Pillar 3

2019

SPAREBANKEN SØR

Contents

It is emphasized that this document is prepared on the background of present information of 31 December 2019. The situation that occurred in March 2020 through the spread of the Covid-19 virus is therefore neither taken into account or featured in this document. Sparebanken Sør initiates different measures to control the Bank's risks in this situation. The Bank follows this situation carefully, and it is referred to the Bank's website for further information.

1. INTRODUCTION

The capital requirements regulations impose requirements for the publication of information on risk management and capital adequacy. This document has been prepared to satisfy Sparebanken Sør's duty of disclosure in accordance with these regulations. The document will be updated each year and published at the same time as the bank's annual report. Information on capital requirements and own funds is updated each quarter and published as a disclosure note in the bank's quarterly financial statements.

For supplementary information on the Group's financial position and performance, including updated information on capital adequacy and own funds, please refer to the annual and quarterly reports and presentations that are published on the bank's website: www.sor.no under Investor Information.

All amounts are stated as of 31 December 2019 and in NOK million unless otherwise specified.

2. CAPITAL REQUIREMENTS REGULATIONS

The purpose of Capital Requirements Regulations is to improve risk management at banks and ensure better alignment of risk and capital. On 19 December 2019, the Norwegian Ministry of Finance adopted regulatory amendments that formally implemented the EU's Capital Requirements Regulation (CRR) / CRD IV (Capital Requirements Directive) in Norway effective 31 December 2019.

CRR and CRD IV are the third revision of the EU's capital requirements regulations, and were adopted by the EU in 2013. The main purpose of the revised regulations is to implement the Basel III recommendations in the EU and help strengthen the banking sector by imposing more stringent requirements for own funds, and new quantitative liquidity requirements. The CRD IV Directive implements the Basel III recommendations, including the general capital buffer requirements (in Pillar 1) and the bank-specific capital requirements (in Pillar 2), and continues previous directives' concession provisions and provisions relating to follow-up by the authorities and corporate governance in banks. The CRR scheme implements the Basel III recommendations on minimum requirements for own funds, liquidity and publication of financial information, and continues previous directives' provisions in areas such as large exposures. The enactment of the scheme in effect reduces the capital requirements for lending to small and medium-sized enterprises (SMEs) and sets aside the "Basel I floor".

The core content of the regulation has effectively been implemented in Norwegian law for a number of years through regulations mirroring the EU rules. Since 31 December 2019, these regulations have been rescinded and replaced by references to the CRR scheme and associated, supplementary schemes.

The capital requirements regulations consist of three pillars.:
Pillar 1 – Minimum requirements for own funds
Pillar 2 – Assessment of overall capital needs and appropriate follow-up
Pillar 3 – Publication of information

Pillar 1 deals with minimum requirements for capital adequacy. The aggregate calculation basis is the sum of the calculation bases for credit risk, market risk and operational risk.

In accordance with the regulations, individual banks may develop different methods to establish the calculation basis; however, some of the methods require the prior approval of Finanstilsynet (the Financial Supervisory Authority of Norway). The following methods can be used to establish the calculation basis:

Credit risk	**Market risk**	**Operational risk**
Standard method	Standardised method	Basic method
IRB Foundation [1]	Value-at-Risk (VaR) [1]	Standardised method
Advanced IRB [1]		AMA method [1]

1) Individual banks must obtain Finanstilsynet's approval to apply the internal IRB, VaR and AMA methods, whereby the capital requirement is calculated based on internal models for each form of risk.

Sparebanken Sør uses the following methods to establish the calculation basis:

Credit risk: Standardised method
Market risk: Standardised method
Operational risk: Basic method

Sparebanken Sør is the only one of the large regional Norwegian banks to use the standard method to calculate capital adequacy. As a "standard bank", the Bank will therefore have a higher basis for calculating capital adequacy in relation to comparable regional banks that use IRB, and the Bank currently has a higher leverage ratio than the other regional banks. Sparebanken Sør has started a process to apply to Finanstilsynet for approval to use internal models for credit risk (IRB). This is a complex process, which is proving more extensive than originally assumed, partly as a result of changed requirements from the EBA affecting the Bank's model development. The Bank aims to submit the IRB application to Finanstilsynet well in advance of implementation of the increased systemic risk buffer requirement in 2022.

The minimum statutory requirement for own funds essentially corresponds to 8 per cent of the overall calculation basis. This means that

$$\frac{\text{Total tier 1 Capital + Tier 2 Capital}}{\text{Credit risk + Market risk + Operational risk}} \geq 8 \text{ per cent}$$

In addition, the Bank must maintain sufficient capital to satisfy the regulatory requirements for buffer capital, which shall consist of common equity tier 1 capital. The law requires enterprises to have a capital conservation buffer of 2.5 per cent and a systemic risk buffer of 3.0 per cent as of 31 December 2019. The Ministry of Finance also sets requirements for countercyclical buffers and particular buffer requirements for systemically important financial institutions. The level of the countercyclical buffer is established by the Ministry of Finance each quarter. The countercyclical buffer was raised from 2.0 per cent to the maximum permitted level of 2.5 per cent from 31 December 2019. Sparebanken Sør was not defined as a systemically important bank at this date.

In December 2019, the Ministry of Finance decided that the systemic risk buffer should be raised from 3.0 per cent to 4.5 per cent from 31 December 2022 for banks that report in accordance with the standard method or the IRB foundation method. The original proposal for the banks that use the standard method was to raise the systemic risk buffer by 1.5 percentage points from 31 December 2021, with a 0.5 percentage point step increase each year from 31 December 2019. For banks that report in accordance with the advanced IRB method, the systemic risk buffer will increase from 3.0 per cent to 4.5 per cent from 31 December 2020, which is one year later than originally proposed.

Total own funds is the sum of total tier 1 capital and tier 2 capital. The calculation basis, capital requirements and own funds are described in more detail in Chapter 4.

In accordance with Pillar 2 of the regulations, the institution must have a process for assessing the overall capital requirements in relation to their risk profile, and banks must have a strategy to maintain their capital levels. The ICAAP (Internal Capital Adequacy Assessment Process) considers all risk to which the bank is exposed, including forms of risk not covered by Pillar 1. The Internal Liquidity Adequacy Assessment Process (ILAAP) will be an important part of the overall risk assessment.

Pillar 2 also provides guidelines on the authorities' review process (Supervisory Review Evaluation Process – SREP). Finanstilsynet will monitor and evaluate the institution's process under Pillar 2, while the supervisory authorities will implement measures if they do not regard the process as satisfactory. Sparebanken Sør's process for assessing risk and capital requirements is described in Chapter 5.2.

Pillar 3 encompasses the requirements for publication of information, while Pillar 3, through the minimum requirements in Pillar 1 and the supervisory follow-up in Pillar 2, is intended to contribute to increased market discipline and a better comparison basis between enterprises. The banks must publish information that gives market players the opportunity to assess the enterprises' risk profile, capitalisation and risk management and control. This information is published on the Bank's website.

2.1. The EU's Bank Recovery and Resolution Directive

The EU's Bank Recovery and Resolution Directive (BRRD) entered into force in the EU in January 2016. In March 2018, the Norwegian Parliament (Storting) passed legislative amendments to implement the Directive in Norwegian law effective 1 January 2019.

The BRRD makes arrangements for banks, credit institutions and certain securities firms to be subject to crisis management or closed down without posing a threat to financial stability. Important considerations are that critical functions can be continued, and that losses are borne by owners and creditors, while deposits, client funds and public funds are protected. The Directive also facilitates arrangements for emergency response and preventive measures.

2.1.1. Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

A key element of the BRRD is the requirement for internal bail-in arrangements recapitalisation as a crisis measure in situations where capital instruments and debt are written down and/or converted to equity. Finanstilsynet shall set a minimum requirement for the sum of own funds and eligible liabilities (MREL), and under the directive, may require that eligible liabilities have lower priority in full or in part than other debt (typically unsecured debt).

The MREL consists of a loss absorption amount and a recapitalisation amount. It will initially be assumed that the ordinary capital requirements for enterprises to be liquidated through public administration in a crisis will be sufficient to absorb the losses. The minimum level for this part of the MREL is related to the applicable capital adequacy requirements. For enterprises where it is considered important that all or part of the operations continue, the MREL should also include a recapitalisation amount. The size of this amount is related to the expected capital requirements after the crisis measures have been implemented, and the enterprise continues to operate. The MREL is determined based on the crisis management authority's crisis response plan for the enterprise in question.

On 20 December 2019, Finanstilsynet established the minimum requirement for own funds and eligible liabilities for Sparebanken Sør and seven other banks.

The requirements are set as an MREL amount, where the MREL percentage is multiplied by the bank's risk-weighted calculation basis. For banks with wholly or partly owned mortgage company, adjustments have been made to reflect that the mortgage company is exempt from MREL requirements, and for the bank's obligations to the mortgage company in the form of guarantees etc. to be included in the MREL calculation.

Sparebanken Sør's MREL requirement has been set at 33.50 per cent of the adjusted calculation basis and as an amount of NOK 19,684 million.

The resolutions establish that the MREL requirement must be covered by own funds or debt instruments with a lower priority than ordinary, unsecured, unprioritised debt (senior bond debt). The requirement for compliance (lower priority) must be satisfied in its entirety by 31 December 2022. Until this date, senior debt with a remaining term to maturity of more than one year that was issued prior to 1 January 2020 will be deemed to be eligible. The banks must establish plans to gradually fulfil this requirement.

2.1.2. National resolution fund

The crisis management authority may need funds to manage an institution in crisis, which can be spent on measures such as issuing guarantees and loans, purchasing assets and contributing to other types of effective solutions. The Bank Resolution and Recovery Directive (BRRD) therefore requires the establishment of a national resolution fund. If the authorities are to contribute funds from the national resolution fund, specific minimum requirements are stipulated for losses and contributions to recapitalisation that should already have been made by the relevant owners of shares, equity certificates, other capital instruments and eligible liabilities.

From 1 January 2019, the Norwegian Banks' Guarantee Fund has been split into a national resolution fund and a deposit guarantee fund. The requirements for capitalisation of the deposit guarantee fund are established in the Deposit Guarantee Schemes Directive (DGSD). In future, the enterprises will be liable to pay annual contributions to both funds, where the rules for contributions are based on the principle that the contributions must be proportionate to the enterprises' risk profile. Many of the enterprises that are covered by these rules already pay contributions to the Banks' Guarantee Fund. The total deposits for these enterprises will not significantly change; however, the proposed risk adjustment of the contributions will result in a greater degree of differentiation between institutions.

3. GROUP RELATIONSHIPS AND CONSOLIDATION

3.1. List of Group companies

In addition to the parent company Sparebanken Sør, the Sparebanken Sør Group consists of the following companies:

3.1.1. Fully consolidated companies – (subsidiaries)

					PARENT BANK 31.12.2019
NOK THOUSAND	**Type of business**	**Registered office**	**Ownership**	**Share capital**	**Book value**
Sparebanken Sør Boligkreditt AS	Mortgage company	Kristiansand	100 %	1.125.000	1.845.695
Sørmegleren Holding AS	Real estate business	Kristiansand	91 %	5.728	6.983
AS Eiendomsvekst	Property managment	Arendal	100 %	3.000	2.935
Arendal Brygge AS	Property managment	Arendal	50 %	601	1.000
Prosjektutvikling AS	Property managment	Arendal	100 %	100	-
Transitt Eiendom AS	Property managment	Kristiansand	100 %	100	1.450
Total					**1.858.063**

Arendal Brygge AS is a joint venture and is not consolidated in the financial statements.

3.2. Limitation of transfer of capital or repayment of debt between Group companies

There are no contractual, private-law or other actual limitations on the transfer of capital between the Group companies. The right to transfer capital or repay debt between the Group companies is otherwise regulated in the prevailing legislation for the sector.

4. PILLAR 1: MINIMUM REQUIREMENTS FOR OWN FUNDS

4.1. Capital adequacy and leverage ratio

PARENT BANK		NOK million	GROUP	
31/12/18	31/12/19		31/12/19	31/12/18
10.518	**11.535**	**Total equity**	**13.081**	**11.845**
0	0	**Tier 1 capital**	0	0
-1.075	-1.375	Equity not eligible as common equity tier 1 capital	-1.375	-1.075
-189	-245	Share of profit not eligible as common equity tier 1 capital	-245	-189
-22	-27	Deductions for intagible assets and deferred tax assets	-27	-22
-24	-44	Deductions for additional value adjustements	-27	-21
0	0	Proportion of common equity tier 1 capital from Brage Finans AS	374	184
0	0	Deductions for internal eliminations from Brage Finans AS	-374	-187
-37	-104	Other deductions	-51	-21
9.171	**9.740**	**Total common equity tier 1 capital**	**11.356**	**10.514**
0	0	**Other tier 1 capital**	0	0
1.075	1.375	Hybrid capital	1.375	1.075
0	0	Proportion of tier 1 capital Brage Finans AS	36	15
0	0	Deductions from other tier 1 capital	0	0
10.246	**11.115**	**Total tier 1 capital**	**12.767**	**11.604**
0	0	**Additional capital supplementary to tier 1 capital**	0	0
1.604	1.971	Subordinated loan capital	1.971	1.604
0	0	Proportion of net subordinated capital Brage Finans AS	49	27
-99	-101	Deductrions from additional capital	-101	-99
1.505	**1.870**	**Total additional capital**	**1.919**	**1.532**
0	0		0	0
11.751	**12.985**	**Net subordinated capital**	**14.686**	**13.135**
0	0		0	0
0	0	**Minimum requirement for subordinated capital Basel II calculated**	0	0
3	2	Engagements with local and regional authorities	2	3
51	70	Engagements with institutions	34	20
148	218	Engagements with enterprises	224	150
452	415	Engagements with mass market	520	537
3.104	3.029	Engagements secured in property	4.167	4.213
76	92	Engagements which have fallen due	98	80
2	2	Engagements which are high risk	2	2
403	384	Engagements in covered bonds	107	86
299	334	Engagements in collective investment funds	184	151
49	49	Engagements, other	49	62
4.587	**4.595**	**Capital requirements for credit and counterparty risk**	**5.387**	**5.304**
1	**1**	**Capital requirements for position, currency and product risk**	**1**	**1**
240	**259**	**Capital requirements for operational risk**	**313**	**298**
0	**1**	**CVA addition**	**1**	**0**
0	**0**	**Deductions from the capital requirement**	**0**	**0**
4.828	**4.856**	**Total minimum requirement for subordinated capital**	**5.702**	**5.603**
0	0		0	0
60.354	60.702	Risk-weighted balance (calculation basis)	71.275	70.036
0	0	Porportionate share of calculation basis Brage Finans AS	2.112	1.336
0	0	Deductions for internal eliminations Brage Finans AS	-955	-484
0	0	Risk weighted balance after proportonate consolidation	72.432	70.888
15,2 %	16,0 %	Common equity tier 1 capital ratio, %	15,7 %	14,8 %
17,0 %	18,3 %	Tier 1 capital ratio, %	17,6 %	16,4 %
19,5 %	21,4 %	Total capital ratio, %	20,3 %	18,5 %

As of 31 December 2019, the Group satisfied the capital requirements for financial institutions of common equity tier 1 capital of 12.5 per cent, total tier 1 capital of 14.0 per cent and total capital of 16.0 per cent. The capital requirements, including the Pillar 2 additional capital requirement of 2.0 per cent, are 14.5 per cent for common equity tier 1 capital, 16 per cent for total tier 1 capital and 18.0 per cent for total capital.

