Storebrand ASA

Capital adequacy regulations (Basel II), Pillar 3

Q3 2013

storebrand

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1 Introduction

The purpose of this document is to disclose information about capital, risk exposures and risk management in accordance with Pillar 3 of the capital adequacy regulations (Basel II), which stipulates a set of requirements concerning the disclosure of financial information. Storebrand is involved in financial business activities which place significant requirements on the management and control of risk. Good risk management is an essential strategic tool for value creation within the entity. Its goals are to maintain good risk-bearing capacity while continuously tailoring the financial risk to the entity's solvency.

This document mainly provides information on the business segments within Storebrand which are governed by the Basel II regulation. More detailed information on insurance activities and other activities within the Storebrand Group can be found in Storebrand ASA's annual report.

The information about primary capital and minimum primary capital requirements in this document is updated quarterly. Otherwise the document is updated annually.

2 Capital adequacy regulations / Basel II

The capital adequacy regulations/Basel II are divided into three pillars (areas). Pillar 1 defines the regulatory minimum capital requirements, and therefore represents a further development of the former Basel I regulations. Pillar 2 addresses institutions' internal processes for overall capital adequacy and supervisory review and evaluation Internal Capital Adequacy Assessment Process (ICAAP), while Pillar 3 addresses the requirements for the disclosure of financial information.

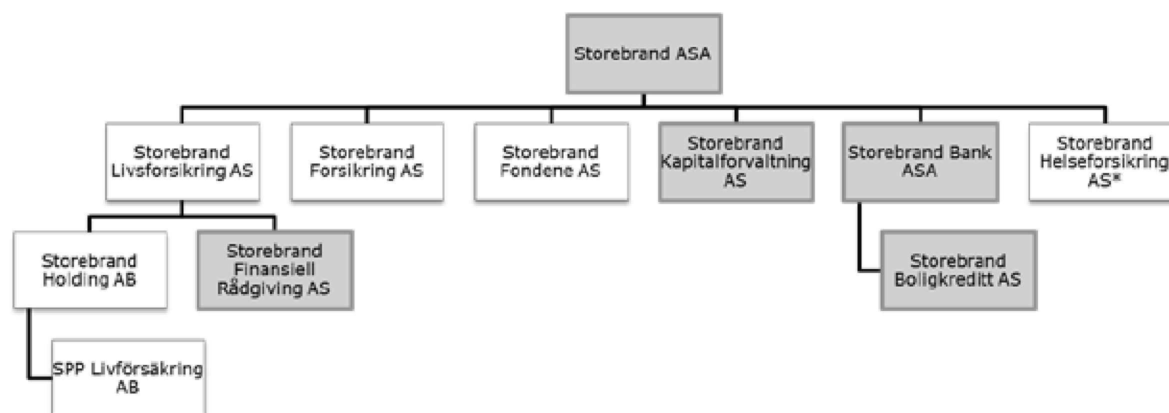
3 Description of the consolidation rules

The consolidated financial statements of Storebrand ASA encompass the holding company, Storebrand ASA, as well as its subsidiaries, jointly controlled companies (joint ventures) and associated companies. The companies in the group subject to the capital adequacy regulations operate in the areas of banking, life insurance, P&C insurance, investment advice, and asset management.

The consolidated financial statements are prepared in accordance with IFRS. Transactions carried out within the group between different units of the group are eliminated in the consolidated financial statements.

The dominant business of the Storebrand Group is insurance, and the various business areas of the group are subject to different capital adequacy rules. Basel II is
primarily intended for banks, credit institutions, capital management companies and investment firms, while insurance companies continue to follow the Basel I framework. Insurance companies will in due course be subject to new solvency regulations as part of the Solvency II process. Since insurance companies are not subject to Basel II, which applies different capital adequacy rules to Basel I, consolidated capital adequacy will be the result of differing capital adequacy principles.

Simplified legal structure:



* 50 percent ownership

The following subsidiaries are governed by the Basel II regulations:

- Storebrand Bank ASA
- Storebrand Boligkreditt AS
- Storebrand Kapitalforvaltning AS
- Storebrand Finansiell Rådgivning AS

The calculation of capital adequacy is subject to the specific rules on consolidation stipulated in the consolidation regulations. In the case of ownership interests in companies of between 10-20 per cent a capital adequacy reserve of 100 per cent of the carrying amount is set aside in the primary capital, as long as the company is not consolidated.

For the purposes of capital adequacy calculations, all subsidiary companies are fully consolidated, while joint ventures and associated companies are consolidated on a proportional basis. Associated companies are consolidated pursuant to the equity method in the consolidated financial statements, while jointly controlled companies are consolidated pursuant to the gross method.

Consolidated capital adequacy is based on the valuation rules applied in the unconsolidated financial statements. The unconsolidated financial statements are prepared in accordance with generally accepted accounting principles in Norway (N GAAP), with the exception of the financial statements of Storebrand Boligkreditt which are prepared in accordance with IFRS, and the financial statements of Storebrand Bank ASA, which are prepared in accordance with simplified IFRS.

Storebrand is classified as a cross-sectoral financial group. Companies involved in P&C insurance and life insurance must carry out calculations pursuant to both the capital adequacy regulations and the solvency margin regulations. The group includes the following insurance companies: Storebrand Livsforsikring AS and its subsidiaries SPP Livsförsäkring AB and Benco, as well as Storebrand Forsikring AS and Storebrand Helseforsikring AS. The Norwegian insurance companies in the group are subject to capital adequacy regulations, but these do not apply to the foreign insurance companies.

Asset management activities are subject to separate capital adequacy rules, and the requirements vary depending on the type of licence under which a particular company operates. This represents whichever is the highest of the requirement for initial capital, capital adequacy with and without operational risk or primary capital in relation to the previous year's fixed costs. This applies to Storebrand Kapitalforvaltning AS and Storebrand Finansiell Rådgivning AS.

4 Risk and capital management

4.1 Capital management

The primary objective of capital management is to optimise the balance between return and risk, whilst maintaining economic and regulatory capital in accordance with risk appetite. The rate of growth and composition of business segments are important factors for the need for capital. Storebrand places a significant emphasis on adapting the level of equity and loans within the Group to financial risk and capital requirement.

The Group aim to maintain a solvency margin for the life insurance companies of more than 150 percent and a core capital adequacy within its banking activities of 11 percent. From 2015 there is a target of 12.5 percent core Tier 1 capital. The level of capital shall support an A-level rating for the life insurance companies. The Group's parent company has established a goal to achieve a net debt ratio of zero. This implies that liquid assets shall equal interest-bearing liabilities. The Group's financial targets are displayed in the table below. In addition to the solvency targets, the Group also has a target to achieve a rate of return on equity (RoE) of 10 percent per year.

4.2 Business management

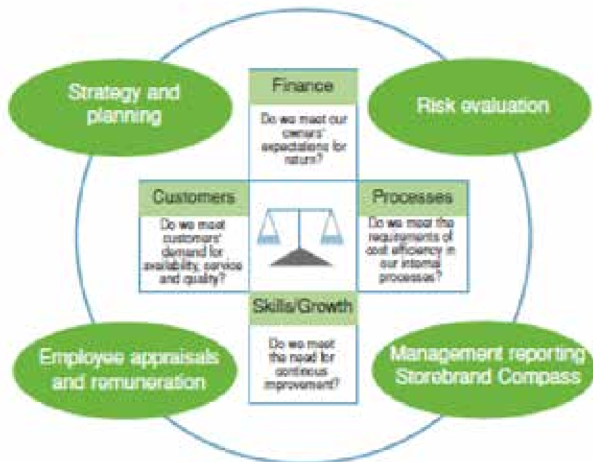
The board of Storebrand has adopted guidelines for overall management and control. The internal audit function in Storebrand is founded on an operational corporate governance model, whereby management is based on group-wide principles and internal regulations in areas such as ethics, information management and information security, as well as a value-based system for financial and operational risk. The group has a common internal audit function which carries out an independent review of the robustness of the management model. The internal auditor is appointed by and reports to the boards of the respective group companies.

KEY FIGURES	TARGETS	31.12.2011	31.12.2010
Return on equity*	10%	7,5%	6%
Rating Storebrand Livsforsikring	A	A-/A3	A-/A3
Solvency margin Storebrand Livsforsikring Group	>150%	162%	161%
Core capital adequacy Storebrand Bank Group	11%	11.2%	11.4%
Net debt ratio Storebrand ASA	0%	9%	12%

*) Adjusted for amortisation of intangible assets

In general, the equity of the group can be managed without material restrictions if the capital requirements are met and the respective legal entities have adequate solidity. Capital can be transferred from foreign legal entities with the consent of local supervisory authorities.

Storebrand's value-based management system



Storebrand's management system shall ensure a correlation between goals and actions at all levels of the Group and an overall policy for creating value for Storebrand's stakeholders. The system is based on a balanced scorecard, where four dimensions – finance, customer, internal processes and learning/growth – reflect both short-term and long-term value creation in the Group.

The Storebrand Group carries out an annual strategy and planning process. The end product is a rolling three-year strategic and financial plan with principal financial and operational targets, plans of action and budgets, in which financial prognosis and capital plans are prepared for each subsidiary and at Group level.

Risk and capital assessments, in addition to internal control reports, are an integrated part of business management. The management teams in the various business areas identify risk areas and improvement measures based on the company's goals and strategy. This work is summed up in an internal control report that is reviewed by the Audit Committee and Boards of Directors.

"Storebrand Kompass" is the company's supervisory tool, providing the management and the Board of Directors with reports on financial and operating goals established during the strategy and planning process. In the event that any parameters have a low level of goal achievement, necessary measures are identified.

4.2.1 Operational risk

Operational risk is defined as unexpected fluctuations in result caused by deficiencies or faults within internal processes and systems, insufficiencies or errors among employees or as a result of external events.

Operational risk for the Group is principally related to system-related problems when adapting and managing products, and as a result of growth in the customer base and increased complexity.

Storebrand's products and customer relationships are based on solid and long-term trust built up between the company and the market. Damage to the company's reputation may have an affect on the capacity to sustain and attract customers and employees. The Group's core values and internal regulations are important factors for managing risk related to reputation.

