, the banks will experience major problems in refinancing funding instalments. It should be expected that access to both short and long-term funding will practically disappear. Large numbers of customers will withdraw their deposits and conditions may resemble what can be referred to as a bank run for several banks. This affects all types of deposit.

3.3.5 Ownership risk

Ownership risk is the risk that SpareBank 1 SR-Bank suffers negative results from equity positions in strategically owned companies and/or has to supply new equity to these companies. Equity positions are defined as companies where SpareBank 1 SR-Bank has a significant shareholding and influence.

SpareBank 1 SR-Bank maintains a focus on management and control of companies where the bank has full or part ownership.

In part-owned companies, either via direct ownership by SpareBank 1 SR-Bank or indirect via ownership of 19.5% in SpareBank 1 Gruppen, SpareBank 1 SR-Bank

as the largest bank in the alliance is represented as board member in all companies of particular significance.

Active participation on these boards provides good access to information which safeguards the interests of SpareBank 1 SR-Bank. Issues which are of importance for SpareBank 1 SR-Bank's other businesses are presented by the individual chairman/board member for plenary discussion by the corporate management group.

3.3.6 Commercial risk

Commercial risk is the risk of unexpected fluctuations in earnings and costs resulting from changes in external conditions, such as market situation or regulations by the authorities.

The Group has over time developed a highly diversified source of earnings, preventing any impact of possible declines within individual product groups or customer segments over time. The Group has also over time developed cost-effective operations in combination with the continual development of competencies and expansion of businesses in terms of product range and geography. SpareBank 1 SR-Bank has followed a policy for several years of systematically focusing on a value chain philosophy and the development of products and services.

3.3.7 Reputation risk

Reputation risk is the risk of a fall in earnings and capital access due to deterioration in trust and reputation on the market, i.e. among customers, counterparts, equity market and authorities.

SpareBank 1 SR-Bank has established a principal communication strategy to ensure communication of information internally and externally in a way which supports the Group's value base, goals and vision. The main element of the communication strategy is a profile as a "Proper bank". This strategy can be summarised as follows:

SpareBank 1 SR-Bank is a proper bank. A bank which promotes integrity and respectability as the fundamental pillars for its operations. This makes SpareBank 1 SR-Bank a bank worth trusting. A proper bank is also a professional and expert bank which has the capacity to provide good advice and adapt its services to customer requirements. The employees are skilled professionals who are motivated by development, cooperation and initiatives to provide the customer with every need relating to financial advice and services throughout the different stages of life. A proper bank is also a modern and forward-looking bank which is available in a way which is suited to customer requirements. A proper bank cares about the surrounding region and takes responsibility. SpareBank 1 SR-Bank is a bank for South and West Norway.

In order to evaluate the reputation of SpareBank 1 SR-Bank, the Group carries out an annual reputation survey on the market. The survey covers three interest groups; population ("retail market"), equity certificate holders and employees. TNS Gallup carries out the survey using their TRI*M model.

SpareBank 1 SR-Bank has also implemented an internal process for identification and evaluation of the Group's risk profile for reputation, at least once a year. All reputation risk is evaluated in relation to inherent risk and established control and management measures. Improvement measures are implemented when required.

3.3.8 Strategic risk

Strategic risk is the risk of loss resulting from unsuccessful strategic investments.

SpareBank 1 SR-Bank carries out a strategy process once a year which involves the Board of Directors, management, key personnel, divisions and subsidiaries. The result of the process is a strategic presentation of goals for the following three years, with a related commercial plan and plan of action. The commercial plan clearly defines the priorities made by the Group during the period, based on scenarios and the competitive and market situation. The commercial plan and plan of action for the upcoming year are the most detailed.

The corporate management group carries out monthly and tertiary evaluations of the Group's performance and strategic direction. The tertiary evaluation also includes new initiatives and measures which are required based on changes in premises or changes in market situation. Strategy work is thus flexible in its approach and can safeguard both short-term and long-term goals.

3.3.9 Compliance risk

Compliance risk is the risk that the Group incurs public sanctions/fees or economic loss as a result of failure to comply with legislation and regulations.

The Group follows a policy of establishing good processes for securing compliance with prevailing legislation and regulations. Efficient tools for these processes include:

- A clearly defined value base which is clearly communicated and understood throughout the organisation.
- A process which detects, communicates and implements changes in legislation and regulations.
- A process to monitor and report compliance with legislation and regulations.

The Group's compliance policy is adopted by the Board of Directors and describes the main principles for responsibility and organisation. The framework for compliance is mainly based on CEBS Internal

Governance, Basel Committee on Banking Supervision; "Compliance and the compliance function in banks" and the Financial Supervisory Authority's "Module for evaluation of principal management and control".

The Group's compliance function is provided by the department of risk management and compliance which is independent from the business units. The department has principal responsibility for framework, follow-up and reporting within the area of compliance.

The Group has a compliance supervisor for the Group's investment firms, who is responsible for checking that the bank's business connected to providing investment services is in compliance at all times with the regulations for securities trading.

The compliance supervisor in the individual investment firm reports directly to the Managing Director of the investment firm and also reports to the department for risk management and compliance.

The managers in the Group have operational responsibility for the practical implementation of and compliance with legislation and regulations. All employees are responsible for ensuring daily compliance and understanding of prevailing legislation and regulations.

The Group carries out a regular review and evaluation of compliance risk and identification and follow-up of measures. Any incidents or breaches of compliance policy are registered in the Group's database for reporting and follow-up of undesired incidents.

Compliance is included in the quarterly and annual reports to the Board of Directors and CEO.

3.4 Framework conditions and risk exposure for SpareBank 1 SR-Bank

3.4.1 Industry structure and framework conditions

SpareBank 1 SR-Bank's geographical target area covers South and West Norway, and the bank has offices in the regions of Hordaland, Rogaland and Agder. Although the Group has enjoyed a relatively high rate of growth in Hordaland and Agder in recent years, the Group's main business is still located in Rogaland. The description and analysis below is therefore mainly based on Rogaland.

In Rogaland, the financial and human capital, to a larger extent than other regions, has been invested in business related to the petroleum industry. These investments so far have generated an economic return which is significantly higher than that achievable if the region had invested in alternative industries.

Business and commerce in Rogaland have one of the highest exposures to competition in Norway. At the same time, Rogaland has, to a lesser extent than other regions, a public sector as a stabilising element in regional economics. Over time, the region has therefore had to develop a strong innovative force and a major capacity for change. Rogaland receives top scores from most indicators measuring the innovative capacity and level of internationalisation among urban regions.
Below, there is given a brief description of the largest industries in Rogaland, measured in number of employees. The description is based on the "Economic barometer for Rogaland- January 2010" The publication is a project of cooperation of NAV Rogaland, LO Rogaland,Greater Stavanger, NHO Rogaland, SpareBank 1 SR-Bank and Rogaland fylkeskommune.

The energy sector
The energy industry comprises extraction of oil and gas, and the supply of power and water. This industry employs 17,300 persons. In addition, the oil service industry employs around 31,000 persons in Rogaland. The energy industry is the single largest industry in Rogaland and sets the standard for very many companies within other categories. A survey executed by Ernst & Young's oil service analysis (The 2009 Norwegian Oilfield Service Analysis) indicates that Rogaland is the largest driver in the Norwegian oil service cluster. In 2008, 38% of the companies in this branch were located in Rogaland. The income earned by the oil service companies totals around NOK 90 billion, representing 32% of the total income of the industry. 50% of the industry's employees live in Rogaland.

Industry
Industry in Rogaland employs 32,000 persons, of which 17,500 within the mechanical industry and the metal products industry and 14,500 within other industry. Within mechanical and metal products, a large ratio of companies has links to the petroleum industry. This sector of the industry is extremely exposed to fluctuations in the petroleum industry and has extremely hard competition. In terms of more traditional industry, the largest sub-groups are the food industry and natural stimulant industry, timber and woodworking and the graphic industry.

Building and construction
This industry employs around 29,500 persons in Rogaland, corresponding to 13% of the total employment in the region. This group comprises companies involved in the sale and operation of real estate, lease of machines and equipment, research and development and commercial services such as legal services, accounting, business advice and data processing companies and consultancies.

Commodities
This industry employs 31,000 persons in Rogaland. The commodities industry comprises retail trade and repair of household goods for retail use, agencies and wholesalers in addition to motor vehicles.

Public sector
The public sector in Rogaland employees 54,400 persons, corresponding to around 25% of the total workforce. These are distributed between official activities with approx. 15,500 employees and approx. 36,000 persons in municipal activities, of which Rogaland county council has approx. 3,000 employees.

3.4.2 Macro-economic outlook

Norway is still experiencing the impact of the economic downturn which started in early 2008, resulting from the global financial crisis. The decline in GDP for mainland Norway at the start of 2010 has now been replaced by a cautious upturn. According to Statistics Norway's "Economic Outlook 2010", the rate of growth is expected to remain moderate in 2010 and Norway will see the end of the recession by year-end 2012.

The Economic barometer 2010 for the region of Rogaland indicates that companies have a positive outlook at the start of 2010. Nonetheless, there is a considerable variation in the level of confidence in the future among the different branches. Those companies targeting the domestic market expect to see growth and positive developments while parts of the export industry still suffer from a greater degree of uncertainty.

The energy sector
The petroleum industry in Norway has fared better throughout the financial crisis than its international competitors. This has helped keep the level of activity in the Norwegian economy on an even keel. For the region of Rogaland, the level of activity has remained high even in the periods of decline. As a result, the region has the lowest unemployment and highest house prices in the country.

A high investment level on the Norwegian continental shelf is expected in the future, although the supplier industry faces challenges as the oil companies are currently practicing caution. A slight decline in the level of investments is expected when compared with the level in 2009. A number of projects and applications for development have been postponed or abandoned due to uncertainty on future oil and gas prices, poor profitability, financing problems and high costs.

The exploration activities on the Norwegian continental shelf have seen a significant increase in recent years and the most important driving force has been the high oil prices. A high level of exploration is also expected for next year. A trend towards more drilling activity than development of new projects has opened the door to more competition for the Norwegian supplier industry. This increase in competition has become more evident for the region's oil companies in recent years, and some companies have been priced out of tender competitions. Wildcat drilling encompasses a number of foreign companies, while Norwegian resources are more likely to provide goods and services.

The trend away from investments in new fields to investments in fields in operation implies smaller contracts and shorter time horizons. This will have an impact on the subcontractors and increase the level of competition among these companies. Within modification and maintenance, contracts are expected to fall in number but increase in size. This implies that the major yards will have fewer contracts in 2010. The number of offshore vessels which are off hire provides an indicator of uncertainty for the future market.

A number of companies are taking an offensive approach to the economic downturn. In the company survey carried out for the Economic Barometer 2010 for Rogaland, 9 of 10 companies state that they expect no change or an increase in turnover and 8 of 10 expect no change or an improvement in operating result in 2010. Challenges obstructing the development in the petroleum industry include competencies, competitiveness, new technology and internationalisation.

The labour market
Unemployment in Rogaland remains one of the lowest in the country. The negative development in unemployment seems to have abated. Unemployment remained practically unchanged in 2009. This may be due to the fact that many companies have hired in labour from outside the region during the upturn of the past years, and that companies tend to wait a period of time before introducing workforce cuts, expecting the level of activity to recover. A total 2 of 3 companies is planning to increase their workforce in 2010. A common challenge seems to be difficulties in recruiting technical personnel with the correct competencies. In the survey of companies, 95% state that they encounter difficulties in recruiting qualified labour, while a majority state that they have vacancies which they cannot fill due to recruitment problems.

The shipbuilding industry in Rogaland has been affected by the downturn and cut 1,300 jobs last year. Despite the continued decline for the shipbuilding industry, no further cuts are expected in 2010. Other industries cut their workforce by 500 man-years, but a cautious optimism on the market is resulting in a stable level of employment also for this area.

The housing market
Rogaland as a region managed to sustain a reasonable level of activity on its housing market during the financial crisis. The fact that unemployment has been much lower in this region than other parts of the country paved the way for a more optimistic outlook and a propensity to invest among consumers. On the housing market, the supply side for detached houses in central areas is limited, which helps sustain and increase prices. Stavanger has the highest growth in house prices in Norway. From studying the housing statistics from the largest cities in Norway, it becomes evident that the prices in 2009 were on average 29% higher than in 2005. The most significant price increase can be found in Stavanger, where house prices increased by 53% during the period. The lowest price increase in this timeframe was in Trondheim and Bergen, with 18.0% and 18.4% respectively. As long as the level of activity remains high and unemployment does not see a dramatic increase, house prices in Rogaland are expected to continue growing.

In summary, it can be concluded that the players on SpareBank 1 SR-Bank's market area have fared relatively well throughout the economic downturn of the past years. A relatively low level of unemployment and lower interest rates have provided higher disposable income for retai consumers. The local industry structure has proved robust in terms of the changes and reorganisations required by a negative trend in global demand.

3.4.3 Principal risk exposure for SpareBank 1 SR-Bank

The bank's total risk exposure has been reduced in 2009 as a result of reinforcements in capital adequacy. In addition, the Group's liquidity risk and credit risk have been diminished.

On the basis of the increased level of uncertainty at the start of 2009 in the Norwegian and international economies and a general recapitalisation of banks on a global scale, SpareBank 1 SR-Bank made the decision to strengthen its capital adequacy in 2009 by issuing shares of NOK 1.2 billion and issuing perpetual capital securities of NOK 800 million. This capital supply was executed on the retail market, without making use of the Norwegian State Finance Fund. In addition, the Group strengthened its core capital by retaining parts of its result in 2009.

The core capital adequacy for the Group was thereby increased from 6.4% to 9.6% at year-end 2009, while capital adequacy increased from 9.8% to 11.9%.

The unrest on the financial markets has also impacted the bank's access to liquidity in 2009. In Norway, the governmental swap arrangement provided improved access to liquidity, thereby reducing the banks' liquidity risk. SpareBank 1 SR-Bank entered swap agreements and gained liquidity corresponding to NOK 7.4 billion in 2009. The swap arrangement therefore contributed to a satisfactory liquidity for the Group throughout the year.

At year-end 2009, the Group had surplus liquidity in the form of deposits in Norges Bank and short-term investments in banks and credit institutions corresponding to NOK 2.2 billion. The Group's buffer capital in the form of liquid assets totals NOK 20.5 billion. Net refinancing requirement in 2010 excluding F-loans (fixed-rate facilities) is NOK 7.5 billion.

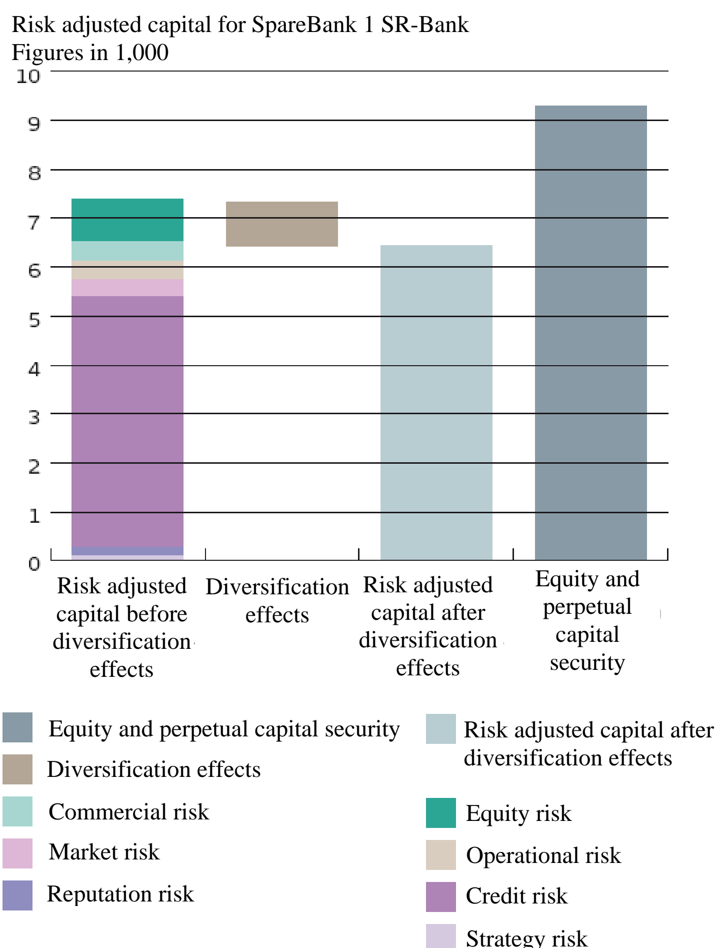
For the Group as a whole, deposits saw an increase of NOK 1.3 billion from the end of 2008 to the end of 2009. As a result of the transfer of mortgages to SpareBank 1 Boligkreditt of NOK 13 billion, lending for the Group fell by NOK 6.5 billion in the same period. The deposit-loan ratio rose from 53.0% to 58.1% during 2009.

Credit risk represents a significant share of the Group's inherent risk. The quality of credit was improved during the last months of 2009 as a result of the upturn in economy and following a significant in-house focus on measures to reduce risk regarding existing customers. The implementation of a restrictive practice for granting loans to new corporate market customers in 2009 also helped strengthen credit quality.

Figure 22 on the next page illustrates the requirement for risk adjusted capital as of Q4 2009, compared to available risk capital which is defined as the Group's book equity plus perpetual capital security. Risk-adjusted capital provides a description of how much capital the Group believes it requires to cover the actual risk assumed. As it is impossible to protect against all loss, the Group has stipulated that the risk-adjusted capital, in principle, shall cover 99.9% of potential unexpected losses in 2009. With effect from 2010, the Group has decided to change the level of confidence to 99.97% which represents an increase in capital requirement of approx. 11%.

In relation to ownership risk in SpareBank 1 Gruppen, a level of confidence of 99.5% has been stipulated, as the risk mainly comprises insurance risk with a different distribution of loss. A confidence level of 99.5% for insurance risk is in line with the international Solvency II regulation.

Figure 22: Risk adjusted capital for SpareBank 1 SR-Bank



Risk adjusted capital is calculated as NOK 7.4 billion before diversification effects and NOK 6.5 billion after diversification effects. The diversification effect amounts to NOK 901 million or 12.2%.

The diversification effect illustrates the risk reduction achieved by the Group by incorporating more risk areas which are not expected to incur unexpected loss simultaneously.

Total risk capital for the Group is NOK 9.3 billion, divided into NOK 8.1 billion for equity and NOK 1.2 billion in perpetual capital security. Buffer capital therefore amounts to NOK 2.8 billion. Furthermore, the Group's subordinated loan capital of NOK 2.8 billion provides an extra buffer.

The figure also illustrates that credit risk represents 69.5% of the total risk, while equity risk constitutes

11.7% followed by commercial risk of 5.5%. Market risk and operational risk represent 4.9% each.