Since the first quarter of 2017, the Group has also reported capital adequacy with cooperating groups consolidated proportionately. In the case of Sparebanken Sør, this applies to Brage Finans AS, in which the Bank has a shareholding of more than 20 per cent.

CRD IV introduces the leverage ratio as a new indicator of financial solvency and a supplement to the risk-weighted minimum requirements. On 20 December 2016, the Ministry of Finance published a regulation on leverage ratios. The regulation applies to banks, credit institutions, financial institutions, holding companies in finance groups that are not insurance groups and securities companies that are authorised to provide investment services. All companies must at all times have a leverage ratio equal to at least 3 per cent of the institution's exposure. All banks must additionally have a leverage ratio equal to at least two per cent of the institution's exposure. Systemically important banks must further have a leverage ratio buffer equal to at least 1 per cent of the institution's exposure. The regulation entered into force on 1 January 2017, and the requirements for leverage ratios have applied since 30 June 2017.

As at 31 December 2019, Sparebanken Sør had a leverage ratio of 9.3 per cent, which comfortably satisfies the minimum leverage ratio requirement of 5 per cent.

NOK MILLION	31.12.2019	31.12.2018
Derivatives	1.408	1.226
Off balance sheet commitments	5.605	4.947
Other assets	128.528	120.352
Proportion Brage Finans AS	2.703	1.593
Eliminations Brage Finans AS	-474	-273
Total Leverage Ratio exposure	**137.770**	**127.845**
Total tier 1 capital incl. proportion Brage Finans AS	**12.767**	**11.604**
Leverage Ratio incl. proportion Brage Finans AS	**9,27 %**	**9,08 %**

4.2. Phasing-in plan for new requirements for buffer capital

Pillar 1 requirement	01.07.2013	01.07.2014	01.07.2015	01.07.2016	31.12.2017	31.12.2018	31.12.2019	31.12.2020	31.12.2021	31.12.2022
Minimum Common equity Tier 1 capital requirement	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %	4,50 %
Capital conservation buffer	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %	2,50 %
Systemic risk buffer	2,00 %	3,00 %	3,00 %	3,00 %	3,00 %	3,00 %	3,00 %	3,00 %	3,00 %	4,50 %
Countercyclical buffer			1,00 %	1,50 %	2,00 %	2,00 %	2,50 %	2,50 %	2,50 %	2,50 %
Common equity Tier 1 capital requirement	**9,00 %**	**10,00 %**	**11,00 %**	**11,50 %**	**12,00 %**	**12,00 %**	**12,50 %**	**12,50 %**	**12,50 %**	**14,00 %**
Hybrid capital	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %	1,50 %
Equity Tier 1 cappital requirement	**10,50 %**	**11,50 %**	**12,50 %**	**13,00 %**	**13,50 %**	**13,50 %**	**14,00 %**	**14,00 %**	**14,00 %**	**15,50 %**
Subordinated loan	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %	2,00 %
Own funds requirement	**12,50 %**	**13,50 %**	**14,50 %**	**15,00 %**	**15,50 %**	**15,50 %**	**16,00 %**	**16,00 %**	**16,00 %**	**17,50 %**

The countercyclical buffer increased by 0.5 percentage points to 2.5 per cent from 31 December 2019. In December 2019, the Ministry of Finance decided that the systemic risk buffer should be raised from 3.0 per cent to 4.5 per cent from 31 December 2022 for banks that report in accordance with the standard method or the IRB foundation method.

5. PILLAR 2: INTERNAL RISK CAPITAL ADEQUACY ASSESSMENT PROCESS

5.1. Process

The Board of Directors is responsible for the Bank's internal risk and capital adequacy assessment process (ICAAP). The Board of Directors is further responsible for assessing the Banks' risk tolerance, capital requirements and capital planning. The Board of Directors also approves the choice of methods, and results. The purpose of the ICAAP is to implement a quantitative and qualitative assessment of the Group's risks, and establish the Group's risk appetite and capitalisation.

The Board of Directors has integrated ICAAP into the Bank's strategic and commercial processes. This means that ICAAP represents an important decision-making basis in areas such as:

- The Strategy Document

- Annual forecasts and investment needs
- Risk assessments for the market and products
- Overarching risk and capital planning.

The Group's processes relating to capital adequacy assessment (ICAAP) are based on a quantification of risk and capital requirements in the key risk areas.

Quantitative analyses of risk are supplemented with qualitative assessments.

Scenario analyses of expected economic developments and stress testing are key considerations in assessing the Group's long-term capital requirements and capital buffer.

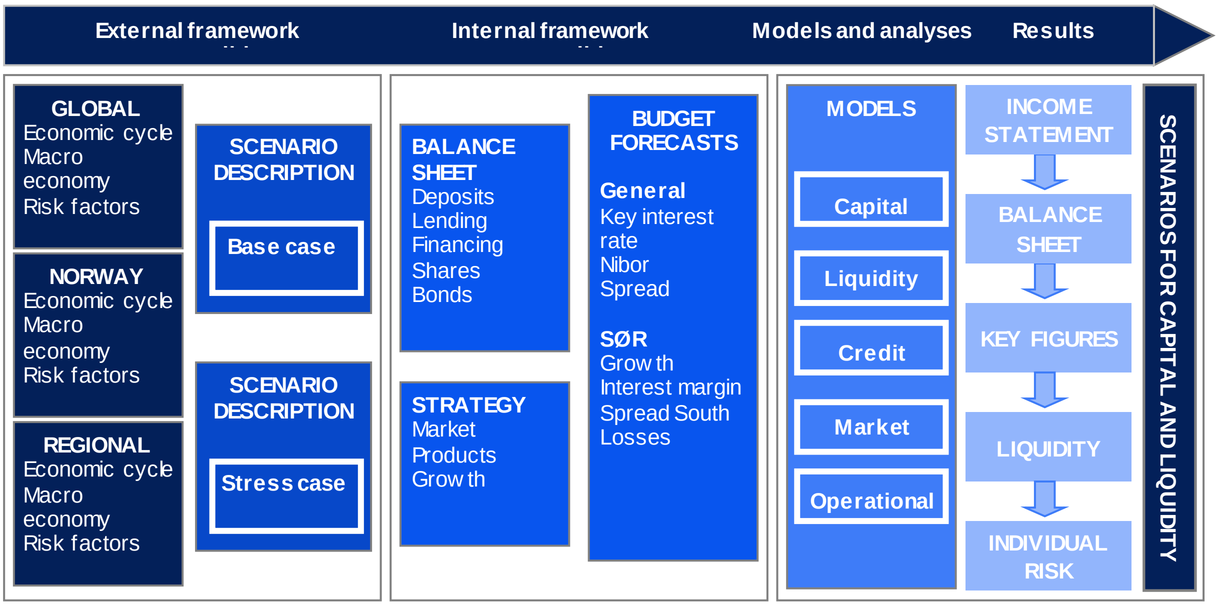

Figure: Model for scenario analyses and stress testing

Risk management and capital adequacy are essentially based on goals and ambitions set out in the Group's strategy plan and other policy documents.

Risks are identified and analysed, and capital requirements are established for individual risks.

Potential future economic scenarios are outlined based on global, national and regional economic trends. Scenarios are prepared for expected developments (Base case) and a Stress case. The Stress case is intended to represent a serious economic downturn.

The scenarios estimate the effects on the income statement, balance sheet, capital, individual risks, liquidity and various key figures. The ICAAP must be forward-looking. The Bank has therefore based its scenario analyses on a four-year period, where the economic downturn bottoms out in year 3 of the Stress case. Sensitivity analyses and reverse stress testing are also performed.

Together with the scenario analyses and other assessments, analysis of individual risks will form the basis for the Group's desired capital and capital buffer.

Liquidity and funding risk will be an important part of the overall risk assessment. This is known as the ILAAP. Short- and long-tern liquidity requirements and the results of implemented stress tests are key factors in this context. Information about the size, composition and quality of the Bank's liquidity buffer be available, along with changes in quantitative measurement parameters such as the "Liquidity Coverage Ratio" (LCR).

The ICAAP/ILAAP is carried out once a year. In the event of material changes in external or internal framework conditions and assumptions, methods or other conditions that will affect capital adequacy, the ICAAP/ILAAP will be revised and updated.

5.2. Assessment of risk and capital requirements

The table below shows the risks that are included in the Group's ICAAP, and the methods that are used to calculate risk and capital.

Risk type	Risk classes	Calculation method
Credit risk	Pillar 1	Standard method
	Pillar 2 (Risk above standard)	Finanstilsynet's methodology/own assessments
	Concentration risk	Sector – Finanstilsynet's methodology/own assessments Large exposures – Finanstilsynet's methodology/own assessments
	High lending growth	Finanstilsynet's methodology/own assessments
Market risk	Pillar 1 (Shares, interest and currency)	Standard method
	Pillar 2 (Risk above standard)	Finanstilsynet's methodology/own assessments
Operational risk	Pillar 1 (External, personnel, procedures)	Basic method
	Pillar 2 (Risk above Basic)	Own assessments
Liquidity risk	Financing cost	Own assessments/calculations
Business risk	Unexpected reductions in income/costs	Own assessments
Strategic risk	Defective/erroneous initiatives	Own assessments
Ownership risk	Shares	Own assessments/calculations
	Shareholdings in insurance companies	Finanstilsynet's methodology/own assessments
Other risk		

Table: Methods for calculating capital

Based on models and methods, as well as qualitative assessments such as those outlined above, risk and capital needs are identified and calculated for the various risks included in ICAAP (Pillar 1 and Pillar 2 risks).

5.3. Capital goals

Results from the ICAAP provide guidance on risk appetite, capital adequacy and the risk strategies adopted by the Board. The ICAAP verifies that:

- The Group has sufficient capital to satisfy the authorities' requirements and internal performance goals for capital adequacy and capital buffers.
- The Group's capital adequacy at the bottom of a serious economic downturn is above the authorities' minimum requirements and internal performance goals, and that there is a high degree of probability that measures can be taken to return the capital adequacy to the performance goal.
- The Group has sufficient capital and capital buffers to implement plans and strategic measures without endangering the financial solvency goal.

An important part of the Group's goal is that the common equity tier 1 capital ratio should be on a par with that of comparable banks. Sparebanken Sør is the only one of the large regional banks in Norway to use the standard method to calculate capital adequacy.

Finanstilsynet's Supervisory Review Evaluation Process (SREP) for Norwegian financial institutions is split into five groups based on the size, complexity and application area, as well as degree of risk that the enterprise presents for the financial system. Sparebanken Sør is in group 2, which encompasses small and medium-sized enterprises that mainly operate within Norway, but have high national or regional market shares. Banks in group 2 will be subject to a detailed SREP with written feedback every other year.

In July 2018, the Bank received Finanstilsynet's assessments and decisions relating to Pillar 2 requirements. The assessment was made in connection with the supervisory review evaluation process (SREP) for 2018, where the Pillar 2 requirement was set at 2.0 per cent of the calculation basis. The Pillar 2 requirement entered into force on 30 September 2018 and must be satisfied at all times. The requirement is linked to an assessment of risk factors not covered by the Pillar 1 requirements and also includes a new method for calculating capital requirements for partly-owned insurance companies. The capital requirement linked to the shareholding in Frende Holding AS alone is around 0.3 percentage points.

The Bank is expected to be assigned a new Pillar 2 requirement in the second half of 2020.