The group uses the Easy Risk Manager risk management tool in the risk assessment process and for monitoring operational risk. Easy Risk Manager supports the identification of areas of risk and helps assess the likelihood and consequences of a risk scenario occurring. The tool also documents who is responsible for implementing risk reducing measures.

The risk assessment process is integrated into business management by linking risk assessment to the unit's capacity to achieve its business goals, comply with regulatory requirements and the degree to which risk impacts on Storebrand's reputation. The audits carried out by the internal auditor of different risk areas are regarded as an extremely important measure for control and reduction of risk. Assessments of risk and measures to reduce risk help ensure that operations can continue and loss is minimised in the event of severe errors or events.

4.2.2 The organisation of control functions for risk management, internal control and compliance

All regulated entities in the Group are required to establish control functions for risk management, internal control and compliance, in addition to an internal auditor.

The control functions are organised so that each function is fully independent from any influence which may undermine the function's capacity to execute its duties in an objective and independent manner.

Smaller Group companies with a low level of complexity may appoint several control functions to one person or one organisational unit. This does not apply however to the internal auditor function, which must be completely independent of operational functions and other control functions.

It is essential to emphasise sufficient independence for the control functions in order to prevent possible conflicts of interest. Situations in which individuals may participate in a decision-making process for which they also act as control function must be avoided.

The control functions have access to the same databases and reports as defined for the operational activities, and have the authority to define their own reports.

Furthermore, the control functions shall monitor all recorded events which have resulted in a notable financial loss, and shall take part in the process of identification, assessment and reporting of operational risk when new financial instruments are implemented within risk management and/or asset management.

The audit plans for the internal audit shall contain an independent assessment of control functions for risk management, internal control and compliance.

The principal corporate responsibility for the Group's risk management system and internal control/risk control is organised under a central staff function, the Chief Risk Officer (CRO), who reports to the CFO. The main task of the CRO is to ensure that the Group's activities comply with strategies and limits for risk-taking, defined within the Group's financial strategy, the 3-year rolling plan and the investment strategies for each company. Furthermore, the CRO shall coordinate the processes within the Group's business units and intragroup functions for identification, assessment and reporting of operational risk, including reputation risk and compliance risk. The central CRO function is divided into several control functions for financial market risk, commercial risk and operational risk.

Moreover, risk control and compliance functions have been established for each company. These are responsible for the coordination of processes for identification, assessment and reporting of operational risk (including reputation risk and compliance risk) within their respective organisational units.

4.2.3 Remuneration

Please see the annual report of Storebrand ASA for a description of the remuneration of the board of directors and executive personnel.

4.3 Internal capital adequacy assessment process (ICAAP)

The risk and capital adequacy assessment process is part of the group's strategy and planning process. Companies subject to the Basel II regulations undergo a risk and internal capital adequacy assessment process (ICAAP) based on the capital adequacy regulations and guidelines issued by Finanstilsynet. The insurance business in Storebrand is not subject to the guidelines and therefore no ICAAP is carried out pursuant to the regulations for this part of the business. Given this, an ICAAP is currently only carried out at a company level in the companies subject to the regulations and not at a group level. Storebrand ASA is not subject to the ICAAP process either. However, an equivalent risk and capital adequacy process, including the preparation of an investment strategy and financial plan that includes a capital plan, is carried out as part of the group's strategy and planning process for the insurance business and other business areas in Storebrand as well.

The process and results from an ICAAP along with an evaluation of the risk profile and pertinent capital requirements are documented in writing and separately discussed and adopted by the various boards of directors. The capital requirement are assessed on the basis of regulatory minimum requirements (Pillar 1) with additional buffers for other areas of risk. The minimum requirements for credit and market risk are calculated using the standard method. The basic method is used for operational risk.

In June 2012, Storebrand Bank and its subsidiary Storebrand Boligkreditt applied for permission to use the IRB method for calculating the minimum primary capital requirement for credit risks. IRB models have been developed for the portfolio of home loans, and portfolio reporting based on the IRB method is expected to be possible from 2013/14. The bank has also developed F-IRB models for the portfolio of business loans. It is expected that the bank will be granted permission to use these models as the basis for capital requirement reporting from 2015/16.

When calculating risk-weighted volume based on the IRB method for the retail market, own models for calculating the risk parameters Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF) are employed in order to determine Exposure At Default (EAD).

For calculating risk-weighted volume based on the F-IRB method for the corporate market, the PD risk parameter is calculated based on the bank's own models. The CCF risk parameter is used to determine EAD, and the LGD risk parameter is determined by template rules contained in the capital adequacy regulations.

The stress scenarios used for Storebrand Kapitalforvaltning AS and Storebrand Finansiell Rådgivning AS affect operating revenues directly, e.g. falls in new sales volumes and customer portfolios, and indirectly, through falls in the value of customers' assets which result in a lower earnings base.

The assessment of the capital level is based on the results from the quantitative analyses and qualitative assessments of what is justifiable from a business perspective. The target capital level is thus derived at on the basis of the company having an adequate and acceptable capital buffer that exceeds the regulatory minimum requirements and in which the size of the capital buffer is a result of the ICAAP analysis. A capital plan for maintaining the capital level in the companies is prepared on the basis of the target capital level, result prognoses, and expected growth and composition of statement of financial position.

4.4 Risk management and control

Storebrand assumes risk as part of its core activities. Good risk management is a prerequisite for achieving the group's financial goals and ensuring the group has the financial strength to withstand and limit losses in its operations.

Storebrand has stipulated guidelines for risk management and internal control at a group level. The purpose of the guidelines is to ensure that the Storebrand Group has effective and robust functions in place for risk management, risk control and compliance, which ensure the implementation of the group's and group companies' strategies and compliance with the framework for risk taking. The guidelines are approved each year by the boards of Storebrand ASA and the subsidiaries.

The risks and risk management in the business areas subject to the Basel II regulations are described below. Please refer to Storebrand ASA's annual report for a more detailed description of risk management in the group's insurance business.

Of the four companies governed by Basel II, it is only the two companies within the banking group that actively manages the balance sheet to take risk. We have therefore chosen to include the Pillar III report for Storebrand Bank in its entirety, while only describing the other two companies at a general level.

4.4.1 Risk management, Storebrand Kapitalforvaltning AS
Storebrand Kapitalforvaltning AS manages assets on behalf of customers and bears limited risk above normal commercial and operational risk for this type of activity. The credit risk is regarded as low and the business' direct exposure to market risk is limited since the company's investments in securities are limited to investments of surplus liquidity.

Storebrand manages a large portion of its assets actively. This means that its fund managers are allowed a degree of freedom with the objective of producing a better return than the market. The group's asset management activities are structured into a number of specialist groups so that each group concentrates solely on taking advantage of investment opportunities in a specific area, subject to clearly defined investment criteria and risk limits. Each specialist group works within an assigned risk framework in which performance, risk exposure and investment profile are continuously monitored. In addition, the co-variance of the groups' exposure is monitored to ensure the greatest possible independence in order to achieve the highest possible risk-adjusted return.

An operations group is responsible for the efficient management of market risk. This group's duties include currency hedging, programme trading, hedging transactions, SRI criteria and liquidity transactions. This structure permits more efficient use of resources and greater control over active risk positions in the group's investment portfolio.

Mid-office in Storebrand Kapitalforvaltning monitors compliance with investment mandates and risk limits. The compliance officer in Storebrand Kapitalforvaltning monitors the proprietary trading regulations, money laundering regulations and the Securities Trading Act, and carries out training as well as random controls. The Risk Manager is responsible for independent monitoring of risk management, including transaction handling. Any breaches are reported to the management group, the Board of Directors and The Financial Supervisory Authority of Norway.

The company's advisors shall follow the regulations regarding good advisory practice. All advisors shall are authorised under the authorisation scheme for financial advisors.

The company's internal control activities in the form of risk assessments, follow-up and reporting satisfy the requirements in the regulations regarding risk management and internal control. The Board of Directors carries out an evaluation of itself and its competence in this area annually.

4.4.2 Risk factors, Storebrand Finansiell Rådgivning AS
Storebrand Finansiell Rådgivning AS offers comprehensive financial advice and order channelling within a broad spectrum of products for the group. The company is exposed to limited financial risk linked beyond normal business and operational risk for this type of business. Operational risk is the largest risk in the company. This is to a significant degree linked to the regulations regarding good advisory practice and the risk linked to complaints in the event of deficient advice. The company is working actively to reduce these risks. This is being done through the training of individual advisors, utilised agents and sales managers, periodic newsletters from the compliance manager in Storebrand Finansiell Rådgivning, monthly control of all proprietary trade and regular random controls of submitted customer profile forms. In addition to the compliance manager's controls, the internal auditor also carries out annual controls. Storebrand Finansiell Rådgivning AS and its associated agents make use of authorised financial advisors only, with the exception of new recruits who are under training.

5 Net primary capital / capital requirement

The table below provides information on core capital, supplementary capital and net primary capital for the Storebrand Group and for the companies governed by Basel II.

Net primary capital as at 30.09.2013

NOK mill.	Storebrand Kapitalforvaltning AS	Storebrand Finansiell Rådgivning AS	Storebrand Bank ASA	Storebrand Boligkreditt AS	Storebrand ASA	Storebrand group
Share capital	4	30	961	350	2 250	2 250
Other equity	194	60	1 383	653	14 059	20 025
Equity	**198**	**90**	**2 343**	**1 003**	**16 309**	**22 274**
Hybrid tier 1 capital			427			1 927
Interest rate adjustment of insurance obligations						-316
Goodwill and other intangible assets	-17		-63			-6 453
Deferred tax assets	-53	-36	-20		-520	-44
Risk equalisation fund						-743
Deductions for investments in other financial institutions						-2
Security reserves						-297
Minimum requirement reassurance allocation						-4
Capital adequacy reserve						-98
Other	-10			-122	-153	-718
Tier 1 capital	**118**	**54**	**2 688**	**881**	**15 636**	**15 527**
Hybrid tier 1 capital						
Perpetual subordinated loan capital			9			2 700
Dated subordinated loan capital			149			2 388
Deductions for investments in other financial institutions						-2
Capital adequacy reserve						-98
Tier 2 capital			**159**			**4 988**
Net primary capital	**118**	**54**	**2 847**	**881**	**15 636**	**20 515**
Capital adequacy						
Capital adequacy ratio	**11,5 %**	**205,2 %**	**15,5 %**	**14,3 %**	**87,4 %**	**13,4 %**
Core capital adequacy ratio	**11,5 %**	**205,2 %**	**14,6 %**	**14,3 %**	**87,4 %**	**10,1 %**

According to Basel II, a capital requirement that amounts to 8 per cent of the basis for calculation. The net primary capital must as a minimum equal the capital requirement. At a consolidated level the capital requirement is also included for the insurance companies subject to rules pursuant to Basel I.