Credit risk: Risk adjusted capital is calculated by using established credit models. Ref. chapter 3.3.1.2 for more detailed information.

Market risk: Risk-adjusted capital is calculated according to the Value at Risk (VaR) principle.

Operational risk: Calculation of risk adjusted capital is based on scenario analyses and statistic models.

Commercial risk: The calculation of risk-adjusted capital is based on the volatility in earnings and costs.

Ownerhip risk: Calculation of risk adjusted capital is based on the results of the companies' own risk and capital assessment process, taking into consideration SpareBank 1 SR-Bank's shareholding.

Reputation risk: Calculation of risk adjusted capital is based on scenario analyses and statistic models.

Strategic risk: Risk adjusted capital for strategic risk is established on the basis of strategic risk analyses and discussions among the corporate management and Board of Directors in connection with the annual business and strategy process.

Liquidity risk: In accordance with international best practice, risk-adjusted capital is not estimated for liquidity risk.

In the following chapters, SpareBank 1 SR-Bank provides more detailed information on the different risk groups.

3.4.4 Credit risk

On the following pages, more detailed information is provided on SpareBank 1 SR-Bank's credit risk exposure at the end of 2009. All figures and amounts apply to the parent bank, but include portfolios transferred to SpareBank 1 Boligkreditt AS unless otherwise specified.

SpareBank 1 SR-Bank owns 33.5% of SpareBank 1 Boligkreditt AS and 23.5% of SpareBank 1 Næringskreditt AS. These are credit enterprises with status as independent legal units primarily established to secure the Group a stable and competitive level of funding. SpareBank 1 SR-Bank is one of several shareholders. The Group has a shareholding in SpareBank 1 Boligkreditt AS and SpareBank 1 Næringskreditt AS which over time shall correspond with the Group's share of the transferred portfolios.

When loans are transferred from the Group to the credit enterprises, SpareBank 1 SR-Bank will continue to manage the loans (operational management of customer requests, follow-up etc.) SpareBank 1 SR-Bank also has the right to take back loans in the event of default.

On this basis, the Group has decided to include portfolios transferred to the credit enterprises in the follow-up and reporting of the Group's credit risk.

At the end of 2009, SpareBank 1 SR-Bank had transferred exposure at default corresponding to NOK 29 billion to SpareBank 1 Boligkreditt AS , while no portfolios were transferred to SpareBank 1 Næringskreditt AS. However, at the end of 2009, SpareBank 1 SR-Bank had a general equity risk in SpareBank 1 Næringskreditt AS as a result of its shareholding. This risk is included and reported under ownership ownership risk.

The credit portfolio in the subsidiary SpareBank 1 SR-Finans is not included in the portfolio overview below. This is because the Group's credit models have not yet been implemented for these portfolios. SpareBank 1 SR-Finans' credit portfolio represents approx. 4% of the Group's total exposure at default and has a credit quality corresponding to the parent company's corporate market portfolio.

3.4.4.1 SpareBank 1 SR-Bank

The following paragraph provides a detailed evaluation of the portfolio quality and portfolio development for the lending portfolio in SpareBank 1 SR-Bank in 2009. For more detailed definitions of default classes, security classes and risk groups, ref. chapter 3.3.1.1.

Figure 23 below illustrates the portfolio divided among the different risk groups according to exposure at default (EAD) and according to number of customers.

Figure 23: SpareBank 1 SR-Bank's portfolio according to risk groups

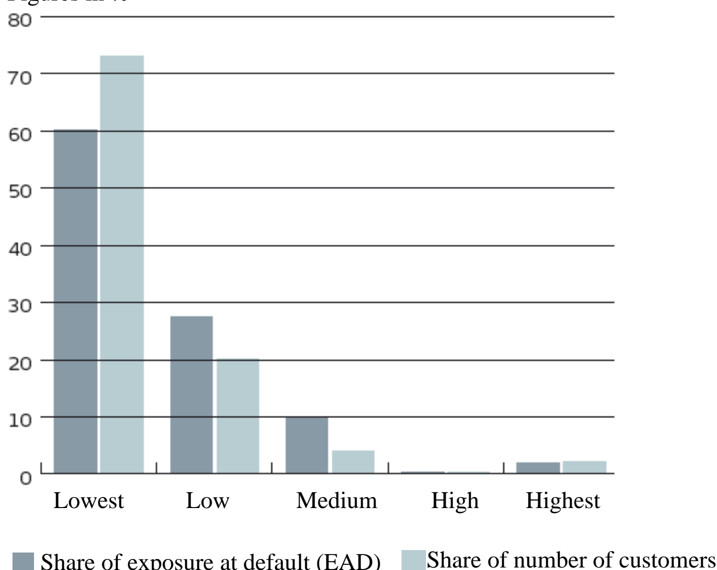


Figure 23 illustrates that 88% of the exposure at default or 93% of the customers meet the criteria for low and lowest risk. Expected loss (long-term outcome) in this part of the portfolio is 0.05%. Exposure to high and highest risk comprises 2.3% of exposure at default or 2.5% of the number of customers. Expected loss (long-term outcome) in this part of the portfolio is 4.05%.

SpareBank 1 SR-Bank maintains a considerable focus on concentration risk. Concentration risk is the risk which occurs when exposure is concentrated around an individual customer, branch or geographical area. Statutory requirements have been established which limit concentration risk connected to major individual customers alone and to the accumulation of major individual customers in total.

In order to ensure a diversified portfolio, separate credit strategic limits have been established for concentration risk which not only limit exposure but also risk profile at portfolio level, and for different branches and individual customers. The development in concentration risk is continuously monitored and the figures below illustrate the status of the portfolio, divided into commitment exposure, branch distribution and geographical distribution respectively.

Figure 24 below illustrates the portfolio according to size of commitment.

Figure 24: SpareBank 1 SR-Bank's portfolio according to size of commitment

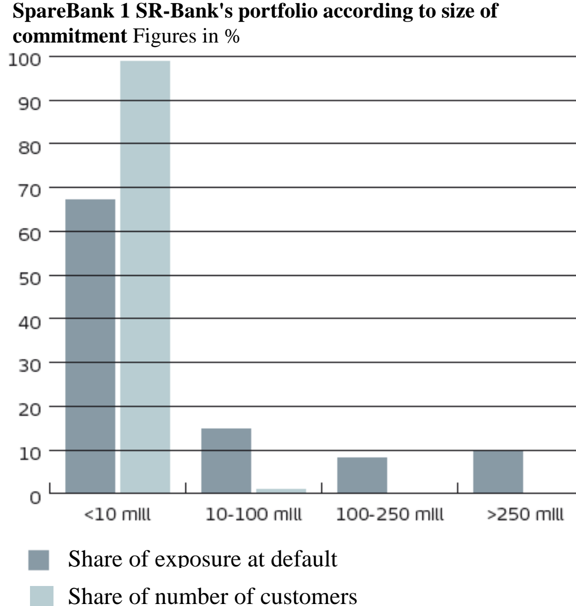
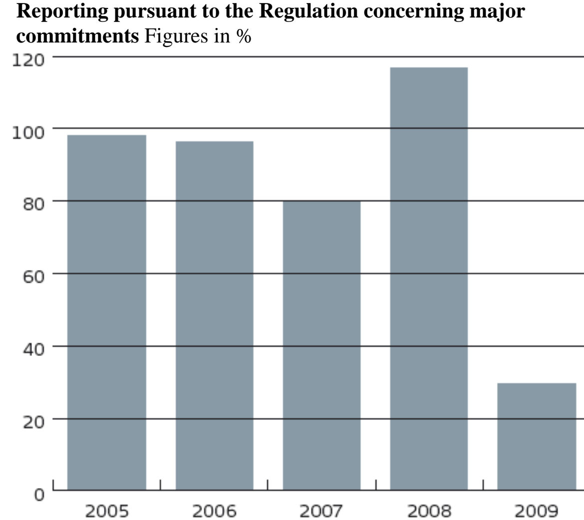


Figure 24 on the previous page illustrates that 99% of the customers corresponding to 67% of exposure at default represent commitments of less than NOK 10 million. Around 100 customers have an exposure in excess of NOK 100 million each. These represent 18% of the total exposure at default for the parent bank. The portfolio comprising major customers has in general a lower probability of default than the portfolio average.

Quarterly reports are submitted to the Financial Supervisory Authority of Norway, Norges Bank and the Bank's Guarantee Fund respectively. These reports are in compliance with the Regulation concerning major commitments for credit institutions and investment firms. This regulation stipulates that all commitments which constitute more than 10% of subordinated loan capital shall be reported. As a maximum, the total of these commitments can constitute 800% of subordinated loan capital, while the limit for the largest individual commitment is 25% of subordinated loan capital. The regulation also stipulates that the limits for the highest total commitment with one counterpart also apply to commitments with two or more counterparts when a controlling interest or economic association between the parties is such that economic difficulties encountered by one party will probably result in payment difficulties for the other party (ies).

Figure 25: Reporting pursuant to the Regulation concerning major commitments



At the end of Q4 2009, SpareBank 1 SR-Bank had a net subordinated loan capital of NOK 9,866 million. Consequently, all commitments which exceed NOK 986 million must be reported in accordance with the regulation. This requires reporting of five commitments which in total amount to 29.7% of subordinated loan capital. Only two of these five are ordinary corporate market commitments with 100% risk-weighting. This represents a significant reduction in the number of commitments in relation to earlier, due to the fact that the Group procured new subordinated loan capital in Q4 2009 without any commitments being granted which were of a size warranting reporting pursuant to the Regulation.

Figure 26 illustrates SpareBank 1 SR-Bank's portfolio according to different branches/segments.

Figure 26: SpareBank 1 SR-Bank's portfolio according to branch

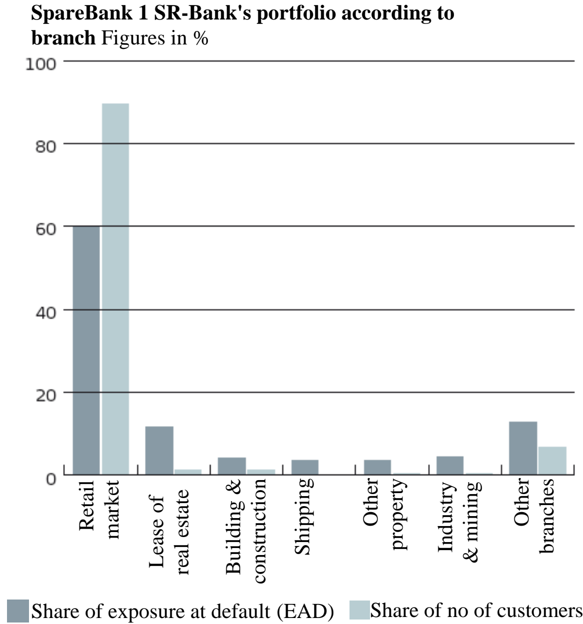
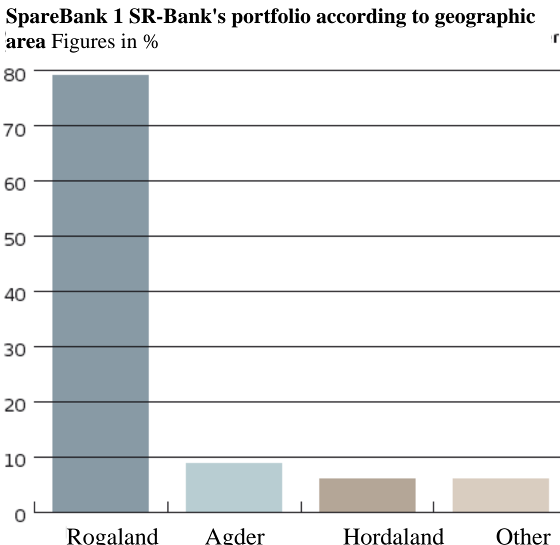


Figure 26 illustrates that the retail market corresponds to around 60% of the total portfolio, calculated according to exposure at default. The quality of the retail market portfolio is considered to be excellent. The major share of the portfolio is secured against property, implying a limited risk of loss, as long as there is no significant impairment in the value of the security provided. The major concentration otherwise is in the branch for lease of real estate, representing 12% of total exposure at default. The other branches constitute up to 4.4% of the total exposure at default. The figure above illustrates that SpareBank 1 SR-Bank has a limited concentration in terms of branches.

Figure 27 illustrates the portfolio according to geographical areas.



79% of the total exposure at default is connected to customers domiciled in Rogaland, while the remaining portfolio is distributed between customers domiciled in Agder, Hordaland and other regions respectively. In 2009, the share of exposure at default connected to Rogaland saw a relative increase, while a geographic diversification is expected in the years to come as a result of the Group's strategy for Agder and Hordaland.

The figures below provide a summary of the risk-related development in the portfolio in 2009. The distribution according to risk group complies with the limit values established internally for expected loss.

Figure 28: Development in SpareBank 1 SR-Bank's portfolio

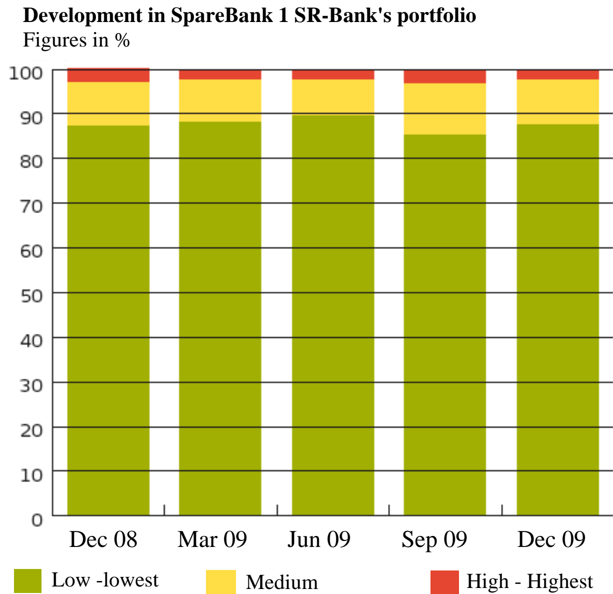


Figure 28 illustrates that the credit quality was impaired throughout parts of the year, but showed clear signs of improvement towards the end of 2009. The credit quality improved in the last months of 2009 as a result of the recovery in the economy and the high focus on in-house measures to reduce risk with existing customers. The implementation of a restrictive practice for granting loans to new corporate market customers in 2009 also helped strengthen credit quality.

The distribution of risk on the portfolio has therefore not seen any significant changes from the start of 2009 to the end of the year.

The change in the portfolio quality throughout the year can be explained by three different factors:

- Disposal: Approved financing is redeemed.
- Additions: Approval of financing to new customers.
- Change in existing portfolio: Changes in approved financing resulting from amortization/provision of new money or as a result of change in risk group.

On the basis of the above distribution, figure 29 below illustrates the main reasons for the change in SpareBank 1 SR-Bank's portfolio in 2009.

Figure 29: Migration in SpareBank 1 SR-Bank's portfolio over the past 12 months

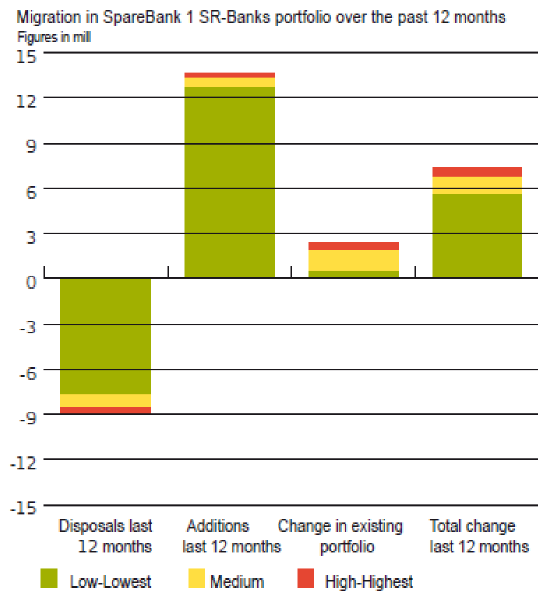


Figure 29 illustrates a generally lower risk from new customers (additions) than from customers who have redeemed commitments (disposals). New customers are dominated by a high ratio of low and lowest risk. This factor helps increase the quality of the portfolio. The existing portfolio has had a certain tendency towards a negative trend, but the effect of this is limited.

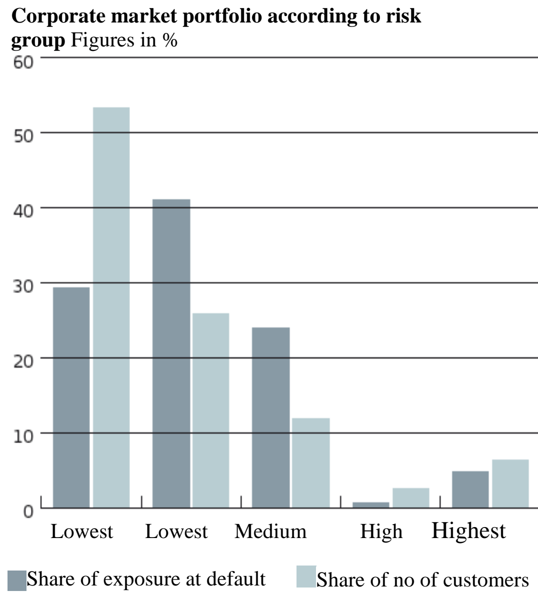
The chapters below provide further information and analyses for the corporate market and retailmarket portfolios respectively.

3.4.4.2 The corporate market

The following paragraph provides a more detailed evaluation of the portfolio quality and portfolio development for the lending portfolio for the corporate market in 2009.

The quality of the corporate market portfolio is considered to be good. Figure 30 illustrates that 70.5% of the exposure at default or 79.3% of the customers meet the criteria for low and lowest risk. Expected loss (long-term outcome) in this part of the portfolio is 0.11%. The share of high and highest risk comprises 5.5% of exposure at default or 8.9% of the number of customers. Expected loss (long-term outcome) in this part of the portfolio is 4.04%.