Capital adequacy 2014–2019

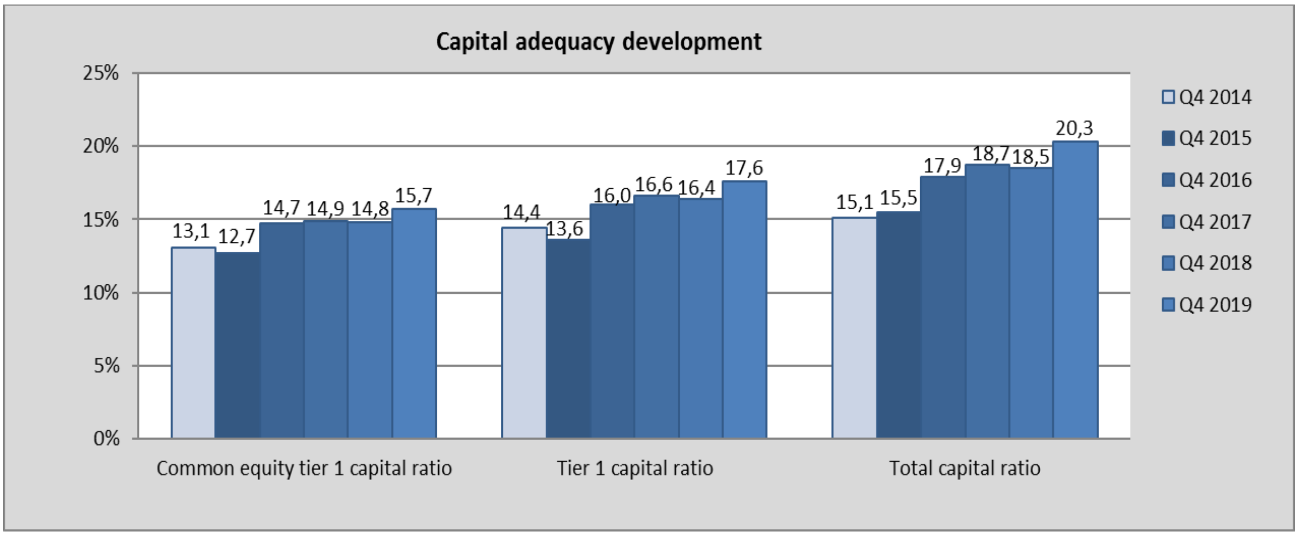

Figure: Fourth-quarter common equity tier 1 capital adequacy, total tier 1 capital adequacy and total capital adequacy (own funds) 2014–2019. Authority requirements for the various types of capital adequacy were all satisfied by a comfortable margin. Includes the Bank's shareholding in Brage from Q4 2017.

The Group had a common equity tier 1 capital ratio of 15.7 per cent, total tier 1 capital ratio of 17.6 per cent and a total capital ratio of 20.3 per cent as at 31 December 2019. The Group has a common equity tier 1 capital requirement of 14.5 per cent, including a Pillar 2 additional capital requirement of 2.0 per cent.

The Group has stated that its goal is a common equity tier 1 capital ratio of 15.3 per cent. In December 2019, the Ministry of Finance decided that the requirement for the systemic risk buffer should be increased by 1.5 percentage points from 31 December 2022, and the Group will adapt to the requirement by this date and ensure necessary buffers above the minimum requirement.

6. RISK MANAGEMENT AND CAPITAL ADEQUACY

6.1. Elements of risk management and capital adequacy

6.1.1. Strategic plan

The purpose of risk management and capital adequacy is to support the Bank's strategic goals and ambitions. The strategy plan lays out the Group's long-term goals for development, growth, financial solvency, profitability and risk profile.

Risk management and capital adequacy must be a holistic process, firmly integrated with other processes in the Group.

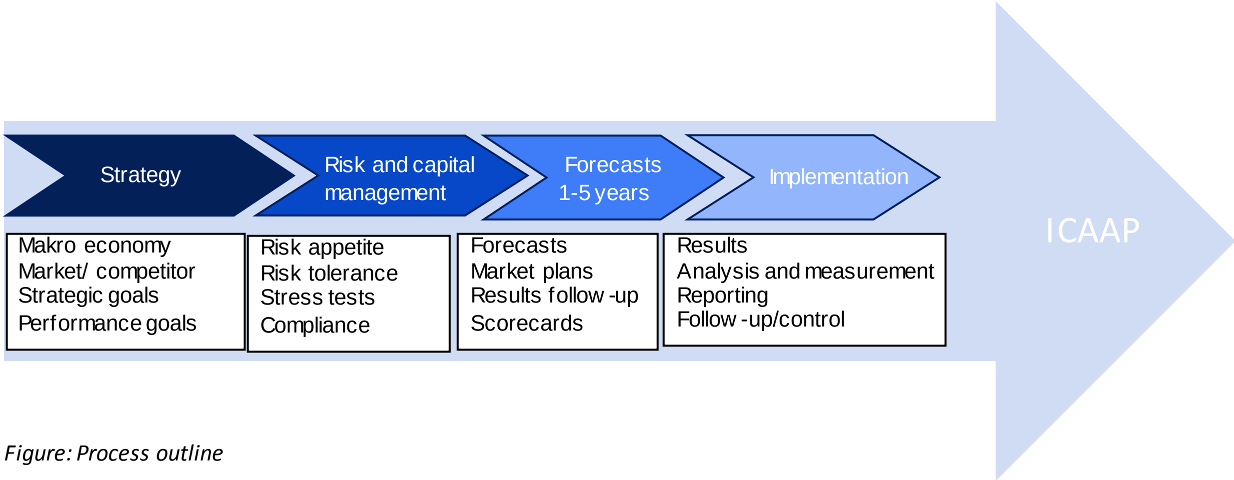

Figure: Process outline

6.1.2. Organisation

Organisational culture is an important element of risk management and capital management. The organisational culture influences employees' knowledge, attitude and ability to manage risk. An inadequate organisational culture cannot be compensated by other control and management measures.

Risk management at Sparebanken Sør is split into the following functions:

- An executive function with day-to-day responsibility for risk management (line and staff function)
- An independent monitoring function (Risk Management and Compliance)
- An independent certification function (Internal Audit)

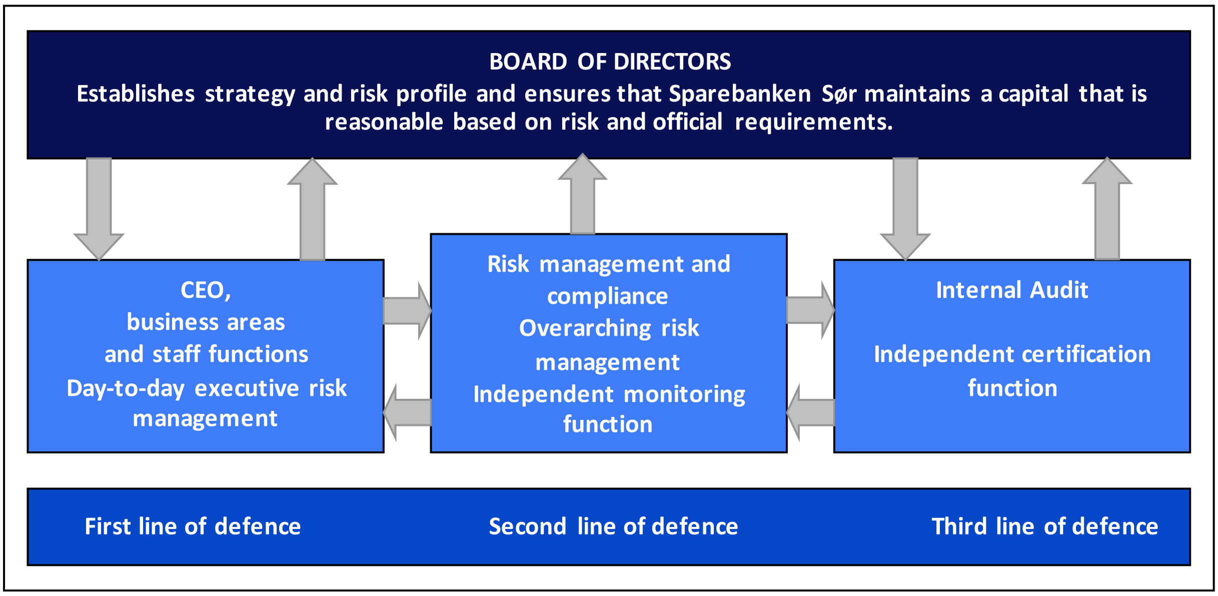

Figure: Overarching risk management and capital adequacy

The management model is intended to ensure independence in decision-making, reporting responsibilities and roles in day-to-day risk management.

The Board has overall responsibility for the Bank's total risk management and aims to ensure that the Bank has appropriate systems in place for risk management and internal control. The Board establishes risk strategies, the risk profile and risk tolerance, and the risk profile is operationalised through the framework for risk management, including the setting of authorities.

The Board of Directors also determines the strategy and guidelines for the level, composition and allocation of equity, and approves the process to ensure the Bank has adequate equity at all times (ICAAP).

The Board has established a Risk Committee as a subcommittee of the Board whose mandate is to help ensure that the Group's risk and capital management activities support the Group's strategic development and goal achievement. The Risk Committee must monitor the aggregate risk and assess whether the Group's management and control systems are appropriate for the risk level and the scope of the business.

The Board has also established an internal Audit Committee as a subcommittee of the Board whose mandate is to perform more in-depth assessments of agreed focus areas, including strengthening work on financial reporting.

The CEO and other members of Group management are responsible for implementing risk management and internal control. The CEO has delegated duties in accordance with the formal responsibility for internal control and risk management. Responsibility for the basis for implementation of the annual assessment of risk and capital adequacy is delegated to the Risk Management division. This analysis must be coordinated and integrated with other planning and strategy work at the Bank. Control tasks are further delegated to the various line managers within the framework of agreed principles, instructions and authorities.

The business areas and staff functions are responsible for day-to-day risk management within their own business area and must ensure that the organisation follows the processes, guidelines and procedures established by the Bank. The business areas are further responsible for ensuring that risk exposure remains within the frameworks, goals and guidelines set by the Board.

Risk Management reports directly to the CEO. Risk management covers the entire Group and does not perform activities which the control function is intended to monitor. The division must identify, measure and assess the Bank's total risk. The Risk Management division is responsible for regularly reporting to Group management and the Board on the banks' total risk exposure.

An independent Compliance function has been established that reports directly to the CEO. The main responsibility of the Compliance function is to prevent, control and report any non-compliances with laws, regulations, directives and policy documents. Compliance's function is to ensure that the Bank performs its tasks in accordance with the authorities' requirements and various standards. Prevailing regulatory requirements must be satisfied at all times.

The Bank has an Internal Audit function staffed by own employees. Internal Audit is a monitoring function independent of general administration, that performs risk assessments, controls and investigations of the Bank's internal control and governance processes to assess whether the internal control systems are satisfactory and ensure that the portfolio and reporting systems function as intended.

6.1.3. Risk management

The purpose of risk management is to support Sparebanken Sør's strategic goals. Frameworks have been established for risk appetite, risk frameworks and risk tolerance for individual types of risk. Systems have been established for measuring, managing and controlling risk. Both the aggregate risk level and the various risk categories must be closely monitored to ensure that the Group is performing in accordance with the adopted risk profile and strategies.

Risk management is also intended to ensure that risk exposure is known at all times, and to help Sparebanken Sør achieve its strategic goals for financial stability and profitability. The Group's risk exposure must be adapted to capital, growth ambitions, competence and market opportunities, as well as the authorities' requirements and guidelines.

Key objectives of the Group's risk management:

- Define and quantify the Group's risk
- Establish frameworks and guidelines for the Group's risk-taking
- Establish risk strategies, risk appetite including appropriate risk goals and risk tolerance
- Create a good balance between commercial goals and risk
- Achieve optimal allocation of the Group's capital based on strategic goals and profitability
- Adopt risk strategies with appropriate performance goals
- Have effective systems and procedures for identifying, measuring and analysing risk
- Have effective systems and procedures for managing, monitoring, reporting and controlling risk.

Together with strategies, procedures and guidelines, a business culture characterised by solid expertise that understands, controls and monitors risk and quality, will ensure that the Bank's activities are implemented in a satisfactory manner with regard to quality, legal competence and objectivity at all levels. Compliance with adopted ethical guidelines play an important role in helping the Group achieve its long-term goals.

Risk management shall ensure:

- A risk profile that is on a par with comparable banks, but is also adapted to the Bank's risk capacity and risk appetite
- Risk-taking that is based on profitability and returns
- A risk profile that ensures that no individual risk threatens Sparebanken Sør's independence
- That all the authorities' requirements are satisfied
- A risk profile that does not harm the Group's good name and reputation.

Risk is concretised through qualitative and quantitative risk frameworks for risk and capital.

The structure of the various policy documents is shown below:

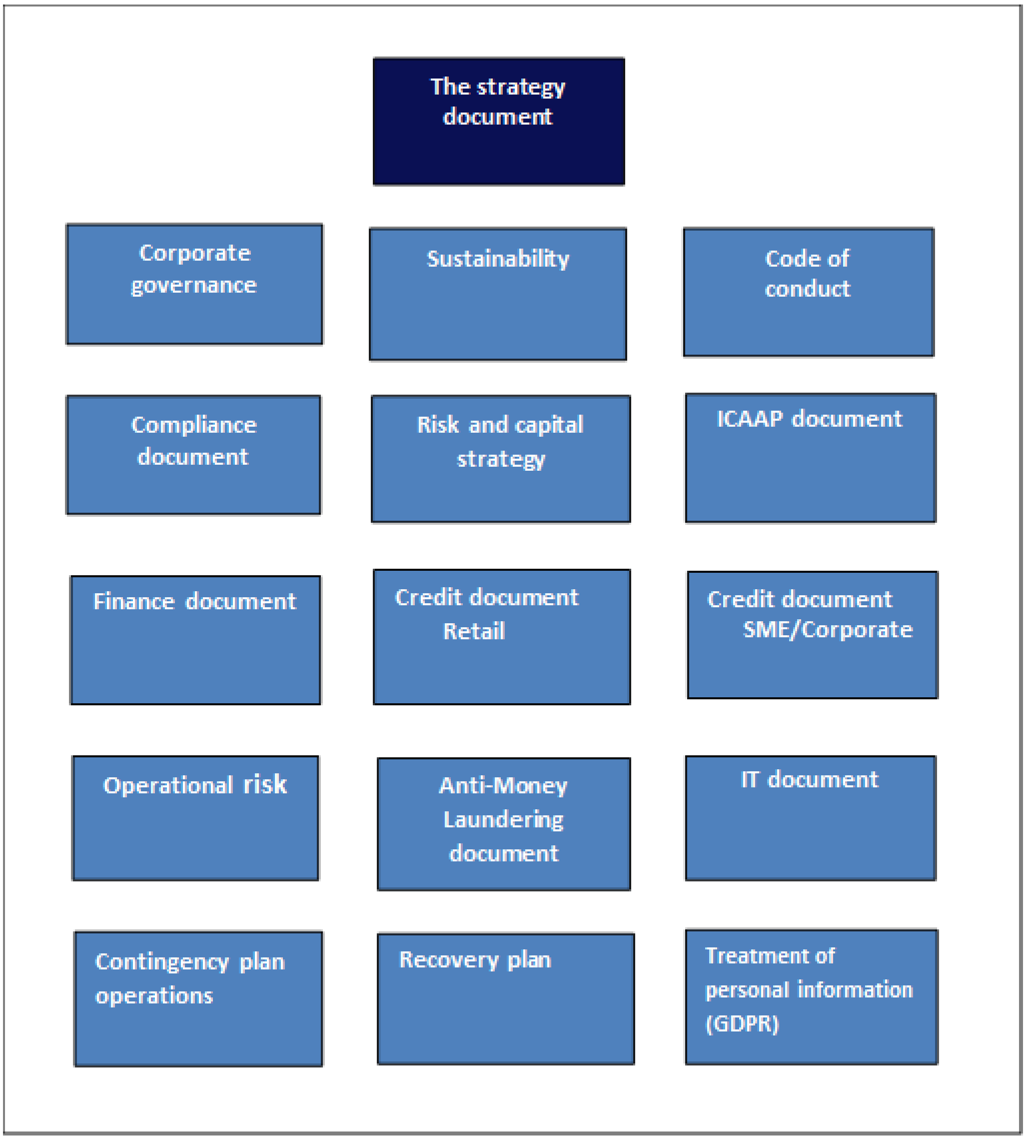

Figure: Structure of policy documents

To ensure that the various policy documents are aligned with the Group's objectives, the policy documents must be regularly revised and maintained, and an audit is normally conducted within a period of 12 months as instructed by a relevant body.