There are separate regulations for calculating the primary capital for capital adequacy. Pursuant to the regulations for primary capital the core capital can be substantially different to the equity on the statement of financial position. The above table specifies additions and deductions when calculating core capital in relation to equity in the financial statements.

Hybrid tier 1 capital can account for a maximum of 15 per cent of core capital, while any overshoot can be included as perpetual subordinated loan capital. The hybrid tier 1 capital satisfies the Norwegian regulations for hybrid capital. Loan terms include a buy-back option for the company, and a clause regarding interest rate increase if the buy-back option is not used.

Minimum requirements primary capital as at 30.09.2013

NOK mill.	Storebrand Kapitalforvalt-ning AS	Storebrand Finansiell Rådgivning AS	Storebrand Bank ASA	Storebrand Boligkreditt AS	Storebrand ASA	Storebrand group
Credit- and counterparty risk						
Local and regional authorities					4	4
Public corporates					3	4
Institutions	2	2	122	13	1 405	33
Corporates			842			842
Retail marked			47			47
Loans secured on real estate			244	452		696
Loans past-due			45	3		48
Covered bonds			92			21
Units in mutual securities funds	2					2
Other	4	0	14	9	9	45
Company using Basel I						10 444
Total minimum requirements credit- and counterparty risk	**7**	**2**	**1 406**	**476**	**1 421**	**12 185**
Of which						
Counterparty risk derivatives Basel II companies			40	4	1	45
Operational risk	75		69	16	10	117
Deductions			-3	0		-19
Minimum requirements primary capital	**82**	**2**	**1 473**	**492**	**1 431**	**12 283**

Specifications of subordinated loan capital

NOK mill.	Nominal value	Currency	Interest rate	Call date and other conditions	Book value Q3 2013
Issuer					
Perpetual hybrid (Tier 1) capital					
Storebrand Bank ASA	107	NOK	Fixed	2014	115
Storebrand Bank ASA	168	NOK	Variable	2014	169
Storebrand Bank ASA	150	NOK	Variable	2018	150
Storebrand Life Insurance	1 500	NOK	Variable	2018	1 502
Perpetual subordinated loan capital					
Storebrand Life Insurance	1 700	NOK	Variable	2014	1 701
Storebrand Life Insurance	1 000	NOK	Fixed	2015	1 064
Dated subordinated loans					
Storebrand Life Insurance	300	EUR	Fixed	2023	2 353
Storebrand Bank ASA	150	NOK	Variable	2017	151
Total subordinated and perpetual loans					**7 206**

Storebrand Bank – Risk management

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Introduction

This document is intended to cover the requirements stipulated for the disclosure of information on risk in accordance with the Capital Requirements Regulation, and has been prepared in order to provide the market with the best possible information on Storebrand Bank's risk and capital management.

The information in this report supplements information contained in notes 3, 4, 5, 6 and 7 to Storebrand Bank's annual report. Unlike the information contained in those notes, the information in this report has not been audited.

The core purpose of a bank is to create value by assuming deliberate and acceptable risk. Storebrand Bank invests significant resources in further development of risk management systems and processes in line with leading international practice. In June 2012, Storebrand Bank applied to the Financial Supervisory Authority of Norway for permission to use the bank's self-developed credit risk models (IRB models) to calculate the minimum requirement for primary capital.

Storebrand Bank has the bulk of its business in Oslo and Akershus where the economic trend is influenced by the population growth in the area. The overall risk exposure for Storebrand Bank is regarded as being low to moderate.

The credit quality of the corporate market portfolio is considered good, and the portfolio in its entirety consists of commercial property. Mortgage-backed commitments in which running cash flows cover the commitment's interest charges account for around 75 per cent of total exposure (loans and lines of credit). The remainder of the portfolio consists of mortgage-backed commitments involving property development.

The credit quality of the retail market portfolio is considered very good. Almost the entire portfolio is secured on real estate. The portfolio's high collateral coverage indicates a limited risk of loss.

At the end of 2012, the bank's target core capital adequacy was 11 per cent, while its actual core capital adequacy was 11.15 per cent. Storebrand Bank has established sound liquidity buffers and finds access to the credit markets to be good.

1. About Storebrand Bank

Storebrand Bank ASA is a wholly owned subsidiary of Storebrand ASA, and is one of four business units in the Storebrand Group. Storebrand Bank is a commercial bank with licences under the Norwegian Securities Trading¬Act. Its head office is in Lysaker, in the municipality of Bærum.

Our ambition in the retail market is to establish the bank as Norway's best direct bank, while in the corporate market Storebrand Bank is a customer-focused partner for value creation that delivers a wide range of services to corporate customers in the commercial property sector.

The Storebrand Bank Group has total assets of NOK 40.7 billion and has achieved a profit before tax of NOK 209 million as of the end of 2012. The Bank Group had a total of 134 employees at the end of the year.

The subsidiary Storebrand Boligkreditt AS holds a licence to issue covered bonds.

Hadrian Eiendom AS is a wholly owned subsidiary that represents the Bank Group's specialised expertise in property development and commercial property brokerage.

A considerable proportion of the bank's services across large parts of the value chain are delivered by the company Storebrand Baltic UAB, located in Vilnius, Lithuania. The company is a centre of expertise for support services for the entire Storebrand Group.

2. Regulations and regulatory development

2.1. Capital adequacy

DEFINITIONS	
Capital	The bank's available capital base.
Pure core capital	Equity; core capital after deductions, excluding other approved core capital (hybrid capital).
Core capital	Equity and hybrid capital; individual deductions and charges to be made, cf. Norwegian Regulations on Measurement of the Own Funds of Financial Institutions, Clearing Houses and Investment Firms.
Other approved core capital	Hybrid capital; perpetual hybrid Tier 1 included as other approved core capital according to specific rules.
Supplementary capital	Subordinated loan capital.
Primary capital	The sum of core capital and supplementary capital.
Risk-weighted volume	Calculation basis (RWA, risk-weighted assets); calculated in accordance with Basel II on credit risk, market risk and operational risk.
Capital adequacy	The ratio of the bank's primary capital and risk-weighted volume.
Capital needs	Expressed via economic capital, which acts as a consistent measurement of risk.
Capital requirement	Regulatory minimum requirement (8% of risk-weighted volume). Capital adequacy is reported to the Financial Supervisory Authority of Norway every quarter; capital adequacy percentage, both actual and target, is calculated according to the capital requirement.

2.1.1 Current capital adequacy regulations (Basel II)

Storebrand Bank must meet the requirements for capital adequacy contained in the Capital Requirements Regulation. The current Capital Requirements Regulation is based on the Basel Committee's second Accord, so-called Basel II, and was introduced into European regulations via the Capital Requirements Directive (CRD), effective from 2007. The purpose of Basel II is to strengthen the stability of the financial system through risk-sensitive capital requirements, improved risk management and control, tighter supervision and increased flow of information to the market. Basel II is built on three pillars:

- Pillar 1 deals with the minimum requirement for capital adequacy.
- Pillar 2 deals with the bank's internal risk and capital assessment process as well as the authorities' supervisory function.
- Pillar 3 deals with the disclosure and communication of key information on capital, risk exposure, organisation and capital requirements.

2.1.2Calculating risk-weighted volume and capital requirements (Pillar 1)

A bank may choose to use different methods when calculating risk-weighted volume.

Table 1: Alternative methods for calculating the minimum requirement for primary capital.

CREDIT RISK	MARKET RISK	OPERATIONAL RISK
Standard method	Standard method	Basic method
IRB method (retail market)*	Internal Model Method (IMM)*	Template method
Foundation IRB method (F-IRB, corporate market)*		Advanced Measurement Approach (AMA)*
Advanced IRB method (A-IRB, corporate market)*		

*requires approval by the Financial Supervisory Authority of Norway

The standard method for both credit risk and market risk, as well as the basic and template models for operational risk, are based on template rules. The capital requirement is determined by using template values given in the capital adequacy regulations, and does not necessarily correspond to the risk in the underlying portfolios.

Banks may also choose to develop models to calculate risk weights that replace the template values. The models are developed based on a bank's own portfolio and/or own risk assessments. These risk weights will then be used when calculating risk-weighted volume. This is the fundamental idea of Basel II (and Basel III) – that the capital requirement should correspond to the risk in the underlying portfolios and as such be more risk-sensitive. The use of internal models requires approval by the Financial Supervisory Authority of Norway.

2.1.3 Choice of methods

TYPE OF RISK	METHOD
Credit risk	Standard method
Market risk	Standard method
Operational risk	Basic method

As of the end of 2012, the Storebrand Bank Group employs the following methods when calculating capital requirements:
In June 2012, Storebrand Bank and its subsidiary Storebrand Boligkreditt applied for permission to use the IRB method for calculating the minimum primary capital requirement for credit risks. IRB models have been developed for the portfolio of home loans, and portfolio reporting based on the IRB method is expected to be possible from 2013/14. The bank has also developed F-IRB models for the portfolio of business loans. It is expected that the bank will be granted permission to use these models as the basis for capital requirement reporting from 2015/16.

When calculating risk-weighted volume based on the IRB method for the retail market, own models for calculating the risk parameters Probability of Default (PD), Loss Given Default (LGD) and Credit Conversion Factor (CCF) are employed in order to determine Exposure At Default (EAD).

For calculating risk-weighted volume based on the F-IRB method for the corporate market, the PD risk parameter is calculated based on the bank's own models. The CCF risk parameter is used to determine EAD, and the LGD risk parameter is determined by template rules contained in the capital adequacy regulations.

2.1.4 Internal assessment of capital needs according to risk profile (Pillar 2)

According to the capital adequacy regulations (Basel II), all financial institutions must have a process in place for assessing risk profiles and corresponding capital needs – a so-called ICAAP (Internal Capital Adequacy Assessment Process) – as well as a strategy for maintaining the level of capital. This process and the results from this process must be documented in writing and submitted by the board of the institution to the Financial Supervisory Authority of Norway for evaluation.