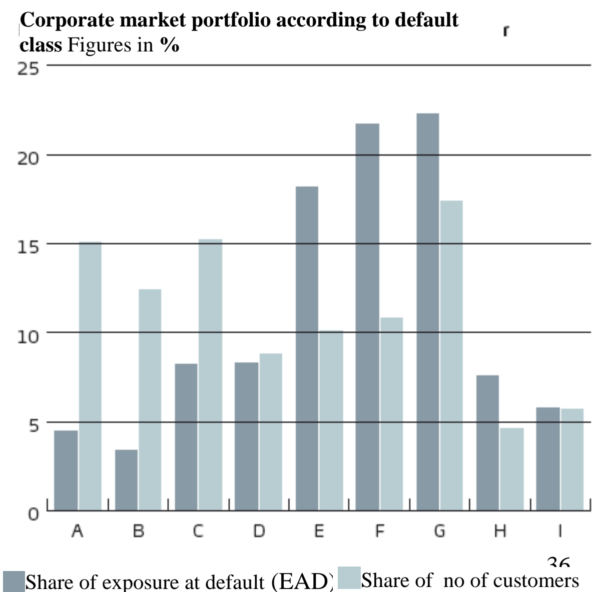
Figure 30: Corporate market portfolio according to risk group



The grouping of risk is based on expected loss for customers. Expected loss is defined as the product of probability of default and exposure at default. Below is an overview of the corporate market portfolio distributed according to these two parameters.

The portfolios are allocated a default class from A - I based on the probability of default for a customer. The distribution into default classes complies with the limit values established internally for probability of default, as defined in chapter 3.3.1.2. In order to more clearly distinguish between the customers with the lowest probability of default, the best default classes have significantly less intervals than the other default classes.

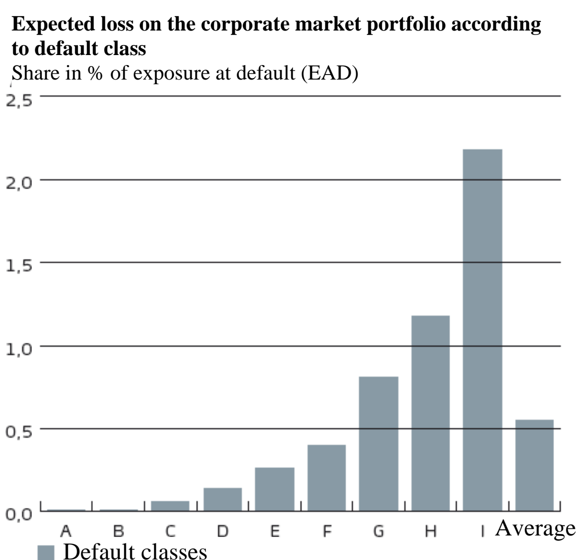
Figure 31: Corporate market portfolio according to default class



The figure illustrates that the main share of exposure at default has a probability of default between 0.75% (class E) and 5% (class G). When considering the number of customers however, there is predominantly high number in the best default classes, i.e. with probability of default lower than 0.75% (class A-D). The probability of default reflects a long-term outcome throughout an economic cycle.

For the corporate market portfolio in total, expected loss is calculated as 0.55% of exposure at default throughout an economic cycle. The variations per default class however are significant. Average expected loss for the different default classes is illustrated in figure 32 below.

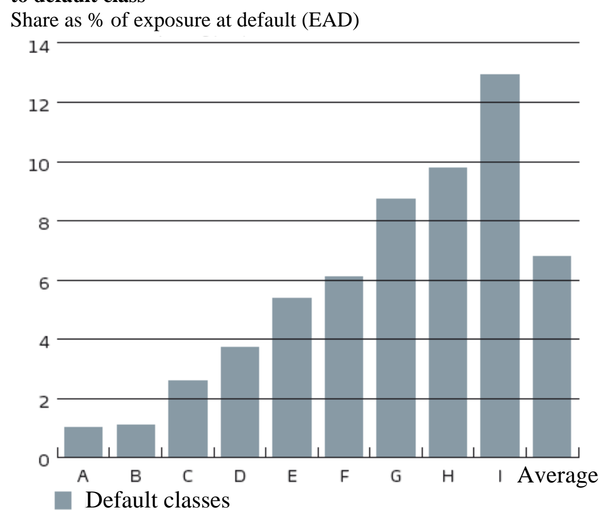
Figure 32: Expected loss on the corporate market portfolio according to default class



Average expected loss in default class A is 0.01%, increasing to 2.18% in default class I.

Risk adjusted captial will also vary significantly between default classes. Risk adjusted capital provides an illustration of maximum unexpected loss over a 12-month period at a specific level of confidence. Average tied up capital for the different default classes is illustrated in figure 33 below. Risk adjusted captial in the figure below is calculated according to the prevailing confidence level in 2009 of 99.9%. With effect from 2010, the Board of Directors adopted an increase in confidence level, to 99.97%. This represents an increase in tied up capital for the different default classes of approx. 11%.

Figure 33: Risk adjusted capital on the corporate market portfolio according to default class

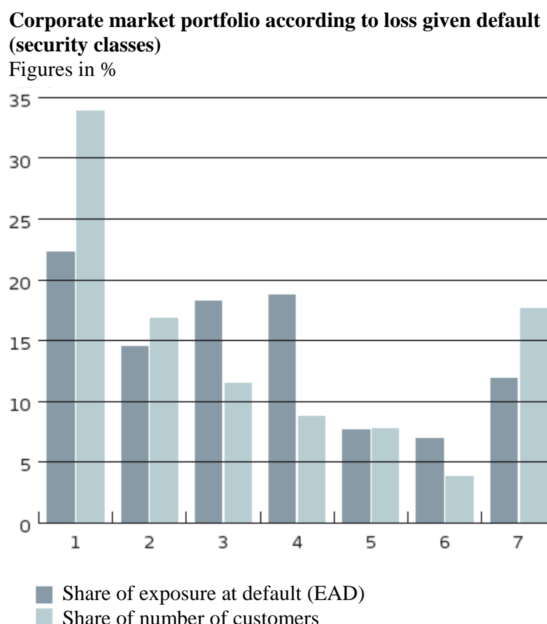


For the corporate market portfolio in total, risk adjusted capital is estimated as 6.79% of exposure at default. Average risk adjusted capital in default class A is 1.0%, increasing to 12.9% in default class I.

As risk adjusted capital provides an illustration of the capital required to cover unexpected loss given a specific level of confidence, this implies that the requirement for risk adjusted capital increases with a rise in probability of default. This is in line with the supporting principle for the Group's risk management that tied up capital for a commitment shall be directly related to the estimated risk.

The portfolios are categorised in classes from 1 to 7 based on the loss given default for each commitment. The distribution into classes complies with the limit values established internally for loss given default, as defined in chapter 3.3.1.2.

Figure 34: Corporate market portfolio according to loss given default (security classes)



Security classes 1 and 2 imply that the customers have provided securities for their commitments which, based on the realisation value during a recession, exceed the size of the commitment. Loss given default for these two security classes will therefore be limited to any collection costs. Figure 34 illustrates that approximately 50% of the customers, corresponding to 1/3 of exposure at default, are classified as security class1 or 2. 12% of exposure at default has securities with a realisation value of less than 20% of the commitment (security class 7). This is partially connected with the fact that securities in the form of negative pledges and unlisted securities are not allocated any security-related realisation value, while sureties can only be allocated a realisation value if certain conditions are met.

Concentration risk
Concentration risk is the risk which occurs when exposure is concentrated around an individual customer, branch or geographical area. This paragraph describes the status of concentration risk on the corporate market portfolio related to the size of commitment and distribution by branch respectively

Figure 35: Corporate market portfolio according to size of commitment

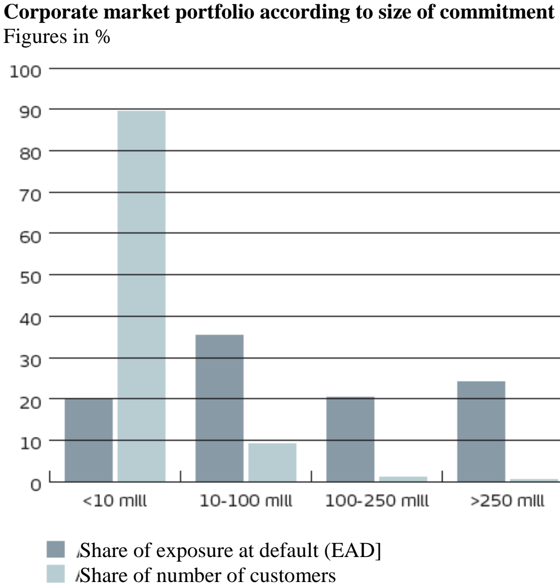


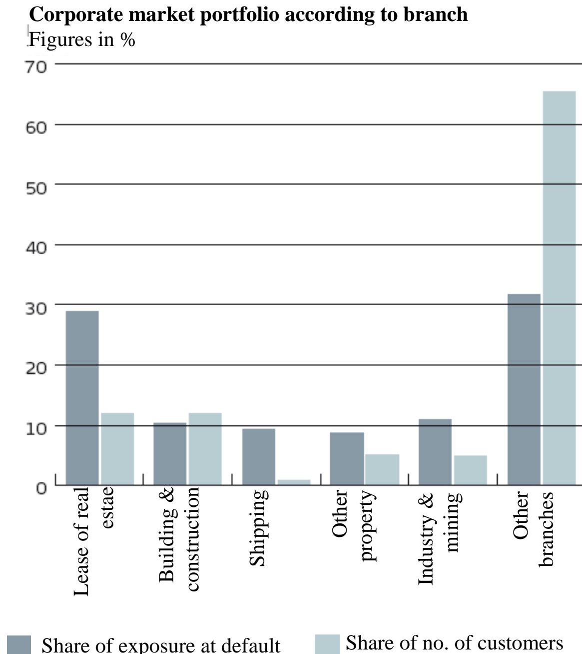
Figure 35 illustrates that 99% of the corporate market customers can be categorised as small and medium-sized commitments, i.e. that they do not exceed NOK 100 million in commitment size. However, these customers represent a significantly lower share of exposure at default on the corporate market (55%). This implies that 45% of exposure at default is connected to customers with a commitment exceeding NOK 100 million. This portfolio composition is based on a clearly defined strategy, and specific credit strategy limits for concentration risk are defined to manage growth and risk profile. This part of the portfolio has a generally lower probability of default than the average of the total portfolio.

Within shipping and shipbuilding financing, individual commitments are also subjected to risk reduction with the GIEK (the central governmental agency responsible for furnishing guarantees and insurance of export credits) and Eksportfinans (the Norwegian export credit institution for Export Financing). The scope of such risk reduction is limited however.

Figure 36 illustrates the corporate market portfolio with distribution by branch.

Figure 36 illustrates that the corporate market portfolio has a satisfactory dispersion among the different branches. The lease of real estate is the largest individual branch and represents 29% of exposure at default for the corporate market, but only 12% of total exposure, including retail market customers. The real estate portfolio connected to lease mainly comprises centrally located properties with long-term lease contracts and solid lessees, and a large part of this portfolio has interest rate hedging. Moreover, exposure at default has a wide diversification covering a number of branches.

Figure 36: Corporate market portfolio according to branch



In 2009, exposure at default connected to branches which are more vulnerable to economic cycles, such as lease of real estate, building & construction and shipping tipped the scales, at the expense of service providing branches which are less vulnerable to economic cycles. At the time of writing, there is a considerable focus on the risk related to exposure at default for lease of real estate, shipping and the oil service industry. These branches have consequently been thoroughly assessed, with details below.

Lease of real estate
The portfolio related to financing of commercial properties for lease is very diversified, robust and has a considerable number of properties where the underlying

lease contracts have a long duration. The above-mentioned factors, combined with solid lessees and a large degree of interest rate hedging, provide for a moderate risk on this portfolio.

Figure 37 below provides an overview of the part of the portfolio with a loan yield lower than 15% or a weighted remaining lease period of less than 10 years. Calculation of loan yield is based on 5% annual payable costs. The figure does not encompass the solidity of the lessees.

Figure 37: Quality of the portfolio of commercial properties

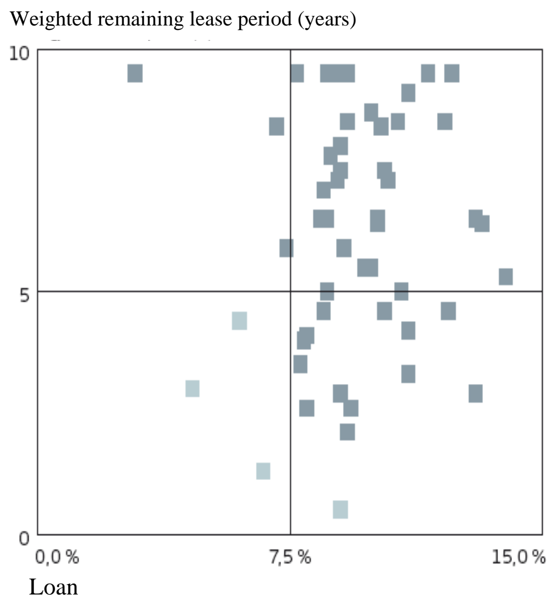


Figure 37 above illustrates that the portfolio principally comprises commitments where the loan yield exceeds 7.5% at the same time as the weighted remaining lease period exceeds 5 years. This confirms the impression of a robust portfolio.

Figure 38: The portfolio of commercial properties according to risk group

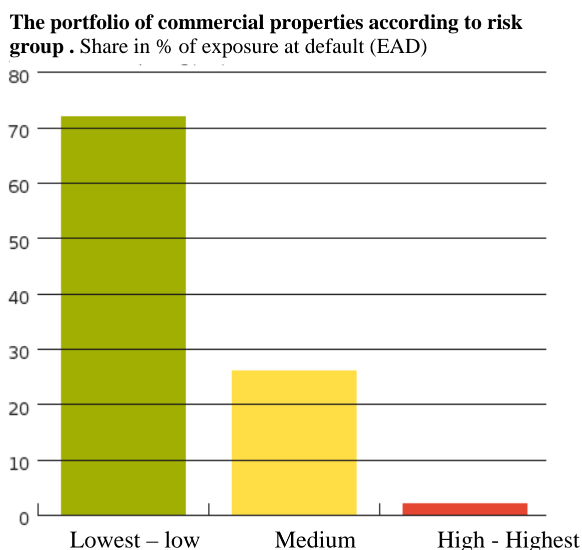


Figure 38 illustrates that the portfolio of commercial properties is dominated by commitments with low risk. These constitute 72% of exposure at default, while only 2% of exposure at default is classified as high risk. In relation to interest rate risk, 65% of the portfolio has interest rate hedging. Of this amount, 78% of the interest rate hedging contracts has a duration of more than 5 years. For 13% of the portfolio, interest rate hedging is considered unnecessary due to the solidity of the debtors. In general, the outlook for the portfolio of commercial properties is considered to be good, but the Group does expect an increase in risk for properties involved in industries dominated by hard competition.

Figure 39: The portfolio of commercial properties according to remaining term

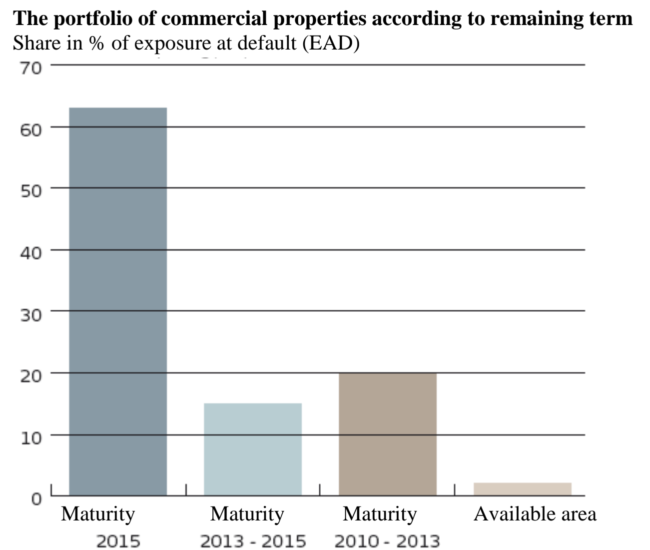
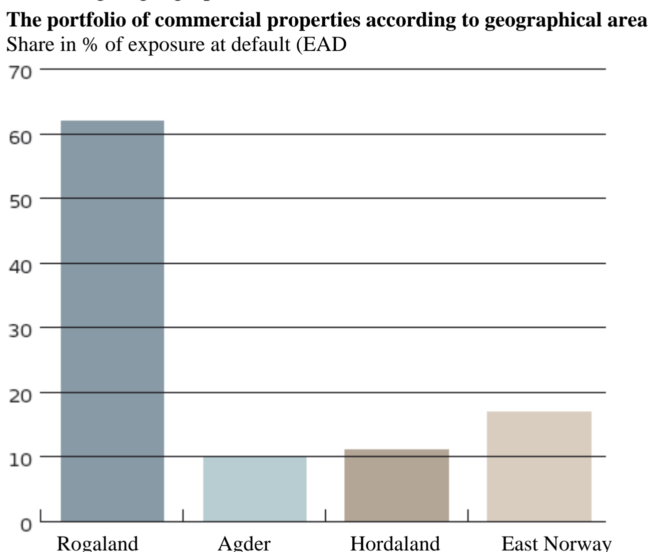


Figure 39 illustrates that 63% of the portfolio has lease contracts with maturity later than 2015, while only 2% is available area. The financial strength of the lessees is good and there has only been a minor ratio of bankruptcies among lessees in 2009.

Figure 40: The portfolio of commercial properties according to geographical area



and two major commitments with one customer domiciled in East Norway.

Shipping
For offshore service vessels, there has been a strong net growth on the supply side, but the demand side has not absorbed this growth. This will most probably result in reduced rates in comparison with the previous year. Even if, in terms of the supply side, older tonnage were to be scrapped and a share of vessels on the order books cancelled, the demand side would still require reinforcement in order to achieve a recovery of the rate level. The decisive factor here is the price of oil and, implicitly, the level of activity within exploration and production. Most players on this market are prepared for 2010 to be a poor year. Taking a long-term perspective, demand will increase. The real question is, however, how quickly this will happen. The time ahead will therefore be challenging for a number of companies in this industry, but it will also present vast opportunities for those companies with a solid balance sheet and financial strength.

SpareBank 1 SR-Bank has carried out a stress test of its own portfolio within offshore service vessels in order to identify the required level of earnings for a vessel on the spot market (taking into consideration existing contractual coverage) so as to cover operating costs plus interest and downpayments. The results of the test imply that the Group's portfolio is relatively robust in terms of contractual coverage and that the minimum earnings required on the spot market are principally viewed as realistic on the current market.

In general, the Group finances business related to offshore service vessels with which the Group has long-term relationships with. Only a limited degree of financing is granted to completely new customers, and these are thoroughly assessed before granting financing. The main volume of the vessels financed operates in the North Sea, and contractual coverage is in general good.

Within shipping, the Group has a significant exposure in terms of offshore service vessels. The market for such vessels, as previously mentioned, is weak, with spot rates which only generate sufficient earnings to cover current operating costs. The main share of the Group's portfolio however has contractual coverage and is therefore not exposed to the weak spot rates in the short to medium term. Counterparty risk is limited as the contracts are with solid charterers.