6.1.4. Capital management

Sparebanken Sør must be well capitalised – so that we have a sound basis for development and growth in economic upturns and are robust enough to weather economic downturns.

Capital management shall ensure that:

- Internal goals and authority requirements for capital are satisfied
- Market opportunities and ambitions are met
- Rating goals are achieved
- Requirements from national and international financial markets are met
- A competitive return.

Sparebanken Sør aims to be solidly capitalised at all times. The Bank's common equity tier 1 capital adequacy must satisfy the authorities' minimum requirements and be on a par with comparable banks.

6.1.5. Risk identification

Risk identification must be a forward-looking process integrated into the Bank's strategy work, and business and financial management processes. The process covers all material risks in the Group. In addition to ongoing follow-up during the year, a thorough analysis of the various risk categories is performed at least once a year.

6.1.6. Risk analysis

An analysis is performed of the nature and drivers of identified risks. The risks must be quantified with regard to probability, consequence and expected losses. Risk analysis must ensure that a qualified and structured assessment of the need for control measures or measures to reduce risk is performed. Ongoing control measures are performed, documented and reported.

6.1.7. Scenario analyses and stress tests

The Group performs scenario analyses (expected economic development) and stress tests (economic development in a serious economic downturn) for liquidity, capital and individual risks. The scenario analyses are based on the Group's strategic goals and long-term forecasts. Stress tests are important in that they enable us to understand how the various risks and portfolios are affected by changes in macroeconomic assumptions and changes in internal assumptions, including how negative events can affect the Group's earnings, balance sheet structure, capital adequacy and liquidity buffer.

6.1.8. Reporting

Frameworks for risk and capital management are established in various policy documents and are followed up through fixed reporting. This ensures ongoing follow-up of performance goals, individual risks and the Group's aggregate risk.

Type of report	Revision frequency	Responsible party	Group management	Risk Committee	Board of Directors
ICAAP/ILAAP	Annual	Risk Management Division	X	X	X
Risk report	Quarter	Risk Management Division	X	X	X
Stress Test Liquidity Risk	Quarter	Risk Management Division	X	X	X
Pillar 3	Annual	Risk Management Division	X	X	X
Annual Report Internal Control	Annual	Risk Management Division	X	X	X
Annual Report Operational	Annual	Risk Management	X	X	X

Risk		Division			
Annual Report Money Laundering	Annual	Anti-Money Laundering Department	X	X	X
Annual Report IT Risk	Annual	Business Development Division	X	X	X
Interim Financial Report Money Laundering	Quarterly	Anti-Money Laundering Department	X	X	X
Quarterly Report Compliance	Quarter	Compliance	X	X	X
Annual Report Compliance	Annual	Compliance	X	X	X
Validation Report scoring models	Annual	Risk Management Division	X	X	
Validation Report IFRS 9 Loss Model	Annual	Risk Management Division	X	X	
Recovery Plan	Annual	Division Risk Management	X	X	X
Non-conformance Report Mortgage Regulation	Quarter	Risk Management Division	X	X	X
Non-conformance report Consumer Loans Regulation	Quarter	Risk Management Division	X	X	X

Table: Reporting

6.1.9. Recovery Plan

The purpose of the Recovery Plan is to ensure that Sparebanken Sør can recover from an extremely serious financial crisis without extraordinary help from the authorities. The plan must be an integral part of the Group's framework for risk management and capital management, and will enter into force in the event of breaches of pre-defined indicators. The plan therefore encompasses identification of relevant indicators to ensure sufficiently early intervention and effective measures to be able to recover the Bank's financial position following a major financial crisis. If following a serious crisis it is not possible to effect a recovery based on the Bank's Recovery Plan, the authorities' Crisis Response Plan will be implemented. Ref. section 2.1.1.

Crisis management of an enterprise must be deemed to be in the public's interest when it is appropriate and necessary to ensure continuation of critical functions and avoid unnecessary negative impacts on the finance system, in particular by avoiding knock-on effects.

Based on the potential negative effects putting Sparebanken Sør into public administration could have for the economy and the financial system, Finanstilsynet believes that such a course of action would not be a credible crisis management strategy. This is primarily due to the Bank's importance for regional businesses, the liquidity strain it would place on the Norwegian Banks' Guarantee Fund, as well as the repercussions and uncertainty closing down the Bank would have for financial stability.

The Recovery Plan is an integral part of Sparebanken Sør's system for management and control, and indicator levels are adapted to the Bank's framework conditions for risk appetite. Calibration of key indicator values is based on factors including assessments and conclusions from the Bank's ICAAP. Reporting on selected indicators is part of standard risk reporting.

If the Bank triggers the threshold values for the defined emergency response indicators, the Emergency Response Team, which is the Bank's Group Management, is convened. The Emergency Response Team will obtain an overview of the situation, and assess the reasons for the indicator breaches. If the nature of an indicator breach means that no special measures are considered necessary, the Emergency Response Team will be stood down. If the indicator breach makes it necessary to implement measures from the Recovery Plan, the Emergency Response Team will assess which measures are to be implemented. Several of the measures must be ratified by the Board. Once the relevant recovery measures have been implemented and deemed to be effective, the Emergency Response Team may decide the Recovery Plan be discontinued and that the organisation return to a normal situation.

The Bank has prepared three different types of stress scenarios where capital and/or liquidity situation are threatened, and where the Recovery Plan is implemented:

- A gradual general-market scenario to test the Bank's robustness in an economic downturn
- A sudden general-market liquidity stress scenario to test the Bank's ability to react, and
- a sudden bank-specific scenario with major lending losses to test the Bank's ability to react.

The scenarios have been prepared to illuminate potential serious crises, but in reality the Recovery Pl an, including emergency response measures, is a category of tools that can also be used for less serious incidents.

The Bank will validate/revise the plan each year, and implement emergency response drills to test how the Recovery Plan can be applied in a genuine crisis situation.

The Recovery Plan will additionally be reviewed and updated to reflect significant changes in strategy or operating conditions at the Bank.

6.2. Credit risk

6.2.1. Definition

Credit risk is the risk of loss due to the Group's counterparties or customers not being able or willing to meet their payment obligations to the Group. Credit risk affects all receivables from counterparties/customers. These are mainly loans and overdraft facilities, but also liabilities for issued guaran tees, securities and counterparty risk relating to derivatives and foreign exchange contracts.

Concentration risk is credit risk that arises from highly concentrated exposure to an individual counterparty or issuer of a security, associated groups of counterparties, counterparties with activities in the same sector or geographic area and companies that use the same form of security, trade in the same product or have the same type of business area.

6.2.2. Risk assessment

Credit risk represents the largest area of risk for Sparebanken Sør. The Bank currently has a well diversified portfolio in terms of geographic location, customer segment and sector.

Capital adequacy for credit risk is calculated using the standard method. The Bank has also assessed whether there are any other aspects of the Bank's credit risk that indicate that capital ought to be set aside for risks that cannot be covered by the standard method.

6.2.3. Management and control

The Board has overarching responsibility for the Bank's granting of credit, and establishes the Bank's credit strategy and credit policy frameworks.

In addition to being the largest bank in Agder, the Bank is also represented in Telemark and Jæren and will open a new office in Vestfold in spring 2020. The Bank additionally operates in a national market segment, through retail customers who have moved away from the Bank's core area, and organisations that form part of KNIF (Kristen-Norges Innkjøpsfellesskap) and their employees.

The figure below shows the principles for management and control of credit risk.

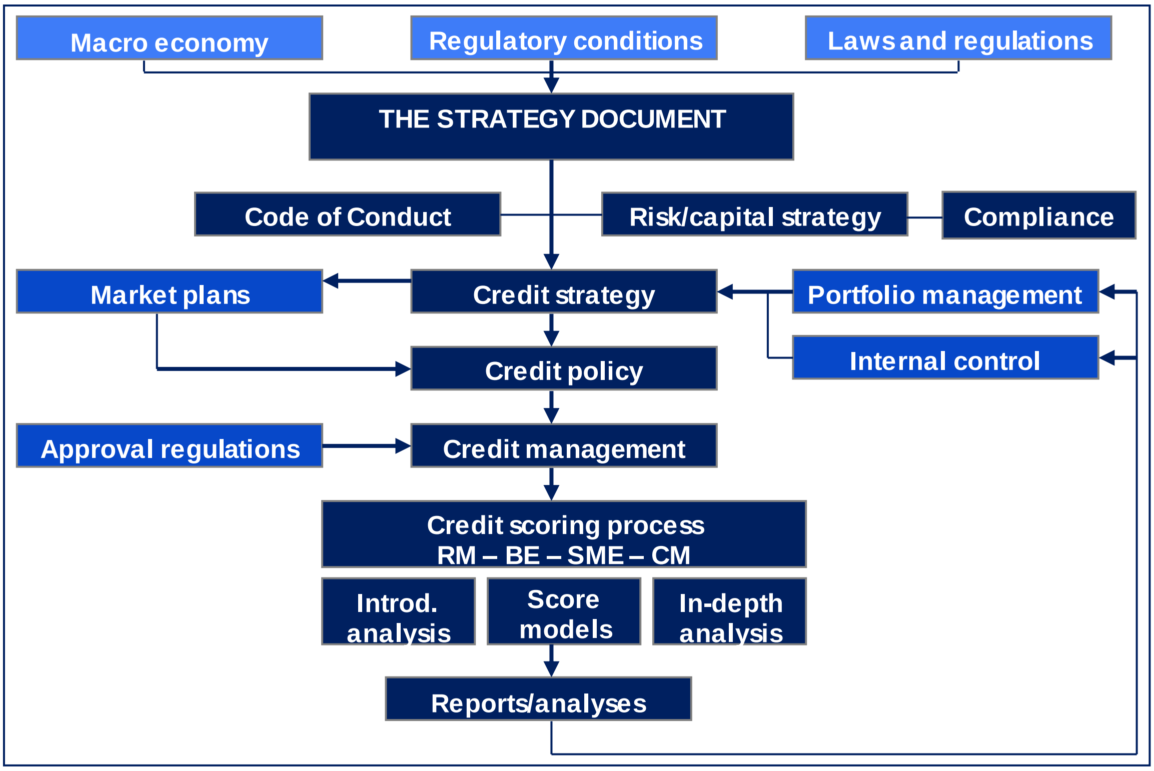

Figure: Management model, Credit risk

Credit risk is managed through the Group's credit strategy, credit policy, credit routines, credit processes and authority mandates. These establish guidelines for the Bank's lending activities.

Sparebanken Sør has developed, and applies models for risk classification for credit processes and portfolio management in the retail and corporate markets.

Credit strategy
The credit strategy encompasses overarching issues relating to the Bank's credit portfolio and granting of credit, and comprises general outlines and a series of credit strategy and quantitative frameworks.

These essentially consist of objectives and guidelines, while the quantitative frameworks can establish both restrictions and goals for risk tolerance and risk appetite.

Credit policy
The credit policy establishes policy rules for individual commitments and more detailed criteria for the granting of credit, as well as principles for operationalising the credit strategy.

Approval regulations
The approval regulations and authorisation mandates describe criteria and authorities for granting and monitoring credit. These authorities are differentiated by competence, risk class and security category, as well as the needs for the individual position.

Credit management procedures
The credit document and credit routines regulate various matters relating to the granting and monitoring of credit, and handling non-performing exposures.

Credit scoring process
The Bank uses decision-support systems as part of its credit scoring process. There is one process flow for retail customers, and three process flows for corporate customers depending on the size and type of the customer. There is also a process flow for renewing commitments for corporate customers.

The main features of the credit scoring process are outlined below.

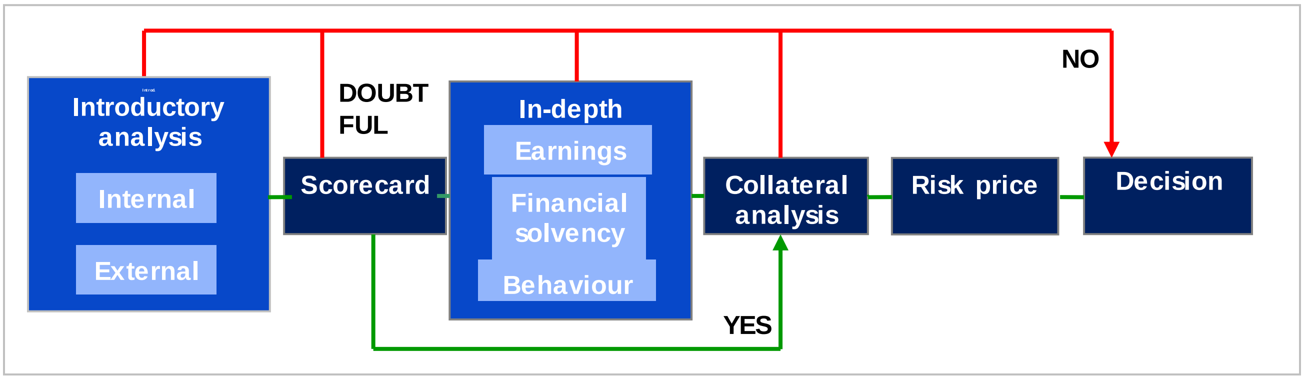

Figure: Credit scoring process

The introductory analysis is based on internal and external assessments and policy controls and is intended to identify whether the application complies with the Bank's strategy and policy, or whether there are risk aspects that indicate that the application should be rejected even at this early stage.