Storebrand Bank measures developments in risk via economic capital, which is calculated for all risk categories that the bank has identified (see section 4 for an overview of risk categories).
Credit risk and concentration risk in the credit portfolio represent the most significant risk exposure for Storebrand Bank. These two risk categories are prioritised when developing methods to calculate economic capital. Statistical models are used for these risk categories. For all other risk categories, simplified approaches are used for the time being.

When calculating economic capital, a confidence level of 99.95 per cent is used. For capital requirement calculations, the confidence level is 99.9 per cent. Economic capital calculations are carried out every quarter.

The bank has an annual plan and budget process in place where a financial plan for the next three years is drawn up, submitted to the Board for consideration and coordinated with the Storebrand Group. The Storebrand Bank ICAAP is based on developments in accordance with the financial plan. Capital need is calculated for the entire plan period. Additionally, an extraordinary but probable stress scenario is defined and the capital need under these circumstances is calculated.

Developments in capital need in a stress scenario are assessed against available capital during the period. This forms the basis of control against fixed capital targets during different phases of the economic cycle. It also determines at which capital levels measures will be taken to strengthen that capital. Developments in framework conditions are taken into account when reporting (see section 2.5).

2.1.5 Solvency target

At the start of 2012, the target core capital adequacy was 11 per cent as of the end of 2012. Based on results from ICAAP 2012 and quantitative capital requirements in CRD IV, the Board of Storebrand Bank has adopted a core capital adequacy target of at least 9 per cent at all times, regardless of the economic situation. In an economic upturn, the core capital adequacy should be well above this level, while the target pure core capital adequacy with the current balance sheet structure is 12.5 per cent from 2015.

2.1.6 Capital adequacy

The Storebrand Bank Group had a core capital adequacy of 11.15 per cent at the end of 2012. The capital adequacy is therefore in line with internal targets. Capital adequacy in relation to pure core capital was 9.94 per cent.

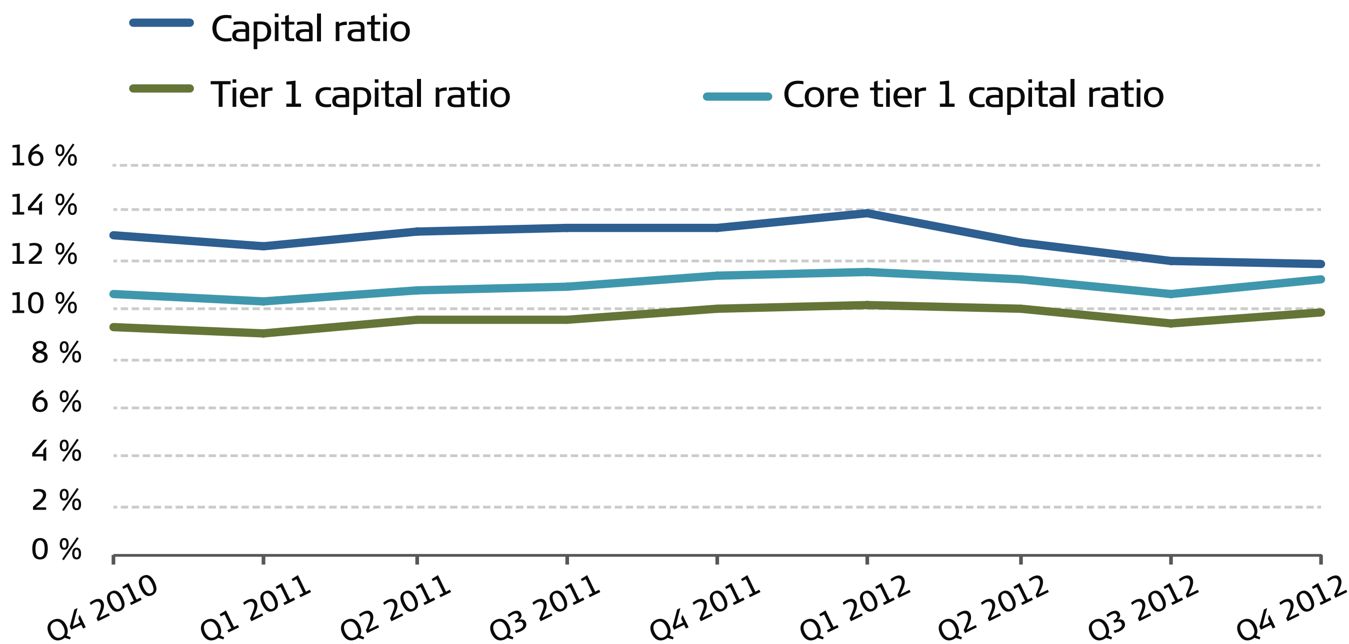


Figure 1: Capital adequacy trend at the Storebrand Bank Group.

2.2. New regulations ("Basel III")

In the wake of the 2008 financial crisis, the Basel Committee has prepared recommendations for new capital and liquidity standards that will address weaknesses in the regulatory framework. These recommendations are known as Basel III. The principles that form the basis of the current regulations (Basel II) will also apply under Basel III.

On 20 July 2011 the European Commission presented its proposal to transpose the Basel Committee's recommendations into a common European regulation. The key principle of such a regulation is a full harmonisation of the regulatory framework – a "single rule book" – with restrictions on the national authorities' ability to impose stricter regulations. Parts of Basel III have been introduced into EU regulations via updates in the Capital Requirements Directive (CRD II and CRD III), which were implemented into Norwegian legislation through updates of relevant laws and regulations.

The latter parts of the Basel II recommendations are being introduced into EU regulations through CRD IV. This sets the stage for a two-part implementation of the regulatory framework:

- a regulation that affects the institutions directly and contains qualitative and quantitative capital requirements, liquidity requirements, provisions relating to large loans and Pillar 3 requirements.
- a directive that regulates the activities of the supervisory authorities.

According to CRD IV, pure core capital (common equity Tier 1, CET1) and core capital (Tier 1) shall amount to 4.5 per cent and 6 per cent of the calculation basis, respectively. Combined with the stricter qualitative requirements for core capital, this will entail the tightening up of current minimum requirements.

To prevent the banks from experiencing any problems meeting the minimum requirements during periods of significant losses in the banking sector, the banks must maintain two different capital buffers. The requirement for a capital conservation buffer means that the banks must maintain a pure core capital of 2.5 per cent of the calculation basis, in addition to the minimum requirement.

In order to protect the banking system against the consequences of strong credit growth, the banks must also maintain a countercyclical buffer during periods of very strong credit growth. This buffer will be 0–2.5 per cent, and must comply with the requirements for pure core capital.

Banks that do not fulfil the combined buffer requirement composed of the capital conservation buffer and countercyclical capital buffer will face restrictions on their dividend policy. A lower combined capital buffer will result in increased restrictions. Banks that do not meet the combined buffer requirement must submit a plan to the authorities outlining how they will ensure compliance with the requirement.

The new capital requirements will be introduced gradually between now and 2018.

In addition, capital requirements linked to system risk will be introduced. The details surrounding this are as yet unknown, but it has been suggested that the capital requirement may constitute between 3 and 10 per cent of pure core capital and will apply to all banks within a region perceived to be affected by the system risk.

As a supplement to the risk-based capital requirements, a requirement will be introduced for the unweighted equity-to-assets ratio (Leverage Ratio). This requirement will be finalised in 2017 and become effective in 2018. The transitional period will be used to test a requirement that the core capital must amount to at least 3 per cent of the bank's exposure, including off-balance sheet items to a varying degree. The banks will be required to disclose their Leverage Ratio from 2015 onwards.

Quantitative liquidity requirements will also be introduced. A minimum requirement for a short-term liquidity indicator – Liquidity Coverage Ratio (LCR) – will be introduced in 2015, while a similar minimum requirement for a long-term liquidity indicator – Net Stable Funding Ratio (NSFR) – will be introduced in 2018.

CRD IV was originally planned to come into force as of 1 January 2013, but it is now evident that it will not be introduced before 1 January 2014. However, Norwegian authorities have suggested that they will speed up the implementation of the requirements. In particular, the countercyclical buffer requirement is expected to become effective over the course of 2013.

As well as the development of CRD IV, the European Banking Authority is also working on technical standards for reporting. The principle of the "single rule book" is the aim, and the reporting requirements will be the same for all banks, regardless of size and complexity.

2.3. Consequences of regulatory development for Storebrand Bank

Issued perpetual hybrid Tier 1 capital and subordinated loans from Norwegian banks do not fulfil the new requirements contained in CRD IV for other approved core capital (hybrid capital) and primary capital. Storebrand Bank is committed to adapting itself to these new requirements.

Storebrand Bank is able to meet future requirements for pure core capital under CRD IV; the bank is also well-capitalised based on the new capital requirements.

Changes to the regulatory framework will have an impact on the composition of the bank's liquidity buffer. Storebrand Bank aims to build up a larger proportion of high-quality liquid assets in order to control the LCR.

