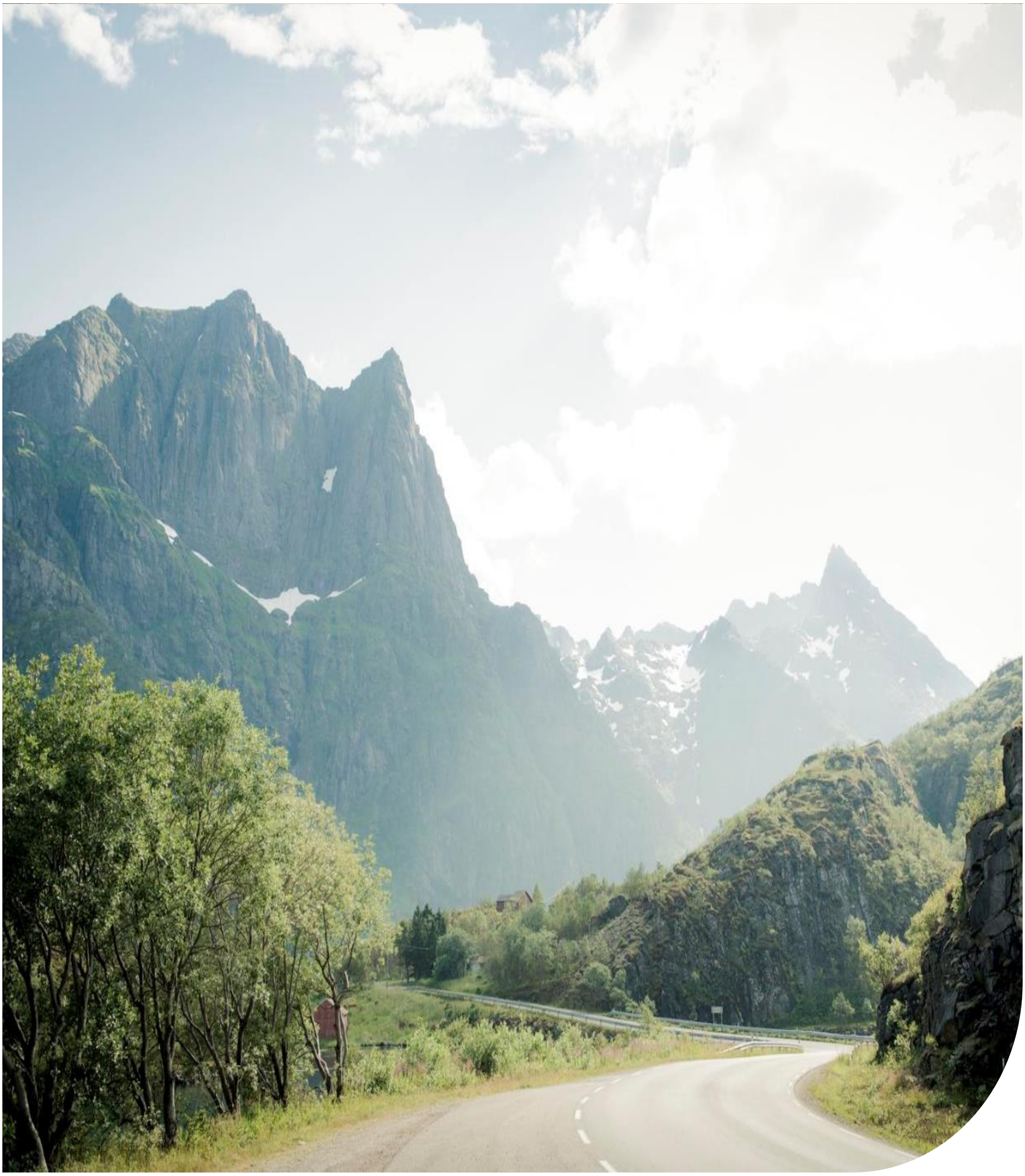
# Pillar III - risk and capital 2015

Eika Boligkreditt AS



# 1 INTRODUCTION

The purpose of this document is to provide the market with information about risk management and capital at Eika Boligkreditt AS (hereafter **EBK**). It is intended to fulfil the requirements for publication of financial information pursuant to part IX of the capital requirement regulations.

EBK's main purpose is to ensure access for the local banks in the Eika Alliance (the owner banks) to long-term and competitive funding by issuing covered bonds. An important part of the company's business concept is to increase the competitiveness of the owner banks by improving their access to external funding in the Norwegian and international financial markets with regard to the length of loans, their terms and the depth of access. The object of the company's business is to reduce risk for the owner banks.

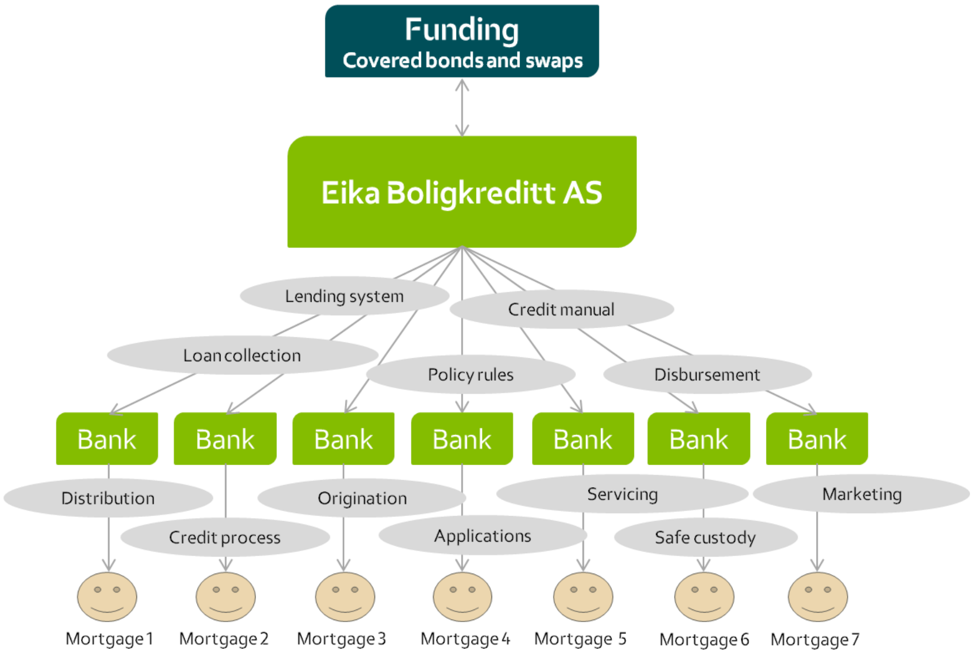
At 31 December 2015, the owner banks had transferred a total of NOK 64.5 billion in residential mortgages and thereby reduced their own funding needs by a corresponding amount. Eika Boligkreditt is licensed as a credit institution and entitled to raise loans in the market through the issuance of covered bonds. Norwegian regulations for covered bonds were adopted in 2007, and thereby established a new type of bond which has become an important source of financing within a few years for the lending activities of banks and credit institutions. By concentrating funding activities relating to covered bonds in Eika Boligkreditt, the owner banks have secured a player in the bond market with the necessary requirements for securing competitive terms and depth of liquidity both in Norway and internationally.

# 2 COMPANY STRUCTURE AND OPERATIONS

A mechanism for providing the company with support from the owner banks has been established, which comprises the obligations resting on the owner banks to provide the company with liquidity and capital as and when required. The owner banks exercise a dynamic ownership of EBK, which ensures an adjustment of the shareholding of each bank at least once a year which ensures that it corresponds to the bank's share of the residential mortgage portfolio in EBK.

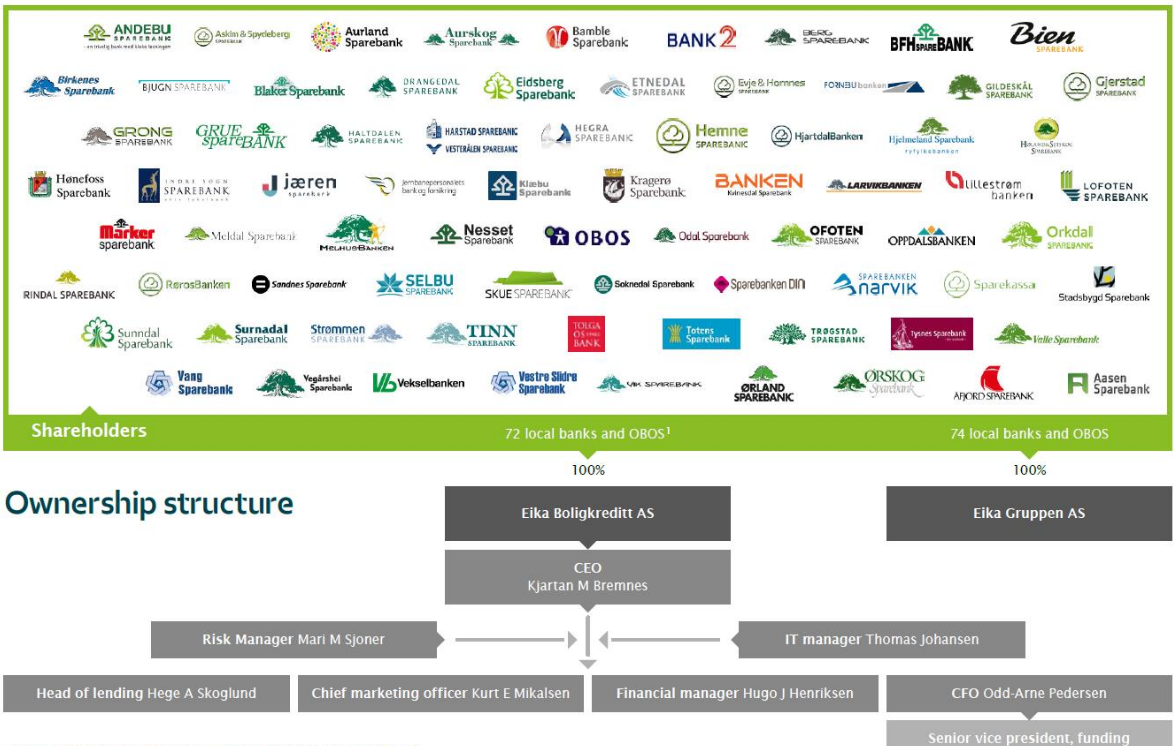
For EBK to be active as an issuer in both Norwegian and international financial markets, its covered bonds must have an international rating. An international rating from Moody's Investors Service (**Moody's**) gives EBK the opportunity to diversify its financing and to obtain funding at the best terms available in the market. The owner banks are prevented from issuing covered bonds directly but, through EBK, they can nevertheless access very favourable financing and maintain their competitiveness in relation to large Norwegian and international banks.