Based on the results of scoring and introductory analysis, requirements are established to determine which credit processes and risk assessments should be performed and which authorities should be applied for the granting and monitoring of commitments in the retail and corporate markets. Depending on the result of the introductory analysis and scoring, doubtful applications (yellow items) are subject to one or more in-depth analyses of earnings, financial solvency and/or behaviour.

Security coverage calculations are based on expected realisable values.

The results of introductory analyses, scorecards, in-depth analyses and the securities policy, as well as any deviations from the risk price, indicate who has authority to approve the case.

Internal control
Procedures have been established for annual risk identification, risk analysis, control plans and follow-up for the various processes in the credit area. Half-yearly management confirmations of assessments of changes in risk are also obtained, and managers in all business areas must update the risk picture and internal control on an ongoing basis.

Commitment follow-up
All customers in a high risk class are followed up each quarter in respect of measures and loss provisions. The Bank's largest exposures are regularly presented to the Board.

Non-performing exposures in the retail customer and sole proprietor segments are assigned to an external debt collection agency for recovery.

Non-performing exposures in the corporate market are subject to separate follow-up procedures, where the central department for special exposures determines further handling of the exposure.

Reports/analyses
Periodic reports for and analyses of the credit area are prepared to ensure that the Bank is acting in accordance with the goals set out in the policy documents.

6.2.4. Framework

Risk classification system
The risk classification system is used in the credit scoring processes, and to calculate risk, tied-up capital and profitability at product, customer and portfolio level.

The risk classification system is made up of the following components:

Probability of default	**Model for calculating probability of default**
Security classes	**Models for calculating security classes**
Exposure	**Models for calculating exposure**
Loss ratio	**Models for calculating loss given default**
Expected loss	**Models for calculating expected losses in next 12 months**
Risk group	**Models for allocation into risk groups**
Risk price	**Models for calculating risk-adjusted price**

Figure: Risk classification system

Probability of default

A scorecard is used to calculate the probability of default. Scorecards allocate customers into 11 risk classes from A–K, where A–D are low risk, E–G are medium risk, H–J are high risk and category K is default. The Group has an application and behaviour scorecard for the retail market and the corporate market.

Risk class	Lower limit for default, %	Upper limit for default, %
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	2.00
G	2.00	3.00
H	3.00	5.00
I	5.00	8.00
J	8.00	99.99
K	100	

Table: Risk classes

Risk classes Retail market

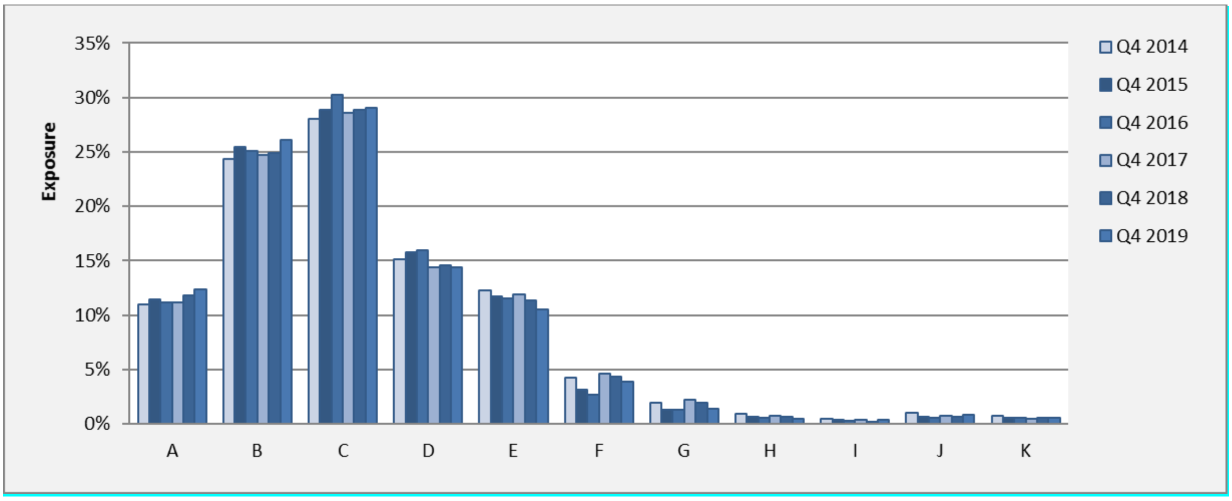

Figure: Risk classes RM

The figure shows the retail market portfolio by probability of default category. In Q4 2019, customers with low risk (A–D) accounted for around 82 per cent of the portfolio. Customers with medium risk (E–G) accounted for around 16 per cent, while customers with high risk (H–J) including category K (default), accounted for around 2.2 per cent.

Risk classes Corporate market

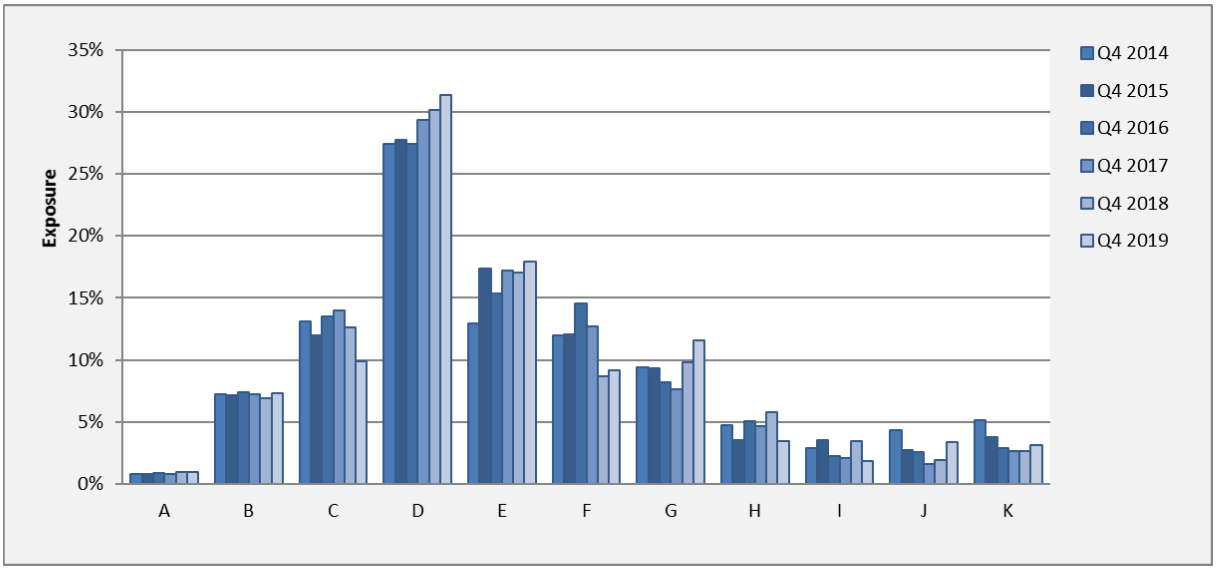

Figure: Risk classes CM

The figure shows the Corporate market portfolio by probability of default category. In Q4 2019, customers with low risk (A–D) accounted for around 50 per cent of the portfolio. Customers with medium risk (E–G) accounted for around 39 per cent, while customers with high risk (H–J) including category K (default) accounted for around 12 per cent.

Loss ratio

Based on the loan-to-value, a loss ratio (LGD – Loss Given Default) is calculated for the exposure in the event of default.

Exposure at default

The Conversion Factor (CF) defines how great a percentage of the unused credit framework is expected to be utilised in the event of default. EAD – Exposure At Default – is calculated as the higher of the balance or total commitments. A CF of 100 is applied for unused credit commitments.

Expected loss

The expected loss for the next 12 months is calculated as follows:
Probability of default (PD) × Exposure (EAD) × Loss ratio (LGD).

Risk-adjusted capital

The Bank reports the capital requirement for capital adequacy using the standard method. Tied-up capital is calculated at product and customer level as risk-adjusted capital for areas such as risk pricing.

Validation

Each year the Group performs a qualitative and quantitative validation of the scoring models. The models are calibrated using a “Through-The-Cycle” (TTC) approach.

6.2.5. Exposure amount by type of exposure

The Bank's overall exposure amount comprises:

NOK MILLION	31.12.2019	31.12.2018	Change	Per cent
Total gross loans	106.704	103.400	3.304	3,2 %
Total unused credits	13.195	12.155	1.040	8,6 %
Guarantees	1.380	1.432	-52	-3,6 %
TOTAL COMMITMENTS	**121.279**	**116.987**	**4.292**	**3,7 %**

6.2.6. Gross lending by geographic area

	GROUP			
NOK million	**31.12.2019**		**31.12.2018**	
Vest-Agder	47.782	44,8 %	46.322	44,8 %
Aust-Agder	25.791	24,2 %	25.003	24,2 %
Telemark	11.743	11,0 %	11.384	11,0 %
Oslo	8.924	8,4 %	8.651	8,4 %
Akershus	2.802	2,6 %	2.716	2,6 %
Rogaland	2.675	2,5 %	2.593	2,5 %
Others	6.765	6,3 %	6.559	6,3 %
Accrued interests	222	0,2 %	173	0,2 %
Total gross loans	**106.704**	**100,0 %**	**103.400**	**100 %**

The Bank's main market area is Agder, Rogaland, and Vestfold og Telemark. The Bank also has a national market segment, comprising organisations that form part of KNIF (Kristen-Norges Innkjøpsfellesskap). This market area also includes some retail customers who now live outside the Bank's core geographic area.

6.2.7. Total exposure amount by sector

NOK MILLION	GROUP	
	31.12.2019	**31.12.2018**
Retail customers	77.229	73.938
Public administration	905	875
Primary industry	1.379	1.116
Manufacturing industry	1.550	1.584
Real estate development	6.773	6.476
Building and construction industry	2.257	2.289
Property management	18.612	19.544
Transport	864	829
Retail trade	1.804	1.716
Hotel and restaurant	334	355
Housing cooperatives	1.255	1.106
Financial/commercial services	2.342	1.428
Social services	5.752	5.558
Accrued interests	222	173
TOTAL COMMITMENTS	**121.279**	**116.986**

As of 31 December 2019, the total exposure in the corporate market accounted for around 35 per cent of the Bank's total portfolio.

6.2.8. Losses on loans, guarantees and undrawn credits

Provisions for losses and the loss expense for the period are calculated in accordance with the new accounting standard IFRS 9, based on expected credit losses (ECL) using a 3-stage model described in the notes to the financial statements.

	GROUP	
Loss expense on loans during the period	**31.12.2019**	**31.12.2018**
Period's change inn write-downs stage 1	-5	-3
+Period's change inn write-downs stage 2	33	-7
+Period's change inn write-downs stage 3	-89	-43
+ Period's confirmed loss	41	22
+ Recognised as interest income	18	4
- Period's recoveries relating to previous losses	13	8
+Change in write downs on guaranties	-1	-1
Loss expenses during the period	**-17**	**-36**

GROUP

NOK million	**Stage 1** Expected losses in the next 12 months	**Stage 2** Lifetime expected credit losses	**Stage 3** Lifetime expected credit losses	**Total**
Provisions for loan losses as at 01.01.2019	**45**	**94**	**335**	**473**
Transfers				
Transferred to stage 1	47	-17	-30	0
Transferred to stage 2	-4	51	-47	0
Transferred to stage 3	-1	-2	3	0
Losses on new loans	20	39	37	96
Losses on deducted loans	-16	-24	-67	-107
Losses on older loans and other changes	-53	-13	0	-66
Provisions for loan losses as at 31.12.2019	**39**	**126**	**231**	**397**
Provisions for loan losses	32	111	228	370
Provisions for guarantees and undrawn credits	8	15	4	27
Total provision for losses as at 31.12.2019	**39**	**126**	**231**	**397**

GROUP

NOK million	Stage 1 Expected losses in the next 12 months	Stage 2 Lifetime expected credit losses	Stage 3 Lifetime expected credit losses	Total
Provisions for loan losses as at 01.01.2018	**51**	**99**	**416**	**566**
Transfers				
Transferred to stage 1	35	-32	-3	0
Transferred to stage 2	-5	5	0	0
Transferred to stage 3	0	-1	1	0
Losses on new loans	19	16	29	64
Losses on deducted loans	-10	-17	-83	-110
Losses on older loans and other changes	-44	23	-24	-46
Provisions for loan losses as at 31.12.2018	**45**	**94**	**335**	**473**
Provisions for loan losses	39	88	331	458
Provisions for guarantees and undrawn credits	6	6	3	16
Total provision for losses as at 31.12.2018	**45**	**94**	**335**	**473**

* Losses on derecognised loans relate to losses on loans redeemed or transferred between banks and credit institutions.

The table also includes impairments of off-balance sheet items (unused credit facilities and guarantees). These are presented as other liabilities in the balance sheet.