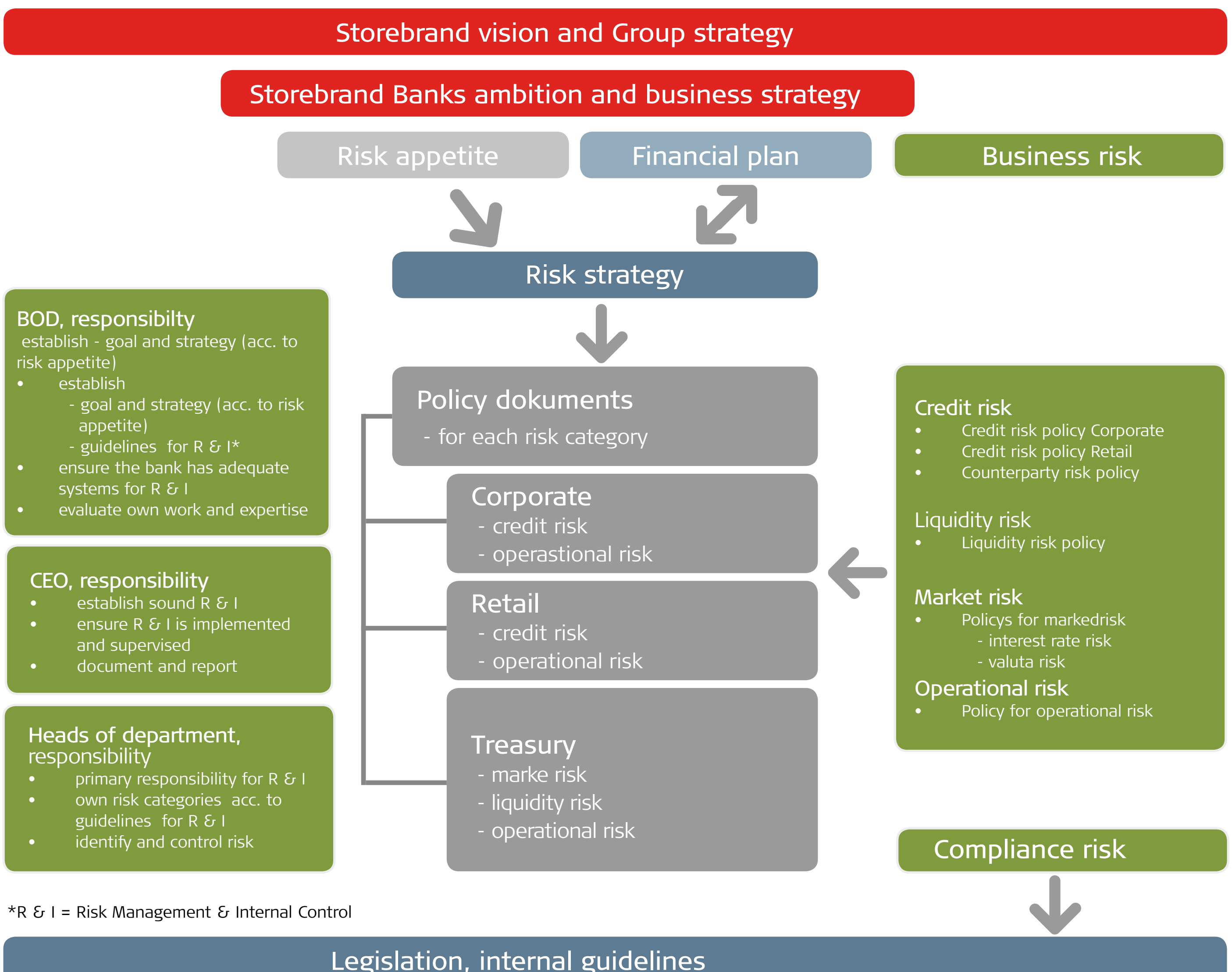
In terms of operations, the bank will experience a sharp increase in reporting scope and complexity. This could potentially result in an increase in operational risk and a possible increase in compliance risk.

3. Risk management and limit structure at Storebrand Bank

3.1. General framework for risk management

The bank's risk profile is a combination of the risk exposure in the bank's defined risk categories (see section 4). Storebrand Bank's risk strategy describes the risk profile and general limits designed to ensure the implementation of the desired risk profile. The risk strategy is adopted by the Board of Storebrand Bank once a year. The Board also adopts the bank's financial plan. On the basis of these resolutions, the management prepares risk policies, procedures and work descriptions designed to ensure goals are achieved, as well as a risk profile that is in accordance with the Board's resolutions.

These general factors can be illustrated as follows:



3.2. Organisation of risk management responsibilities

Ownership of the various risks to which the bank is exposed follows the lines of organisation. Risk owners for the different risk categories are therefore defined according to the management of the overall company organisation and the management model used.

Risk is managed using policies that may apply to more than one business area. The main responsibility for maintaining effective risk management and internal control rests with the line managers; they are therefore the first line of defence.

The control units may be considered the second line of defence. These monitor the risk management of the business areas through adopted policies. As a third line of defence, internal auditing should provide independent corroboration of risk management as a whole.

4. Information per risk category

Storebrand Bank has identified a number of risk categories to which the bank is exposed.

RISK CATEGORY	DEFINITION	RISK OWNER
Credit risk	The risk of loss arising from the client lacking the capacity or intent to fulfil their obligations. This includes the risk that the security is less effective than expected (residual risk) as well as concentration risk. Credit risk encompasses counterparty risk.	Head of BM Head of PM Head of Treasury
Liquidity risk	The risk of the Bank Group, the parent bank or the subsidiaries being unable to fulfil their obligations without incurring substantial additional expenses in the form of reduced prices for assets that must be realised, or in the form of especially expensive financing.	Head of Treasury
Market risk	The risk of losses on open positions in financial instruments due to changes in market variables and/or market conditions within a specified time horizon. Encompasses counterparty risk when trading financial instruments as well as securities risk, interest rate risk and exchange rate risk.	Head of Treasury
Operational risk	The risk of financial loss due to ineffective, inadequate or failing internal processes or systems, human error, external events or failure to comply with internal guidelines. Breach of laws and regulations can obstruct the bank from achieving its objectives; this part of compliance risk is included in operational risk.	Included in the Storebrand Bank Group's definition of managerial responsibility
Business risk (incl. strategic risk)	Risk of reduction in earnings and funding due to changes in business framework conditions, poor business decisions, errors in the implementation of decisions or insufficient adaptation to changes in business framework conditions. Encompasses reputation risk, i.e. risk of reduction in earnings and funding due to a fall in confidence and a fading reputation in the market. This also includes risk of losses in subsidiaries (owner risk). Owner risk encompasses the risk assumed by the individual companies in their operations as well as the risk of a need for the injection of fresh capital. This is monitored in the same way as operational risk, and will not be mentioned further in this document.	Managing Director and heads of the business areas
Compliance risk	The risk of the Group incurring public sanctions or financial loss due to failure to comply with external and internal regulations.	Included in the Storebrand Bank Group's definition of managerial responsibility

4.1. Credit risk

4.1.1 Management and control

Risk management and control is described in note 4 to Storebrand Bank's annual report.

4.1.2 General portfolio information

Storebrand Bank has a credit portfolio made up of approximately two-thirds lending to the retail market and one-third lending to the corporate market. This distribution has remained stable in recent years.

BUSINESS AREA	PRODUCT	GRANTED		DRAWN	UNUSED CREDIT	DEGREE OF UTILISATION
Retail market	Home loan	16,269.0	(40.8%)	16,269.0		
	Residential mortgages	9,455.3	(23.7%)	7,105.3	2,349.9	75.1%
	Credit card, credit accounts	1,308.4	(3.3%)	262.1	1,046.3	20.0%
	Other	128.7	(0.3%)	104.4	24.3	81.1%
	Total	**27,161.4**	(68.1%)	**23,740.9**	3,420.5	**87.4%**
Corporate market	Commercial property	11,793.5	(29.6%)	11,128.1	665.4	94.4%
	Other	944.9	94.4%	794.8	150.1	84.1%
	Total	**12,738.4**	**(31.9%)**	**11,923.0**	**815.5**	**93.6%**
Total		**39,899.8**		**35,663.9**	**4,236.0**	**89.4%**

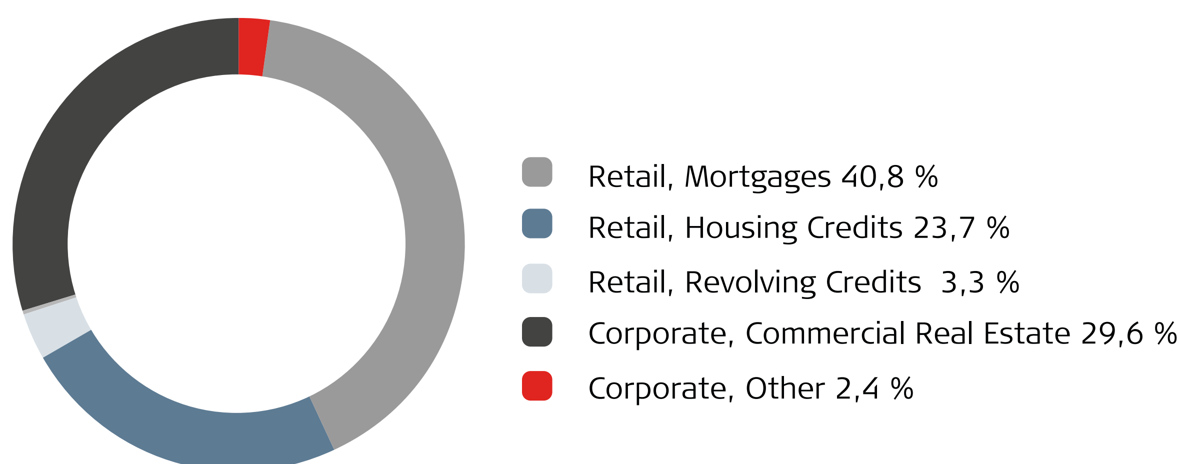


Figure 3: Distribution of total loan portfolio as of 31 December 2012.

Retail market

The credit quality of the retail market portfolio is considered very good. Almost the entire portfolio is secured on real estate. The portfolio's high collateral coverage indicates a limited risk of loss. The loan-to-value ratio of the home loans is relatively low and only a very limited number of loans exceed 80 per cent of the market value of the collateral. These are largely only given if the customers can put up additional collateral.

The retail market portfolio has had very few losses historically. For the bank as a whole, the increase in retail market loans is considered very important in reducing the bank's total risk.

The proportion of residential mortgages from total lending in the retail market amounts to approximately 30 per cent as of the end of 2012. This proportion has been stable since mid-2011 following almost constant growth for several years. There are stricter lending criteria for residential mortgages and closer monitoring of customers with a high degree of utilisation or those who do not pay interest and instalments on a regular basis.

Corporate market

The credit quality of the corporate market portfolio is considered good. Mortgage-backed commitments in which running cash flows cover the commitment's interest charges account for around 75 per cent of total exposure (loans and lines of credit). The remainder of the portfolio consists of mortgage-backed commitments involving property development.

Cash flow loans are characterised by a good, diversified tenant profile and long leases. The bank is secured a cash flow from tenants with these types of loans, in addition to having security in the property itself. Tenant diversification ensures corresponding diversification of cash flows, which significantly reduces the overall risk inherent in the portfolio. Around 95 per cent of the portfolio has a loan-to-value ratio of less than 86 per cent.

