SPAREBANKEN SØR

PILLAR 3 2021

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1. INTRODUCTION

The capital requirements regulations impose requirements for the disclosure of information on risk management and capital management. This document including appendices has been prepared to satisfy Sparebanken Sør's duty of disclosure in accordance with these regulations. The main document will be updated each year and published at the same time as the bank's annual report. The appendix to Pillar 3 is updated quarterly. Information on capital requirements and minimum requirements for own funds is updated each quarter and published in the form of an updated appendix and as a disclosure note in the bank's quarterly financial statements.

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

All amounts are stated are as of 31 December 2021 and in million NOK, unless otherwise specified. This document is a translation from Norwegian and has been prepared for information purposes only.

2. GROUP RELATIONSHIPS

Sparebanken Sør is an independent financial institution whose core business is banking, securities trading and acting as a real estate agent in Agder, Vestfold and Telemark and Rogaland. The head office and registered address are in Kristiansand.

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

					PARENT BANK 31.12.2021
NOK THOUSAND	**Type of business**	**Registered office**	**Ownership**	**Share capital**	**Book value**
Sparebanken Sør Boligkreditt AS	Mortage company	Kristiansand	100 %	1.375.000	2.095.695
Sørmegleren Holding AS	Real estate business	Kristiansand	91 %	10.739	11.499
Sørlandets Forsikringssenter AS	Ensurance	Kristiansand	78 %	45.000	5.300
AS Eiendomsvekst	Property managment	Arendal	100 %	3.000	2.935
Arendal Brygge AS	Property managment	Arendal	50 %	601	0
Prosjektutvikling AS	Property managment	Arendal	100 %	100	0
Transitt Eiendom AS	Property managment	Kristiansand	100 %	100	780
Total					**2.116.209**

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

Limitations on transfer of capital or repayment of debt between Group companies

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

Objective and main strategy

The Bank's objective is to generate growth and development in the region in a long-term, responsible and sustainable manner.

To generate growth and development in the region, Sparebanken Sør has a strategy for high value creation. The Bank's strategic objective will be achieved through proximity to the market, customer focus, building of relations, expertise, local decision-making power, competitive products, motivated employees and cost-effective processes. By doing this, the Bank's reputation is enhanced, customer loyalty is built up and the Bank's profitability is safeguarded.

Sparebanken Sør's main market area is Agder as well as Vestfold and Telemark and Rogaland. In addition, the Bank will strengthen its position in the KNIF segment, in both the retail and corporate markets. Expansion in the KNIF segment will provide growth potential and diversification of risk. Growth will be controlled and based on profitability and low risk.

Social responsibility

Social responsibility is integral to Sparebanken Sør's business. Sparebanken Sør's social responsibility is expressed in the Bank's business concept of contributing to growth and development in the region, and the goal of its social responsibility activities is to help achieve this in a responsible and sustainable way. The work on social responsibility helps to strengthen the Bank's competitiveness, reduce risk, and attract good customers, investors and skilled employees.

3. CAPITAL REQUIREMENTS AND CAPITAL ADEQUACY

The purpose of the Capital Requirements Regulations is to improve risk management at banks and ensure better alignment of risk and capital. The EU's CRR (Capital Requirements Regulation)/CRD IV (Capital Requirements Directive) were first formally introduced in Norway with effect from 31 December 2019.

CRR and CRD IV are the third revision of the EU's Capital Requirements Regulations and were adopted by the EU in 2013. The main purpose of the revised regulations is to implement the Basel III recommendations in the EU and help strengthen the banking sector by imposing more stringent requirements for own funds and new quantitative liquidity requirements. The CRD IV Directive implements the Basel III recommendations, including the general capital buffer requirements (in Pillar 1) and the bank-specific capital requirements (in Pillar 2). The CRR scheme implements the Basel III recommendations on minimum requirements for own funds, liquidity and disclosure of financial information. The enactment of the scheme in effect reduced the capital requirements for lending to small and medium-sized enterprises (SMEs) and set aside the "Basel I floor".

The core content of the regulation has effectively been implemented in Norwegian law for a number of years through regulations mirroring the EU rules. When the CRR was introduced in Norway, these regulations were rescinded and replaced by references to the capital requirements scheme and associated, supplementary schemes.

3.1 The EU's banking package

In the spring of 2019, a number of changes in the EU's Capital Requirements Regulations (CRR/CRD IV) and the Bank Resolution and Recovery Directive (BRRD) were adopted for banks, based on recommendations from the Basel Committee on Banking Supervision and proposals from the European Commission. The changes are referred to overall as the EU's banking package and entail significant regulatory changes in a number of different parts of the capital requirements and recovery and resolution regulations. The changes include a revised Capital Requirements Directive (CRD5) and a revised Capital Requirements Regulation (CRR2), as well as a revised Bank Recovery and Resolution Directive (BRRD2).

The regulatory changes were initially intended to enter into force in the EU two years after they were adopted, in other words, in the spring of 2021. However, several of the changes have already entered into force in the EU as a result of Regulation (EU) 2020/873, which accelerated already-adopted regulatory relief in the banking package and introduced new relief in some other regulations, as a response to the economic effects of the Covid-19 pandemic. In Norway, the Banking Package will not enter into force until 2022, probably from 30 June.

The regulatory changes in the Banking Package include minimum requirement for leverage ratio, a requirement for stable and long-term financing (NSFR), a narrowing of the supervisory authority's opportunity to establish Pillar 2 requirements for systemic risk, and greater flexibility for national authorities to implement measures to deal with various forms of systemic risk, including increased capital buffer requirements and minimum requirements for weighing risk of lending with real estate as collateral. In addition, the so-called SME discount is continued and expanded, and a new capital requirement discount is introduced for lending to certain infrastructure projects.