## Figure 1 The company's area of operation




The owner banks are EBK's local representatives as distributors. They make all the arrangements related to providing residential mortgages. That includes processing mortgage applications, establishing the loan, amending existing mortgages and borrowing, and so forth. As a result, a residential mortgage transferred to EBK will be wholly perceived by the mortgagee as one taken out with the owner bank, because it will always be the mortgagee's point of contact for the mortgage. EBK is responsible in the mortgage process for operating the IT system, credit policy and disbursals.

## Figure 2 Ownership structure in the Eika Alliance




[1] Bank2 and Sandnes sparebank are only shareholders in Eika Gruppen AS.

EBK is organised in five departments:

- lending
- funding and investment
- marketing
- accounting and back office
- risk management and compliance.

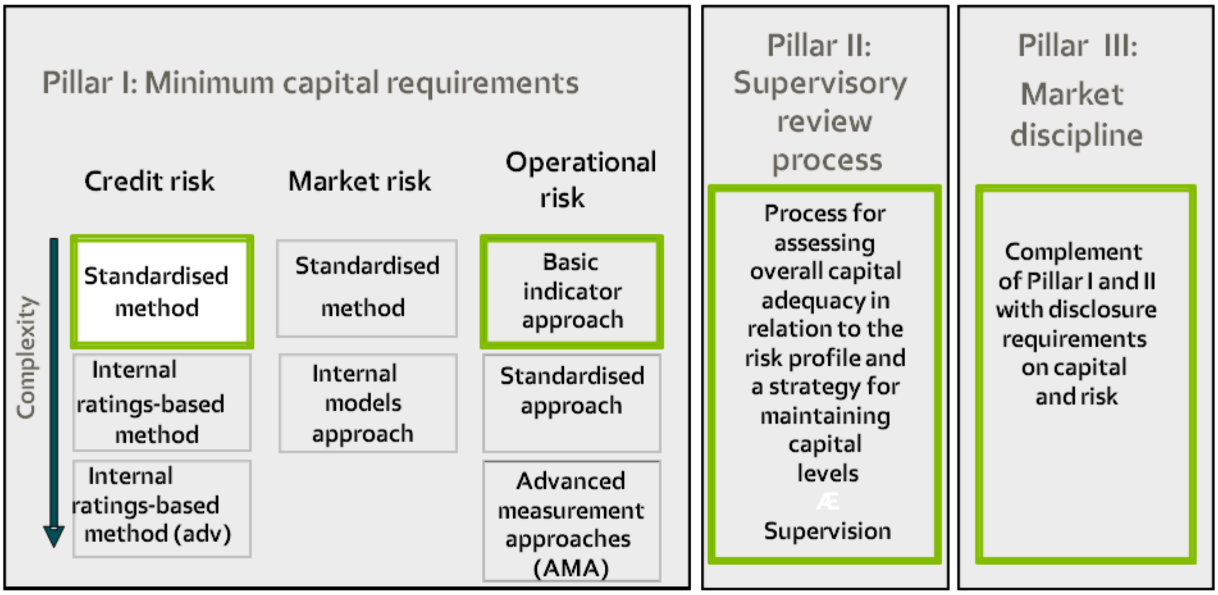
Company staffing at 31 December 2015 was the equivalent of 19.8 work-years. In addition, services are provided by Eika Gruppen in such areas as human resources, payroll, legal affairs, accounting and marketing. EBK's IT platform is also supplied by Eika Gruppen.

## 3 BASEL II – CAPITAL ADEQUACY STANDARDS

The Basel II requirements on the calculation of capital adequacy by financial institutions were introduced in Norway at 1 January 2007. They are based on a new standard for calculating capital adequacy established by the Bank for International Settlements (BIS). The purpose of the capital requirement regulations is to strengthen the stability of the financial system through

- more risk-sensitive capital requirements
- better risk management and control
- closer supervision
- more information to the market.

**Figure 3 Basel II pillars**




When calculating capital requirements, the company utilises the standardised method for credit and market risk and the basic indicator method with regard to operational risk. This means that the calculation of capital requirements for these risks accords with the categories and risk weighting rules in the capital requirement regulations.

## PILLAR I

Pillar I addresses minimum capital adequacy requirements related to credit, market and operational risk. It also covers capital adequacy related to the creditworthiness of counterparties to derivatives (CVA risk).

## PILLAR II

Pillar II is based on two main principles. EBK must have a process in place for assessing its total assets in relation to its risk profile and a policy for maintaining its capital adequacy. The Financial Supervisory Authority (FSA) of Norway as the regulator can also review and evaluate EBK's internal assessment of its capital requirements and policies, and monitor and ensure compliance with official capital requirements. The FSA has the authority to initiate appropriate supervisory measures if it is dissatisfied with the result of the process.

## PILLAR III

Pillar III is intended to supplement the minimum requirements in Pillar I and the regulatory follow-up specified in Pillar II. It will help to enhance market discipline through requirements for the publication of information which make it possible for the market, including analysts and investors, to assess the institution's risk profile and capitalisation as well as its management and control. The publication requirements are particularly important when players can make greater use of their own systems and methods for calculating their capital requirement.

The capital requirement and targets are assessed on the basis of the international Basel II and Basel III regulations on capital adequacy as specified in the Act on Financial Institutions and the capital requirement regulations. Pursuant to section 13, sub-section 6 of the Act on Financial Institutions, a financial institution must at all times have a primary capital (tier 2 capital) which is acceptable in relation to the risk and scope of the institution's business. This must be assessed for both the immediate future and the long term. Capital adequacy must accordingly be higher than the minimum requirement of eight per cent and applicable buffer requirements, as specified in detail in chapter 14 of the Act on Financial Institutions. The FSA will evaluate both EBK's capital target and the documentation of the assessments on which the board's conclusions are based.

## CONTINGENCY PLAN FOR CAPITAL ADEQUACY

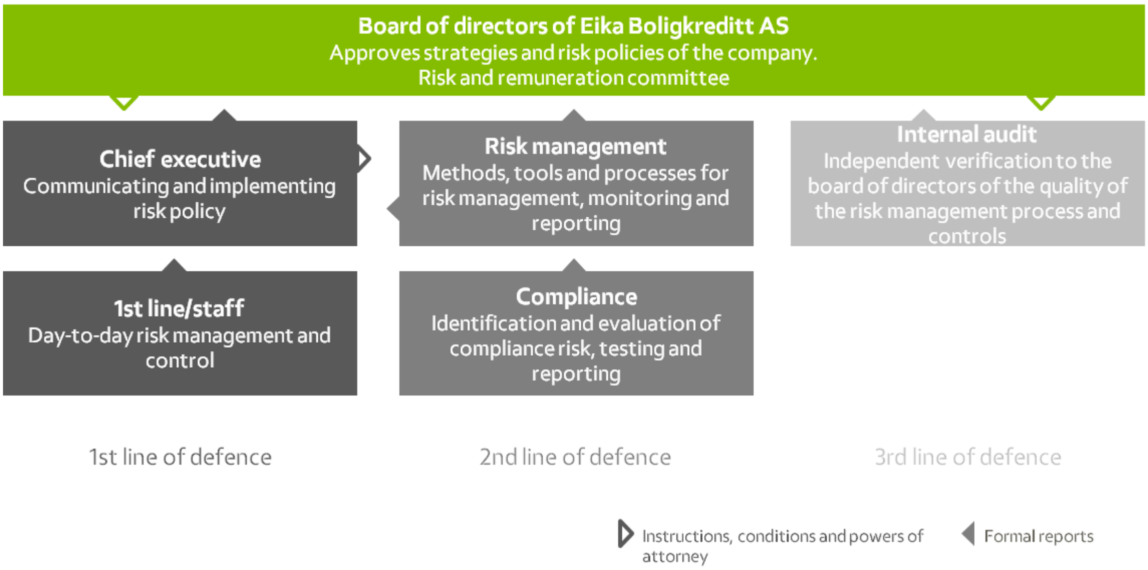
The company has established a contingency plan for capital adequacy which is intended to help ensure that good processes are in place for capital management. EBK's owner banks are all subject to capital requirements and all have good solvency. The owner banks are committed by agreements to participate in issues to strengthen the company's capital in accordance with each shareholder bank's share of EBK's residential mortgage portfolio.

# 4 OVERALL RISK AND CAPITAL MANAGEMENT

## RISK MANAGEMENT IN EBK

Responsibility for conducting the company's overall management and control is organised as follows.

**Figure 4 Governance and control**




EBK has established a framework for management and control through risk policies determined by the board of directors, with quarterly reporting of status and developments. Overall professional responsibility for risk management in the company lies with the chief executive. The company's attention will be focused on maintaining sufficient resources to pursue risk management and compliance, and will assess available expertise and capacity on a continuous basis.

Quarterly risk and compliance reporting is conducted to provide an overview of exposure in relation to established parameters in the company, allowing the executive management and the board to verify that risk exposure falls within the defined willingness to accept risk. This reporting quantifies and assesses all main risks relevant to the company, including strategic, credit, counterparty, market, interest rate, liquidity and refinancing, and operational risk.

A good internal control regime depends on entrenchment in the whole organisation, from the individual employees to the executive management and the board. PricewaterhouseCoopers is the company's internal auditor.

## ICAAP

The business is required pursuant to section 13, sub-section 6 of the Act on Financial Institutions to conduct an internal capital adequacy assessment process (ICAAP). This process involves assessing capital requirements in relation to the company's goals, policies, current and anticipated risk exposures, and applicable risk parameters and regulatory provisions. Furthermore, the ICAAP is intended to help provide a shared understanding of the risk picture in the company and provide opportunities for evaluating risk in relation to the quality of management and control. That provides a basis for determining the capital targets.