The Group has a moderate exposure within shipping for chemical tankers and product tankers. The market for this segment is currently difficult, but the Group's portfolio comprises a relatively new fleet of vessels which in the main are built at renowned shipyards. The Group also has a moderate exposure in terms of seismic vessels. The market for these vessels is challenging, but the trend is towards an improved outlook.

The Group has a limited exposure to gas tankers, mainly LNG vessels with long-term contracts. The Group only has minor exposure in terms of dry bulk vessels, container vessels, RORO vessels or tankers. These branches can at times be volatile, and financing may involve a higher risk than for other types of vessel.

Oil service
2009 was a year of declining order backlogs and few new contracts. This trend was particularly evident for newbuildings and made its mark on operation, maintenance & modifications (OMM). The background for this trend is the postponement of planned projects and a strong focus on costs among the oil companies. For the OMM segment, this stagnation was further reinforced by the change in contract philosophy at Statoil, where the structure was modified away from major turnkey contracts to a division into a higher number of smaller contracts. The last months of 2009 saw an improvement in the market. Among other factors, Statoil awarded a couple of major maintenance contracts which also benefited a number of the Group's customers. Furthermore, decisions were made regarding the Gudrun and Goliat fields, which represent significant supplies from the Norwegian oil service industry. This, together with factors such as the decision to build a new accommodation platform for Ekofisk, has provided a brighter outlook for the market and the newbuilding market when entering 2010. In other respects, the general market trend is poor in the short and medium-long term but with expectations that demand will recover in the long term.

The Group's portfolio for the oil service industry is deemed as relatively robust when considering the challenging market forecast for 2010. This is because most companies on the portfolio have their main share of turnover from the Operation and Maintenance segment. Those companies which exclusively relate to Newbuildings have partly experienced a dry up in orders in 2009 and will have a difficult year in 2010. The Group has a limited portfolio for this segment.

A number of the Group's customers have a high consolidated debt ratio due to the fact that they have been subject to debt financed acquisitions. These customers are therefore less robust than other companies in the portfolio and the Group pays special attention to monitoring their accounts.

Development in portfolio quality
The figures below provide a summary of the risk-related development in the corporate market portfolio in 2009. The distribution of risk groups complies with the limit values established internally for expected loss, as these are defined in the introduction to the paragraph on risk exposure.

Figure 41: Development in corporate market portfolio

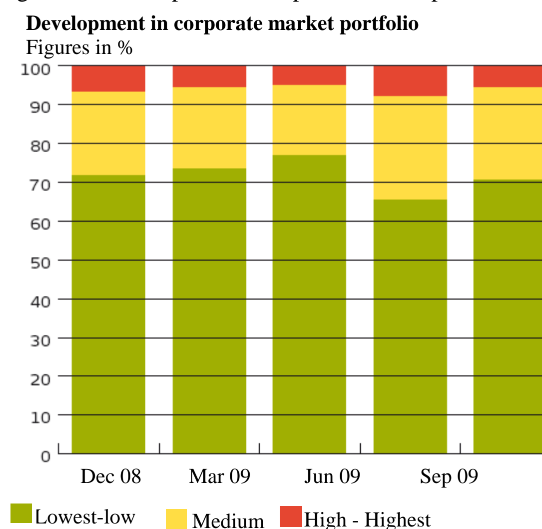


Figure 41 illustrates a development in 2009 marked by a reduction in credit quality throughout parts of the year, with an improvement in credit quality during the last months of 2009 as a result of the economic upturn and a considerable in-house focus on measures to reduce risk for existing customers. The difficult market, resulting in a lower level of activity within business, has caused a reduction in demand for loans from corporate customers. Exposure at default therefore saw a decline in 2009 but is expected to gradually increase in the future.

The distribution of risk on the portfolio however has not seen any significant changes from the start of 2009 to the end of the year.

The change in the portfolio quality can be explained by three different factors:

- Disposals: Approved financing is redeemed.
- Additions: Approval of financing to new customers.
- Change in existing portfolio: Changes in approved financing resulting from downpayments/provision of new money or as a result of change in risk group.

On the basis of the distribution above, figure 42 below illustrates the development in the corporate market portfolio in 2009.

Figure 42: Migration in the corporate market portfolio over the past 12 months

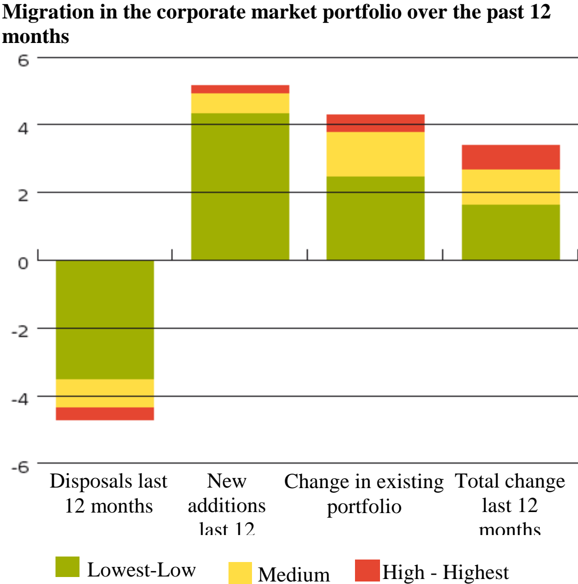
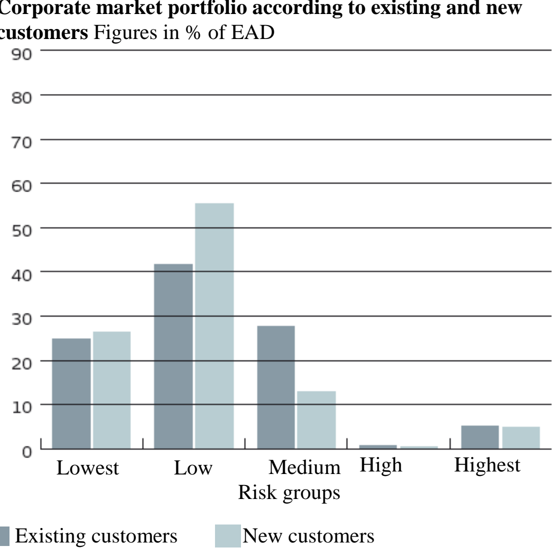


Figure 42 illustrates that new customers principally have low risk and that there is a somewhat more negative development in the existing portfolio. This reflects a period with a somewhat more challenging market situation for the companies in the Group's market area.

The positive development connected to the addition of new customers can be illustrated by examining the distribution of risk for new customers compared with the distribution of risk for existing customers.

Figure 43 illustrates a positive development which is generally marked by lower risk for the new commitments added to the portfolio in 2009 than the average for the existing portfolio. 82% of exposure at default granted in 2009 is categorised as lowest or low risk. This is a significantly higher share than in the existing portfolio. This development is also confirmed in that the probability of default is lower for new customers granted financing in 2009 than for the average of existing customers.

Figure 43: Corporate market portfolio according to existing and new customers



The weak negative development in existing portfolio can be illustrated by examining how the customers have migrated between the default classes over the past 12 months.

Figure 44: Migration in the existing corporate market portfolio over the past 12 months

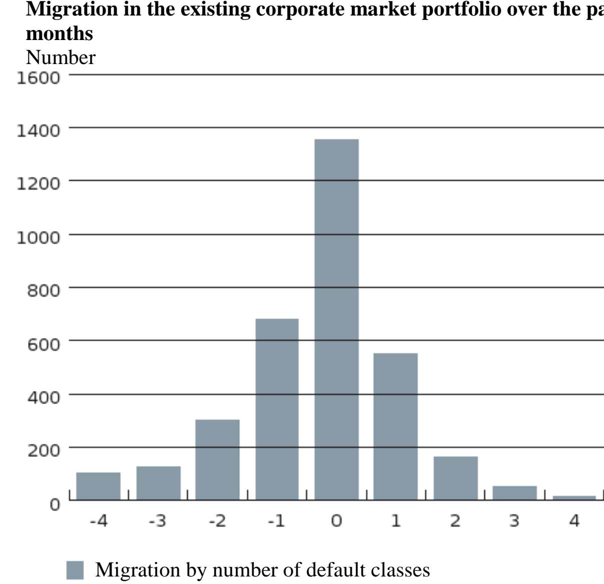
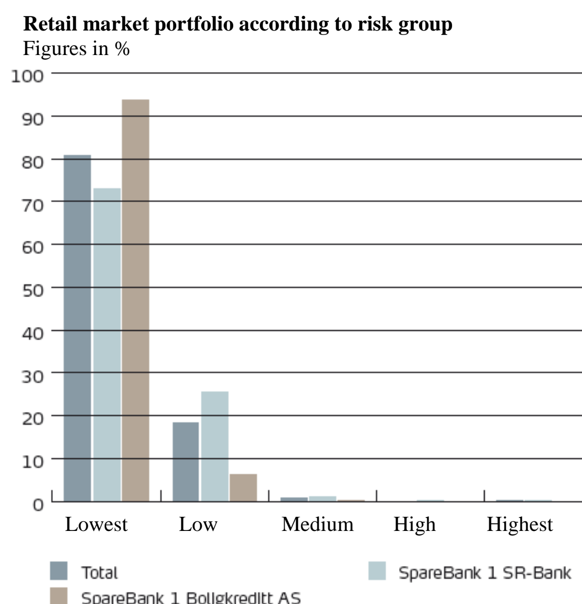


Figure 44 illustrates that approx. 40% of corporate customers remained in the same default class throughout 2009. Of the remaining 60% of corporate customers, 36% had a negative migration. This was to be expected, in light of the economic situation in 2009. 10% of corporate customers migrated by more than 2 default classes throughout the year.

3.4.4.3 The retail market

The following paragraph provides a more detailed evaluation of the portfolio quality and portfolio development for the lending portfolio for the retail market in 2009.

Figure 45: Retail market portfolio according to risk group



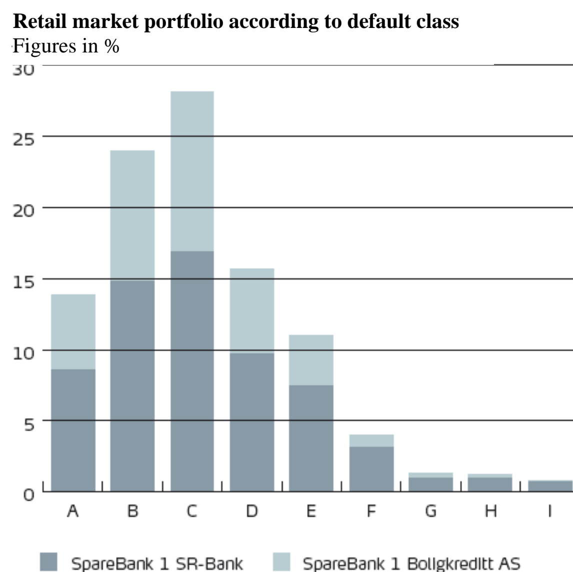
Retail market portfolio according to risk group
Figures in %

The quality of the retail market portfolio is marked by low risk and deemed to be excellent. The rate of development is stable. Low interest rates, low unemployment and rising house prices have a positive impact on the portfolio by sustaining the customers' debt servicing capacity at the same time as the value of securities increases. Most of the portfolio is secured against property. Cover for securities is good, indicating a limited risk of loss provided there is no significant impairment in the value of securities.

At the end of Q4 2009, one portfolio totalling NOK 29.0 billion was transferred to SpareBank 1 Boligkreditt AS. The quality of this portfolio is in line with the criteria for transfer of loans and is extremely good and better than the remaining portfolio. While the average probability of default in the portfolio transferred to SpareBank 1 Boligkreditt AS is 0.50%, the corresponding figure in the remaining retail market portfolio is 0.79%. The portfolio transferred to SpareBank 1 Boligkreditt AS satisfies the criteria for a risk group with lowest or low risk.

The grouping of risk is based on expected loss. Expected loss is defined as the product of probability of default and exposure at default. Below is an overview of the retail market portfolio distributed according to these two parameters.

Figure 46: Retail market portfolio according to default class



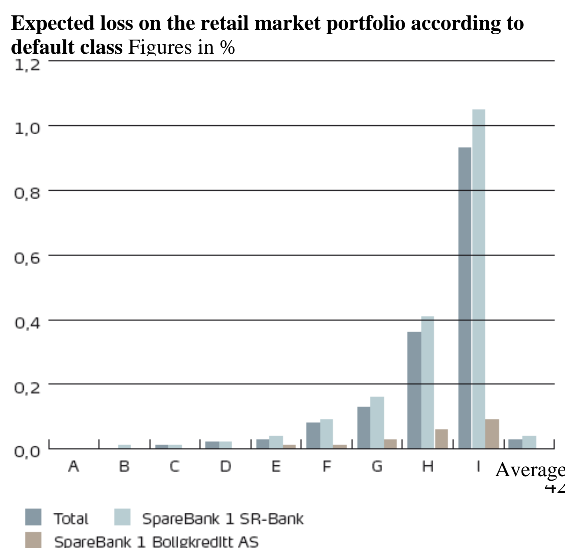
Retail market portfolio according to default class
Figures in %

The portfolios are allocated a default class from A - I based on the probability of default for a commitment. The distribution into default classes complies with the limit values established internally for probability of default, as defined in chapter 3.3.1.2. In order to more clearly distinguish between the customers with the lowest probability of default, the best default classes have significantly less intervals than the other default classes.

Figure 46 illustrates that 82% of the portfolio has a limited probability of default of less than 0.75% (class A-D). For the portfolios transferred to SpareBank 1 Boligkreditt AS, the estimated probability of default is mainly less than 0.50% (class A-C). The probability of default reflects a long-term average throughout an economic cycle. The retail market portfolio, distributed according to number of customers, does not differ that much from the distribution of exposure at default illustrated in the figure above.

For the retail market portfolio in total, expected loss is calculated as 0.03% of exposure at default throughout an economic cycle. The variations per default class however are significant. Average expected loss for the different default classes is illustrated in figure 47 below.

Figure 47: Expected loss on the retail market portfolio according to default class



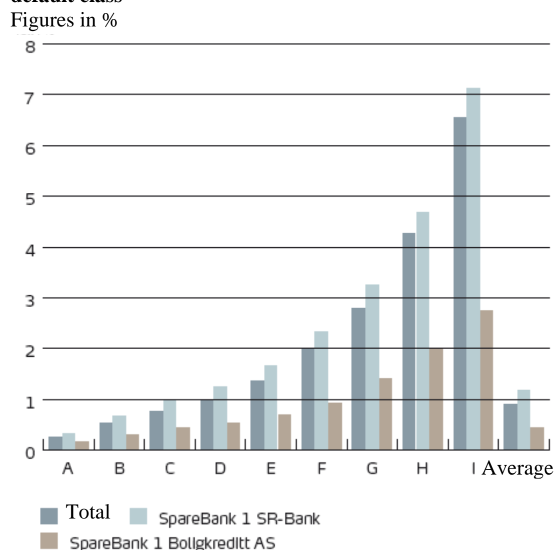
Expected loss on the retail market portfolio according to default class Figures in %

Average expected loss in default class A is practically 0%, increasing to 0.93% in default class I.

Risk adjusted capital will also vary significantly between default classes. Risk adjusted capital provides an illustration of maximum unexpected loss over a 12-month period at a specific level of confidence. Average tied up capital for the different default classes is illustrated in figure 48. Tied up capital in the figure below is calculated on the basis of a level of confidence of 99.9% in 2009. With effect from 2010, the Board of Directors adopted an increase in confidence level, to 99.97%. This represents an increase in tied up capital for the different default classes of approx. 11%.

Figure 48: Risk adjusted capital on the retail market portfolio according to default class

Risk adjusted capital on the retail market portfolio according to default class
Figures in %



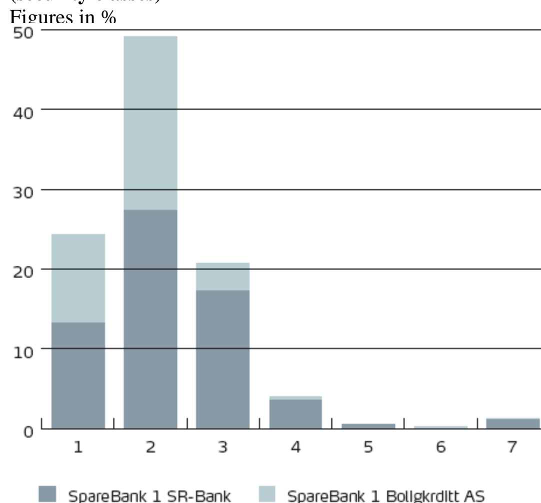
For the retail market portfolio in total, risk adjusted capital is calculated as 0.90% of exposure at default. Average risk adjusted capital in default class A is 0.26%, increasing to 6.56% in default class I.

As risk adjusted capital provides an illustration of the capital required to cover unexpected loss given a specific level of confidence, this implies that the requirement for risk adjusted capital increases with a rise in probability of default. This is in line with the supporting principle for the Group's risk management that risk adjusted capital for a commitment shall be directly related to the estimated risk.

Loss given default
The portfolios are categorised in classes from 1 to 7 based on the loss given default for each commitment. The distribution into classes complies with the limit values established internally for loss given default, as defined in chapter 3.3.1.2.

Figure 49: Retail market portfolio (EAD) according to loss given default (security classes)

Retail market portfolio (EAD) according to loss given default (security classes)
Figures in %



Security classes 1 and 2 imply that the customers have provided securities for their commitments which, based on the realisation value during a recession, exceeds the size of the commitment. Loss given default for these two security classes will therefore be limited to any collection costs. Figure 49 illustrates that 73% of exposure at default is categorised in security classes 1 or 2.

Figure 49 illustrates that a total 94% of exposure at default (EAD) is categorised within security class 3. This implies that the realisation value of the securities provided represents minimum 80% of exposure at default and implies a limited loss given default. The Group only grants a limited level of financing where the realisation value of the securities provided is less than 80% of the exposure at default. However, 12% of the customers have been granted small credit lines where the realisation value of the securities provided totals less than 20% of the credit granted.

The Group focuses on the estimated loss given default of a commitment when assessing potential loss. The assessment is based on the realisation value of the securities provided. This is considerably lower than the market value (a reduction factor of 20% is applied to mortgages in homes) and shall reflect the security value upon realisation during a recession.

However, the enterprises within the financial industry continue to focus on the measurement of potential loss as exposure at default as a percentage of the market value of the securities provided.

As a supplement, the figure below therefore illustrates the ratio of the retail market portfolio secured against property which falls within the ranges of 60%, 60-75% and over 75% of the market value of the securities provided.