Impairments by sector, industry and stage

NOK million				GROUP
	Loss allowances as of 31.12.19	**Stage 3**	**Stage 2**	**Stage 1**
Retail customers	59	35	19	5
Public administration	0	0	0	0
Primary industry	3	1	1	1
Manufactoring industry	9	4	2	4
Real estate development	94	66	20	8
Building and construction industry	17	13	3	1
Property management	142	58	68	15
Transport	25	24	0	0
Retail trade	22	18	3	1
Hotel and restaurants	1	0	1	0
Housing cooperatives	2	0	1	0
Financial/commercial services	16	8	6	2
Sosial services	7	3	2	2
Total loss allowances on loans, guarantees and undrawn credit	**397**	**231**	**126**	**39**
Loss allowances on lending	370	228	111	32
Loss allowances on unused credits and guarantees	27	4	15	8
Total loss allowances	**397**	**231**	**126**	**39**

NOK million				GROUP
	Loss allowances at 31.12.18	Stage 3	Stage 2	Stage 1
Retail customers	52	31	17	5
Public administration	0	0	0	0
Primary industry	2	1	0	0
Manufactoring industry	38	35	2	1
Real estate development	56	36	9	10
Building and construction industry	96	91	4	1
Property management	173	101	50	22
Transport	9	7	1	1
Retail trade	25	20	4	1
Hotel and restaurants	1	0	0	0
Housing cooperatives	2	0	1	0
Financial/commercial services	13	9	3	1
Sosial services	7	3	2	3
Total loss allowances on loans, guarantees and undrawn credit	**473**	**335**	**94**	**45**
Loss allowances on lending	457	331	88	39
Loss allowances on unused credits and guarantees	16	3	6	7
Total loss allowances	**473**	**335**	**94**	**45**

Industries are presented based on official industrial codes and are grouped as the Group reports these internally.

Expected annual average net loss

As at 31 December 2019, impairment losses totalling NOK 397 million were recognised for losses on loans, guarantees and unused credit facilities (NOK 473 million as at 31 December 2018). These relate to different risk classes.

6.2.9. Non-performing exposures

Retail customers and corporate customers are scored each month, and are allocated to 11 classes (A–K) based on their probability of default. Category K comprises non-performing loans.

The Group deems a financial asset to be in default if a minimum of one of the following criteria is met:

- The contractual payments have been overdue for more than 90 days and the amount exceeds NOK 1,000.
- Credit losses have been recognised
- Bankruptcy has been declared
- Qualitative assessments and default notices have been made.

Qualitative assessments are made when observable data is available relating to the exposure, for example, significant financial difficulties at the issuer or borrower. When the borrower's lender, due to financial or contractual grounds relating to the borrowers' financial difficulties, has granted the borrower concessions that the lender would not otherwise have considered and when it becomes probable that the borrower will enter bankruptcy or undergo another form of financial reorganisation.

Non-performing exposures

	GROUP	
NOK Million	**31.12.2019**	**31.12.2018**
Gross non-performing loans > 90 days	286	213
Other non performing loans	787	797
Total non-performing loans (step 3)	**1073**	**1.010**
Impairement losses in stage 3	231	335
Net non-performing loans	**842**	**675**
Provisioning non-performing loans	21,5 %	33,2 %
Gross non-performing loans in % of gross loans	**0,27 %**	**0,21 %**

Gross non-performing loans by sector and industry

NOK MILLION	**31.12.2019**	**31.12.2018**
Retail banking customers	249	229
Corporate customers	824	781
Total defaulted commitments	**1.073**	**1.010**
Public administration	0	0
Primary industry	16	17
Manufacturing industry	19	40
Real estate development	424	180
Building and construction industry	25	177
Property management	223	256
Transport	48	10
Retail trade	43	47
Hotel and restaurant	1	8
Housing cooperatives	0	0
Financial/commercial services	16	30
Social services	8	16
Total corporate customers	**824**	**781**

The weighted average security coverage for non-performing loans was 73 per cent as at 31 December 2019 and 77 per cent as at 31 December 2018. Security coverage represents the degree of the pledged security relating to each loan, and cannot exceed 100 per cent.

6.2.10. Pledging of security

The following main types of collaterals are used to establish the weighting of exposures for calculating capital requirements:

- Mortgages on property (homes, holiday homes)
- Bank deposits

Collateral is essentially valued based on the expected realisation value at the realisation date. The valuation principles are described in detail in the Bank's Credit Document. Mortgages on property in the retail market are valued on establishment and updated at least once a year.

The following additional types of guarantees are used to calculate the capital requirement.

- Guarantees from the government, county municipalities and municipalities

The Norwegian government has an AAA rating. Municipalities and county municipalities cannot declare bankruptcy, see the Norwegian Local Government Act. In light of this, guarantees from these bodies are deemed to sufficient to cover the nominal value.

Total exposure amount by category

Total exposure 31.12.2019 NOK MILLION	Secured in residential property	Secured in commercial property
Engagements with enterprises	3	104
Engagements in covered bonds		
Engagements in collective investement funds		
Engagements which are matured	345	460
Engagements with institutions		
Engagements which are high risk		
Engagements other	50	11
Engagements with local and regional authorities		31
Engagements with mass market	5.262	2.313
Engagements secured in property	72.847	23.496
Total	**78.506**	**26.416**

Procedures and guidelines for offsetting on- or off-balance-sheet commitments

Sparebanken Sør does not offset on- or off-balance-sheet commitments when calculating capital requirements for credit risk.

Procedures and guidelines for valuing collaterals

The Bank's Credit Document contains templates and estimated values for valuing relevant types of collateral objects. Calculations are essentially based on sales value, estimates from Real Estate Norway, book value or other relevant indicators of sales value. The value of the objects is then reduced by a standard factor that varies with the type of collateral object. This reduced value is then the realisation value.

6.3. Counterparty risk

6.3.1. Definition

Counterparty risk is the risk of the Bank's business partners/suppliers in the financial field not being able to fulfil their contractual obligations to the Bank.

6.3.2. Management and control of counterparty risk

The Bank can enter into derivative contracts to cover market risk. Derivative contracts must be established with reputable counterparties, with a good rating, and must be regulated by an underlying ISDA agreement. Contractual relationships must be diversified over several counterparties.

The Bank complies with the regulations for derivatives trading under EMIR (European Market Infrastructure Regulation) for settlement, certifications, documentation and reporting to the authorities.

Derivative contracts are entered into to hedge the risk that arises in the Bank's ordinary operations in connection with funding at fixed interest rates and in a currency other than NOK, loans to customers at fixed interest rates, and in foreign currency and in derivatives trading with customers.

The Bank's counterparty risk is regulated using clearing, and established agreements on the pledging of security (Credit Support Annex) between the parties. Since the middle of October 2019, all new derivatives trades have been conducted using a new clearing agreement. A clearing house (central counterparty) will then guarantee the obligations relating to derivatives trades by acting as counterparty for both the buyer and seller. This means in reality a transaction will consist of two underlying trades, one between the clearing house and buyer, and one between the clearing house and the seller. Settlement risk is reduced through daily calculations of the margin each party should pledge for outstanding trades. CSA settlement will apply to all derivatives transactions that are not covered by clearing. Under CSA settlement, the value of derivatives is reconciled with the derivative counterparty, and settlement of security takes place. This enables the Bank to maintain low counterparty risk.

6.4. Market risk

6.4.1. Definition

Market risk includes risk associated with fluctuations in the value of unhedged interest rate, credit spread, currency and equity positions. Losses may arise due to fluctuations in interest rates and credit spreads, and in the event of fluctuations in foreign exchange rates and share prices. In addition, the valuation of hedge transactions (basis swaps), which are used to hedge interest rate and foreign exchange risk arising when the Bank carries out financing in foreign markets, will also have a temporary impact on profit or loss.

The Board has established risk-tolerance guide levels for investment in shares, bonds and positions in the interest rate and currency markets. Compliance with these performance goals is followed up regularly and reported to the Board.

6.4.2. Risk assessment

The Bank is exposed to interest rate risk, share risk, foreign exchange risk and credit spread risk.

Sparebanken Sør's market risk exposure is low, but is impacted by the scope of the Bank's calculated spread risk in the liquidity portfolio. There will also be temporary results effects relating to the valuation of hedge transactions for the Group's foreign financing.

The interest rate risk limit is determined as an upper limit for the permitted loss on unhedged interest rate positions in case of shifts or distortions in the interest rate curve. Interest rate risk arising in the Group's ordinary operations in the form of fixed-interest customer loans, derivatives trades with customers, fixed-interest investments and funding at fixed rates of interest and in foreign currencies is hedged on an ongoing basis.

At the end of the year, the Group's investments in shares totalled NOK 1,158 million, of which NOK 5.7 million relates to the trading portfolio. The Bank's largest commercial investments include shareholdings in Frende Holding AS, Brage Finans, Balder Betaling AS, Eksportfinans ASA and VN Norge AS totalling NOK 1,078 million.

The Group is affected by fluctuations in the currency market through its currency-related activities with customers. Foreign exchange exposure is hedged on an ongoing basis using different instruments including currency futures and swaps. The total foreign exchange risk framework is NOK 20 million.

An upper risk tolerance level has been set for results effects deriving from general market changes in credit margins that could impact the value of the Group's interest-bearing securities portfolio.

Capital adequacy for market risk is calculated using the standard method. The Bank has also assessed whether there are other aspects of the Bank's market risk that indicate capital ought to be set aside for risks that cannot be covered using the standard method.

6.4.3. Management and control

Market risk is managed through guidelines contained in board-adopted guidelines, authorities and procedures.

Specific performance goals and risk tolerance levels have been set for the different market risks.

Market risk is reported to Group management, the Risk Committee and the Board in accordance with board-adopted guidelines.

Interest rate risk

Interest rate risk is defined as the risk of financial losses arising from changes in interest rates if the fixed -interest period for the Bank's liabilities and receivables do not coincide.

The purpose of managing interest rate risk is to ensure that the Group at all times has a known risk exposure and that this remains within an established risk tolerance level.

The interest rate risk limit is determined as an upper limit for permitted losses on unhedged interest rate positions in the event of a two percentage point parallel shift in the interest rate level or six different scenarios involving distortions in the interest rate curve. Interest rate risk arising in the Group's ordinary operations in the form of fixed-interest customer loans, fixed-interest investments and funding at fixed rates of interest and in foreign currencies is hedged on an ongoing basis. At the end of 2019, the Group had a net interest position of NOK 24 million.

Share price risk

Share price risk consists of market risk associated with positions in equity instruments, including derivatives with underlying equity instruments. Exposure is measured as the size of the potential loss, where the market value of the shares falls by 45 per cent, and the exchange rate risk is regulated by limits for the maximum aggregated position in a share portfolio. The calculation must be based on market rates, to the extent that these are available for the instrument. The upper limit has been set at NOK 45 million.

The framework for investments in shares includes investments in equity instruments, as well as investments in hedge funds, private equity funds, venture funds and incubator funds. Shares in subsidiaries and/or strategic shareholdings in the financial sector are not included, but are subject to special measures.

The purpose of managing share price risk is to ensure that the Group at all times has a known risk exposure and that this remains within an established performance goals.

Exchange rate risk

Exchange rate risk is the risk of financial loss arising from a disadvantageous change in the value of asset and liability items (on and off the balance sheet) measured in the base currency (NOK) due to fluctuations in exchange rates. Exposure is measured as the size of the potential losses in a stress scenario, where exchange rates change by 25 per cent and the exchange rate risk is regulated by limits for the maximum aggregated exchange rate position. The upper limit has been set at NOK 20 million.

Credit spread risk

Credit spread risk is defined as the risk of changes in the market value of interest-bearing securities due to a general market change in credit margins. A general increase in credit margins would lead to a reduction in the value of a portfolio of interest-bearing securities. Changes in the credit margin are a consequence of changes in investors' requirement for a risk premium for a shift in anticipated credit risk and/or changes in other market conditions.

Finanstilsynet's stress test model for credit spread risk is used to calculate risk exposure. The Bank's credit spread exposure relates to the liquidity portfolio.

A board-approved framework has been established for the scope of the Bank's credit spread exposure. The Bank's credit risk is also adjusted indirectly via frameworks for maximum investments in different portfolios. At the end of 2019, 74 per cent of the limit adopted by the Board had been used.

6.4.4. Shares

The Group values share investments at fair value and in accordance with the equity method (associates).

The table below shows the largest investments, and their classification.

NOK MILLION

Classification	Company	31.12.2019	31.12.2018
Associated companies	Frende Holding AS	483	483
Associated companies	Brage Finans AS	374	187
Associated companies	Balder Betaling AS	103	93
Fair value	Norne Securities AS	6	8
Associated companies	Others	8	8
Total strategic investments		**974**	**779**
Fair value	Others	184	175
Total shares		**1.158**	**954**

The Bank increased its shareholding in Brage Finans AS in 2019 and changed classification from fair value to associate (the equity method) due to the shareholding now exceeding 20 per cent. Further information on the shares can be found in the consolidated annual financial statements.

6.4.5. Interest rate risk

The Bank's interest rate risk exposure is measured by taking into account unhedged balance sheet and derivative positions. The methods used are a two per cent parallel shift in the interest rate curve, and six different scenarios involving distortions in the interest rate curve. The scenario with the greatest loss potential is taken as a basis for measuring interest rate risk.

If the date on which the rate of interest for the Bank's market funding at floating 3-month NIBOR is set differs from the date on which the rate of interest for the Bank's lending volume is set, the Bank is exposed to a fixing risk.

The risk tolerance level for interest rate risk is NOK 125 million.

Measured at market value, the Bank's interest rate exposure at the end of 2019 was NOK 24 million. However, recognising income statement items related to fixed rate financing (hedge accounting) has an expected lower impact on profit in the event of changes in the yield curve (NOK 7 million).

6.4.6. Credit spread risk

Guidelines have been issued for managing the Bank's liquidity risk applying a minimum level adopted by the Board for the scope of the liquidity portfolio for interest-bearing securities. The liquidity portfolio must be LCR-compatible and the Bank must be able to receive loans from Norges Bank. Limits have been set for exposure in individual sectors.

At the end of the year, the Group's liquidity portfolio of interest-bearing certificates and bonds was valued at NOK 19.9 billion. The securities holdings are part of the Bank's liquidity reserve, which is intended to safeguard the Bank's liquidity situation in volatile market conditions. The holdings comprised portfolios of covered bonds (70 per cent), and government securities and other government and municipality guaranteed securities with commensurate capital weighting. The Group's liquidity portfolio is used to satisfy the authorities' requirements for LCR or as supplementary security in the mortgage institution.