Estimated budgets and forecasts for three years ahead are prepared by the management. On the basis of budgets and forecasts of anticipated developments in the company, the risk management and compliance department calculates capital needs for the coming three years.

Stress tests are also carried out by the department with what would be a reasonable but stringent downturn scenario. This scenario is intended to reflect a worst-case condition for EBK.

The preliminary ICAAP report is important for the board's assessment that the Company has adequate level of capital and liquidity, pursuant to section 3, sub-section 4 of the Act on Private Limited Liability Companies and possible opportunities to pay dividend, requirements for additional capital and so forth. The board process involves reviewing and discussing important assumptions in the ICAAP analysis, including

- significant assumptions in the budget and the three-year forecast
- an assessment of whether the stress tests are sufficiently conservative to cover a worst-case scenario
- an assessment of the capital adequacy – in other words, how much capital the company ought to have, including how large a buffer the board finds prudent/desirable.

Contributions from the initial ICAAP process, with assessments from the final board meeting for the year, and the final annual financial statements, form the basis for updating the ICAAP calculations. A report is prepared to summarise the company's ICAAP work. The final ICAAP is approved by the board and submitted to the FSA on request.

## 5 RISK APPETITE AND CAPITAL POLICY

**Table 1 The company's risk appetite**

| Risk type | Risk appetite |
|---|---|
| Strategic risk | Low |
| Credit risk on lending | Low |
| Couterparty risk | Low |
| Market risk | Moderate |
| Interest rate risk on net interest income | Low |
| Financing and liquidity risk | Moderate |
| Operational risk | Low |

### CAPITAL AND BUFFER REQUIREMENTS

In line with the introduction of countercyclical buffer requirements at 30 June 2015, EBK has updated its capital targets to satisfy the regulatory minimum requirements and applicable buffer requirements for capital. A Pillar II buffer will be established with effect from 31 March 2016 on the basis of the results from the final ICAAP. The buffer has been set at 0.5 per cent in order to cover an estimated potential for loss in the ICAAP. EBK must satisfy an increased countercyclical buffer requirement, which has been set at 1.5 per cent from 30 June 2016. This means that the capital target will rise by one percentage point during the first half of 2016. The company has resolved to meet capital targets in line with the table below as well as to fulfil the applicable buffer requirements at all times.

**Table 2 Capital targets for EBK in the ICAAP period**

| Capital targets | 31 December 2015 | 31 March 2016 | 30 June 2016 | 30 June 2017 |
|---|---|---|---|---|
| Core tier 1 capital ratio | 11.0 % | 11.5 % | 12.0 % | 12.0 % |
| Tier 1 capital ratio | 12.5 % | 13.0 % | 13.5 % | 13.5 % |
| Tier 2 capital ratio | 14.5 % | 15.0 % | 15.5 % | 15.5 % |

Should the need for capital change, the shareholder agreement provides considerable predictability over the provision of capital from the owner banks. The company's capital targets will be adjusted if countercyclical buffers change and, in the event of an increase in buffers, will have a minimum of 12 months to adjust to a new requirement.

Combined buffer requirements which exceed the company's minimum requirements must be met with core tier 1 capital, and comprise system-risk, capital-conservation and countercyclical buffers. In addition, a requirement has been set for core tier 1 capital in systemically important financial institutions (SIFI). A common denominator for the new buffer requirements is the restrictions imposed on opportunities to make dividend and bonus payments in circumstances where the company fails to satisfy the requirements.

**Table 3 Capital buffer requirements at 31 December 2015 (amounts in NOK thousand)**

| Buffertypes | | Core tier 1 requirements |
|---|---|---|
| Capital conservation buffer | 2.5 % | 687,750 |
| Systemical risk buffer | 3.0 % | 825,300 |
| Countercyclical buffer | 1.0 % | 275,100 |
| **Combined buffer requrienments** | | **1,788,150** |

The company had a combined buffer requirement of about NOK 1.8 billion at 31 December 2015, which is covered by core tier 1 capital.

## 6 CAPITAL

The company applies the standardised method for calculating capital requirements for credit and market risk and the basic indicator method for calculating operational risk. The standardised method for credit risk is used in calculating capital requirements for market risk, including capital requirements for liquidity investments.

Pursuant to the capital requirement regulations, the following weighting rules are significant for credit risk in the company:

| Commitment | Risk weighting | Assessment of capital in relation to risk |
|---|---|---|
| Residential mortgages secured on the property with an LTV of at least 80 per cent | 35% | Credit risk |
| Mortgage loan approvals and partly disbursed loans with an LTV of at least 60 per cent. Conversion factors of 20 and 50 per cent | 35% | Credit risk |
| Bank deposits without fixed terms | 20% | Counterparty risk |
| Derivatives, depending on rating | 20/50% | Counterparty risk |
| Local and regional government, including local authorities | 20% | Market risk |
| Covered bonds | 10% | Market risk |
| Governments and central banks | 0 % | Market risk |

Capitalised assets and other credit risk are basically weighted at 100 per cent unless special rules have been specified.

Calculating the capital requirement for operational risk using the basic indicator method means that the capital requirement is determined in relation to the company's net interest income and other revenues. Assessment of the operational risk is based on incidents experienced, events in the rest of the banking industry, and intrinsic risks.

Calculating the capital requirement for counterparty risk, including the risk of a reduction in the counterparty's creditworthiness (CVA risk) is calculated in accordance with the standardised method for CVA risk. See section 20a, sub-section 3 of the capital requirement regulations. Calculated on the basis of the counterparty's creditworthiness, this supplementary requirement is known as the credit valuation adjustment (CVA). The CVA became part of the calculation basis from 30 September 2014.

Risk types not covered by Pillar I – minimum primary capital requirement – have been calculated on the basis of overall exposure and the company's risk management and control.

**Table 4 Capital adequacy status at 31 Dec 15(amounts in NOK thousand)**

| Capital status | 31 December 2015 |
|---|---|
| Share capital | 856,674 |
| Share premium | 2,203,709 |
| Other paid-in equity | 477,728 |
| Fund for unrealized gains | 85,773 |
| Other equity | 1,003 |
| **Total equity capital** | **3,624,887** |
| Intangible assets | (3,690) |
| Prudent valuation | (14,657) |
| **Total core tier 1 capital** | **3,606,540** |
| Hybrid capital | 448,775 |
| **Total tier 1 capital** | **4,055,315** |
| Subordinated loan capital | 449,518 |
| **Total tier 2 capital** | **4,504,832** |
| | |
| **Risk-weighted assets and capital adequacy ratio** | |
| Credit risk | 25,243,451 |
| CVA risk | 1,929,894 |
| Operational risk | 336,653 |
| **Total risk weighted assets** | **27,509,998** |
| | |
| Capital requirement corresponding to 8 % of risk-weighted assets | 2,200,800 |
| Surplus equity and subordinated capital | 2,304,033 |
| | |
| **Core tier 1 capital ratio** | **13.11 %** |
| **Tier 1 capital ratio** | **14.74 %** |
| **Tier 2 capital ratio** | **16.38 %** |

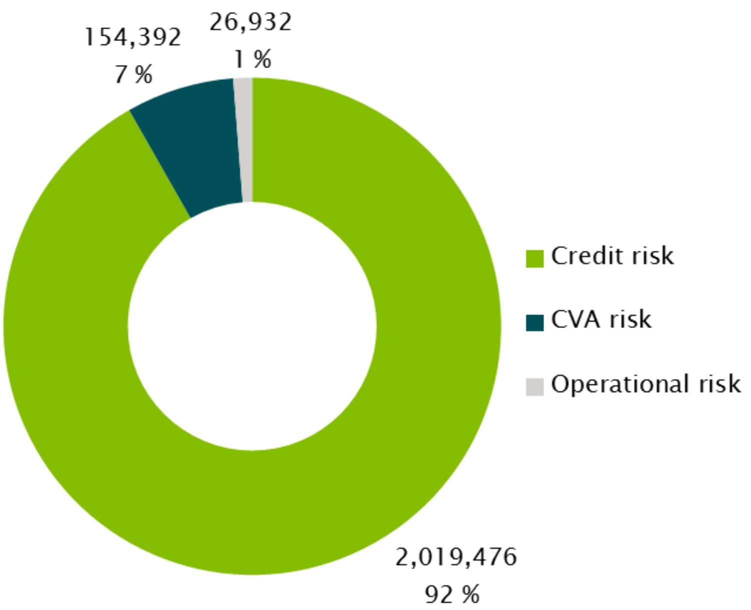
The company's capital adequacy status at 31 December 2015 comprised a core tier 1 capital adequacy of 13.11 per cent, a tier 1 capital ratio of 14.74 per cent and a tier 2 capital ratio of 16.38 per cent.

## SUMMARY OF MINIMUM CAPITAL REQUIREMENT

**Table 5 Capital adequacy by risk type (amounts in NOK thousand)**

| Capital status | 31 December 2015 |
|---|---|
| Core tier 1 capital ratio | 13.11 % |
| Tier 1 capital ratio | 14.74 % |
| Capital ratio | 16.38 % |
| Credit risk | 2,019,476 |
| CVA risk | 154,392 |
| Operational risk | 26,932 |
| **Sum Pillar I** | **2,200,800** |

**Figure 5 Capital requirements on Pillar I (amounts in NOK thousands)**




## LEVERAGE RATIO

Implementing CRD IV in the Norwegian regulations means that the leverage ratio must be reported and incorporated in the assessment of overall capital requirements under Pillar II before a minimum requirement in Pillar I is introduced in 2018. This is intended to act as a safeguard against setting the calculation basis too low when calculating capital adequacy.

Reporting of the leverage ratio under CRD IV in Norway will be in line with EU standards. The FSA has been asked by the Ministry of Finance to prepare a consultation document and proposals for regulatory requirements on the leverage ratio by 31 March 2016. Furthermore, the ministry has asked for definitions of numerators and denominators in the formula for the leverage ratio. It has also requested an assessment of the appropriate level to adopt for Norwegian banks, credit institutions and parent companies in financial institutions, including differentiation between these, given that the leverage ratio is being introduced without replacing other capital requirements.