Development projects involve somewhat greater risk and the total exposure here is around NOK 4.1 billion. This segment is largely composed of loans to construction projects in the housing and office sector in and around the centre of Oslo. A high proportion of advance sales is required for loans for new housing projects. Around 95 per cent of the portfolio has a loan-to-value ratio of less than 80 per cent and the risk is considered satisfactory.

Credit risk in the corporate market portfolio improved during the year as new lower risk loans have been made and current loans have developed in a positive direction. There is strong managerial focus on monitoring loans that have had a negative development. Continuous monitoring of all arrears in the corporate market is carried out via establishing measures and monitoring previous measures. In addition, the Board receives updates each quarter on the largest deferred loans along with developments since previous reports.

The bank relieves parts of the largest loans by selling them to Storebrand Livsforsikring. In this case, the bank takes out a second mortgage. These loans are characterised by the debtors generally being of good quality.

4.1.3 Securities

Loans for Storebrand Bank ASA and Storebrand Boligkreditt AS are mainly secured on real estate. Loans to retail market customers are largely secured on homes, principally within 80 per cent of market value. Small credit accounts are opened without security and credit cards are issued with short-term credit limits to retail market customers. However, such unsecured loans represent an extremely small share of the bank's total loans to retail market customers. Each quarter, Eiendomsverdi (an enterprise which monitors developments on the property market) carries out a valuation of the property mortgages in Storebrand Bank's retail market portfolio.

Similar loans are provided to the corporate market secured on real estate in the form of leased properties and project financing. A very limited number of unsecured loans are granted. The bank does not offer unsecured short-term financing to the corporate market. The value of the assets pledged on the corporate market is updated at least once a year.

Storebrand Bank ASA and Storebrand Boligkreditt AS do not use guarantees and/or credit derivatives in connection with the calculation of capital requirements.

4.1.4 Risk classification

Retail market

Storebrand Bank has developed internal models for risk classification of home loans. The models estimate a loan's exposure at default (EAD), probability of default (PD) and loss given default (LGD).

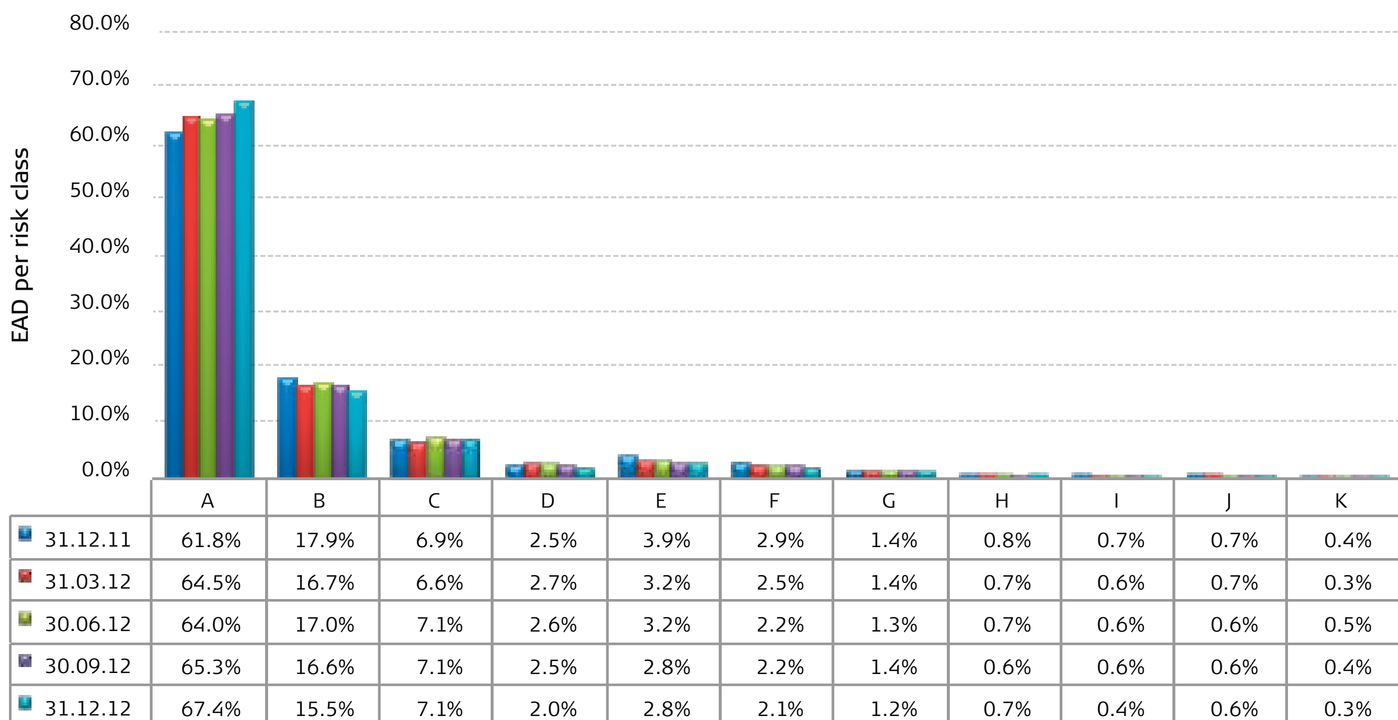
EAD	The estimate represents the total loan amount. In assessing the EAD, a Credit Conversion Factor is used for any unused credit.
PD	The estimate represents the probability of default over the course of one year and is a result of a logistic regression model that encompasses loan- and customer-specific explanatory variables as well as behaviour variables.
LGD	The estimate represents the loss given default and is a result of an expert model that has calculated the loan-to-value ratio and expenses associated with the realisation of non-performing loans as significant explanatory variables.

Definition of non-performance
Underlying all of the bank's internal models is a definition of non-performance that applies to both home and business loans, and which has been drawn up in accordance with the Capital Requirements Regulation. Storebrand Bank deems a loan to be non-performing if a demand for payment is overdue by more than 90 days, and the outstanding amount is at least NOK 2,000 (payment default). Non-performance over and above a payment default arises when defined objective events indicate that the customer will not meet their obligations.

PD
PD is estimated using a continuous scale. The estimated PD is ascribed to a security margin and a PD adjusted for type of security is assigned to a risk class used for granting credit. Storebrand Bank employs a master scale composed of 10 risk classes as well as a class for non-performing loans. Each risk class has an upper and lower limit for PD. The master scale is displayed in the table below.

RISK CLASS		LOWER LIMIT PD (STARTING FROM)	UPPER LIMIT PD (UP TO)
A	A1	0.00%	0.03%
	A2	0.03%	0.05%
	A3	0.05%	0.10%
B		0.10%	0.25%
C		0.25%	0.50%
D		0.50%	0.75%
E		0.75%	1.25%
F		1.25%	2.50%
G		2.50%	5.00%
H		5.00%	8.00%
I		8.00%	15.00%
J		15.00%	100.00%
K		100.00%	

The purpose of the master scale is to score all of the loans and allocate them a risk class. Non-performing loans are allocated to risk class K. Allocation takes place automatically.



	A	B	C	D	E	F	G	H	I	J	K
31.12.11	61.8%	17.9%	6.9%	2.5%	3.9%	2.9%	1.4%	0.8%	0.7%	0.7%	0.4%
31.03.12	64.5%	16.7%	6.6%	2.7%	3.2%	2.5%	1.4%	0.7%	0.6%	0.7%	0.3%
30.06.12	64.0%	17.0%	7.1%	2.6%	3.2%	2.2%	1.3%	0.7%	0.6%	0.6%	0.5%
30.09.12	65.3%	16.6%	7.1%	2.5%	2.8%	2.2%	1.4%	0.6%	0.6%	0.6%	0.4%
31.12.12	67.4%	15.5%	7.1%	2.0%	2.8%	2.1%	1.2%	0.7%	0.4%	0.6%	0.3%

Figure 4: Development of EAD per risk class over the course of 2012, based on internally used PD.

In 2012 there was a risk reduction in the portfolio of home loans. Figure 4 shows a positive trend in EAD per risk class over the course of 2012. At the end of 2012, two-thirds of EAD for home loans were classified in risk class A, based on PD adjusted for type of security.

LGD

The model for estimating LGD has been developed based on a combination of observed relationships between incidents of non-performance loans and observed loan losses and qualified subjective assessments. The loan-to-value ratio is a significant explanatory variable in the LGD model. The above loan-to-value ratio is also included in the LGD model.

The valuation of the mortgaged property substantially affects the calculation of the loan-to-value ratio. When arranging home loans Storebrand Bank gathers information of significance to the value of the property. Each quarter the bank obtains an updated, independent valuation of residential properties from Eiendomsverdi. For properties for which Eiendomsverdi has not updated a valuation (for instance, individual housing cooperative flats, shared ownership flats and individual holiday homes), the last updated market value will be used until the next update. To the extent that Eiendomsverdi cannot state with a high degree of certainty the market value of a residential property, a "haircut" is employed to ensure that the risk of quoting an estimated market value that is too high is reduced. If Eiendomsverdi has never received information regarding the property's market value, the value recorded at the time of entering into the contract will be used. Loans such as those mentioned here constitute just under 1 per cent of the total portfolio exposure. The bank regularly checks the list of mortgaged properties that have not been given an updated value in the last three years, and then implements measures to reduce the number of properties on the list.

AS %	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
0-50	44.5	44.5	44.2	50.1	48.1
50-75	49.8	49.6	49.9	44.2	45.3
75-85	3.8	4.0	4.2	4.1	4.9
OVER 85	1.9	1.8	1.6	1.6	1.8

The weighted average loan-to-value ratio in the Bank Group is approximately 54 per cent on home loans. In Table 5, the loans are categorised in different groups depending on the loan-to-value ratio. The table shows the development in the groups over the course of 2012.

Validation and stress testing

Validation is central to the quality assurance of the bank's classification system. The system is post-tested (validated) at least once a year both quantitatively and qualitatively. The models' ability to distinguish between good customers and customers who default on their loans is assessed during quantitative validation. Estimated values for PD, LGD and EAD are also collated along with actual observed outcomes. Among other things, the utilisation of the internal models in the credit-granting process, work and decision-making processes, control

mechanisms and IT systems connected to the classification system are checked during the qualitative validation.

In addition, sensitivity analyses of the impact of macro-economic disturbances in the PD, LGD and EAD – so-called stress testing – are carried out at least once a year.