At the end of 2019, the calculated credit spread risk in accordance with Finanstilsynet's model totalled NOK 221 million.

At the reporting date, 74 per cent of the limit adopted by the Board for credit spread risk had been used.

6.5. Operational risk

6.5.1. Definition

Operational risk is defined as the risk of losses due to inadequate or defective internal processes, procedures or systems, human error or external events. The definition covers legal risk, but not strategic risk and reputation risk, which must be evaluated separately.

6.5.2. Risk assessment

Capital adequacy for operational risk is calculated using the basic method. The Bank has also assessed whether there are other aspects of the Bank's operational risk that indicate that capital ought to be set aside for risks not covered by Pillar 1.

The Bank's operational risk is considered low.

6.5.3. Management and control

Operational risk is managed through the Group's framework for operational risk, procedures and authorities. The performance goals for operational risk are established each year by the Board.

Management and control of risk can be split into three levels:

- Operational management and control
- Overarching risk management and control
- Internal Audit control

Line management has operational responsibility for management and control of operational risk. Risk management puts systems in place and is responsible for tasks relating to overarching management and reporting of operational risk. Internal Audit give their assessments of the Group's management and control within operational risk to the Board.

Undesired incidents that arise in the Group are registered in an incident database. Registered incidents are followed up on an ongoing basis, and needs for measures to prevent recurrences are assessed. It is important that as many incidents as possible are registered when they first arise, as they provide valuable information for risk assessments.

Performance goals, status, development and registered incidents in operational risk are included in the quarterly risk report to the Board.

6.5.4. Money laundering and the financing of terrorism

Money laundering is often defined as actions that make illegally-gained proceeds appear legal. Financing of terrorism includes receiving, procuring or collecting funds to finance acts of terrorism. Sparebanken Sør is subject to laws and regulations designed to combat money laundering and the financing of terrorism. The Bank is aware of its corporate social responsibility and continually strives to reinforce its compliance with laws and regulations.

The Bank is required and expected to assume even greater corporate social responsibility in this area. The authorities have sharpened their focus on banks' compliance with the money laundering regulations, and the Bank is actively striving to reduce its risk of being used as an instrument for money laundering and the financing of terrorism. In Q1 the Bank will complete a major project to update customer information and verification of all customers. An annual e-learning course is arranged for all employees and there is a major focus on this area in the Bank's day-to-day operations. In 2019, the Bank more than doubled its full-time equivalents working in investigation, customer measures and reporting of suspicious transactions. The Bank's approach to preventing money laundering and the financing of terrorism is risk-based, and work is continually performed to improve manual and electronic processes that reduce the Bank's overall risk in this area.

6.6. Liquidity risk

6.6.1. Definition

Liquidity risk is defined as the risk of the Group not being able to meet its obligations or fund its assets, as well as not being able to obtain funding without incurring significant additional costs, in the form of a fall in the value of assets that must be realised, or in the form of funding at an above-normal cost level. Liquidity risk also includes the risk that the financial markets that the Bank wishes to use are not functioning.

Sparebanken Sør's liquidity risk must comply with the authorities' and board-imposed requirements. The risk must be moderate to low and be adapted to the Bank's general operations. The Bank's adaptation arrangements must be similar to such arrangements in comparable banks and satisfy the requirements of investors in the Bank's securities.

6.6.2. Risk assessment

Liquidity risk affects two main areas:

- Risk of refinancing outstanding debt
- Price risk is: the risk of not achieving competitive terms for the Bank's funding

Deposits from customers are the Bank's most stable source of funding. The Board of Directors emphasises that the ratio between deposits from customers and lending must be tailored to the Group's overall funding situation. The Group's deposit-to-loan ratio was 54 per cent at year end.

In addition, Sparebanken Sør Boligkreditt AS is an important funding instrument, ensuring access to long-term funding through the issuance of covered bonds. To be able to issue covered bonds, mortgages equivalent to 57 per cent of all loans to the retail market were transferred from the parent bank to the mortgage company in 2019.

The Bank attaches importance to diversifying market funding. EMTN (European Medium Term Note) programmes have been established for both the Bank and mortgage company that facilitate market funding from sources outside the Norwegian bond market. At the end of 2019, the Bank had issued senior debt to foreign investors corresponding to EUR 300 million. Similarly, Sparebanken Sør Boligkreditt had issued covered bonds with a value of EUR 2.5 billion.

Levels of risk tolerance adopted by the Board of Directors for the Bank's liquidity risk follow guidelines issued by Finanstilsynet. At the end of the year, the levels of liquidity risk were within the limits adopted by the Board.

At the end of 2019, the liquidity indicator for long-term funding stood at 123 per cent.

The Group has a liquidity reserve in the form of liquid interest-bearing securities that satisfy requirements imposed by the authorities and adopted by the Board for LCR holdings and liquidity stress testing. The Bank also has mortgages cleared for transfer to the mortgage company. The Bank's interest-bearing liquidity portfolio consists of government securities, other interest-bearing securities with zero capital weighting, covered bonds and securities issued by Norwegian municipalities and county councils.

The Bank's short-term liquidity risk is managed partly by adaptation to the Liquidity Coverage Requirement (LCR). At the end of 2019, the total LCR indicator for Sparebanken Sør (Group and Parent Bank) and Sparebanken Sør Boligkreditt AS was sufficient to comfortably satisfy all the projected liquidity maturities within the next 30 days under a stress scenario. The Group and parent company had an LCR ratio of 148 per cent and 140 per cent respectively at 31 December 2019. The regulatory requirement was 100 per cent.

In addition to LCR, the Bank analyses liquidity risk using stress tests. According to these analyses, the Group would be able to continue operating normally for 29 months in a stress alternative, where new market funding is assumed to be unavailable and the regulatory liquidity reserves can be used.

6.6.3. Management and control

Liquidity risk is managed through the Group's liquidity strategy, and general guidelines and procedures. Key operational management parameters include requirements for the deposit-to-loan ratio, long-term funding indicator, stress indicator for liquidity disposals within 30 days (LCR) and, in addition, guidelines for the ability to survive in situations where there is no access to market funding. Liquidity risk is also managed by ensuri ng that funding from the capital market is distributed across various terms to maturity, funding sources, markets and instruments.

Rolling liquidity forecasts and rolling analyses of funding requirements are prepared to satisfy requirements set by the authorities and the Board.

In addition, stress tests are used to be able to measure the Group's ability to survive without the injection of new funding from the market and assuming the loss of deposit funds.

Board-adopted risk tolerance levels have been adopted to control liquidity risk. Emergency response plans have also been established to incorporate guidelines for implementation of measures in the event of non-conformances with board-adopted risk tolerance levels and for evaluation of a liquidity crisis, which also describe relevant measures and responsibilities.

Liquidity risk is managed on an ongoing basis and followed up through fixed monthly and quarterly reports to the Board and Group management.

Stress test, liquidity

Sparebanken Sør performs stress tests of liquidity to assess how long the Bank could survive without the injection of new funding in given scenarios. Stress testing is based on the following scenarios:

- Base case
- Bank crisis
- Market crisis
- Bank and market crisis

Specific performance goals have been set for the different scenarios.

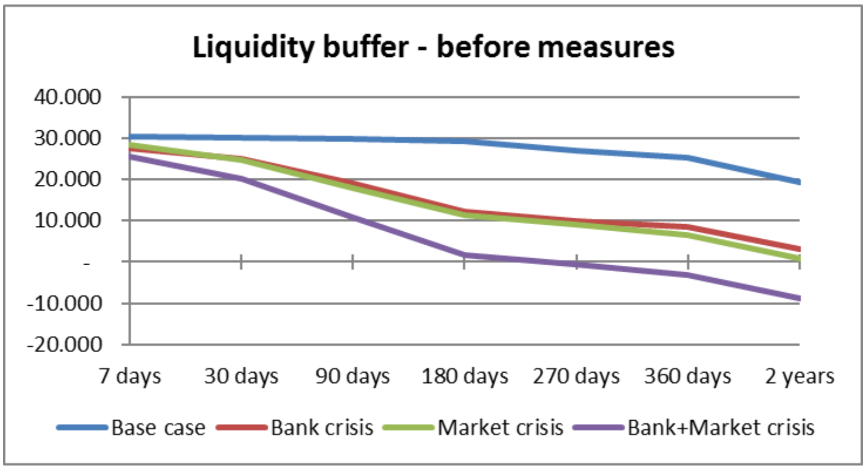

Figure: Liquidity stress test

Scenario	Risk tolerance	Results	Margin
Base case	12 months	> 2 years	25.299
Bank crisis	6 months	> 2 years	12.105
Market crisis	6 months	> 2 years	11.338
Bank + Market crisis	3 months	> 6 years	10.878

Comments:
The Bank's stress testing of liquidity risk showed that the liquidity buffers satisfied the minimum requirements for compliance adopted by the

The performance goal for survival in the Base case without injection of external capital has been set at 12 months. The performance goals under the Bank's liquidity strategy, including requirements relating to the results of stress testing, represent effective limitations of the scope of external funding and establish requirements for maturity structures, and provide guidance on the size of the Bank's liquidity profile.

A separate analysis has been prepared for implementation of special liquidity measures. The measures involve the re-establishment of relevant risk tolerance levels for liquidity and market risk under different stress scenarios.

6.7. Business risk

6.7.1. Definition

Business risk is the risk of unexpected fluctuations in revenues and expenses in the next year's operations as a result of changes in external factors such as cyclical fluctuations, the competitive situation, customer behaviour, unsatisfactory business performance and regulations issued by public authorities, i.e. factors other than credit risk, market risk and operational risk.

Reputation risk, which is the risk of loss of earnings or access to capital due to lack of credibility or reputation in the market, is included as part of business risk.

6.7.2. Risk assessment

The Group has good control of the effect of proposed regulatory changes in areas such as capital adequacy and liquidity requirements. The competitive situation is closely monitored and adaptations are continually made. The Bank has little control of the effects of economic cycles, other than through stress tests to quantify possible effects of various scenarios.

The Bank's business risk is considered low.

6.7.3. Management and control

The Group's results, balance sheet and key figures are monitored through monthly reporting to Group management and the Board.

Predicting reputation risk, and establishing effective procedures and solutions to reduce its scope and consequences, can be challenging. This is primarily achieved through pre-defined communication strategies if individual incidents arise, as well as the clarity, credibility and compliance of the information issued by the Bank. Long-established high standards of ethical and business conduct also help to create security for customers, partners and the market.

6.8. Strategic risk

6.8.1. Definition

Strategic risk is defined as internal factors where the strategic risk relates to the strategies, plans and changes that the Bank has either implemented or proposed.

6.8.2. Risk assessment

The Bank's strategic risk is considered to be low.

No performance goals have been adopted for strategic risk.

6.8.3. Management and control

Strategic risk is managed through Board and Group management processes for implementation and follow-up of the Bank's strategy.

6.9. Ownership risk

6.9.1. Definition

Ownership risk is defined as the risk of the Group being adversely affected by shareholdings in subsidiaries and associates and/or having to contribute new equity to these companies.

6.9.2. Risk assessment

The Bank's ownership risk is considered to be low.

6.9.3. Management and control

No performance goals have been adopted for ownership risk.

Management and the boards of subsidiaries are run in accordance with the provisions of the Norwegian Public Limited Liability Companies Act. Several of the companies employ managers and/or employees from the Group on their boards of directors or in other positions.

Any loans to subsidiaries are included under credit risk and concentration risk.

A list of subsidiaries is presented in item 3.1.1

6.10. Compliance risk

6.10.1. Definition

Compliance risk is the risk of incurring legal or regulatory sanctions, financial losses or impaired reputation as a result of non-compliance with laws, regulations or policy documents.

6.10.2. Risk assessment

The Board has set a goal of ensuring that Sparebanken Sør has low compliance risk. This requires effective management and control of compliance risk and minimal compliance violations.

The scope of Norwegian legislation, including through international regulations and directives implemented under Norwegian law, is significantly expanding. A common feature of many of the changes is that compliance requires considerable input from the organisation in the form of investments in new system solutions and development of new processes at the Bank. Enterprises that do not comply with the law also face an increased risk of economic sanctions.

Sparebanken Sør is undergoing a period of rapid change. New products, new systems, new legal requirements, system changes and new and departing employees all entail an inherent risk of weaker compliance. New digital solutions also entail risk, and the consequence of errors in digital solutions is often greater than from individual human errors.

The compliance culture in the operative business is deemed to be good, but ensuring timely ongoing implementation of and compliance with an increasing scope of Norwegian and international regulations is increasingly becoming an ever-greater challenge.

6.10.3. Management and control

The Compliance function covers the entire Group including Sparebanken Sør Markets and Sparebanken Sør Investeringsrådgivning. The Group must have effective management, monitoring and control of compliance risk to ensure that no incidents cause significant harm to the Group's reputation or financial position.

The basic rule is that the Bank and the subsidiaries must at all times comply with prevailing legislation and policy documents. This will be achieved through:

- Clearly communicated and understood core values and ethical standards.
- Identification of risk of inadequate agreement/compliance must be an integral element of every process at the Bank.
- The Board, trustees and all employees at the Bank must perform their duties in accordance with authority requirements and guidelines set by the Bank, which is consistent with accepted norms and generally accepted financial and administrative practice.
- An established process for registering, communicating and implementing changes in legal requirements and regulations.
- An established process for monitoring and controlling compliance with the law and policy documents.

The Group's Compliance function is independent of the Group's various operational business environments and the other control functions. Compliance shall identify, monitor, report, advise and provide information to management of the Group's various business areas and subsidiaries to prevent non-conformances with compliance risk. Significant non-conformances with legal requirements must be reported and measures implemented to limit risk.

Line management and staff departments are responsible for implementation, compliance, follow-up and control of laws, regulations, industry standards and internal guidelines within their own business areas.