EBK has reported its leverage ratio to the regulators since 30 September 2014. Reporting is done on a standardised form, but without any indicator requirements being specified for the moment. EU regulations on the leverage ratio are still not ready but, based on the Basel committee's proposal, it appears for the moment that the minimum requirement will be three per cent from 2018. EBK has produced estimated projections of the ratio on the basis of the FSA's calculation method, and fulfils the indicated requirement of three per cent.

When calculating the leverage ratio, today's reporting standard does not permit collateral from derivative counterparties to be taken into account when calculating derivative exposure. In addition, the amount must be calculated using the market value method. That has unfortunate effects for EBK, and means that the indicator fails to provide a good picture of the actual risk associated with an irresponsible increase in debt. It is actually the case that the calculation method punishes enterprises with agreements on receiving collateral for the increased market value of derivatives. EBK has therefore also carried out calculations of the leverage ratio which show net derivative exposure calculated in accordance with the standardised method in the capital requirement regulations.

**Table 6 Leverage ratio at 31 December 15**

| Leverage ratio | 31 December 2015 |
|---|---|
| Balance sheet items (excluding derivatives) | 79,618,811 |
| Change in value of financial instruments at fair value | 14,657 |
| Derivative exposure (Market value method) | 13,319,888 |
| Derivative exposure (Standardised method) | 3,451,519 |
| Loan commitments to customers | 1,303,965 |
| Total on- and off-balance sheet exposures (MV method) | 94,257,321 |
| Total on- and off-balance sheet exposures (Std. Method) | 84,388,952 |
| Core tier 1 capital | 3,606,540 |
| Tier 1 capital | 4,055,315 |
| Leverage ratio - core tier 1 (Market value method) | 3.83 % |
| **Leverage ratio - tier 1 (Market value method)** | **4.30 %** |
| Leverage ratio - core tier 1 (Standardised method) | 4.27 % |
| Leverage ratio - tier 1 (Standardised method) | 4.81 % |

# 7 STRATEGIC AND BUSINESS RISK

*Definition:* *Strategic and business risk are defined as the risk of weakened profitability owing to changes in competitive terms, operating parameters and external factors, and also includes political and regulatory risk. This includes the risk of a lack of correlation between revenue and expenses over time. It is considered appropriate to assess business risk in relation to strategic risk. Strategic and business risk also cover rating, reputational, owner, and reward and incentive risk.*

## RISK APPETITE AND EXPOSURE

Strategic and business risk in the company must be low. EBK has established a good business strategy and comprehensive risk policies for managing strategic risk. Goals have been set in the business strategy, and other policies have overarching parameters related to risk appetite. The company's business concept is to improve the competitiveness of the banks and reduce their risk by issuing covered bonds in the Norwegian and international financial markets. Through professional cultivation of the financial markets, good international ratings and high-quality collateral, EBK will thereby secure long-term and competitive funding for the owner banks. To achieve this strategy, the priority areas relate to:

- sustainable development
- good international ratings
- profitability and cost-effectiveness
- prudent risk
- quality at every level.

EBK's reputational risk relates most significantly to the company as a source of funding. It has rated covered bonds, and a reduction in rating would be damaging. The Moody's rating agency assesses the owner banks as a single category as well as the quality of the company's cover pool. The assessment of the owner banks is particularly vulnerable, since this depends on how far the Norwegian government would be willing to rescue them in a crisis. Should a downturn occur, fewer investors would invest in the company's covered bonds and would require a compensation in the credit spread if they opt to invest.

The company is exposed to reputational risk related to Eika as a brand. Adverse developments in one of the Eika companies or the banks could give rise to detrimental rumours and consequences which EBK must deal with. In addition, the company is exposed to the effects of political changes. A significant proportion of market-based issues by Norwegian bond issuers are conducted in currencies other than the Norwegian krone. Possible political developments in Norway have an impact on the international reputation of Norwegian issuers. That also relates to the willingness of the Norwegian authorities to support Norwegian banks in crises. Decisions taken by the Norwegian government have historically had a direct effect on the financing opportunities for Norwegian issuers and on credit spreads. Nevertheless, the risk associated with these considerations is greatest internationally and for state-owned issuers, and such political/reputational risk is particularly high in periods when the company needs to refinance maturing bonds with an order of magnitude which cannot be accommodated by the Norwegian market.

**MANAGEMENT AND CONTROL**

Good policy processes are important for ensuring management and control of business and strategic risk. EBK has an annual cycle in which revision of business and risk policies plays a fixed role. Part of the management and control of business risk includes changes to the company's guarantee agreements with the shareholders.

Focusing attention on good risk management, compliance, business ethics, whistleblowing, managing conflicts of interests, and other policies, strategies and routines will help the company to handle processes in a positive way.

**CAPITAL REQUIREMENTS**

Strategic and business risk is not included in the calculation of Pillar I capital requirements. An assessment of capital requirements for strategic and business risk is included in the assessment of Pillar II requirements, and the company's capital targets are considered adequate to cover risks over and above the minimum requirements in Pillar I.

## 8 CREDIT RISK

*Definition: Credit risk is the risk of loss posed by customers or counterparties failing to meet their payment obligations. Credit risk affects all claims on customers/counterparties, lending, credits, guarantees, open trades, residential mortgage approvals to customers, and the counterparty risk arising through derivatives and foreign-exchange contracts. Credit risk depends in part on the size of the claim, the time to maturity, the probability of default and possibly the value of collateral. Credit losses can also be incurred as a result of operational errors.*

### RISK APPETITE AND EXPOSURE

The credit risk related to lending must be low. In its credit policy and lending activity, EBK will take account of the applicable regulations which govern credit institutions issuing covered bonds at any given time. See section 11, sub-section 5 of the Act on Financial Institutions. The company's policy for credit risk on lending is intended to minimise the risk of defaults and to keep credit risk below the level in comparable companies. This will ensure that the company's bonds are a preferred choice for investors.

The company's credit risk is strictly limited through the company's business purpose, policies, credit guarantees from the distributor banks and the company's credit risk policy. EBK's credit risk is primarily related to balance sheet items, but it is also exposed to off-balance sheet credit risk. EBK uses the standardised method to calculate capital requirements for credit risk. Credit risk accounted for 92 per cent of the company's capital requirement under Pillar I at 31 December 2015. This chapter deals with credit risk related to residential mortgages. Other credit risk is handled under counterparty and market risk.

The company reports pursuant to the International Financial Reporting Standards (**IFRS**), and measures mortgages with floating interest rates at amortised cost and mortgages with fixed interest rates at fair value. The market value of floating-rate mortgages is measured as equal to amortised cost. The fair value of fixed rate loans is correspondingly measured as equal to amortised cost adjusted for the difference between the loans' fixed rate of interest and the applicable fixed interest rate offered at the balance sheet day. The fair value of mortgages with a fixed interest rate is determined pursuant to the regulations on credit agreements. The fair value of each individual fixed-interest mortgage is determined on the basis of the discount or premium which the customer will receive or have to pay in the event of early redemption. This value is therefore contingent on interest-rate developments, and value fluctuations will affect the financial results. The company also provides mortgages for residential cooperatives.

### GENERAL CONSIDERATIONS RELATED TO CREDIT RISK IN EBK

EBK has never experienced accounting defaults exceeding 90 days on its lending, or losses related to its mortgage business[1]. The guarantee structure between EBK and its distributors reduces the company's credit risk, and it therefore also expects no bad debts in the future. Consequently, the company has never taken an impairment charge on mortgages.

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[1] Pursuant to section 10, sub-section 1 of the capital requirement regulations, a loan is to be regarded as being in default if an instalment has fallen due more than 90 days earlier, and the delay is not the result of fortuitous circumstances at the client. Should the institution have loans in default with instalments overdue by more than 90 days, the loan is to be regarded as doubtful. Doubtful loans are not necessarily in default, but the customer's financial position and the value of the collateral indicate a risk of loss.

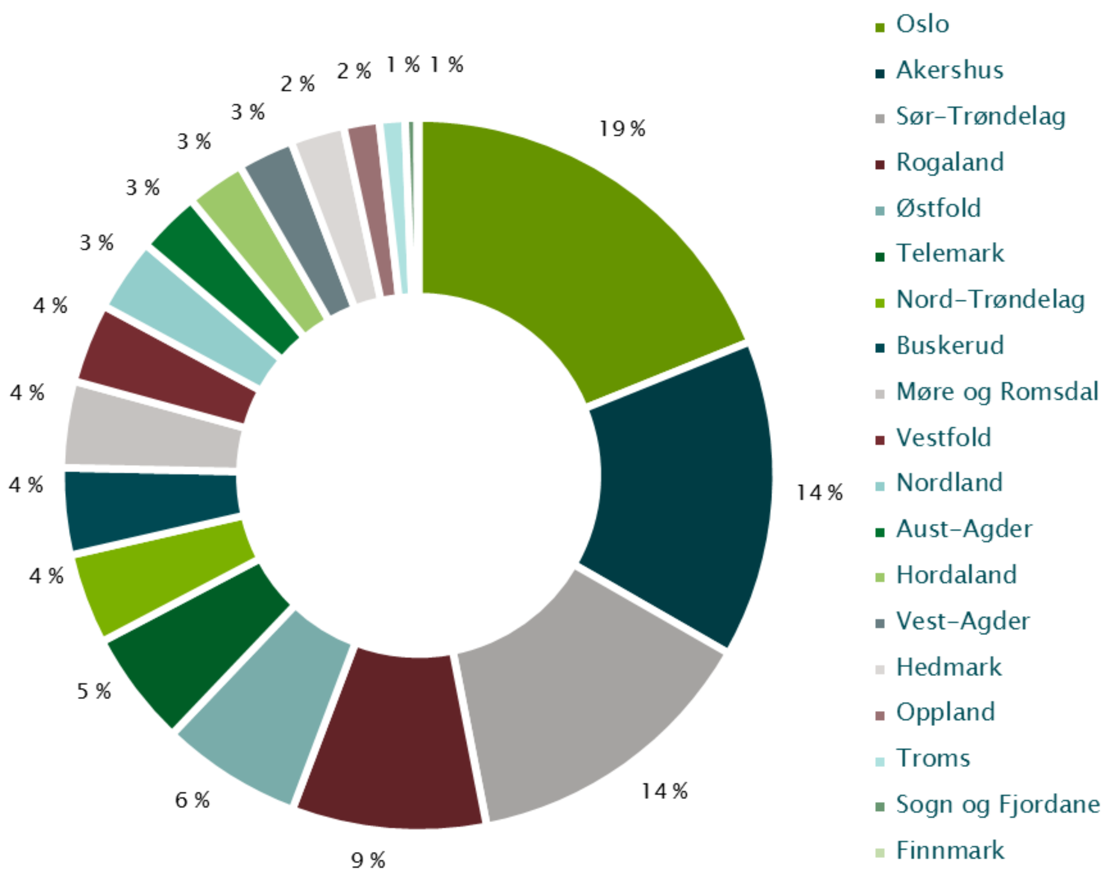
### Table 7 Credit risk: specification of risk-weighted volume and capital requirement (amounts in NOK thousand)