Figure 50: LTV (Loan To Value) for the retail market portfolio

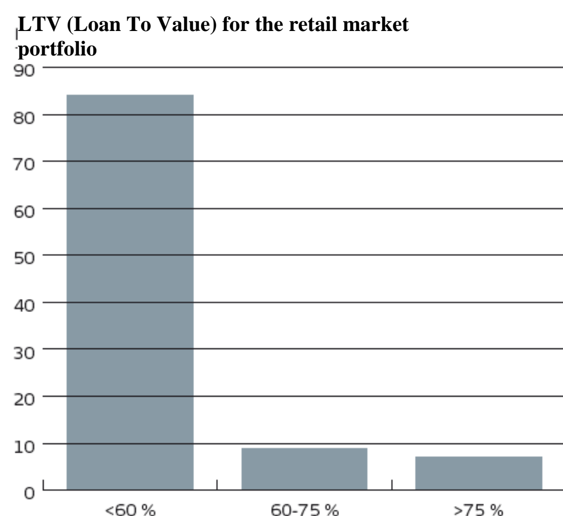
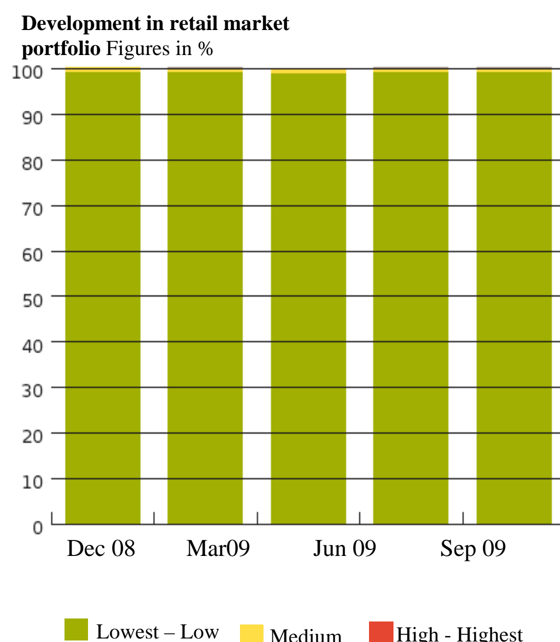


Figure 50 illustrates Loan To Value for the retail market customers, including the portfolios transferred to SpareBank 1 Boligkreditt AS. The calculation of LTV is based on the market value of the securities. For loans which exceed 60% of the market value of the security, the excess amount is distributed over the intervals in the figure. The figure illustrates that cover for securities is good, where 84% of exposure at default is within 60% of the market value of the securities provided. Excluding the portfolios transferred to SpareBank 1 Boligkreditt AS, 79% of the portfolio would be within the range of 60%.

Development in portfolio quality
Figure 51 below provides a summary of the risk-related development in the retail market portfolio in 2009. The distribution of risk groups relates to the limit values established internally for expected loss, as these are defined in the introduction to the paragraph on risk exposure.

Figure 51: Development in retail market portfolio

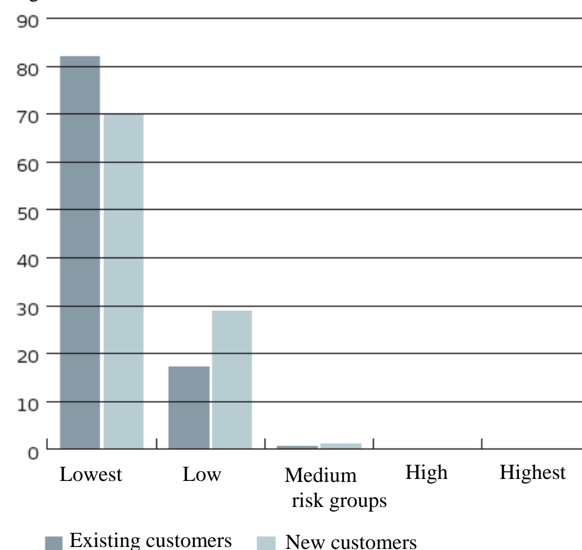


The figure illustrates that the retail market portfolio principally comprises commitments with low risk. The rate of development has remained stable throughout the year. The major share of the portfolio is secured against property and cover for security is good, implying a limited risk of loss, as long as there is no significant impairment in the value of the security provided.

The development connected to the addition of new customers can be illustrated by examining the distribution of risk for new customers compared with the distribution of risk for existing customers as illustrated in figure 52.

Figure 52 illustrates a development which is generally marked by low (but some higher) risk for the new commitments added to the portfolio in 2009 than the average for the existing portfolio. 99% of exposure at default granted in 2009 is categorised as lowest or low risk, as with the existing portfolio. The fact that the share of low risk is somewhat higher (and the share of lowest risk somewhat lower) for new customers is partly attributable to the Group's strategy to target younger customers in an establishment phase. During a limited period, these customers will represent a somewhat higher risk than the average on the portfolio, due to lower earnings and weaker corrosion.

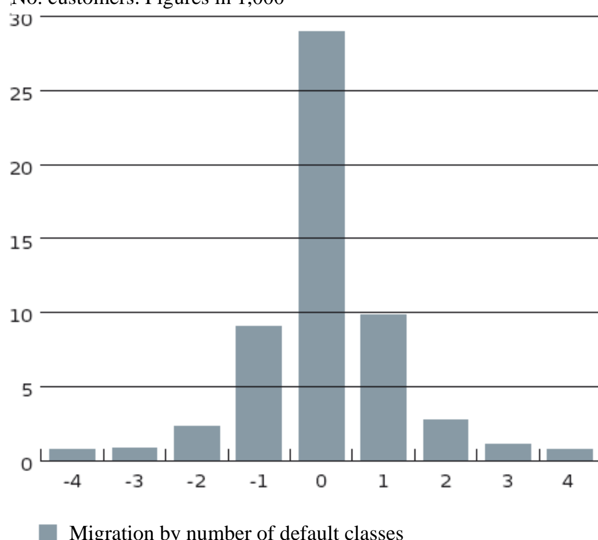
Figure 52: Retail market portfolio according to existing and new customers



The development in existing portfolio can be illustrated by examining customer migration between default classes over the past 12 months.

Figure 53: Migration in existing retail market portfolio last 12 months

Migration in existing retail market portfolio last 12 months
No. customers. Figures in 1,000



The figure illustrates that 51% of the retail customers remained in the same default class throughout 2009. Of the remaining 49% of customers, there was a minor predominance of positive migration (26%). The level of stability on the retail market portfolio is high, and only a few customers migrated by more than 2 default classes throughout the year.

3.4.4.4 The securities portfolio

The security market activities are organised in SR-Markets. The Group has two different portfolios comprising bonds and certificates – respectively the liquidity portfolio and the trading portfolio. The respective portfolios are governed by separate management mandates.

The liquidity portfolio comprises interest-bearing securities which either meet the requirements for deposit in Norges Bank or which have a remaining maturity of less than 6 months. The size of the portfolio will, at all times, rely on the Group's balance sheet and thereby the requirement for liquid assets. Securities which do not meet the above-mentioned requirements imply a particular credit risk and these are subject to specific processing regulations. At the end of Q4 2009, the portfolio contained investments in a total of 9 different interest-bearing securities valued at NOK 320 million which represented a particular credit risk.

The trading portfolio comprises financially oriented investments in interest-bearing securities. The prevailing limits for such investments are NOK 500 million. All investments in the trading portfolio which do not meet the criteria for uncommitted credit lines stipulated by the Board of Directors shall be subject to ordinary credit management. At the end of Q4 2009, the trading portfolio contained 5 investments valued at NOK 102 million.

The table below provides an overview of SpareBank 1 SR-Bank's exposure in bonds within the different portfolios:

Table 6: Securities exposure, bonds and certificates (NOK million)

Currency	2009	2008	2007
Norwegian krone balance sheet	14	30	8
Foreign currency balance sheet	-1	3	4
Total	13	33	12

The Group has its own risk model for calculation of risk adjusted capital connected to the above-mentioned bond portfolios.

SpareBank 1 SR-Bank has no business related to credit derivatives.

3.4.4.5 SpareBank 1 SR-Finans

SpareBank 1 SR-Finans is a wholly-owned subsidiary of SpareBank 1 SR-Bank, where the main business is leasing financing and secured car loans. The results achieved are excellent and the subsidiary has had an impressive growth, principally helped by increased margins. Provisions for loss are stable. In 2009, the company has practiced caution in offering financing and has followed a very specific strategy for both customer selection and pricing of new and existing portfolios. As a result, the subsidiary managed to sustain its portfolio quality.
SpareBank 1 SR-Finans' credit portfolio represents approx. 4% of the Group's total exposure at default and has a credit quality corresponding to the parent company's corporate market portfolio.

3.4.5 Market risk

Interest rate risk
The Group's principal limits for interest rate risk define maximum loss in the event of changes in interest rates of 1 percentage point. Maximum loss in total shall not exceed NOK 30 million on the Norwegian krone balance sheet, and within a maturity limit (0-3 months, 3-6 months, 6-12 months, 1-2 years etc.) maximum loss shall not exceed NOK 15 million. Maximum net loss related to interest rate risk on the foreign currency balance sheet is NOK 8 million. The maximum interest rate risk for individual currencies is NOK 5 million.

The table illustrates the impact on result of a parallel change in the interest rate curve of 1 percentage point (100 basis points) at the end of the last three years (figures in NOK million).

Table 7: Impact on result of a parallel change in interest rate curve of 1 percentage point (NOK million)

Currency	2009	2008	2007
Norwegian krone balance sheet	14	30	8
Foreign currency balance sheet	-1	3	4
Total	13	33	12

Currency risk
The Group has prepared limits for net exposure in each currency, and limits for aggregate net currency exposure. The overnight foreign exchange risk for spot trading in currency as net must not exceed NOK 100 million per individual currency and NOK 125 million on aggregate.

The table illustrates net currency exposure including financial derivatives in accordance with the definition provided by Norges Bank.

Table 8: Currency exposure including financial derivatives (million)

Currency	2009	2008	2007
EUR	5	23	-9
USD	1	1	15
CHF	1	-7	-
GBP	-1	1	2
Other	32	-46	3
Total	38	-28	5

Security risk, shares
Shares, units and other equity interests are classified within the categories for fair value and held for sale. Securities which can be reliably estimated and reported internally at fair value are classified as fair value over result. Other shares are classified as held for sale.

The table below provides an overview of the Group's portfolio of shares at the end of the last three years (figures in NOK million).

Table 9: The Group's shareholdings at the end of the past three years (NOK million)

	2009	2008	2007
Fair value	**437**	**402**	**580**
- Listed shares	14	164	331
- Unlisted shares	423	238	249
Held for sale	**2**	**2**	**9**
- Listed shares	-	-	-
- Unlisted shares	2	2	9

The table above illustrates that the Group's portfolio of listed shares saw a reduction of NOK 150 million in 2009, at the same time as the portfolio of unlisted shares increased by NOK 185 million. For many years, the Group had a portfolio of listed current shares managed by SpareBank 1 SR-Forvaltning AS. This portfolio was realised in 2009 and the majority of the funds placed as start-up capital for the newly established management company, SpareBank 1 SR-Fondsforvaltning AS. SpareBank 1 SR-Bank placed NOK 129 million in SpareBank 1 SR-Fondsforvaltning, distributed among the new company's three unlisted combination funds. For more information on the Group's investments in shares, see chapter 4.4.

Spread risk, bonds and certificates
In 2009, the Group increased its balance of liquid assets in the form of bonds which qualify for access to borrowing in Norges Bank (liquidity portfolio) by NOK 13.5 billion. NOK 7.7 billion of this figure relates to covered bonds (OMF) utilised in the government's swap arrangement. Of the total reserves on the liquidity portfolio corresponding to NOK 22.5 billion, bonds classified as "held to maturity" total NOK 11.9 billion.

These investments are recognised at amortised cost and are therefore
not exposed to market risk in terms of accounting. The table below provides an overview of the share of the bond portfolio exposed to market risk. The total portfolio amounts to NOK 10.6 billion.

Table 10: Bond portfolio exposed to market risk (NOK million)

Sub portfolio	Fair value
Treasury	**10 503**
- Norwegian government/municipality	6 441
- OMF	788
- Norwegian bank/finance	2 260
- Norwegian industry	149
- Other Norwegian	89
- Foreign bank/finance	781
Trading/sales	**102**
- Norwegian bank/finance	31
- Norwegian industry	71

3.4.6 Operational risk

The level of complexity in society increases in line with new technology, automation of processes and the increase in specialisation within different fields. At the same time, external threats have changed in character from physical attacks on banks to the use of technology for illegal procurement of values and information. Accessibility via stable operations and protection of customer information and data from unwarranted access are therefore high priorities for SpareBank 1 SR-Bank.

The Group has not experienced downtime resulting in significant damage or loss of data in 2009. Good security routines established to safeguard information security and physical security help reduce operational risk. The security routines and contingency plans are deemed as satisfactory for safeguarding sound operations.

Potential criminality which could affect the area of ICT is continuously monitored by the Group. Mass distribution

of malicious code such as Trojans and worms via the Internet appears to represent the greatest threats. This type of Internet malware has seen an increase of approx. 20% in 2009, and all experience indicates that financial institutions and Internet banks are attractive targets. In 2009, SpareBank 1 SR-Bank has not been exposed to ICT crime involving a successful attack on e.g. the Internet banking system.

In the autumn of 2008 and start of 2009, a new type of crime emerged with the theft of point of sale terminals where equipment was fitted to copy the magnetic stripe and PIN code. Manipulated point of sale terminals were fitted in shops and intruders gained unwarranted access to data via the mobile network.

Several of SpareBank 1 SR-Bank's customers fell victim to criminal gangs specialising in observation as PIN codes were entered into point of sale terminals and cash point machines. The banks entered into close cooperation with the police, and this type of incident diminished towards the end of the year.

In 2008 and 2009, the financial industry also uncovered a new type of fraud which impacted both banks and insurance companies. This fraud was based on taking out loans on false premises for house purchases, by utilising fake employment contracts, payroll slips etc.

Experience indicates that operational risk is often a contributory factor to loss within the area of lending. The loss occurs for example as a result of lack of response from the banks to negative incidents among customers. As a result, the banks take action later in the credit security process than they could have done, and the loss is subsequently higher. Another cause could be that security values are erroneously registered. Furthermore, all loss resulting from economic crime related to lending is considered as operational risk. In terms of accounting however, these losses are reported as ordinary loss on lending for banks.

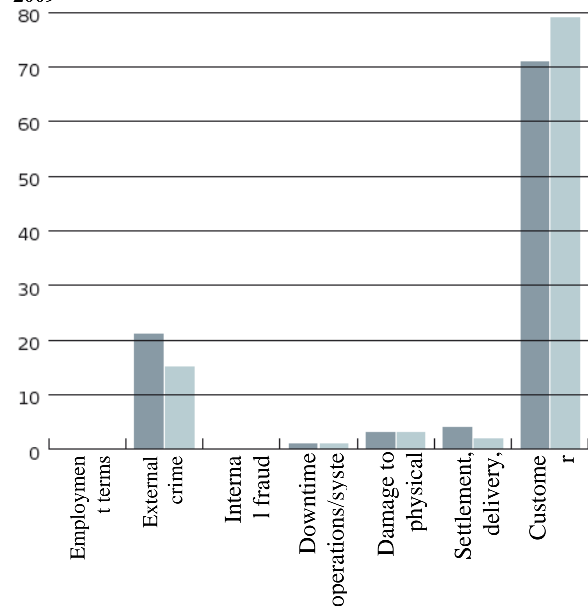
SpareBank 1 SR-Bank evaluates all significant loss from lending in relation to possible operational risk, and attempts thereby to continuously improve on competencies and processes in those areas where loss from operational risk occurs.

Figure 54 illustrates how the Group's reported loss events (excluding the credit area) are distributed according to the different predefined categories as specified in Basel II.

The reported events indicate that the majority take place during customer processes. In order to gain a good overview of cause and effect, the Group categorises all events according to main cause.

Figure 54: Categorisation of reported undesired events 2008 and 2009

Categorisation of reported undesired events 2008 and 2009



All significant undesired events shall be reported on the Group's database for reporting and follow-up of such events. The Group makes continuous efforts to improve its reporting systems and reporting culture in order to encompass as many events as possible.

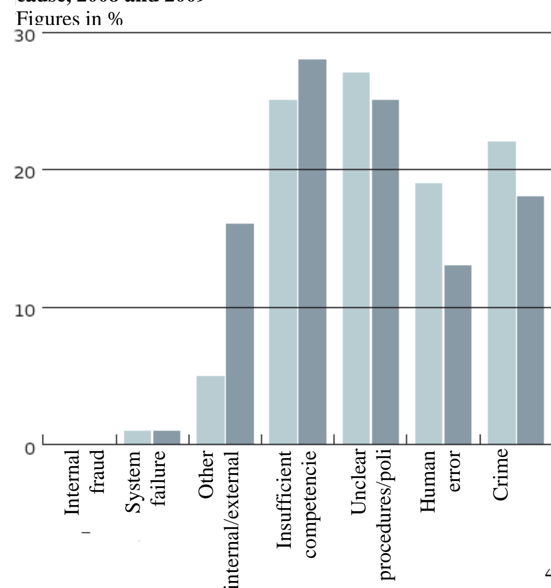
Figure 55 illustrates how the Group's reported events are accordingly distributed.

The figure illustrates that the main causes of undesired events are due to insufficient competencies and poorly defined routines. Other important causes are also human error and external crime. By analysing the causes of loss events, it is possible to target measures in order to improve on quality and reduce the risk of operational errors.

Figure 55: Distribution of reported undesired events according to cause, 2008 and 2009

Distribution of reported undesired events according to cause, 2008 and 2009

Figures in %

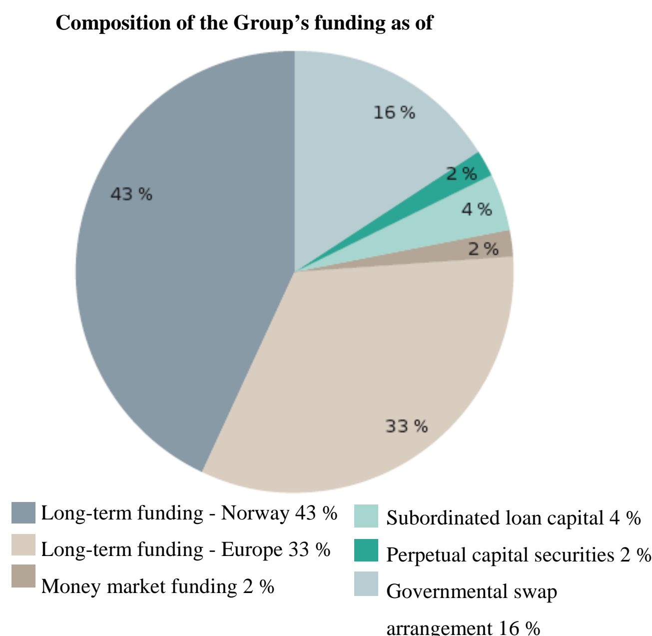


3.4.7 Liquidity risk

From 2008 to 2009, the Group’s security debt saw a reduction of NOK 4.2 billion or 7.4%. Around 75% of the financing business in 2009 was channelled through the government’s swap arrangement. This implies that the funding from national investors has increased since 2008.