Reports documenting the results from validation and stress testing are prepared. These reports are reviewed by a separate committee before they are submitted to the boards of the bank and residential mortgage company for consideration.

IRB permission

Storebrand Bank believes that the bank's internal models meet the requirements contained in the Capital Requirements Regulation concerning IRB models (Internal Rating Based). In June 2012, the bank applied for permission from the Financial Supervisory Authority of Norway to use the IRB method in calculating capital requirements.

Corporate market

The classification model for firms in the property industry is used when determining debtors' capacity to service debt. The model is composed of a qualitative and a quantitative element. The qualitative portion systematically assesses the significant qualitative factors in the project and debtors. The range of factors assessed includes the management, structure, board, history, market, political risk and tenants. The quantitative factors are evaluated differently for construction loans and debenture loans. Construction loans are assessed based on reserves available for unforeseen costs, the sales buffer, advance sales and project management.

Debenture loans are assessed quantitatively through analysis of cash flows and evaluating certain key figures. The cash flow is calculated for the duration of the project.

For corporate market loans, risk is classified on a scale from 1 to 5, where 1 is best. The first number indicates the debtor's debt servicing capacity (ability to make repayments), the second number indicates the quality of the security (degree of security/loan-to-value ratio). The bank measures the credit quality of the corporate market portfolio on a monthly basis by looking at the proportion of loans that are classified as 2/3 or 3/2. As at the end of December 2012, this proportion constitutes 89% of the portfolio.

The classification methodology established for corporate market customers and certain retail market customers (including private investors etc.) is used as a basis to identify risk in the bank's loans to and receivables from customers. The loans are to be classified both when taken out originally, and when there are changes in the loans. In addition, corporate market customers are to be reclassified annually or as necessary. The classifications thereby provide an overview of the risk exposure in the portfolio at all times.
New classification models

	I %	DEBITORKLASSE				
		1	2	3	4	5
SIKKER-HETS-KLASSE	1	3.1	1.0	0.7	0.0	0.0
	2	7.7	47.9	24.6	1.4	0.0
	3	0.3	3.5	5.1	0.5	0.0
	4	0.3	2.0	0.3	0.1	0.1
	5	0.1	0.0	0.1	0.0	1.1

In 2012, Storebrand Bank developed an internal expert model for risk classification of corporate market loans. All customers in the corporate market are scored using the new model. The model allocates customers to risk classes with the associated PD from the bank's master scale (table 4). This model will form the basis of credit being granted in the future.

4.1.5 Impairment of financial assets

For financial assets not carried at fair value, an assessment is made at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that impairment has occurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not occurred), discounted at the financial asset's original effective interest rate (i.e. the effective interest rate calculated at initial recognition). The carried value of the asset is reduced either directly or by making use of an appropriation account.
The amount of the loss is recognised in the income statement. Losses expected as a result of future events, no matter how likely, are not recognised.

Evaluation of impairment losses on loans

Each reporting date, the Group carries out an assessment to determine whether there is objective evidence that the value of a loan or a group of loans has been impaired. An impairment loss on a loan is established if there is objective evidence of an impairment which may result in reduced future cash flow to serve the loan. The impairment must be the result of one or more events which have occurred after the initial carrying date, and the result of the loss event must allow for reliable measurement. Objective evidence that the value of a loan or group of loans has been reduced comprises observable data of which the Group is aware for the following loss events:

- significant financial difficulties for the issuer or debtor
- breach of contract, with defaulted payment of overdue interest or overdue principal
- the Group provides the borrower with special terms as a result of the borrower's financial situation
- it is probable that the borrower will enter into debt settlement negotiations, bankruptcy or other methods of financial re-organisation
- when an active market for the financial asset disappears due to financial difficulties
- observable information indicates that there has been a measurable decline in the estimated future cash flows from a group of financial assets since the initial recognition of these assets

Impairment losses on loans are divided into two categories:

a. Individual impairment losses

Impairment losses on individual loans are based on a specific evaluation of loans where there is objective evidence of impairment. For corporate and private loans, the objective criteria for impairment are considered to be correlated with non-performance status. In addition, an impairment assessment of loans is carried out where other information indicates that the loan may be subject to losses. Any impairment figure is calculated on the basis of a specific assessment of the most probable future cash flows which the debtor could generate in relation to the loan. When making such an assessment, the management applies knowledge from previous experience of the debtor and other information available which is deemed relevant.

b. Group impairment losses

Group impairment losses on loans are calculated separately for corporate loans and for loans to private individuals. For corporate market loans, the objective criteria for impairment losses on loans are deemed to be strongly correlated to changes in the loan's risk classification. The classification model for loans to the corporate market has three parts, in relation to debtor (repayment capacity), security (degree of security/loan-to-value ratio) and commercial factors (internal and external risk). The risk classification model specifies classification on the basis of data registered in the accounting module at the time when the calculation of the group impairment losses is carried out, the realisation value recorded for the security and the assessment of commercial factors. Changes in macro-economic factors which could potentially have a major impact on corporate market loans are also taken into account, and these include changes in interest rate and changes in projections of interest rates.

For the group of loans issued to private individuals, the objective criteria for write-downs on loans are deemed to be correlated with the non-performance status for the group and the historical degree of solvency. Non-performance status is classified as 30–90 days or more than 90 days for loans where individual impairment has not occurred as there are no objective criteria for impairment. The degree of solvency is updated every quarter, in line with the results of the portfolio.

4.1.6 Credit risk (counterparty risk) in the investment portfolio

Storebrand Bank ASA and Storebrand Boligkreditt AS limit their credit risk linked to investment activities by setting minimum requirements for the rating. The model for credit limits and credit ratings at Storebrand Kapitalforvaltning AS (SBK) is utilised when there is no rating available from a rating agency.

4.1.7 Capital requirement

The total capital requirement for credit risk is calculated at NOK 1,758 million. This capital requirement is specified in more detail in section 6.

4.1.8 Capital needs

The overall capital needs for credit risk cover the following elements:

- capital needs calculated according to internal models for the retail market and corporate market;
- capital needs linked to concentration risk in the corporate market;
- capital needs linked to counterparty risk in the liquidity portfolio, including the CVA (Credit Value Adjustment) charge.

As of the end of 2012, the overall capital needs for credit risk are NOK 1,062 million.

4.2. Liquidity risk

4.2.1 Management and control

Risk management and control is described in note 5 to Storebrand Bank's annual report.

4.2.2 General portfolio information

The bank's liquidity portfolio consists solely of securities which have an "investment grade" rating (external or internal) or which can be deposited at Norges Bank (see figure 5).

The proportion of long-term funding over one year as measured by the Financial Supervisory Authority of Norway's liquidity indicator was above 100 per cent throughout 2012. The bank attaches great importance to having a balanced funding structure as regards the different maturities and issuances in different markets. The average remaining maturity for external funding excluding subordinated loans is 3.1 years, an increase from 2.7 years last year. The proportion of contributions below NOK 2 million has remained relatively low at a rate of between 65 per cent and 69 per cent since spring 2010, with the effect of reducing the exposure to risk.

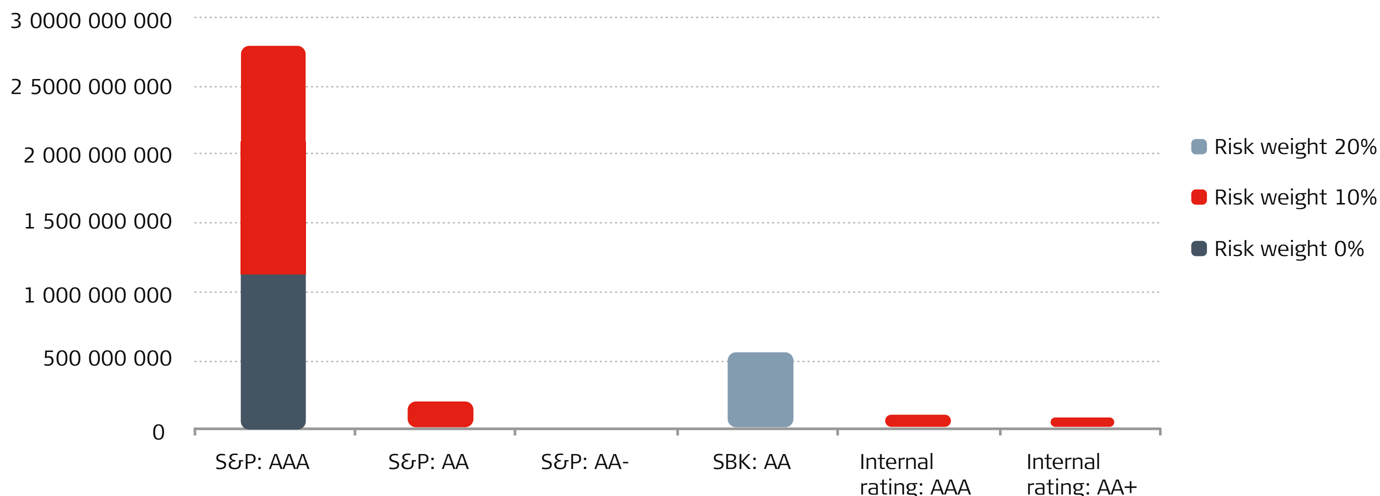


Figure 5: The investment portfolio as of 31 December 2012 broken down by rating and risk weight (MNOK).

Of Storebrand Bank's total market funding of approximately NOK 16.5 billion, around NOK 1.7 billion has a term of maturity of less than one year as of the end of 2012. The security holding at Storebrand Boligkreditt allows new issuances of just over NOK 3 billion.

The bank has established credit facilities/agreements with other banks that can be drawn on as required. These agreements reduce the risk in order to be allowed to take up more expensive emergency loans and/or redress a situation where there is no lending or deposit market.

4.2.3 Stress tests

The bank prepares monthly liquidity forecasts. These forecasts are based on the updated expectations and plans of the business areas for the coming six-month period. Liquidity stress tests for both Storebrand Bank and Storebrand Boligkreditt, with a time horizon from one week to six months, are carried out on the basis of these forecasts. Assumptions used in these stress tests describe the effects of stressful situations as a result of events specific to the bank and market, as well as combinations of these. These assumptions are well-established within the bank's balance sheet management committee.