| Credit risk | Section | CCF | Balance sheet | Off-balance sheet items | Risk Weight | Calculation basis | Capital requirement |
|---|---|---|---|---|---|---|---|
| Government Bonds | § 5-1 | | 2,866,306 | | 0 % | - | - |
| Regional or local government | § 5-2 | | 2,862,239 | | 20 % | 572,448 | 45,796 |
| Banks and institutions (deposits in other banks) | § 5-6 | | 3,386,650 | | 20 % | 677,330 | 54,186 |
| Credit guarantees from the shareholders | § 5-6 | | | 1,876,973 | 20 % | 375,395 | 30,032 |
| OTC derivatives AA-rating (standardized method) | § 5-7 og § 23 | | | 2,706,471 | 20 % | 541,294 | 43,304 |
| OTC derivatives A-rating (standardized method) | § 5-7 og § 23 | | | 745,047 | 50 % | 372,524 | 29,802 |
| Claims on corporates (unrated) | § 5-7 | | 29,700 | | 100 % | 29,700 | 2,376 |
| Claims or contingent claims secured on real property | § 5-9 | | 64,595,710 | (1,876,973) | 35 % | 21,951,558 | 1,756,125 |
| Loan commitments to customers (duration 30 days) | § 5-9 og § 6-1 (9) | 0.2 | | 891,202 | 7 % | 62,384 | 4,991 |
| Loan commitments to customers | § 5-9 og § 6-1 (8) | 0.5 | | 412,763 | 18 % | 72,234 | 5,779 |
| Covered Bonds | § 5-13 | | 5,878,365 | | 10 % | 587,837 | 47,027 |
| Other assets | § 5-15 | | 749 | | 100 % | 749 | 60 |
| Total credit risk | | | **79,619,718** | **4,755,484** | | **25,243,451** | **2,019,476** |

### Table 8 Credit risk by commitment category (amounts in NOK thousand)

| Claims | Capital requirement |
|---|---|
| Claims on regional or local government | 45,796 |
| Claims on institutions | 157,323 |
| Claims on corporates | 2,376 |
| Claims or contingent claims secured on real property | 1,766,894 |
| Covered Bonds | 47,027 |
| Other items | 60 |
| **Total capital requirement credit risk** | **2,019,476** |

### Figure 6 Residential mortgages by Norwegian county as % of total mortgage volume at 31 Dec 15



Having the owner banks as the distributor channel means that customers are well spread geographically. The company's customers are primarily private individuals, each of whom accounts for a relatively small proportion of the company's total portfolio.

**Table 9 Residential mortgages by commitment type and residual time to maturity (amounts in NOK thousand)**

| Expected maturities | 31 December | 0-1 mnd | 1-3 mnd | 3-6 mnd | 6-12 mnd | 1-3 år | 3-5 år | 5-10 år | Over 10 år |
|---|---|---|---|---|---|---|---|---|---|
| ***Lending:*** | | | | | | | | | |
| Residential cooperatives | 55,621,950 | 38 | 1,982 | 889 | 4,726 | 121,042 | 436,133 | 2,668,839 | 52,388,301 |
| Residential | 8,868,801 | - | - | 5,277 | 3,016 | 12,000 | 56,125 | 325,554 | 8,466,829 |
| ***Investments:*** | | | | | | | | | |
| Government Bonds | 2,852,377 | 1,200,397 | 1,361,603 | 290,378 | - | - | - | - | - |
| Covered Bonds | 5,855,077 | 169,672 | 274,724 | 360,420 | 676,784 | 3,677,577 | 695,901 | - | - |
| Municipality | 2,846,055 | 619,931 | 833,907 | 948,483 | 244,317 | 199,416 | - | - | - |
| Bank deposits | 3,386,131 | 3,386,131 | - | - | - | - | - | - | - |
| Total | 79,430,391 | 5,376,169 | 2,472,215 | 1,605,448 | 928,843 | 4,010,035 | 1,188,158 | 2,994,393 | 60,855,131 |

Table 9 shows that EBK has a good spread of maturities on its mortgages and other lending, which helps to reduce the company's credit risk.

EBK has a diversified mortgage portfolio in terms of geographical distribution and individual customers. The Herfindahl-Hirshman index (HHI) is applied when assessing the concentration risk. This index will expose an inadequately diversified portfolio in terms of individual customers, business sectors or geographical distribution through high α and β values. Premium levels are fixed on the basis of the sector standard.

## CREDIT RISK – THE STANDARDISED METHOD

As an issuer of covered bonds, EBK must ensure that all loans and advances in its cover pool comply with credit quality step 1 or 2. When assessing ratings, only those from Standard & Poor's Rating Services, Moody's Investors Service, Fitch Ratings and DBRS are utilised. Where a counterparty has been rated by more than one of these agencies, the second best rating is used pursuant to section 7, sub-section 2 of the capital requirement regulations. Where two ratings are available, the lower one is used. If the counterparty is rated by one only accredited agency, that rating will be used.

- States and central banks: long-term ratings by an accredited agency are used to assign the credit quality step.
- Local and regional government: the national long-term rating is applied.
- Institutions: long-term rating of institutions rated by approved rating agencies will be utilised to determine the credit quality step for financial institutions.
- Enterprises: long-term ratings from an accredited agency are used to assign the credit quality step, with a 100 per cent weighting applied to relevant claims if no approved rating exists.

## GUARANTEES

All residential mortgages transferred to EBK must have a loan-to-value (LTV) ratio of up to 60 per cent at origination. A further requirement is that collateral must be secured in completed residential properties or holiday homes. EBK's collateral requirements satisfy the provision in the capital requirement regulations calling for 35 per cent risk weighting of mortgages and advances with collateral in residential properties. Documentation of value must be an approved appraiser's valuation, an estate agent's valuation, a purchase contract or a valuation by Eiendomsverdi AS, which must not be more than six months old when the mortgage is approved.

Upon transfer to Eika Boligkreditt, the owner banks assume mandatory guarantees for the mortgages they have transferred. The main features of these guarantees are as follows.

1. *Case guarantee,* covering the entire amount of the mortgage over the period from the owner bank’s request for payment until the mortgage's collateral has been perfected (legally registered) and the custody department of the owner bank has checked the documentation.

2. *Loss guarantee*, where the bank undertakes to cover 80 per cent of a loss recognised on a mortgage. The loss guarantee is limited to one per cent of the bank’s mortgage portfolio in EBK, with a minimum of NOK 5 million, or the whole portfolio if it is smaller than NOK 5 million. The remaining 20 per cent of the loss may be offset by EBK against its commission payments to all the owner banks, calculated pro rata on the basis of each bank’s share of the mortgage portfolio at the point when the loss is recognised. The offsetting right applies for a period of 12 months.

An overview was established at 31 December 2015 of the outstanding residential mortgage portfolio compared with the valuation of the mortgage collateral at origination. This shows that the company has mortgages within the following collateral bands.

### Table 10 Distribution of LTV at origination (amounts in NOK thousand)

| Loan to value (LTV) | Unindexed values | | | |
|---|---|---|---|---|
| | Residential | Residential cooperatives | Total | Share of total |
| 0 <= 40 | 8,883,521 | 7,999,773 | 16,883,294 | 26 % |
| 40 < x <= 50 | 9,134,531 | 556,067 | 9,690,597 | 15 % |
| 50 < x <= 60 | 37,603,899 | 312,962 | 37,916,860 | 59 % |
| **Total** | **55,621,950** | **8,868,801** | **64,490,751** | **100 %** |
| **Average LTV** | **50.8 %** | **18.5 %** | **46.4 %** | |

EBK’s residential mortgages have a maximum loan-to-value (hereafter **LTV**) ratio of 60 per cent of the property at origination. The collateral is accordingly regarded as very good and the risk considered small.

## CONTINUOUS VALUATION OF COLLATERAL

The portfolio is indexed on a quarterly basis against market values estimated by Eiendomsverdi AS, whose weighting model calculates a market value based on objects sold over time in the immediate vicinity, adjusted for price developments. It also takes account of the valuations registered by EBK on the mortgaged property at origination. Were residential property prices to fall, the company would have a good margin before possible repossessions might lead to loss. The table below presents indexed market values for EBK’s mortgage portfolio.

### Table 11 Distribution of indexed LTV (amounts in NOK thousand)

| Loan to value (LTV) | Indexed values | | | |
|---|---|---|---|---|
| | Residential | Residential cooperatives | Total | Share of total |
| 0 <= 40 | 12,407,862 | 8,412,479 | 20,820,341 | 32 % |
| 50 < x <= 60 | 20,768,575 | 172,471 | 20,941,045 | 32 % |
| 60 < x <= 70 | 9,288,910 | 25,000 | 9,313,910 | 14 % |
| 70 < x <= 75 | 404,279 | - | 404,279 | 1 % |
| 75 < x | 308,375 | - | 308,375 | 0 % |
| **Total** | **55,621,950** | **8,868,801** | **64,490,751** | **100 %** |
| **Average LTV** | **48.8 %** | **14.9 %** | **44.2 %** | |

The weighted average indexed LTV at 31 December 2015 was 44.2 per cent, compared with a non-indexed LTV of 46.4 per cent. Indexing of residential cooperatives shows a weighted average LTV of 14.9 per cent, compared with a non-indexed weighted average LTV of 18.5 per cent. This indicates that house prices have risen across the board since the mortgages were granted (combined with payment of instalments).