The figure below illustrates the dispersion of the Group’s funding as of 31.12.09.

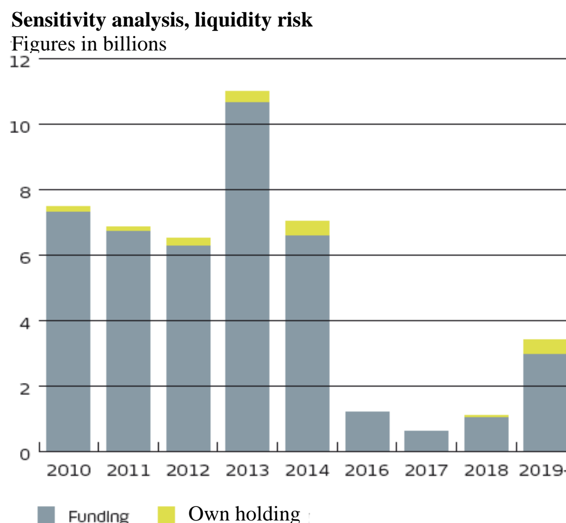
Figure 56: Composition of the Group’s funding as of 31.12.2009



The unrest on the financial markets has also impacted the bank's access to liquidity in 2009. In Norway, the governmental swap arrangement provided improved access to liquidity, thereby reducing the banks' liquidity risk. SpareBank 1 SR-Bank entered into swap agreements and gained liquidity (by swapping covered bonds for government certificates which could be sold in the market) corresponding to NOK 7.4 billion in 2009. The swap arrangement therefore contributed to a satisfactory liquidity for the Group throughout the year. Customer deposits are the most important source of financing for the Group. For the Group as a whole, deposits saw an increase of NOK 1.3 billion from the end of 2008 to the end of 2009. As a result of the transfer of mortgages to SpareBank 1 Boligkreditt of NOK 13 billion, lending for the Group fell by NOK 6.5 billion in the same period. The deposit-loan ratio rose from 53.0% to 58.1% during 2009.

At year-end 2009, the Group had surplus liquidity in the form of deposits in Norges Bank and short-term investments in banks and credit institutions corresponding to NOK 2.2 billion. The Group's buffer capital in the form of liquid assets totals NOK 20.5 billion. During 2010, liabilities corresponding to NOK 8.5 billion are to be refinanced, of which NOK 1.0 billion is an F-loan from Norges Bank. The net refinancing requirement, excluding the F-loan, is thus NOK 7.5 billion. Figure 57 below illustrates the funding portfolio's maturity structure, excluding the F-loan as of 31.12.2009.

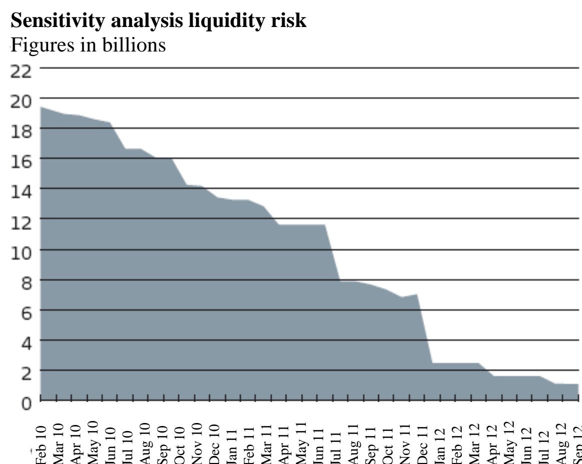
Figure 57: Funding portfolio's maturity structure excluding F-loan as of 31.12.2009



Every month, a sensitivity analysis is performed which measures the Group's capacity to survive a closure of the capital markets. The main purpose of this analysis is to measure liquidity risk in relation to the formulation of goals for liquidity management adopted by the Board of Directors which specifies that the Group, in a normal situation, shall be able to survive for minimum 12 months without external access to liquidity. The analysis is based on a variety of scenarios. In the basic scenario, the growth in net funding requirement is set at zero, i.e. that the ratio between deposits and loans remains constant. Other scenarios project a liquidity situation based on a growth in net funding requirement in accordance with budgeted growth figures or following a 12-month trend growth.

Figure 58 illustrates the basic scenario from the sensitivity analysis as of 31.12.2009:

Figure 58: Sensitivity analysis liquidity risk



In the basic scenario, the growth in net funding requirement is set at zero, i.e. the ratio between deposits and loans remains constant. As the stress test presupposes that access to external liquidity disappears, new loans can only be financed by downpayments from and maturity in existing loan portfolios. In such a situation, the Group secures its liquidity buffer, which is NOK 20.5 billion as of 31.12.2009, a survival capacity of 2 years. The liquidity buffer comprises cash, short-term investments, withdrawal rights in Norges Bank (bonds including covered bonds) and mortgages which are currently ready for transfer to SpareBank 1 Boligkreditt AS.

3.4.8 Ownership risk

Ownership risk varies from company to company, depending upon the type of business with its inherent risk and SpareBank 1 SR-Bank's shareholding.

At year-end 2009, principal ownership risk for SpareBank 1 SR-Bank involves the Group's shareholdings in SpareBank 1 Gruppen (19.5%), BN Bank ASA (23.5%) and SpareBank 1 Næringskreditt (23.5%).

SpareBank 1 Gruppen is owned by SpareBank 1 SR-Bank (19.5%), SpareBank 1 Nord-Norge (19.5%), SpareBank 1 SMN (19.5%), Sparebanken Hedmark (12%), Samarbeidende Sparebanker AS (19.5%) as well as the Norwegian Federation of Trade Unions (LO) and associated trade unions (10%).
possible declines within individual product groups or customer segments over time.
– Training (Tromsø), Payment Services (Trondheim), and Credit Control (Stavanger).

Of the companies owned by SpareBank 1 Gruppen, the shareholding in SpareBank 1 Livsforsikring is considered to carry the highest equity risk. This is primarily due to the fact that the company invests customer assets on the equity and bond markets where yield varies over time.

BN Bank operates in Trondheim, Oslo, Ålesund and Fosnavåg. The bank has 160 employees and a total loan portfolio of NOK 47 billion. The bank is involved in traditional bank operations targeting mortgages for the retail market and commercial properties and shipping on the corporate market. The bank's underlying credit risk principally represents SpareBank 1 SR-Bank's ownership risk.

SpareBank 1 SR-Bank owns 23.5% of SpareBank 1 Næringskreditt AS. SpareBank 1 Næringskreditt's portfolio can only include loans for commercial properties with lease contracts in central locations. The maximum limit for the company's loans is 60% of market value. As of Q4 2009, SpareBank 1 SR-Bank has not transferred loans to the company, but other owners have transferred a total of NOK 8.0 billion to the company. SpareBank 1 SR-Bank has equity risk on this portfolio which corresponds to its shareholding.

SpareBank 1 SR-Bank owns 33.5% of SpareBank 1 Boligkreditt AS. The company is involved in the financing of loans to retail customers who provide

SpareBank 1 Gruppen AS owns 100% of the shares in SpareBank 1 Livsforsikring, SpareBank 1 Skadeforsikring AS, ODIN Forvaltning AS, SpareBank 1 Medlemskort AS and SpareBank 1 Gruppen Finans Holding AS, and 75% of the shares in Argo Securities AS. SpareBank 1 Gruppen Finans Holding AS owns SpareBank 1 Factoring (100%), Actor Fordringsforvaltning (100%), Actor Portefølje (100%) and Actor Verdigjenvinning (100%). SpareBank 1 Gruppen AS also has an interest in SpareBank 1 Utvikling DA.

SpareBank 1 Gruppen also has administrative responsibility for the collaboration processes in the SpareBank 1 Alliance, with particular emphasis on technology, brands, competence, common processes, use of best practice and purchasing. The Alliance also conducts development work at three competence centres

3.4.9 Commercial risk

The analysis of the Group's income and cost structure in relation to economic cycles indicates that volatility for the Group's foreign exchange gain is greatest with equity investments and bonds, income within the area of savings and commission income from estate agency business. A decline in income is partially compensated for by reductions in costs.

For some time now, the Group has developed a highly diversified source of earnings, preventing any impact of

security of up to 75% of the value base for real estate. At the end of 2009, SpareBank 1 SR-Bank had transferred NOK 29.0 billion (EAD) to the company. Ownership risk principally represents the share of the transferred portfolio, and the risk is therefore monitored and reported as credit risk.
For more detailed information, see chapter 3.4.4.

3.4.10 Reputation risk

The results of the reputation survey carried out in 2009 among the general population (retail market), equity certificate holders and employees indicate that the financial industry in general has a poorer reputation in in 2008 than before. SpareBank 1 SR-Bank's reputation however has remained almost unchanged when compared with 2008

An overall assessment shows that the Group makes use of a set of successful tools when monitoring the companys reputation. The companys reputation is deemed as good, providing a comfortable risk situation. A number of minor incidents in 2009 were managed in accordance with guidelines and routines and have not had a negative impact of the companys reputation.

3.4.11 Strategic risk

For the period 2010-2012, the Group has adopted a set of ambitious goals but will continue to maintain a focus on cost and capital development. In 2009, as a result of the financial crisis, the Group placed a focus on consolidation and caution and is therefore very satisfied to confirm that the majority of strategic goals for the year have been met. This indicates that the organisation is adaptable and willing to change, and that it is well equipped for further development in the future.

At the end of 2009, the Group had further strengthened its position in the market with numerous new customers, both retail and corporate, an improvement in savings and investments and a good overview of loss and default.

3.4.12 Compliance risk

The targeted efforts of the EU to fully harmonise the EU/EEA area regulations give rise to a constant flow of new directives and regulations to which SpareBank 1 SR-Bank must adapt.

The most significant areas for follow-up over the past years have been related to:

- Investment service business and the MiFID regulation
- Implementation of a new money laundering act
- The purpose of the MiFID regulation is to provide optimal protection for investors in relation to investments. The Group has a target to ensure that its investment services at all times meet these requirements, benefiting both customers and the Group. The Group's approval committee, established to ensure a wide ranging assessment of all genuine aspects of product development and implementation of new products, is an important measure for the reduction of risk of failure to comply with legislations and regulations related to savings, investments and investment services.The Money Laundering Act is an important legislation for protecting companies against fraud and economic crime. The fight against money laundering and financing of terrorism takes top priority both at home and abroad. The new requirements mainly involve a strengthening of customer control in terms of both scope and intensity. The Group's implementation of the new Money Laundering Act, internal training and a new structure for routines and guidelines are all examples of measures taken to ensure the highest level of compliance. The consequences of failure to comply may be fines, loss of licences, termination of cooperation with correspondent banks and negative reputation

3.5 Financial projections of economic setbacks/stress test

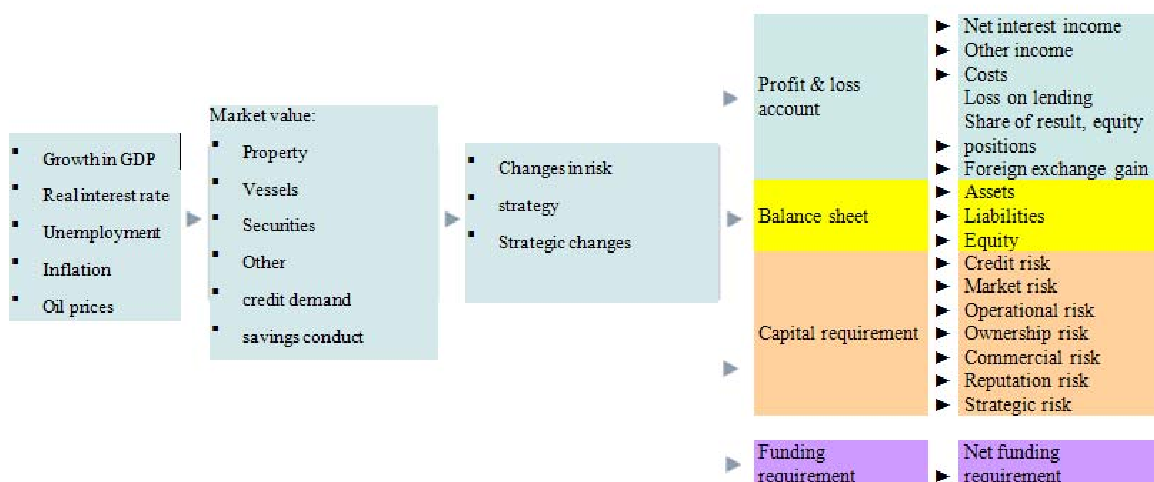
The purpose of a financial projection of an economic downturn is as follows:

- To assess potential losses in different scenarios including major/extreme but plausible shock.
- To assess the vulnerability of portfolios/activities in the event of major/extreme but plausible shock.
- To increase understanding of how shock affects the Group's profitability, liquidity and capital adequacy.
- To assess the potential losses based on different strategic possibilities.
- To identify weaknesses in the Group's risk strategies and processes in order to aid the development of measures to reduce risk and the planning of emergency preparedness.

The projections have a time horizon of 5 years and therefore cover a projected economic cycle.

In order to assess the consequences of an economic downturn for SpareBank 1 SR-Bank, the Group places a considerable focus on those areas of the economy which have an impact on financial development. These are primarily the development in demand for credit, the equity market, interest rate market and the development in credit risk. Not only will a serious economic downturn have an effect on the return from underlying assets, it will also impact the way in which customers save money.

Figure 59: The main elements of the Group's stress test model



3.5.1 Method description

SpareBank 1 SR-Bank's process for stress tests comprises 4 stages: (1) choice of stress test scenario, (2) impact of market values, credit demand and savings conduct, (3) changes in strategy or risk policy and (4) evaluation of results.

The main elements of the stress test process can be described as illustrated in figure 59 below.

Stage 1 involves the selection of a stress test scenario. Important input to the scenario includes growth in GDP, real interest rate, unemployment, inflation and oil prices.

Stage 2 involves an evaluation of how the scenario is expected to impact on market values for the groups of objects in which the Group has security from the customers in connection with loans. The Group also carries out an evaluation of the projected effect on credit demand and savings rate in Norway.

Stage 3 involves the incorporation of any planned changes to risk strategy for the Group. This may for example be planned changes in risk profile for loans resulting from changes in cyclical trends. The Group also evaluates the impact of any changes in its strategic goals.

Scenarios with related assumptions are presented to the Board of Directors for discussion and approval.
Stage 4 involves the calculations of the effect of stages 1-3 on:

- The profit & loss account including financial key figures such as return on equity, margins, deposit-to-loan ratio and capital adequacy.
- The balance sheet, such as lending volume, liabilities and equity. A third central element is the development in capital requirement for the different risk groups.
- Capital requirement for regulatory capital (credit, market and operational risk) and for risk adjusted capital (all significant types of risk).
- Funding requirement.

On the basis of the results from the financial projections of a severe economic downturn/stress test, measures are implemented as required. Over the past 5 to 10 years, SpareBank 1 SR-Bank has made considerable investments in resources aimed at making risk management more professional. Major areas for improvement have been:

- Preparation of models and systems for the management of total risk.
- Effective processes for the identification and management of operational risk in the processes and learning continuously from undesired incidents.
- New credit process:

  - Implementation of credit models and analyses which provide a more thorough and more independent risk assessment than before.
  - Use of price models for correct pricing of risk.
  - Extensive use of terms (covenants) in loan agreements which ensure early action for the bank and the power to act if a customer is heading for difficulties.
  - A change of main focus from security cover to probability of default when granting credit.
  - Improvement in efficiency of default follow-up process.
  - System for management of total portfolio, early warning system for early identification of problematic commitments and system for monitoring process of granting credit.
- Development of competencies throughout the organisation related to understanding of credit, focus on quality and general risk management.
  - Development of an independent competencies unit for risk management.
  - Development of a separate unit for credit analysis and credit assurance.

The above-mentioned measures have a considerable effect on the current risk assessments and decision making for the Group. Over time, these measures reduce the long-term outcome of default and loss when compared with historic outcomes.

The chapter below provides information on individual results of a financial projection of a severe economic downturn/stress test.

3.5.2 Description of the stress test scenario

For the stress test on credit and market risk, the Group decided to take its starting point in the stress test alternative for the period from 2010 to 2012 as presented in the Norges Bank report regarding Financial Stability 2/09. The projection carried out by Norges bank covers three years, while SpareBank 1 SR-Bank's stress test scenarios have a duration of five years. The Group has therefore decided to project the scenario by a further two years (2013 and 2014) based on its own assessment.

In the verbal analysis below, it is emphasised that the main lines from the Financial Stability report are followed, but that individual factors and argumentation sequences are compiled by SpareBank 1 SR-Bank.

Table 11 below provides the values of the macro variables as defined in Financial Stability for the years 2010-2012 and SpareBank 1 SR-Bank's own values for the years 2013 and 2014.

Table 11: Development in macro variables 2010 to 2014

Norges Banks' stress alternative (2010-2012)						
Macro variables	**2009**	**2010**	**2011**	**2012**	**2013***	**2014***
Nationwide uemployment	2,75%	3,25%	4,00%	4,50%	4,20%	4,00%
Inflation	2,00%	1,75%	1,50%	1,00%	1,20%	1,50%
GDB growth maniland Norway	-1,25%	0,00%	0,75%	1,50%	2,00%	2,50%
Banks interest rates on loans	4,50%	4,25%	5,00%	6,00%	4,50%	4,50%
Housing prices	2,50	0,75%	-9,00%	-9,00%	2,50%	5,00%
Oil prises in USD	54	40	42	50	55	55

* Norges Bank stress alternative deals with the years 2010-2012. The figures for the two subsequent years 2013-2014 are prepared by SpareBank 1 SR-Bank.

The scenario involves an assumption of international decline in growth outlook. Unemployment in Europe is very high, resulting in a significant decline in global demand. The international key interest rate is low and there are very few monetary policy aids remaining which could stimulate growth. The crisis which has hit central government finances in several European countries forces these countries to limit financial incentives such as crisis packages and the like.

Norway has a sector which is exposed to competition and relies on global market conditions. The decline in levels of activity over time results in lower production and unemployment in this sector. The Norwegian krone will be weakened by the low oil prices, and confidence in the Norwegian economy will be impaired. In itself, the depreciation of the Norwegian krone will have a positive impact on exports, but this cannot counterbalance the fall in demand.