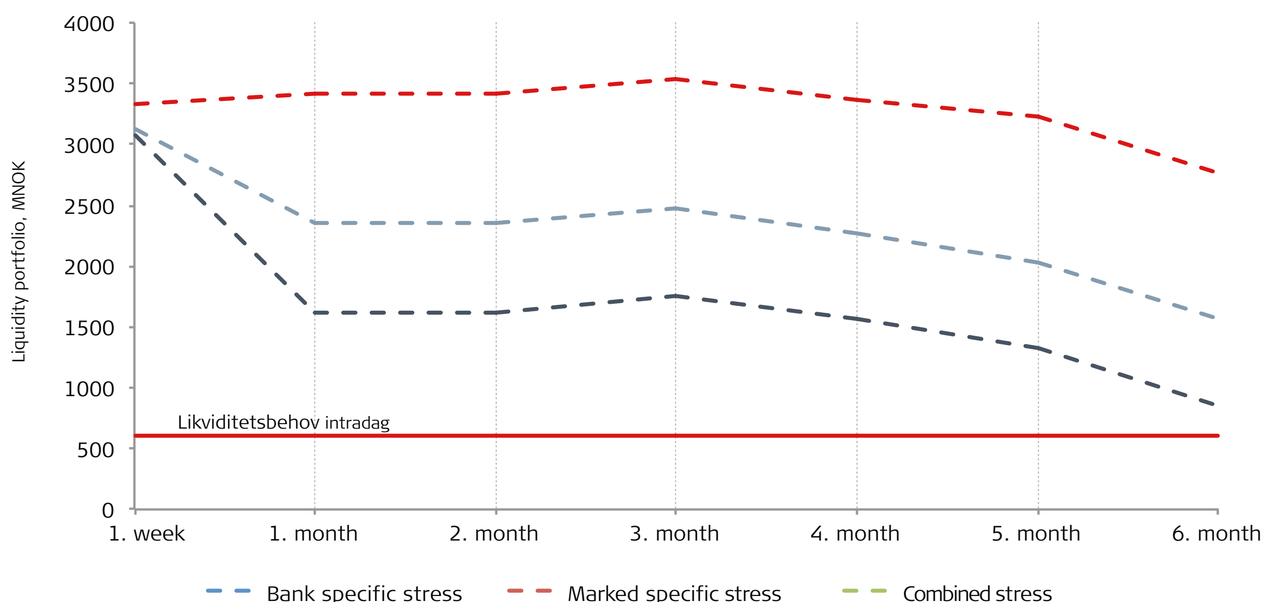


Figure 6: Effect of stress tests on the liquidity portfolio as of December 2012.

Development in the liquidity portfolio is simulated during the stress tests. At the same time, a stressed cash flow which emerges from the difference between a stressed liquidity portfolio and total liquidity needs according to the forecast is examined. The results from these stress tests form the basis of the formulation of the liquidity risk policy.

4.2.4 Capital requirement

Capital requirement for liquidity risk is not calculated.

4.2.5 Capital needs

Capital needs for liquidity risk are not calculated. Storebrand Bank aims to minimise this risk by employing both a good funding structure and good internal processes.

4.3. Market risk

4.3.1 Management and control

Risk management and control is described in note 6 to Storebrand Bank's annual report.

4.3.2 General portfolio information

The bank's aggregate interest and exchange rate exposure and the maximum risk of loss on the liquidity portfolio are restricted through low exposure limits. The bank does not have an active investment strategy for shares. Market risk is followed up in sub-portfolios and reported on a monthly basis to the Board in the risk report.

4.3.3 Capital requirement

Capital requirement for market risk is not calculated.

4.3.4 Capital needs

Capital needs for interest rate risk, exchange rate risk and credit spread risk in the liquidity portfolio are calculated. As of the end of 2012, the total capital needs are NOK 47.6 million.

4.4. Operational risk

4.4.1 Management and control

Risk management and control is described in note 7 to Storebrand Bank's annual report.

4.4.2 Capital requirement

The minimum requirement for primary capital for operational risk is calculated at 15% of the average earnings of all business areas over the last three years. The total capital requirement for operational risk is calculated at NOK 1,758 million.

4.4.3 Capital needs

Storebrand Bank believes that satisfactory monitoring of the bank's operational risk is ensured by employing the processes described in note 7 to the annual report. As of the end of 2012, capital needs are calculated at NOK 107.1 million.

4.5. Compliance risk

4.5.1 Management and control

Risk management and control is described in note 7 to Storebrand Bank's annual report.

4.5.2 Capital requirement

Capital requirement for compliance risk is not calculated.

4.5.3 Capital needs

Capital needs for capital risk are not calculated.

5. Calculating capital requirements

5.1. Primary capital

Table 7 below shows the minimum requirement for primary capital and capital adequacy for Storebrand Bank ASA, Storebrand Boligkreditt AS and the Storebrand Bank Group.

Table 7: Minimum requirement for primary capital and capital adequacy.

PRIMARY CAPITAL 31.12.2012	STOREBRAND BANK ASA	STOREBRAND BOLIGKREDITT AS	STOREBRAND BANK GROUP
NOK million			
Share capital	960.6	350.0	960.6
Other equity	1,414.0	356.1	1,495.1
Equity	**2,374.6**	**706.1**	**2,455.7**
Deductions:			
Intangible assets	-65.7		-106.3
Dividends and group contributions set aside for distribution			-50
Deferred tax assets	-14.0		-7.3
Core capital excluding perpetual hybrid Tier 1 capital (pure core capital)	**2,294.9**	**706.1**	**2,292.0**
Perpetual hybrid Tier 1 capital (hybrid capital)	278.8		278.8
Core capital	**2,573.6**	**706.1**	**2,570.8**
Subordinated loan capital less own holdings	158.6		158.6
Net primary capital	**2,732.2**	**706.1**	**2,729.4**

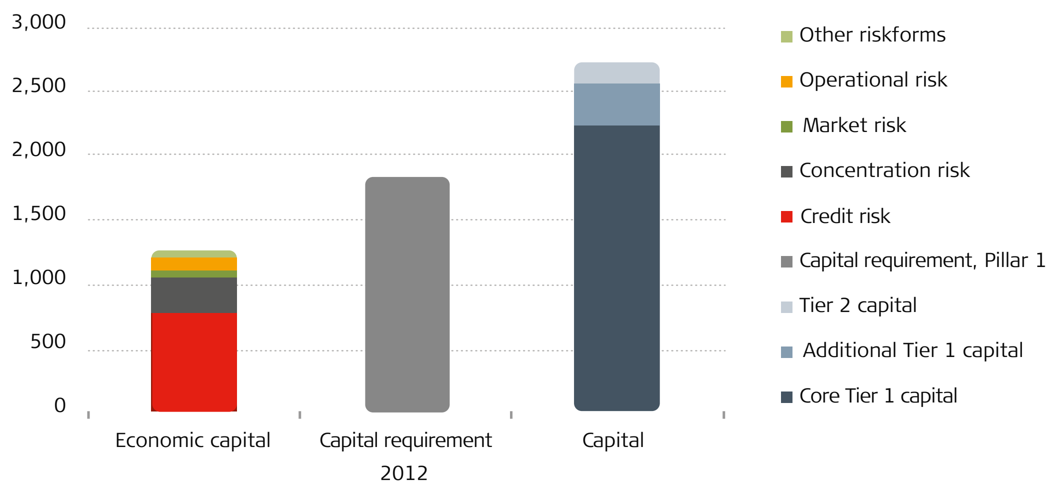
MINIMUM REQUIREMENT FOR PRIMARY CAPITAL 31.12.2012	STOREBRAND BANK ASA	STOREBRAND BOLIGKREDITT AS	STOREBRAND BANK GROUP
NOK million			
Credit risk	1,433.6	526.1	1,758.1
Of which:			
Local and regional authorities	**9.2**		**9.2**
State-owned businesses	0.0		0.0
Institutions	167.6	11.9	15.4
Businesses	947.6		938.9
Loans secured on homes	189.9	503.7	693.6
Mass market loans	47.8		47.8
Overdue loans	10.6	2.3	12.9
Covered bonds	39.1		17.1
Other loans	21.8	8.2	23.2
Total minimum requirement for credit risk	**1,433.6**	**526.1**	**1,758.1**
Total minimum requirement for credit risk	0.0	-	0.0
Operational risk	69.4	15.7	89.5
Deductions:			
Group impairment losses	-3.1	-0.0	-3.1
Minimum requirement for primary capital	**1,499.9**	**541.8**	**1,844.5**

CAPITAL ADEQUACY 31.12.2012	STOREBRAND BANK ASA	STOREBRAND BOLIGKREDITT AS	STOREBRAND BANK GROUP
Capital adequacy	**14.57%**	**10.43%**	**11.84%**
Core capital adequacy	**13.73%**	**10.43%**	**11.15%**
Pure core capital adequacy	**12.24%**	**10.43%**	**9.94%**

6. Comparison of regulatory capital and economic capital

In the annual ICAAP (see section 2.1.4), Storebrand Bank and Storebrand Boligkreditt carry out an assessment of capital needs according to the risk profile.

Figure 7 below shows the calculated economic capital and minimum capital requirement (described in section section 4) as well as available capital as of the end of 2012. ICAAP simulates development in figures in three years' time, based on forecasts and in both a normal scenario and a stressful scenario representing a serious economic setback.



For Storebrand Bank, the credit risk represents the most significant risk for which capital requirement and capital needs are calculated. Capital requirement for credit risk is calculated based on template values where all loans within a segment are assigned the same risk weight. There is therefore no connection between a loan's inherent risk and the capital requirement associated with that same loan. The risk weight for home loans is 35 per cent, while for business loans it is 100 per cent.

When calculating capital needs, the bank's internal models for calculating the risk weight of a loan is used. The risk weight for home loans may vary from less than 5 per cent for the very best loans to nearly 100 per cent for the most risky loans. Home loans at the Storebrand Bank Group are of extremely good credit quality with a significant proportion of the portfolio containing risk weights of less than 35 per cent, which means that overall the capital needs for credit risk are considerably lower than the corresponding capital requirement. The proportion of home loans that are transferred to Storebrand Boligkreditt is further evidence of the portfolio's excellent credit quality. As of the end of 2012, this proportion constitutes approximately 73 per cent.