The various compliance functions present their assessment of compliance in a quarterly Compliance Report that is reviewed by Group management and the Risk Committee. The annual Compliance Report contains a summary of controls and findings and an assessment of compliance risk in the Group, which is also reviewed by the Board. The Compliance Officer may escalate matters directly to the CEO or Board if required.

7. SUSTAINABILITY

Sparebanken Sør has a long history of being a responsible corporate citizen and has assisted with the development of the local community for generations in the market areas where we operate. Sustainability, which also encompasses environmental, social and corporate governance (ESG), has been a cornerstone of Sparebanken Sør's business development right from the start. We also define our role for corporate social responsibility in terms of ESG.

Sustainability is a priority area of the Bank's overarching strategy. Within these areas, the Bank will help establish a pattern of consumption that will allow future generations to enjoy the same opportunities to meet their needs that we enjoy today. This is only a vision, but one that the Bank shares with the whole world, including through the UN's Sustainability Goals Even though the Bank, as the region's largest and leading financial group, focuses primarily on the local community, we are also committed to ensuring that everything we do is also sustainable in a global context.

For Sparebanken Sør, sustainable development means having a responsibility to contribute to positive future development of the environment and climate, social conditions and corporate governance, as well as upholding corporate social responsibility in the areas where the Group operates. Sparebanken Sør wishes to contribute to a sustainable transition, to the development of a low-emission society, and to achieve the UN's Sustainable Development Goals by 2030 within the areas that are relevant and on which the Bank can have a positive impact.

Sustainability work is firmly embedded at Board and management level. Policy documents have been prepared at the general strategic level, and at the more operative level within relevant areas.

UN Global Compact:

Sparebanken Sør has signed up to the UN Global Compact. The UN Global Compact is a global network for companies that want to work on sustainability and contribute to responsible and sustainable business practices. The Global Compact is the world's largest corporate social responsibility initiative in the area of sustainability, ESG.

UN Environmental Programme (UNEP) (Principles for Responsible Banking)

The UN Environmental Programme aims to enable the banking industry to play a leading role in achieving the sustainable development goals and fulfilling the Paris Agreement. The UN's principles for responsible banking activities provide guidance for the global banking industry on taking responsibility for, operating and benefiting from sustainable economic development.

Finance Norway's "Roadmap for Green Competitiveness in the financial sector"

Finance Norway has prepared a roadmap for green competitiveness in the financial sector with a vision that the financial services industry will be profitable and sustainable by 2030. The Roadmap encompasses six principles for the finance industry and two principles for banks, which the bank will integrate into its strategic and operational plans in work on sustainability.

GRI Standards (Global Reporting Initiative)

In 2019, Sparebanken Sør has reported in accordance with the GRI Standard (Global Reporting Initiative). The GRI Standard is a recognised global system and framework for sustainability reporting (ESG). The Oslo Børs guidelines on the reporting of sustainability recommend the GRI Standard.

You can read more about Sustainability at Sparebanken Sør in our Sustainability Report, Fact Book and GRI Index on the Bank's website.

ANNEX 1
Agreement terms for subordinated loan capital

Form for publication of key terms for capital instruments

1	Issuer	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør
2	Unique identification code (e.g. CUSIP, ISIN or Bloomberg's identification code for private placements)	NO0010730112	NO0010737026	NO0010743255	NO0010809460	NO0010825094	NO0010832157	NO0010837313	NO0010871247
3	Applicable law	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian
	Treament pursuant to the capital requirement regulations								
4	Rules applicable during the transition period	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital
5	Rules applicable following the transition period	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital	Additional Tier 1 capital
6	Included at company and consolidated level, company or consolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level
7	Instrument type (type should be specified for each jurisdiction)	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital
8	Amount included in subordinated capital (in NOK millions at the latest reporting date)	0	NOK 300m	NOK 300m	NOK 200m	NOK 250m	NOK 250m	NOK 100m	NOK 500m
9	Nominal value of instrument	NOK 70m	NOK 300m	NOK 300m	NOK 200m	NOK 250m	NOK 250m	NOK 100m	NOK 500m
9a	Issue price	100 percent	100 percent	100 percent	100 percent	100 percent	100 percent	100 percent	100 percent
9b	Excercise price	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value
10	Classification of accounts	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost
11	Original date of issuance	30 January 2015	03 June 2015	25 August 2015	02 November 2017	14 June 2018	14 September 2018	23 November 2018	12 December 2019
12	Perpetual or time limited	Time limited	Time limited	Time limited	Time limited	Time limited	Time limited	Time limited	Time limited
13	Original date of maturity	30 January 2025	03 June 2025	25 August 2025	02 November 2027	14 June 2028	14 September 2028	23 November 2028	12 December 2029
14	Redemption right of issuer dependent upon approval by the FSA of Norway	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
15	Date of redemption right, any conditional redemption rights and redemption amount	30 January 2020 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	03 June 2020 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	25 August 2020 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	2 November 2022 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	14 June 2023 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	14 September 2023 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	23 November 2023 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest	12 December 2024 100 % of nominal value In addition a "regulatory redemption right" at 100 % of nominal value plus accrued interest
16	Dates of any subsequent redemption rights	Each consecutive interest payment date following 30 January 2020	Each consecutive interest payment date following 3 June 2020	Each consecutive interest payment date following 25 August 2020	Each consecutive interest payment date following 2 November 2022	Each consecutive interest payment date following 14 June 2023	Each consecutive interest payment date following 14 September 2023	Each consecutive interest payment date following 23 November 2023	Each consecutive interest payment date following 12 December 2024
	Interest / dividend								
17	Fixed or floating interest	Floating	Floating	Floating	Floating	Floating	Floating	Floating	Floating
18	Reference rate and margin	3 m NIBOR +1,65 percent	3 m NIBOR +1,52 percent	3 m NIBOR +1,55 percent	3 m NIBOR +1,40 percent	3 m NIBOR +1,45 percent	3 m NIBOR +1,45 percent	3 m NIBOR +1,65 percent	3 m NIBOR +1,33 percent
19	Requirement to halt share dividend payment due to deferred coupon payment ("dividend stopper")	No	No	No	No	No	No	No	No
20a	Full flexibility, partial flexibility or mandatory (with regards to date)	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory
20b	Full flexibility, partial flexibility or mandatory (with regards to amount)	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory
21	Terms of interest rate increase, or other incentive to repayment	No	No	No	No	No	No	No	No
22	Non-cumulative or cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative	Cumulative
23	Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, level(s) that trigger conversion	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
25	If convertible, full or partial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
26	If convertible, conversion price	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
27	If convertible, mandatory or voluntary	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
28	If convertible, list the instrument type of the converted assets	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
29	If convertible, list the issuer of the converted assets	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
30	Terms of write-down	No	No	No	No	No	No	No	No
31	If write-down, level(s) that trigger write-down	N/A	N/A	NA	NA	NA	NA	NA	NA
32	If write-down, full or partial	N/A	N/A	NA	NA	NA	NA	NA	NA
33	If write-down, permanent or temporary	N/A	N/A	NA	NA	NA	NA	NA	NA
34	If temporary write-down, list the mechanism for write-up	N/A	N/A	NA	NA	NA	NA	NA	NA
35	Priority at liquidation (list the instrument type with the closest superior priority)	Senior bonds	Senior bonds	Senior bonds	Senior bonds	Senior bonds	Senior bonds	Senior bonds	Senior bonds
36	Terms which prohibit the assets being included after the transition period	No	No	No	No	No	No	No	No
37	If yes, specify which terms that do not fullfill new requirements	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Agreement terms for subordinated bonds

	Form for publication of key terms for capital instruments						
1	Issuer	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør
2	Unique identification code (e.g. CUSIP, ISIN or Bloomberg's identification code for private placements)	NO0010748908	NO0010768229	NO0010768237	NO0010793318	NO0010806649	NO0010867658
3	Applicable law	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian	Norwegian
	Treament in the capital requirement regulations						
4	Rules applicable during transition period	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital
5	Rules applicable following transition period	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital	Additional Tier 1 Capital
6	Included at company and consolidated level, company or consolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level	Company and colsolidated level
7	Instrument type (type should be specified for each jurisdiction)	Subordinated bond	Subordinated bond	Subordinated bond	Subordinated bond	Subordinated bond	Subordinated bond
8	Amount included in subordinated capital (in NOK millions at the latest reporting date)	NOK 310m	NOK 125m	NOK 190m	NOK 250m	NOK 200m	NOK 300m
9	Nominal value of instrument	NOK 310m	NOK 125m	NOK 190m	NOK 250m	NOK 200m	NOK 300m
9a	Issue price	100 percent	100 percent	100 percent	100 percent	100 percent	100 percent
9b	Excercise price	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value	100 percent of nominal value
10	Classification of accounts	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost	Debt - amortized cost
11	Original date of issuance	17 November 2015	29 June 2016	29 June 2016	23 May 2017	28 September 2017	07 November 2019
12	Perpetual or time limited	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual
13	Original date of maturity	No maturity date	No maturity date	No maturity date	No maturity date	No maturity date	No maturity date
14	Redemption right of issuer dependent of approval by the FSA of Norway	Yes	Yes	Yes	Yes	Yes	Yes
15	Date of redemption right, any conditional redemption rights and redemption amount	17 November 2020 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest	29 June 2023 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest	29 June 2021 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest	23 May 2022 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest	28 September 2022 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest	7 November 2024 100 % of nominal value In addition an "regulatory redemption right" at 100 % of nominal value plus accrued interest
16	Dates of any subsequent redemption rights	Each consecutive interest payment date following 17 November 2020	Each consecutive interest payment date following 29 Juni 2023	Each consecutive interest payment date following 29 Juni 2021	Each consecutive interest payment date following 23 June 2022	Each consecutive interest payment date following 28 September 2022	Each consecutive interest payment date following 7 November 2024
	Interest / dividend						
17	Fixed or floating interest	Floating	Fixed	Floating	Floating	Floating	Floating
18	Reference rate and margin, or fixed rate	3 m NIBOR +4,10 percent	6,5 percent	3 m NIBOR +5,50 percent	3 m NIBOR +3,20 percent	3 m NIBOR +3,20 percent	3 m NIBOR +3,20 percent
19	Requirement to halt share dividend payment due to defered coupon payment ("dividend stopper")	Yes	Yes	Yes	Yes	Yes	Yes
20a	Full flexibility, partial flexibility or mandatory (with regards to date)	Full	Full	Full	Full	Full	Full
20b	Full flexibility, partial flexibility or mandatory (with regards to amount)	Full	Full	Full	Full	Full	Full
21	Terms of interest rate increase, or other incentive to repayment	No	No	No	No	No	No
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
23	Convertible or non-convertible	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.	Could be converted into Common Equity Tier 1 Capital if instructed by the Norwegian FSA or by other relevant public athority, at a severe fall in solidity or if the regulators see it as neccessary to avoid liquidation.
24	If convertible, level(s) that trigger conversion	At a severe fall in solidity, or when necessary to avoid liquidation	At a severe fall in solidity, or when necessary to avoid liquidation	At a severe fall in solidity, or when necessary to avoid liquidation	At a severe fall in solidity, or when necessary to avoid liquidation	At a severe fall in solidity, or when necessary to avoid liquidation	At a severe fall in solidity, or when necessary to avoid liquidation
25	If convertible, full or partial	Full or partial	Full or partial	Full or partial	Full or partial	Full or partial	Full or partial
26	If convertible, conversion price	N/A	N/A	N/A	N/A	N/A	N/A
27	If convertible, mandatory or voluntary	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory	Mandatory
28	If convertible, list the instrument type of the converted assets	Common Equity Tier 1 Capital	Common Equity Tier 1 Capital	Common Equity Tier 1 Capital	Common Equity Tier 1 Capital	Common Equity Tier 1 Capital	Common Equity Tier 1 Capital
29	If convertible, list the issuer of the converted assets	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør	Sparebanken Sør
30	Terms of write-down	Yes	Yes	Yes	Yes	Yes	Yes
31	If write-down, level(s) that trigger write-down	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level	Common Equity Tier 1 Capital below 5,125 percent on the issuer's company level or consolidated level
32	If write-down, full or partial	Full or partial	Full or partial	Full or partial	Full or partial	Full or partial	Full or partial
33	If write-down, permanent or temporary	Permanent or temporary	Permanent or temporary	Permanent or temporary	Permanent or temporary	Permanent or temporary	Permanent or temporary
34	If temporary write-down, list the mechanism for write-up	Write-ups possible by adding parts of accumulated profits	Write-ups possible by adding parts of accumulated profits	Write-ups possible by adding parts of accumulated profits	Write-ups possible by adding parts of accumulated profits	Write-ups possible by adding parts of accumulated profits	Write-ups possible by adding parts of accumulated profits
35	Priority at liquidation (list the instrument type with the closest superior priority)	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital	Subordinated loan capital
36	Terms which prohibit the assets being included after the transition period	No	No	No	No	No	No
37	If yes, specify which term that doesn't fullfill new requirements	N/A	N/A	N/A	N/A	N/A	N/A

ANNEX 2
Information on mortgaged and non-mortgaged assets

		Carrying amount of encumbered assets			Fair value of encumbered assets		Carrying amount of unencumbered assets		
			of which: issued by other entities of the group	of which: central bank's eligible		of which: central bank's eligible		of which: issued by other entities of the group	of which: central bank's eligible
Item	Code	010	020	030	040	050	060	070	080
Assets of the reporting institution	010	37.550.998.519	-	-			91.945.734.686	-	19.254.236.292
Loans on demand	020	-					644.217.523		
Equity instruments	030	-							
Debt securities	040	-					19.645.614.292	-	19.254.236.292
of which: covered bonds	050	-	-				13.835.263.928		13.595.247.928
of which: asset-backed securities	060	-	-						
of which: issued by general governments	070	-					4.039.309.049		3.988.785.049
of which: issued by financial corporations	080	-					1.771.041.315		1.670.203.315
of which: issued by non-financial corporations	090	-							
Loans and advances other than loans on demand	100	37.550.998.519		-			69.190.538.508		-
of which: mortgage loans	110	37.550.998.519					63.617.024.786		
Other assets	120	-					2.465.364.363		