Inflation sees a decline as early as 2010 and the growth in prices is weak throughout the entire period. The money market interest rates are expected to remain relatively low during the period, hitting bottom in 2010. Taking into consideration the inflation figures, the real interest rate will also remain low during the entire period.

A low rate of growth and demand also results in a decline in international prices for raw materials and the oil price is expected to reach its lowest level in 2010. The prices will remain low until 2013 and 2014, when it will begin to increase. Oil prices are at their lowest point, half of current levels and expected development. The low oil prices may result in the postponement or cancellation of a number of projects and applications for development projects due to the uncertainty regarding future energy prices, poor profitability, financing problems and high costs.

Unemployment in Norway is expected to increase over the years leading up to 2012. From 2013, unemployment will remain low but a minor positive development is expected. Households will have a low growth in disposable income. Retail consumption sees a reduction due to unemployment and expectations of a decline in the country's economic development. The level of investment activity is practically non-existent and prices for houses and commercial properties etc. are expected to see a considerable drop.

Furthermore, prices for houses and commercial properties are expected to increase once more from the end of 2012 when economic activities recover and the future outlook is somewhat more optimistic and there is a fall in unemployment.

In table 12 below, SpareBank 1 SR-Bank has carried out their own projections of variables which are not directly expressed in the Financial Stability report scenario or to encompass specific geographical factors.

Table 12: Values for additional variables utilised in SpareBank 1 SR-Bank's model

SpareBank 1 SR-Bank's extended stress alternative						
Macro variables	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Unemployment Rogaland	1,73 %	2,75 %	3,50 %	4,00 %	3,50 %	3,00 %
Price development in commercial properties	n/a	-5 %	-13,50 %	-13,50 %	-5,00 %	0,00 %
Price development in other security objects	n/a	-5 %	-13,50 %	-13,50 %	-5,00 %	0,00 %
Development on Oslo Stock Exchange	60,00 %	-20,00 %	-15,00 %	5,00 %	20,00 %	30,00 %

It is expected that unemployment in Rogaland will be somewhat lower than the rest of the country throughout the period. This assumption is based on historical figures which indicate that unemployment in Rogaland on the whole has been lower than the national average. Unemployment in Rogaland is at a relatively high level throughout the period, with a peak of 4.0% in 2012 compared with 4.5% on a nationwide scale.

The weak development in economy will also result in a decline in the market value of commercial properties and other objects provided as security, falling by just under 40% throughout the period.

Credit demand will be lower as a result of the fall in activities and the banks will introduce a more restrictive practice for loans. The scenario also assumes a stable volume of lending for the period.

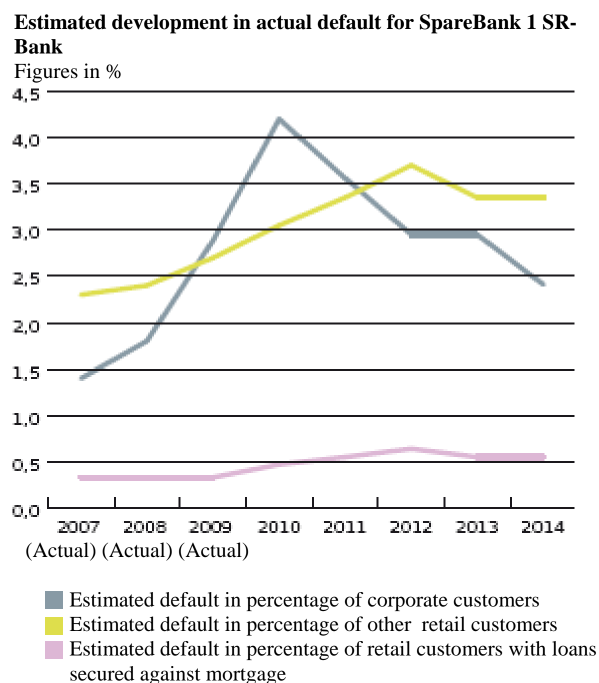
A fall in demand for goods and services will lead to lower results for Norwegian companies. This, in combination with a relatively sombre market outlook internationally, a lower oil price and an increase in unemployment, will contribute towards a significant fall in the values on the Oslo Stock Exchange (OSEBX) in 2010 and 2011. The Stock Exchange is expected to fall to 180-190 points before recovering in 2012. History has shown that the Stock Exchange tends to recover slightly before the real economy. The scenario also assumes a relatively low development in the values on the Oslo Stock Exchange in 2012, followed by an increase in 2013 and 2014.

3.5.3 Results of projections/stress test

Credit risk

Figure 60 illustrates the expected development in actual default for the stress scenario. Actual default is the number of customers which are in default or have defaulted over a 12-month period. A full definition of default is provided in chapter 3.3.1.2.

Figure 60: Estimated development in actual default for SpareBank 1 SR-Bank



In other words, customers with minor loans are allocated less weight than customers with major loans. Customers with minor loans are historically over-represented in default statistics.

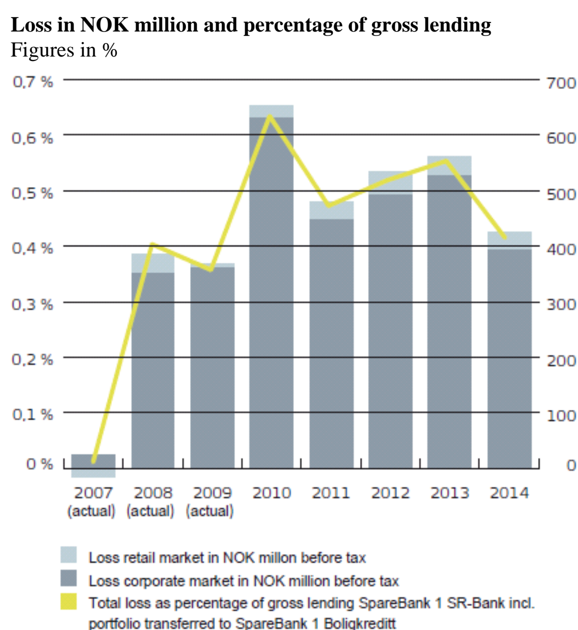
Figure 60 illustrates that default for corporate customers will increase from 2.9% in 2009 to 4.2% in 2010, then will subsequently see a slight reduction. By comparison, default in 2007 was 1.4% and 1.8% in 2008.

Default for retail customers with loans secured against property will increase from 0.3% in 2009 to 0.6% in 2012

then will subsequently see a slight reduction. By comparison, default in 2007 and 2008 was 0.3%. For other retail customers, default will increase from 2.7% to 3.7% in 2012 then see a minor fall again. By comparison, default in 2007 was 1.4% and 1.8% in 2008.

Figure 61 below illustrates that an economic downturn/stress test as described above would result in a forecast increase in the Group's loss on default from NOK 368 million (0.31% of gross lending incl. portfolio transferred to SpareBank 1 Boligkreditt AS) in 2009 to NOK 653 million (0.55% of gross lending incl. portfolio transferred to SpareBank 1 Boligkreditt AS) in 2010, followed by a reduction to more normalised loss in 2014. The Group underlines that these calculations are uncertain as loss on individual customers may have an unsystematic effect on losses during an economic downturn.

Figure 61: Stress test credit risk lending



The main share of loss occurs on the corporate market. The percentage of loss has a relatively even distribution over different branches, but is somewhat higher within the branches for commercial buildings and building/construction. Loss for corporate customers in relation to lending to corporate customers increases from 0.76% in 2009 to 1.33% in 2010, then sees a slight reduction. The actual loss from corporate customers was 0.07% in 2007 and 0.73% in 2008.

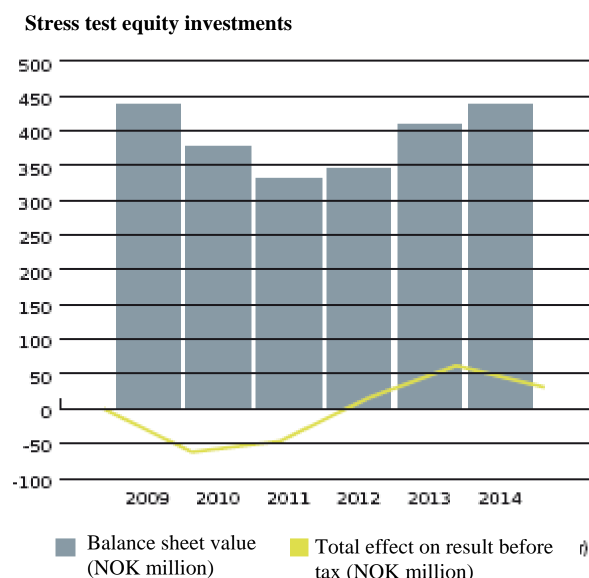
Loss on the retail market is low throughout the period but reaches a peak in 2012. Loss for retail customers in relation to lending to retail customers (including portfolio transferred to SpareBank 1 Boligkreditt AS) increases from 0.01% in 2009 to 0.06% in 2012, followed by a minor decline. Actual loss on retail customers totalled -0.03% in 2007 and 0.05% in 2008.
The low rate of losses in the retail customer market throughout the period reflects the Group's solid portfolio which in the main comprises loans secured against property. At year-end 2009, 93% of exposure at default is secured by 75% of the market value of real estate. The market values for houses in the Financial Stability report scenario are estimated to fall by 17.2% during the period.

When calculating the losses in the retail market, an assumption is made that any defaulted loans on the SpareBank 1 Boligkreditt AS portfolio which were previously transferred from SpareBank 1 SR-Bank will be retrieved in order to follow-up on default and to recognise any loss for the bank. The losses on retrieved loans from SpareBank 1 Boligkreditt AS are marginal.

For a more detailed description of the portfolio quality, see chapter 3.4.4.

Market risk
Figure 62 illustrates that a financial projection of a severe economic downturn as described above will result in a loss for the Group of NOK 109 million during the first two years of the stress test period. This stress test alternative assumes that there are no realisations or reinvestment during the 5-year period. Equity investments which at the start of 2010 were valued at NOK 439 million will therefore be valued at NOK 330 million at the end of 2011. The Stock Exchange boost from 2013 to 2014 will help the Group recover its lost values. In the period from 2012 to 2014, the value of the equity investments will increase to NOK 439 million, a rise of NOK 109 million since the bottom level in 2011.

Figure 62: Stress test equity investments



4 PILLAR III. DETAILED INFORMATION ON REGULATORY CAPITAL ADEQUACY

4.1 Consolidation

Table 13: Consolidation basis (figures in NOK 1,000)

Subsidiary	No. shares	Book value	Voting right	Consolidation method
Companies which are wholly consolidated				
SpareBank 1 SR-Finans AS	334 000	337 233	100 %	Acquisition method
EiendomsMegler 1 SR-Eiendom AS	150	18 120	100 %	Acquisition method
Westbroker Finans AS	100	-	100 %	Acquisition method
SR-Investering AS	3 500	161 847	100 %	Acquisition method
SR-Forvaltning ASA	6 000	29 019	100 %	Acquisition method
SR-Forretningsservice AS	1 000	125	100 %	Acquisition method
Vågen Eiendomsforvaltning AS	5 000	19 639	100 %	Acquisition method
SpareBank 1 SR-Fondsforvaltning ASA	10 000	8 036	100 %	Acquisition method
Total		**574 019**		

Consolidation method is equal for accounting purposes and capital adequacy purposes

Investments in associated companies
Investments in associated companies are recognised according to the equity method for the Group and according to the acquisition method for the parent bank. Investments are recognised in the same way as for capital adequacy, with the exception of the Group's investments of 33.77% in SpareBank 1 Boligkreditt AS and 23.5% in SpareBank 1 Næringskreditt AS. Proportionate consolidation is utilised for the Group's capital adequacy.

Investments in joint ventures
The Group has a shareholding of 19.5% in SpareBank 1 Gruppen AS and 23.5 % in BN Bank ASA. These investments are recognised according to the equity method. For the Group, the book value of the investment in SpareBank 1 Gruppen is deducted from subordinated loan capital and in the calculation basis for capital adequacy. In relation to the investment in BN Bank ASA, proportionate consolidation is applied to the Group's capital adequacy. Investments in SpareBank 1 SR-Bank parent bank are recognised according to the acquisition method. The share of the investment in SpareBank 1 Gruppen AS' book value which exceeds 2% of SpareBank 1 Gruppen AS' subordinated loan capital is deducted from subordinated loan capital and the calculation basis

Table 14: Subordinated loan capital in other financial institutions

Figures in NOK million	Book value
SR-Pension fund	35
Other financial institutions	6
Total	**41**

SpareBank 1 SR-Bank places an emphasis on maintaining satisfactory capitalisation at all times for all business units within the Group. The Group's control 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. Neither are there any articles of association which impose such limitations.

For the same reason, the bank and its subsidiaries do not enter into agreements which impose limitations on the Board of Directors' capacity to transfer capital as mentioned above. This applies to funding agreements and agreements with suppliers and customers.

Based on the above, the Board of Directors has an unlimited authorisation to transfer capital between the different business units in the parent bank. 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 with investments in subsidiaries, the Group has a strategic interest

in supporting the activities of SpareBank 1 Boligkreditt AS and SpareBank 1 Gruppen AS. In this context, the Group avoids entering into agreements or adopting measures and the like which imply a limitation on the owner banks' capacity to transfer capital to these companies, should this be necessary to generate satisfactory capital adequacy/solidity. The Group is not aware of any such limitations 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 has based the Group's own risk profile on this assumption. The Group is not aware of any retail-law limitations which restrict payment of dividends from these companies.

4.2 Subordinated loan capital

Table 15: Subordinated loan capital, including core capital and supplementary capital and actual supplements, deductions and limitations as of 31.12.2009

Group (NOK million)	2009	2008
Equity certificate capital	3 023	1 872
- Own equity certificates	-9	-7
Share premium reserve	458	92
Equalisation fund	759	838
Provision for dividends	212	75
Savings bank`s reserve	2 241	2 066
Compensation fund	20	-
Endowment fund	240	122
Fund for unrealised gain	127	69
Other equity	1 002	827
Total equity carried on balance sheet	**8 073**	**5 954**
Deferred tax, goodwill and other intangible assets	-42	-23
Fund for unrealised gains, held for sale	-1	-1
Deduction for dividend provision	-212	-75
50% of subordinated loan capital in other financial institutions	-17	-17
50% of expected loss IRB deduction provision for loss	-337	-188
50% capital adequacy reserve	-552	-547
Share of non-performing non amortised estimate deviations	-	38
Perpetual capital security 1)	1 218	526
Total core capital	**8 130**	**5 667**
Supplementary capital in addition to core capital		
Perpetual subordinated loan capital 1)	760	872
Time-limited subordinated loan capital 1)	2 045	2 834
50% of subordinated loan capital in other financial institutions	-17	-17
50% of expected loss IRB deduction provision for loss	-337	-188
50% capital adequacy reserve	-552	-547
Total supplementary capital	**1 899**	**2 954**
Net subordinated loan capital	**10 029**	**8 621**
1) Terms and conditions stipulated in table "Subordinated loan capital and perpetual capital security"		
Minimum requirement subordinated loan capital	**2009**	**2008**
Credit risk (see table 31)	5 864	5 700
Market risk (see table 37)	319	378
Operational risk (see table 38)	320	306
Capital requirement related to transitional schemes	264	657
Minimum requirement subordinated loan capital	**6 767**	**7 041**
Capital adequacy	**11.86 %**	**9.80 %**
Of which core capital	9.61 %	6.44 %
Of which supplementary capital	2.26 %	3.37 %

Time-limited subordinated loan capital sees a reduction in equity value of 20% every year over the last 5 years before maturity. To the extent that the Group has subordinated loan capital in other financial institutions, this is directly deducted from the Group's own subordinated loan capital for the share which exceeds 2% of the recipient financial institution's subordinated loan capital.

If the Group has subordinated loan capital in other financial institutions which constitutes less than 2% of the individual financial institution's subordinated loan capital, the total amount of such capital is deducted from the Group's subordinated loan capital for the share which exceeds 10% of the Group's subordinated loan capital. If the Group is obliged to have 100% capital adequacy reserve for specific assets, a figure corresponding to the asset's book value shall be deducted from the subordinated loan capital and the calculation basis. The calculation basis is evaluated in relation to risk.

Table 16: Subordinated loan capital & perpetual capital security

Principal	**Terms**	**Maturity**	**First instalment**	**2009**	**2008**
Time-limited					
EUR 65	3 month Libor + margin	2014	2009	-	641
JPY 13 000	3 month Libor + margin	2035	2012	853	1 067
NOK 450	3 month Nibor + margin	2017	2012	450	450
NOK 500	3 month Nibor + margin	2018	2013	499	499
Total time-limited				**1 802**	**2 657**
Perpetual:					
USD 75	3 month Libor + margin			429	522
SEK 200	3 month Stibor + margin			173	196
NOK 170	3 month Nibor + margin			170	170
Total perpetual				**772**	**888**
Perpetual capital security:					
USD 75	3 month Libor + margin			493	625
NOK 684	3 month Nibor + margin			669	-
NOK 116	3 month Nibor + margin			113	-
Total perpetual capital security				**1 275**	**625**
Accrued interest				**22**	**32**
Total subordinated loan capital				**3 871**	**4 202**

Subordinated loan capital and perpetual capital security against foreign currency are included in the Group's total currency position such that there is no currency risk related to the loans. Of total NOK 3,871 million in subordinated loan capital, a figure of NOK 1,218 million is core capital, NOK 760 million is perpetual subordinated loan capital and NOK 1,763 million is time-limited subordinated loan capital. Capitalised costs for taking out loans are reflected in the calculation of amortised cost. The maximum limit for perpetual capital security is 15% of total core capital. Any excess amounts are deemed to be perpetual subordinated loan capital.

Financial institutions included in consolidations

Table 17: Capital requirement, net subordinated loan capital and capital adequacy for the individual consolidated companies

Figures in NOK 1,000	Capital requirement	Net subordinated loan capital	Capital adequacy as percentage
SpareBank 1 SR-Finans AS	345 745	470 000	10,88
SpareBank 1 Boligkreditt AS	2 642 890	3 616 147	10,95
BN Bank ASA	2 549 793	4225 005	13,26
SpareBank 1 Næringskreditt AS	562 182	730 103	10,39

SpareBank 1 Boligkreditt AS utilises the IRB method when reporting capital adequacy. The other companies make use of the standard method when reporting capital adequacy

4.3 Credit risk - general information on credit risk, default and impairment

4.3.1 Portfolio information based on regulatory estimations

The tables below present a summary of the bank's positions in relation to credit risk.

Table 18: Total size of commitment, defined as gross lending to customers + guarantees + unutilised credit in the Group, after any write-downs and without consideration for any securities provided and the average size of the commitments during the period, according to type of commitment.