Some mortgages are indexed with a higher LTV than at origination, which might indicate a fall in house prices for objects related to these mortgages. The table above shows that no loans exceed the limit of 75 per cent of the property's value, which is the maximum permitted LTV pursuant to section 11, sub-section 8 of the Act on Financial Institutions.

## RISK OF DEFAULT IN THE COVER POOL

EBK's covered bonds are rated by Moody's. Moody's Collateral Score informs investors about the agency's modelling of the risk of loss related to the credit quality of the cover pool in an Aaa scenario. The higher the credit quality, the lower the collateral score. This score determines the level of loss which Moody's estimates will affect investors in the company's covered bonds in the event of default on these, based on the credit quality of the cover pool. The collateral score presents Moody's analysis of the amount of risk-free assets which must be added to the cover pool in order to offset the negative effect of the stress test scenario as defined by the rating agency. For further information, see Moody's methodology for the definition of the collateral score and the way it is calculated.

In its report covering the second quarter of 2015, Moody's specified a collateral score of two per cent, which is the lowest figure for global issuers of covered bonds rated by the agency. The table presents EBK's covered bonds as the Eika Boligkreditt Mortgage Covered Bond Programme.

**Table 12 Collateral score in Moody's global CB performance overview at 30 June 2015**

EXHIBIT 11

**Deals with lowest (best) Collateral Scores**

| Name of Programme | Type of Programme | Country | Cover Pool Losses |
|---|---|---|---|
| Eika Boligkreditt AS Mortgage Covered Bonds | Mortgage | Norway | 2.0% |
| OP Mortgage Bank Mortgage Covered Bonds II | Mortgage | Finland | 2.2% |
| Nordea Bank Finland PLC - Covered Bonds | Mortgage | Finland | 2.2% |
| HSBC Covered Bond Programme | Mortgage | UK | 2.2% |
| SpareBank 1 Boligkreditt AS Mortgage Covered Bond Programme | Mortgage | Norway | 2.5% |
| Royal Bank of Scotland Plc - Mortgage Covered Bonds | Mortgage | UK | 2.5% |
| Coventry Building Society Covered Bond Programme | Mortgage | UK | 2.6% |
| Barclays Bank plc Covered Bonds | Mortgage | UK | 2.6% |
| Moorland Covered Bond Programme | Mortgage | UK | 2.7% |
| Commerzbank AG - Mortgage Covered Bonds | Mortgage | Germany | 2.7% |

## STRESS TESTS FOR RESIDENTIAL PROPERTY PRICES

EBK conducts stress tests for falls in residential property prices in order to identify the company's mortgage credit risk. The capital requirement regulations require residential mortgages to have an LTV of at least 80 per cent before the mortgage can be assigned a risk weight of 35 per cent. If this is not the case, the company's capital requirement will be increased for that part of the mortgage portfolio which must be weighted at 75 per cent[2] rather than 35 per cent when calculating capital requirements. Calculations are carried out when residential property prices fall by 15, 25 and 35 per cent respectively. Before the worst-case scenario with a price fall of 35 per cent could occur, for example, EBK would already have taken a number of steps to improve the quality of its cover pool, including initiating its emergency response plan for a fall in residential property prices. If certain mortgages in the cover pool acquire an LTV greater than 75 per cent (60 per cent for holiday homes), this part of the mortgage can no longer be included when determining the overall value of the cover pool. That will be significant for the company's compliance with the balance-sheet requirements in the legislation and its obligations related to overcollateralisation.

The company has better security in its portfolio and a lower minimum for LTV than is usual among covered-bond issuers in Norway, and is accordingly well equipped to handle the risk related to a fall in residential property prices. Reactions to such a fall would generally be swift because of the guarantee structure and the need to comply with legislation on covered bonds. No increased Pillar I requirement has accordingly been incorporated for a worst-case scenario, since the risk associated with a general fall in residential property prices is adequately covered by the company's guarantee structure and by maintaining requirements for overcollateralisation of the cover pool.

## MANAGEMENT AND CONTROL

EBK's distribution channel runs through the owner banks. These banks are locally entrenched with a high proportion of loyal customers and good knowledge of their markets. Customer selection through the owner banks is regarded as helping to ensure that the company's customers are generally good and loyal.

The company has established policies for credit risk on mortgages, counterparty risk and capital management, which form the basis for management and control of credit and counterparty risk. The status of compliance with the company's credit policy is assessed continuously, and the position in relation to the approved level of risk acceptance is reported quarterly to the board in the risk and compliance report. Compliance with the credit handbook, including safe custody department checks, is monitored on a continuous basis. Overall management and control of risk is described in more detail in chapter 4 above.

## CAPITAL REQUIREMENTS

EBK applies the standardised method to calculate the capital requirement for credit risk. This was calculated to be NOK 2 019 million at 31 December 2015. The company's capital targets are considered to be adequate for possible credit risk assessed to be over and above the minimum capital requirements in Pillar I.

[2] The mortgages are assumed to satisfy the requirements for the retail exposures class and can accordingly be weighted at 75 per cent pursuant to the capital requirement regulations.

# 9 COUNTERPARTY RISK

*Definition:* *Counterparty risk is the risk of loss because counterparties are unable to meet their payment commitments and accordingly represent a credit risk. It relates to all claims with counterparties, including guarantees, unsettled transactions and undrawn credits, and to the counterparty risk which arises from exposure to derivatives. Counterparty risk depends in part on the size of the claim, time to maturity, probability of default and value of possible collateral.*

**RISK APPETITE AND EXPOSURE**

The company has established a policy for counterparty risk to ensure that overall requirements for management and control of such risk are met. This policy is intended to meet the company's need for control over large exposures, including the total exposure with a single counterparty. It will ensure that counterparty risk is manageable at all times by establishing parameters for such risk, ensuring the establishment of an ISDA with associated CSA for counterparties to derivatives, and providing a clear division of responsibility and authority.

EBK has established the following risk parameters for counterparty risk:

- maximum limit for total exposure (regulations on large exposures)
- internal maximum limit for total exposure
- entering into derivative contracts and defining maximum exposure to a counterparty.

The company is exposed to counterparty risk through lending, investment of surplus liquidity and derivatives. Attention in this chapter is focused on counterparty risk related to derivatives and bank deposits, since this does not belong naturally with the assessment of other risk factors. Counterparty risk is treated as part of credit risk when it relates to lending, and as part of market risk when it relates to investment of surplus liquidity.

- **Counterparty risk related to bank deposits in credit institutions**

EBK uses bank deposits when investing surplus liquidity, and is accordingly exposed to counterparty risk in relation to the various banks concerned. Deposits must be confined to banks with a low credit risk, and must fall within the requirements for inclusion in the cover pool (minimum credit quality step 2, rating A-/A3 for residual times to maturity of up to 100 days). Parameters for counterparty risk per bank are defined in the company's policy for capital management, including the investment mandate.

- **Counterparty risk related to derivatives**

Activities in EBK are subject to strict regulations for risk exposure, and the company is obligated to refrain from accepting greater interest-rate and foreign-exchange risk than is prudent at any given time.[3] This means that the company uses both interest-rate and foreign-exchange derivatives when borrowing in foreign currencies and/or fixed interest rates in order to keep risk at a minimum. The same applies to hedging interest-rate risk relative to lending at fixed interest rates.

[3] FOR-2007-05-25-550 Regulations on bonds in credit institutions, sections 5 and 7.

Derivative contracts can only be entered into with counterparties which have a low credit risk, and must fall within the requirements for inclusion in the cover pool (minimum credit quality step 2, rating A-/A3).[4] EBK will only enter into derivative contracts within the framework established by the International Swaps and Derivatives Association (ISDA). ISDA master agreements with credit support annex (CSA) are based on a standardised template utilised by most of the Norwegian covered-bond issuers who enter into derivative contracts. They are used with each individual counterparty and for each currency in the underlying covered bond issue.

The company calculates counterparty risk in derivatives using standardised methods.[5] Account is taken of financial collateral in the form of cash and securities[6] when calculating capital requirements related to the counterparty risk in derivatives. At 31 December 2015, the company had the following counterparty exposure in derivatives by rating category.

**Table 13 Counterparty risk in derivatives pursuant to the standardised method (amounts in NOK thousand)**

| Counterparty rating | EAD* | Risk classification | Risk weight | Risk weighted assets |
|---|---|---|---|---|
| AA | 2,706,472 | 1 | 20 % | 541,294.32 |
| A | 745,046 | 2 | 50 % | 372,523.20 |
| | **3,451,518** | | | **913,818** |

*Exposure at default, the company`s exposure to derivatives, is calculated as the maximum of the derivatives potential future exposure and market value less received collateral in cash or securitties.

CSA agreements have been signed with all the company's derivatives counterparties. The company's contracts with derivative counterparties specify that the company has the unilateral right to collateral for the market values of derivatives which exceed the predetermined rating limits. Since the CSA agreements are unilateral, EBK will avoid finding itself in a position where it needs to post collateral in the event of a possible downgraded rating. Market values are normally calculated weekly in the existing agreements. EBK has established daily valuation and cash posting with some counterparties and is working to do the same with additional counterparties, which helps to reduce the company's credit risk even further. EBK has entered into agreements concerning securities to be accepted as collateral from some counterparties. Underlying securities are not regarded as part of the company's counterparty risk, since they are off the balance sheet. Nevertheless, limits must be set on the securities considered acceptable as collateral, and a spread sought between different counterparties. This is regulated in the agreement with the counterparties.

- **CVA risk**

CRD IV introduced a new requirement intended to cover the risk related to changes in the fair value of bilateral derivative contracts which are not traded on a stock exchange.[7] This additional requirement is calculated on the basis of the counterparty's creditworthiness and is called the credit valuation adjustment (CVA).[8] The CVA supplement became part of the calculation basis from 30 September 2014, and was calculated to be NOK 1.9 billion at 31 December 2015.

[4] Should the derivatives be downgraded below credit quality step 2, they can still be included in the cover pool providing the counterparty provides satisfactory collateral.
[5] FOR-2006-12-14-1506 Capital requirement regulations, chapter 23.
[6] FOR-2006-12-14-1506 Capital requirement regulations, chapters 17 and 18.
[7] Bilateral derivative contracts are also called over-the-counter or OTC derivatives.
[8] FOR-2006-12-14-1506 Capital requirement regulations, chapter 20a.

**Table 14 Total calculation basis for counterparty risk related to derivatives and bank deposits at 31 Dec 15 (amounts in NOK thousand)**

| Risk weighted assets | | Amount |
|---|---|---|
| Bank deposits | | 677,330 |
| Derivatives | | 913,818 |
| Credit valuation adjustment (CVA) | | 1,929,894 |
| **Total** | | **3,521,041** |
| **Pilar I capital requirement** | **8 %** | **281,683** |

### MANAGEMENT AND CONTROL

EBK has established a policy and associated parameters for counterparty risk which forms the basis for management and control of this risk in EBK. The status of compliance with the company's policy for counterparty risk is assessed continuously, and the position in relation to the approved level of risk acceptance is reported quarterly to the board in the risk and compliance report.

### CAPITAL REQUIREMENTS

The capital requirement calculated in accordance with Pillar I is considered to cover the potential risk of loss related to counterparty risk in the portfolio.

## 10 MARKET RISK

*Definition: Market risk is the risk of loss on the market value of portfolios of financial instruments as a consequence of fluctuations in interest rates, credit spreads and exchange rates. It comprises interest, spread, currency and equities risk.*

### RISK APPETITE AND EXPOSURE

The company's business purpose is to obtain favourable funding by issuing covered bonds. This means that its excess liquidity must satisfy legal and regulatory requirements concerning what may be included in the cover pool. The objective of the company's investment of surplus liquidity is to have liquidity available at all times to secure the financing of growth and maturation, and to secure the highest possible return within specified risk parameters. Surplus liquidity is held in bank deposits or fixed-income securities in Norwegian kroner. In addition, the company has received liquidity in NOK and EUR which reflects the receipt of cash collateral from counterparties to derivatives. Collateral received is held in bank deposits or secure securities in the currency of receipt to ensure that no currency risk arises for the company on its collateral.

The company aims to maintain a low to moderate market risk. Market risk will normally comprise interest-rate and credit-spread risk. The total risk parameter in the balance sheet will be four per cent of its core tier 1 capital, with an expected composition of one per cent interest-rate risk and three per cent credit-spread risk. The individual investment must not have an interest rate fixed for longer than one year, and the maximum limit for the average duration of the whole liquidity portfolio is 0.3 years. The residual time to maturity for the individual security must be less than 3.5 years, and the average residual time to maturity must be less than two years. Interest-rate risk is stress-tested by looking at a parallel shift of two percentage points in the interest-rate curve. Credit-spread risk is stress-tested on the basis of the FSA's module for market risk for all surplus liquidity with the exception of municipal bills. Spread changes for municipal bills build on a database and are stress-tested on the basis of historical crisis scenarios over a one-year period (source: *Weekly Credit Report,* DNB Markets). On the basis of this analysis, the company utilises a credit spread of 0.6 per cent for municipal bills. The liquidity portfolio must not accept unsecured currency risk.

EBK's portfolio of securities totalled NOK 11.6 billion at 31 December 2015 and constituted about 13 per cent of the company's total assets. The company has invested in government bills, covered bonds and municipal bills. Government bills denominated in EUR break down into NOK 1.44 billion invested in French government bills and NOK 1.03 billion in German government bills. The liquidity portfolio varies in size in line with the company's liquidity requirements over the coming year. The company calculated capital requirements for the portfolio of securities at 31 December 2015, based on the standardised method for credit risk (Pillar I) pursuant to part II of the capital requirement regulations.

**Table 15 Calculation basis and capital requirement for market risk (amounts in NOK thousand)**

| Assets | EUR | NOK | Total NOK | Risk weight | Risk weighted | Capital requirement |
|---|---|---|---|---|---|---|
| Government Bonds | 2,466,778 | 399,528 | 2,866,306 | 0 % | - | - |
| Covered Bonds | 633,719 | 5,244,646 | 5,878,365 | 10 % | 587,837 | 47,027 |
| Municipality | - | 2,862,239 | 2,862,239 | 20 % | 572,448 | 45,796 |
| **Total** | **3,100,497** | **8,506,413** | **11,606,910** | | **1,160,284** | **92,823** |

The company is also exposed to market risk in the form of interest-rate risk which arises from differences between interest terms for borrowing and lending. This risk is treated in detail in section 11 on interest-rate risk related to net interest income.

### MANAGEMENT AND CONTROL

The company has established policies for asset liability and for investment management with an associated investment mandate, which form the basis for management and control of market risk. The company's risk management and compliance function continuously assesses exposure in relation to approved risk acceptance and parameters in quarterly risk and compliance reports for the board. The board-approved parameter as a percentage of core tier 1 capital is meant to cover the interest-rate risk of a two-percentage-point parallel change in the interest-rate curve and increased credit-spread outcomes in the company's portfolio of securities. Market risk in the liquidity portfolio is managed on a daily basis by the funding department.

### CAPITAL REQUIREMENTS

The capital requirement for market risk is taken into account in the standardised method for credit risk, and totalled NOK 93 million at 31 December 2015, including risk weighting of the various investments in securities.

## 11 INTEREST-RATE RISK RELATED TO NET INTEREST INCOME

*Definition: Risk associated with net interest income arises from differences between interest terms for borrowing and/or lending, and from borrowing by the company in different markets than those it lends to, so that the borrowing interest rate may change without the company being able to adjust the lending rate equally quickly.*

### RISK APPETITE AND EXPOSURE

Interest-rate risk will be limited by ensuring that lending on floating interest-rate terms is financed by borrowing or derivatives at floating interest rates, and that lending at fixed interest rates is hedged with derivatives at floating rates. The company will make active use of derivatives to reduce interest-rate risk. Interest-rate risk related to net interest income must be low.

The bulk of the residential mortgages in EBK's portfolio have a floating interest-rate. Pursuant to the Financial Contracts Act, interest rates on such mortgages can be adjusted at six weeks notice in line with the development of the company's borrowing costs. EBK is not subject to such notice in relation to the interest rates it charges to the owner banks. Interest-rate changes can therefore be implemented more quickly, which ensures efficient adjustment to changes in EBK's funding costs.

EBK permits the addition of fixed-rate mortgages to the cover pool, and this is regulated by separate agreements with the banks. EBK establishes the interest rate for fixed-interest mortgages, while the owner banks specify customer terms and interest rates based on borrowing costs and risk assessment for the advance.

EBK uses hedge accounting pursuant to the IFRS on borrowing at fixed interest rates, and an interest swap must be assessed as very effective when entered into. The company measures interest-rate risk on the balance sheet quarterly, based on the duration of the various claims and commitments. Duration means the number of years until the next interest-rate adjustment.

**Table 16 Interest-rate sensitivity in the balance sheet (amounts in NOK thousand)**

| Interest rate sensitivity | Duration | Amount | Effect negative shift | Effect positive shift |
|---|---|---|---|---|
| Funding | 0.13 | 70,565,313 | (184,359) | 184,359 |
| Lending with floating rate* | -0.12 / -0.06 | 61,560,714 | 147,746 | (73,873) |
| Lending with fixed rate | -3.24 | 2,930,037 | 190,139 | (190,139) |
| Derivatives lending | 2.95 | 2,747,397 | (162,314) | 162,314 |
| Government Bonds | -0.12 | 2,852,377 | 6,678 | (6,678) |
| Covered Bonds | -0.16 | 5,855,077 | 19,172 | (19,172) |
| Municipality | -0.21 | 2,846,055 | 12,125 | (12,125) |
| Bank deposits | -0.01 | 3,386,131 | 464 | (464) |
| **Interest rate risk by shift in yield curve of 2 %-point** | | | **29,652** | **44,221** |

*In the event of an increase in financing costs or money market the duration on lending with floating interest-rate is estimated to be 0.06 or 0.12 in the event of a decrease. Asymmetry occurs because of the ability to await to cut interest rate on the lending portfolio in the event of a decrease.

Fixed interest rates on the company's borrowing have longer periods than on its lending. Circumstances where the interest rate for funding costs increase by two percentage points will in reality produce a gain for the company as long as the asset side of the balance sheet has a shorter fixed-interest period than the liability side. Other factors may nevertheless exist which prompt the company to reduce its lending margin and net interest income, but these will be independent of the interest-rate risk.

### MANAGEMENT AND CONTROL

The company has established a policy for asset liability management which forms the basis for total interest-rate risk in its balance sheet. This also includes the liquidity portfolio, and interest-rate risk associated with net interest income relates to the company's total interest terms.

In the event of an increase in financing costs or money market interest rates, a decision to adjust the interest-rates charged to the owner banks will be made by the CEO in consultation with the rest of the company's executive management and based on forecasts of anticipated interest-rate developments and planned new funding. Such forecasts are made by the finance and accounting department.

Interest-rate risk is measured quarterly as the change in value arising from a two-percentage-point adjustment to the level of interest rates, and the company has defined maximum exposure related to this. The exposure is reported quarterly in the risk and compliance report submitted to the board.

### CAPITAL REQUIREMENTS

Interest-rate risk related to net interest income is not included in Pillar I capital requirements. An assessment of capital requirements for interest-rate risk is included in the assessment of the Pillar II buffer, and the company's capital targets are considered adequate to cover risks over and above the minimum regulatory requirements.