Figures in NOK million	Size of commitment as of 31.12.09	Average size of commitment in 2009
Corporate market	60 018	60 724
Retail market	50 773	54 245
Gross commitment customers	**110 791**	**114 969**
Individual write-downs	-329	-337
Write-downs of groups of loans	-320	-275
Write-down guarantees	-8	-6
Net commitment customers	**110 134**	**114 352**
Governments (Norges Bank]	541	3 643
Institutions	1 301	1 359
Total size of commitment	**111 976**	**119 353**

Table 19: Size of commitment for every type of commitment divided into significant geographical areas before deduction for write-downs

Figures in NOK million	Rogaland	Agder counties	Hordaland	Other	Total
Gross lending to customers	70 526	8 724	7 265	6 958	93 473
Unutilised credit	8 355	1 037	870	803	11 065
Guarantees	4 663	371	521	698	6 253
Total gross commitment customers	**83 544**	**10 132**	**8 656**	**8 459**	**110 791**

Table 20: Size of commitment for every type of commitment divided into significant branches before deduction for write-downs

Figures in NOK million	Loans	Unutilised credit	Guarantees	Total
Agriculture/forestry	3 139	596	9	3 744
Fishing/aquaculture	607	29	106	742
Mining/extraction	2 178	46	341	2 565
Industry	2 970	1 000	831	4 801
Power and water supply/building and construction	2 315	708	1 861	4 884
Commodities, hotel and restaurants	2 856	582	288	3 726
International shipping, pipe transport, other transport	5 667	26	1 165	6 858
Property management	21 622	1 826	627	24 075
Services	5 535	960	470	6 965
Public administration and financial services	460	693	505	1 658
Not allocated (added value fixed interest loans)	277	-277	-	-
Total corporate market	47 626	6 189	6 203	60 018
Retail market	45 847	4 876	50	50 773
Total gross commitment customers	**93 473**	**11 065**	**6 253**	**110 791**

Table 21: Size of commitment for each type of commitment according to remaining maturity

Figures in NOK million	On request	<1 year	1-5 years	over 5 years	Total
Gross loans to customers	34 432	2 368	10 579	46 094	93 473
Unutilised credit	11 065				11 065
Guarantees		521	569	5 163	6 253
Total gross commitment customers	**45 497**	**2 889**	**11 148**	**51 257**	**110 791**
Governments (Norges Bank)	541				541
Institutions	1 301				1 301

Table 22: Credit and impairment risk according to significant branches

	Total size of commitment			
Figures in NOK million	**Commitments with impairment**	**Overdue commitments**	**Value change and write-downs**	**Value changes recognised during the period**
Agriculture/forestry	3	7	7	4
Fishing/aquaculture	3	-	1	-
Mining/extraction	-	-	-	-
Industry	57	22	15	75
Power and water supply/building and construction	23	19	20	4
Commodities, hotel and restaurants	32	13	14	28
International shipping, pipe transport, other transport	76	3	43	46
Property management	374	172	96	90
Services	88	29	91	22
Public administration and financial services	-	-	-	-
Total corporate market	**656**	**265**	**287**	**269**
Transferred from write-down of groups of loans				91
Retail market	97	130	50	8
Total	**753**	**395**	**337**	**368**

Table 23: Actual loss per default class for the period

Figures in NOK million	2009	2008	2007
A (0.00-0,10 %)	-	-	-
B (0.10-0,25 %)	-	-	-
C (0.25-0,50 %)	-	-	-
D (0.50-0,75 %)	-	-	-
E (0.75-1,25 %)	-	-	-
F (1.25-2,50 %)	-	-	-
G (2.50-5,00 %)	-	-	-
H (5.00-10,00 %)	-	-	-
I (10.00-)	-	-	-
J	-	-	-
K	368	386	10
Total	**368**	**386**	**10**

Table 24: Separate specification of the total size of commitment with impairment and defaulted commitments according to significant geographical area, including total changes in value and write-downs

	Total size of commitment		
Figures in NOK million	Commitments with impairment	Defaulted commitment	**Total value changes and write-downs**
Rogaland	306	308	228
Agder-counties	192	37	66
Hordaland	249	35	34
Other	6	15	9
Total	**753**	**395**	**337**

Table 25: Reconciliation of changes in value changes and write-downs respectively for commitments with impairment

Figures in NOK million	**Opening balance as of 1.1.09**	**Figure recognised for write-downs**	**Provisions for or reversals from estimated loss**	**Closing balance as of 31.12.2009**
Individual write-downs	345	353	337	329
Write-downs of groups of loans	229	-	91	320
Specific loss provisions for guarantees	4	-	4	8
Total	**578**	**353**	**432**	**657**

Table 26: Distribution according to risk class based on the IRB-method

Figures in NOK million	**Default class**	**Total EAD**	**Total unutilised facility**	**Average risk weight**	**Average loss given default**	**Average conversion factor**
Corporate	A	219	37	0.26	0.45	0.99
	B	907	310	0.47	0.45	0.91
	C	3 204	1 225	0.58	0.45	0.89
	D	3 949	681	0.66	0.45	0.95
	E	9 314	1 986	0.76	0.45	0.93
	F	10 821	1 325	0.98	0.45	0.96
	G	11 143	1 295	1.19	0.45	0.96
	H	3 400	341	1.44	0.45	0.97
	I	2 860	202	2.10	0.45	0.98
	J	126	10	0.00	0.45	0.98
	K	661	30	0.00	0.45	0.99
Total corporate		**46 603**	**7 443**			
Retailmarket	A	11 427	3 053	0.02	0.10	1.00
	B	19 023	2 058	0.06	0.11	1.00
	C	21 496	1 689	0.10	0.11	1.00
	D	12 498	769	0.13	0.12	1.00
	E	9 731	460	0.17	0.12	1.00
	F	3 738	137	0.26	0.13	1.00
	G	959	43	0.35	0.13	1.00
	H	978	26	0.54	0.14	1.00
	I	689	12	0.79	0.15	1.00
	J	65	0	0.12	0.14	1.00
	K	173	0	0.61	0.24	1.00
Total retail market		**80 777**	**8 247**			

A commitment is deemed as defaulted if a claim is overdue by more than90 days and the amount exceeds NOK 1,000, or when the bank has reason to believe that it is probable that the debtor does not have the capacity to repay in accordance with the commitment. The table below illustrates the average estimated and actual default for the portfolio from 2007 to 2009. The percentage of default is defined as the total number of customers which are, or which have been in default within a 12 month period, in relation to the total number of customers on the portfolio. This implies that a customer in default with a small commitment carries as much weight as a customer in default with a large commitment.

Table 27: Level of default

Portfolio	Estimated default	Actual default
RetailRetail market with securities against property	0,90%	0,35%
Other retail market	3,43%	2,33%
Portfolio	3,09%	2,12%

Table 27 shows that the level of default is significantly over-estimated, both for the retail market and for the corporate market. SpareBank 1 SR-Bank expects that a long-term outcome (median) will most probably be in the interval from 0.6% to 0.7% for the retail market providing security against property, and in the interval from 3.0% to 4.0% for the rest of the retail market. For the corporate market, SpareBank 1 SR-Bank expects that the long-term outcome (median) will most probably be between 2.0 and 2.5%. SpareBank 1 SR-Bank is in discussions with the Financial Supervisory Authority of Norway regarding the recalibration of the models to a somewhat lower level which is more concordant with long-term outcome (median).

Table 28 illustrates estimated and actual loss given default for defaulted loans in SpareBank 1 SR-Bank. The regulation concerning capital requirement stipulates that the estimated loss given default shall represent an economic downturn. The estimated loss given default of 10% for the retail market with security against property is the statutory minimum level, while an estimated loss given default of 45% for the corporate market has been stipulated by the authorities in the Regulation concerning capital requirement. The period for loss data covers 2000 to 2009 for the retail market with security against property and the remainder of the retail market, while for the corporate market, the loss data covers 2004 to 2009. As validation of loss given default requires a certain period for clarification, the results from the previous year's validation will contain the best estimate of loss for defaulted and non settled commitments. Both data sets principally contain realisations made during positive periods, which can mainly explain the difference between estimated and actual loss given default

Table 28: Loss given default for defaulted loans

Portfolio	Estimated loss given default	Actual loss given default
Retail market with security against property	10,00%	3,30%
Other retail market	50,00%	31,20%
Corporate market	45,00%	19,50%

Table 29: Total size of commitment and share secured against property, according to commitment category (IRB).

Commitment category		Size of commitment	Of which secured against property 1)
RetailRetail market	Commitments secured against property	73 956	95%
	Retail market SMB	4 057	85%
	Other retail market commitments	2 780	2% 8)
Total		**80 793**	

1) The share is the total commitment with such securities in relation to total commitment for prevailing commitment category.

2) A commitment with a retail market customer where the realisation value of the house is valued at lower than 30% of the customer's commitment is not categorised as a commitment secured against property, but as other retail market. SpareBank 1 SR-Bank has no securities which imply a reduced size of commitment. For the corporate market, securities are not taken into consideration in the calculation of LGD. Instead, the LGD factors stipulated by the authorities are applied. Consequently, there is no list of such commitments in the table above

Table 30: The actual value changes for individual commitment categories and development from previous periods (IRB)

Figures in NOK million		Commitment	Commitment EAD	Minimum requirement for subordinated loan capital Consolidated
Corporate market	Specialised enterprise	26 515	25 410	2 045
	Other enterprises	23 665	22 097	1 755
Retail market	Retail market SMB	4 057	4 053	33
	Retail market persons	73 956	73 948	614
	Retail market other	2 780	2 776	93
Minimum requirement, credit risk IRB		**130 973**	**128 284**	**4 540**
Governments		1 406		4
Institutions		7 131		93
Corporate market		1 854		98
Retail market		621		17
Consolidated companies		16 702		984
Other assets		3 188		216
Minimum requirement standard method		**30 902**		**1 412**
Intangible assets				3
Deduction				-91
Total minimum requirement for subordinated loan capital connected to credit risk				**5 864**

4.4 Market risk

4.4.1 Portfolio information

Table 32: Investments (equity position outside of the trading portfolio) according to objective

Figures in NOK million	Investments	Amount
Financial investments at fair value over result	Austevoll Seafood	3
	Kverneland	-
	Sparebanken Vest	1
	Borea Opportunity II	7
	Marin Vekst II	2
	Oslo Stock Exchange VPS Holding	2
	Progressus	9
	Sandnes Investering	-
	Viking Fotball	4
	Viking Venture II	2
	Hitec Vision RetailEquity IV LP	24
	OptiMarin	12
	RPT Gass	8
	Other financial investments	26
Total financial investments at fair value over result		101
Strategic investments at fair value over result	Nordito	151
Strategic investments held for sale	Other strategic investments	2
Total		**254**

Shares and units are classified either as fair value over result or held for sale. Change in fair value from opening balance sheet is recognised as income from financial investments.

Table 33: Overview of book value and fair value, gain and loss

Figures in NOK million	**Book value**	**Fair value**	**Total realised gain or loss in 2009**	**Unrealised gain or loss in 2009**	**Figure included in core capital or supplementary capital**
Financial investments at fair value over result	101	101	-2	-4	-
Strategic investments at fair value over result	151	151	2	59	-
Strategic investments held for sale	2	5	2	0	1
Total	254	254	-2	55	1

Table 34: Overview of type and value of listed shares, unlisted shares in diversified portfolios and other commitments

Figures in NOK million	**Value 2009**	**Value 2008**
Unlisted	248	197
Traded on stock exchange	4	9
Other	2	2
Total	**254**	**209**

Table 35: Overview of counterpart risk for derivatives etc. outside of the trading portfolio

Figures in NOK million	**Nominal value**	**Fair value**	**Size of commitment**	**Minimum requirement for subordinated loan capital 1)**
Currency forwards	3 813	80	96	3
Currency swaps	9 029	231	206	10
Currency options	-	-		
Currency instruments on the trading portfolio	**12 842**	**311**	**302**	**13**
Interest rate swaps	93 032	543	748	
Non-standardised contracts	-	-	-	-
Interest rate instruments on the trading portfolio	**93 032**	**543**	**748**	**29**
Interest rate swaps	19 780	1 073	161	19
Interest rate instruments outside of the trading portfolio	**19 780**	**1 073**	**161**	**19**
Credit derivatives				
Credit derivatives	-	-	-	-
Accrued interest			365	20
Total	**125 654**	**1 927**	**1 211**	**61**

1] Minimum requirement for subordinated loan capital is calculated in whole according to the standard method.

Table 36: The sensitivity of net interest cost before tax (interest rate change of 1 percentage point) at year-end 2009 (figures in NOK million)

Sensitivity of net interest cost	31.12.09
Currency	
NOK	14
EUR	-
USD	-
CHF	-2
Other	1

Interest rate risk occurs as the Group may have different fixed-rate periods for assets and liabilities. Trading activities related to sale of interest rate instruments shall comply with adopted limits and authorisations at all times. The Group's limits define quantitative targets for maximum potential loss. The commercial risk is quantified and continuously monitored. The Group's principal limits for interest rate risk define maximum loss in the event of changes in interest rates of 1 percentage point. Maximum loss in total shall not exceed NOK 30 million on the Norwegian krone balance sheet, and within a maturity limit (0-3 months, 3-6 months, 6-12 months, 1-2 years etc.) maximum loss shall not exceed NOK 15 million. Maximum net loss related to interest rate risk on the foreign currency balance sheet is NOK 8 million before tax. The maximum interest rate risk for individual currencies is NOK 5 million.

4.4.2 Minimum requirement for subordinated loan capital

Table 37: Minimum requirement for subordinated loan capital for market risk, including position risk, counterpart risk, settlement risk, currency risk and commodity risk

Figures in NOK million	Consolidated 2008	Consolidated 2009
Position risk	**258**	**240**
-Of which equito instruments	47	50
-Of which debt instruments market portfolio	82	101
-Of which debt instruments bank portfolio	129	89
Counterpart risk (derivatives in trading portfolio)	**61**	**138**
-Of which derivatives in trading portfolio	42	25
-Of which derivatives outside of trading portfolio	19	113
Currency risk	**-**	**-**
Total	**319**	**378**

4.5 Operational risk

Table 38: Minimum requirement for subordinated loan capital for operational risk according to standardised method

Figures in NOK million	Consolidated	EiendomsMegler 1	SR-Finans	SR-Forvaltning
Banking services for retail market customers	195	29	-	8
Banking services for corporate customers	118	-	15	-
Payment and settlement services	7	-	-	-
Total	**320**	**29**	**15**	**8**

The minimum requirement for subordinated loan capital for operational risk is calculated as a percentage of average income for each business segment over the past 3 years. Banking services for the retail market 12%, banking services for the corporate market 15% and 18% for other services

5 COMPARISON OF REGULATORY CAPITAL AND RISK-ADJUSTED CAPITAL

Figure 63 below illustrates a comparison between the minimum requirement for subordinated loan capital (Pillar I) and the requirement for risk-adjusted capital (Pillar II) before and after diversification effects

Figure 63

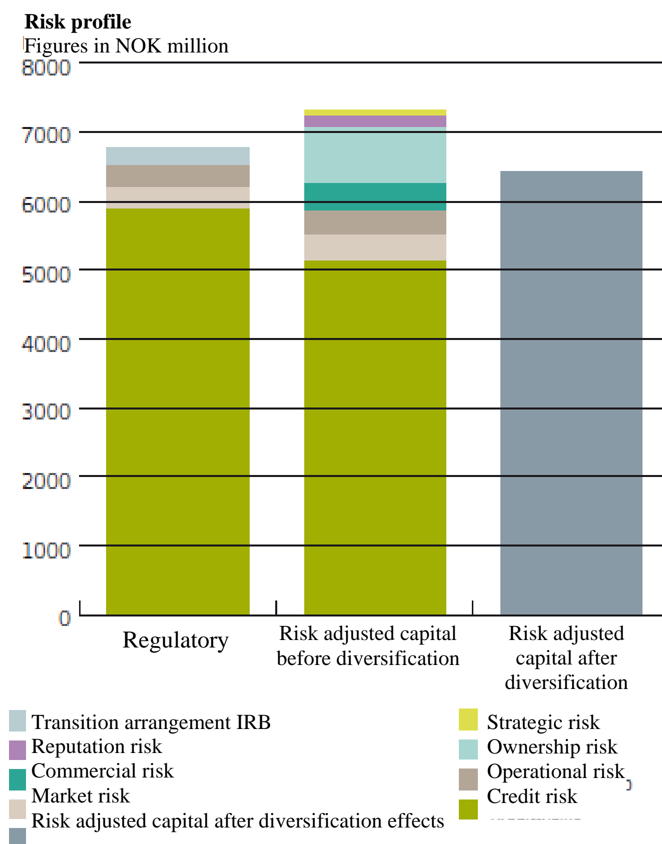


Figure 63 illustrates that the minimum requirement for subordinated loan capital is NOK 6.5 billion before the IRB transition arrangement, and NOK 6.8 billion including the transition arrangement. The Regulation concerning Capital Requirement stipulates that, during a transitional phase, the requirement for regulatory capital in 2009 cannot be lower than 80% of the minimum requirement, when calculating according to the old regulations (Basel 1 from 2006). It has been decided that the prevailing "floor" shall be sustained in 2010 and 2011. The floor implies that the requirement for regulatory capital is NOK 264 million higher than what it should have been.

The requirement for risk adjusted capital is NOK 7.4 billion before diversification effects and NOK 6.5 billion after diversification effects. The diversification effect amounts to NOK 901 million or 12.2%. The diversification effect illustrates the risk reduction achieved by the Group by incorporating more risk areas which are not expected to incur loss simultaneously.

The main causes of deviations in capital requirement between regulatory capital and risk adjusted capital are, as described in the document, slightly different approaches in method and risk categorisation.

The main differences are attributed to:

Credit risk
Risk adjusted capital encompasses concentration risk. Concentration risk is not included in regulatory capital. When calculating regulatory capital, loss given default for defaulted corporate commitments (enterprises) according to the standardised approach is 45% in relation to the Regulation concerning capital requirement. When calculating risk adjusted capital, the security values are taken into consideration (realisation values). This provides loss given default when calculating risk adjusted capital of 20%.

Ownership risk SpareBank 1 Gruppen
With the regulatory calculations, the part of the investment in SpareBank 1 Gruppen's book value which exceeds 2% of SpareBank 1 Gruppen's subordinated loan capital is deducted from the subordinated loan capital and calculation basis. When calculating risk adjusted capital, SpareBank 1 Gruppen is included as ownership risk.

Other risk
Commercial risk, reputation risk and strategic risk are not included when calculating regulatory capital, while risk adjusted capital is calculated for these types of risk.

Diversification effects
Regulatory capital does not encompass diversification effects, while these are taken into consideration when calculating risk adjusted capital.