## 12 FINANCING AND LIQUIDITY RISK

*Definition: The risk that the company will be unable to meet its commitments as and when they fall due without incurring substantial costs in the form of expensive refinancing or the need for premature realisation of assets. In the worst case, liquidity risk is the risk that the company will be unable to refinance itself sufficiently in order to meet commitments as and when they call due.*

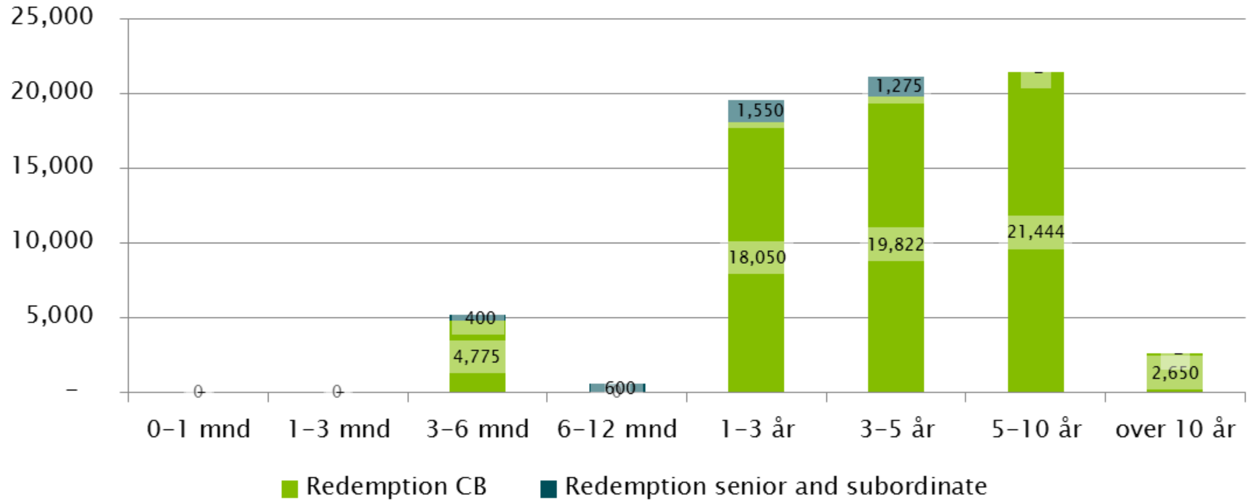
### RISK APPETITE AND EXPOSURE

EBK finances lending primarily through the issue of covered bonds. Through its opportunity to make such issues, the company achieves lower borrowing costs than its owner banks. The company will also raise ordinary senior unsecured bonds in order to cover overcollateralisation related to the Euro Medium Term Covered Note (EMTCN) programme and bail-in-able debt assessments from rating agencies. EBK has established an international borrowing programme for issuing covered bonds. This EMTCN programme was signed and approved by the UK Listing Authority for the first time on 10 August 2007. Bonds are issued under the EMTCN programme to both Norwegian and international investors. The programme is revised annually.

The company has established parameters for financing and liquidity risk to keep financing and liquidity risk satisfactorily low, and to comply with section 11, sub-section 12 of the Act on Financial Institutions, the regulations for credit institutions issuing covered bonds, and the regulations on sound liquidity management.

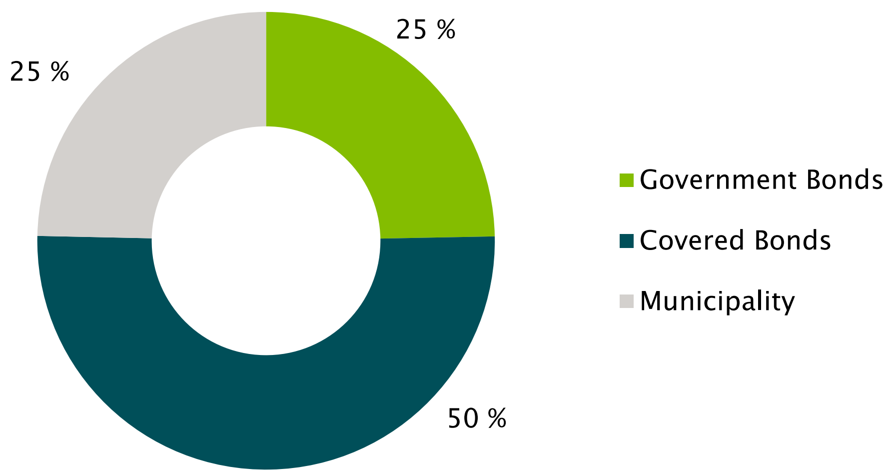
EBK had a good liquidity position at 31 December 2015, with total liquid assets of about NOK 10 billion exclusive of collateral received. The company issued a total of NOK 11.5 billion in bonds during 2015. It complied with all parameters for risk exposure during the year. Owing to low funding activity through 2015 as well as redemptions, the average remaining residual time to maturity on total funding, covered bonds and senior unsecured bonds declined somewhat. Nevertheless, activity in 2015 and the status at 31 December were in line with targets and parameters for liquidity management.

**Figure 7 Redemption profile at 31 December 2015 (amounts in NOK thousand)**




EBK obtained funding at very advantageous terms during the first half of 2015. During the second half, in contrast, the Norwegian market lost some momentum and levels declined substantially. The company opted to obtain new funding in EUR during the fourth quarter of 2015. Investor interest in subscribing to the company's covered bonds was again very high in 2015, and the company has also achieved good terms for its borrowing despite the outcome for the second half.

**Figure 8 Composition of the liquidity buffer**




The Ministry of Finance specified rules on 25 November 2015 for the liquidity coverage ratio (LCR) applying to banks, credit institutions and holding companies in financial institutions which are not insurance groups. These rules are incorporated in the CRR/CRD IV regulations and the regulations on prudent liquidity management.

EBK will satisfy the LCR requirements applicable at any given time. The company monitors the LCR closely and uses its own forecasting models in order to be prepared for the need to adapt liquid assess which can be included in the indicator at short notice. An LCR of 312 per cent was reported by the company at 31 December 2015. Excluding collateral received and invested in bank deposits and securities, however, the LCR indicator was 194 per cent.

The introduction of a possible minimum requirement for the net stable funding ratio (NSFR) by 2018 has been proposed. Until specific recommendations have been presented by the European Banking Authority (EBA), and until a final definition of the NSFR has been established, the FSA's calculation of the NSFR will be based on the Basel committee's final recommendations of October 2014. The company has reported the NSFR to the authorities on a quarterly basis since 30 September 2014. Its NSFR indicator was 102 per cent at 31 December 2015.

**MANAGEMENT AND CONTROL**

EBK has established a separate risk policy for financing risk, including defined risk appetite, risk parameters and a crisis plan in the event of insufficient liquidity. This risk policy forms the basis for liquidity management.

Financing and liquidity risk is managed through parameters for financing structure, requirements for diversification of instruments, markets and residual times to maturity, and the establishment of contingency facilities. An agreement has also been entered into between the shareholders and EBK to ensure that the company can access liquidity in a crisis. The agreement commits the owner banks, under given circumstances, to purchase the company's covered bonds limited to the maturity of the company's covered bonds issued under the EMTCN programme and the associated swap agreements over the coming 12 months. EBK's own liquidity is deducted when calculating the liquidity obligation. The owner banks can deposit these covered bonds as collateral with the Central Bank of Norway in exchange for a haircut. EBK is not permitted to make such deposits in the Central Bank of Norway.

The company has a separate funding department headed by the CFO, who is responsible for operational liquidity management and reports to the CEO. The funding department utilises liquidity forecasts, particularly when obtaining new funding. The future liquidity holding, refinancing indicators and the average time to maturity of funding are then simulated. The board receives a quarterly overview of the maturity structure of the company's assets and liabilities, in addition to the development of the company's liquidity indicators in order to evaluate liquidity risk.

EBK's risk and compliance function measures exposure linked to financing and liquidity risk in relation to approved parameters on a continuous basis, and reports quarterly on the actual exposure in the risk and compliance report to the board. These reports provide a basis for the executive management and the board to assess the exposure status in relation to established parameters and targets.  The company performs stress tests which simulate the effect of possible liquidity crises, including market-specific, company-specific and combined market/company crises.

**CAPITAL REQUIREMENTS**

Financing and liquidity risk is not included in the capital requirements defined under Pillar I. The assessment of capital requirements for financing and liquidity risk is included in the assessment under ICAAP/ILAAP, and the company's capital targets are considered adequate to cover capital and liquidity needs over and above the minimum regulatory requirements.

## 13 OPERATIONAL RISK

*Definition:* *Operational risk is the risk of loss as a result of inadequate or deficient internal processes or systems, human error, or external events. Operational risk also comprises compliance and legal risk.*

### RISK APPETITE AND EXPOSURE

EBK has a simple and readily comprehensible organisation, and has therefore adopted the basic indicator method for calculating capital requirements. With this approach, the calculation basis for the minimum primary capital requirement is 15 per cent of average income over the past three years multiplied by 12.5. See section 42, sub-section 1 of the capital requirement regulations.

**Table 17 Calculation basis and capital requirement for operational risk (amounts in NOK thousand)**

| Operational risk | 2013 | 2014 | 2015 |
|---|---|---|---|
| Net income | 189,804 | 181,689 | 167,151 |
| Average income | | | 179,548 |
| Basis of calculation | | | 336,653 |
| **Capital requirement** | | | **26,932** |

The company will have a low-risk profile for operational risk. Operational risk which could expose EBK to loss consists virtually entirely of a failure to establish adequate collateral, deficient internal control or failure of IT systems.

### MANAGEMENT AND CONTROL

EBK has established a policy for operational risk which forms the basis for its management and control. A number of guidelines and routines have been implemented for all significant processes in the company. These are intended to help identify that operational risk is being handled in a way which ensures an acceptable level of residual risk. The company will have an updated business continuity plan at all times, which ensures that it can maintain its operations, while functions will have adequate back-up. Relevant contingency plans have also been drawn up to deal with crises.

The company monitors operational risk through reporting and registering undesirable events, pursuing compliance activities, internal auditing and so forth. The company's risk and compliance department prepares quarterly risk and compliance reports, which quantify and assess operational risk through event reporting. These reports provide the executive management and the board with the basis for assessing the status of exposure in relation to established parameters and targets.

### CAPITAL REQUIREMENTS

EBK applies the basic indicator method to calculate the capital requirement for operational risk. The capital requirement was calculated to be about NOK 26.9 million at 31 December 2015.