For Sparebanken Sør, it is estimated that introduction of the Banking Package will have a positive effect of approximately 0.7 percentage points.

The Capital Requirements Regulations consist of three pillars:

Pillar 1 – Minimum requirements for own funds

Pillar 2 – Assessment of overall capital needs and appropriate follow-up

Pillar 3 – Disclosure of information

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

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

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

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

Sparebanken Sør uses the following methods to establish the risk weighted assets:

Credit risk:	Standard method
Market risk:	Standard method
Operational risk:	Basic method

An important part of the Group's objectives is that the common equity tier 1 capital ratio should be on a par with that of comparable banks. Sparebanken Sør is the only one of the large regional banks in Norway to use the standard method to calculate capital adequacy, and the bank currently has a markedly higher unweighted capital adequacy than the other regional banks. Sparebanken Sør also has a goal of having the quality of its risk management on par with comparable banks. Sparebanken Sør has therefore started a process of developing the bank's risk management framework and collection of models so that it will be possible to apply to Finanstilsynet for approval to use internal models in the capital calculation (IRB). This work has been assigned a high priority by the bank.

The introduction of the revised Basel III framework ("Basel IV") was supposed to have been implemented in the EU from 2022 with transition rules up until 2027, but this has been postponed. The Commission has drafted a proposal for implementation of the last part of the Basel III framework into EU law, and the goal is for the revised regulations (CRR3/CRD6 and BRRD3) to enter into force in the EU from 1 January 2025 at the earliest. The implementation date in Norway will therefore depend on how quickly the new legislative acts can be incorporated in the EEA Agreement, but this will not occur until 1 January 2025 at the earliest. A very critical element in the new regulations will be the introduction of a new, more risk-sensitive, standard method for credit risk. Given the composition of the Group's loan portfolio, it is expected that the new standard regulations for credit risk will result in a very positive effect for the Group. Based on preliminary information, it has been estimated that this may result in a positive effect on common equity Tier 1 capital ratio in the area of 2.0 to 2.5 percentage points.

In connection with a new, more risk-sensitive standard method in Basel IV, which will be beneficial for the Group, some changes have also been outlined in the IRB regulations. It is expected that Basel IV will not be implemented until 2025 at the earliest, and it is therefore presumed that important details in the regulations will not be clarified until close to the implementation date.

The Bank plans to submit an application for IRB-F approval by the end of 2023. However, it is expected that the capital effects of IRB-F will result in limited effects compared with the estimated effects of a new standard method that is coming in Basel IV. Nevertheless, the bank considers an IRB approval to have key elements that are important for the bank's future development.

3.2 Capital requirements

The minimum statutory requirement for own funds essentially corresponds to 8 per cent of the overall risk weighted assets. In other words,

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

In addition, the Bank must maintain sufficient capital to satisfy the regulatory requirements for buffer capital, which shall consist of common equity tier 1 capital.

Institutions must have a capital conservation buffer of 2.5 per cent and a systemic risk buffer. The Norwegian Ministry of Finance has decided that the systemic risk buffer should be raised from 3.0 per cent to 4.5 per cent from 31 December 2022 for banks that report in accordance with the standard method or the Foundation IRB method. The Ministry of Finance also sets requirements for countercyclical buffers and particular buffer requirements for systemically important financial institutions. The level of the countercyclical buffer is established by Norges Bank each quarter. The level of the countercyclical buffer will increase to 1.5 per cent from 30 June 2022 and to 2.0 per cent from 31 December 2022. Sparebanken Sør was not defined as a systemically important bank as of 31 December 2021.

Table with overview of capital buffers for Sparebanken Sør:

	Q4 2021	Q4 2022
Capital conservation buffer	2.5	2.5
Systemic risk buffer	3.0	4.5
Countercyclical buffer	1.0	2.0

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

Pillar 2 also provides guidelines on the authorities' review process (Supervisory Review Evaluation Process – SREP). Finanstilsynet will monitor and evaluate the institution's process under Pillar 2, while the supervisory authorities will implement measures if they do not regard the process as satisfactory.

Sparebanken Sør's process for assessing risk and capital requirements is described in Chapter 4.

Sparebanken Sør received an assessment by Finanstilsynet of the risk and capital requirements (SREP) for the group ICAAP for 2021. Finanstilsynets provisional assessment of capital requirements under Pillar 2 is 1.8 percent of the risk weighted assets. This is a reduction of 0.2 percentage points from the previous Pillar 2 requirement. The Pillar 2 requirement must be satisfied at all times. The requirement is linked to an assessment of risk factors not covered by Pillar 1 requirements.

Finanstilsynet also assesses that the bank ought to have a margin in the form of common equity tier 1 capital in addition to the total requirement for common equity tier 1 capital, total Tier 1 capital ratio and capital adequacy of 1.0 per cent.

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

3.3 Capital ratio

The Group had a common equity tier 1 capital ratio of 16.4 per cent, total tier 1 capital ratio of 18.1 per cent and a total capital ratio of 20.3 per cent as at 31 December 2021. The Group satisfied the capital requirements of 16.5 per cent for total capital, 14.5 per cent for total tier 1 capital and 13.0 per cent for common equity tier 1 capital by a good margin. The Group's applicable internal target for 2021 was 15.3 per cent in common equity tier 1 capital. The Group's preliminary capital target for 2022 will be 16.3 per cent in total capital, and the change is related to an increased requirement for systemic risk buffer, an increased countercyclical buffer and a preliminary Pillar 2 decision from Finanstilsynet.

Capital adequacy 2014–2021

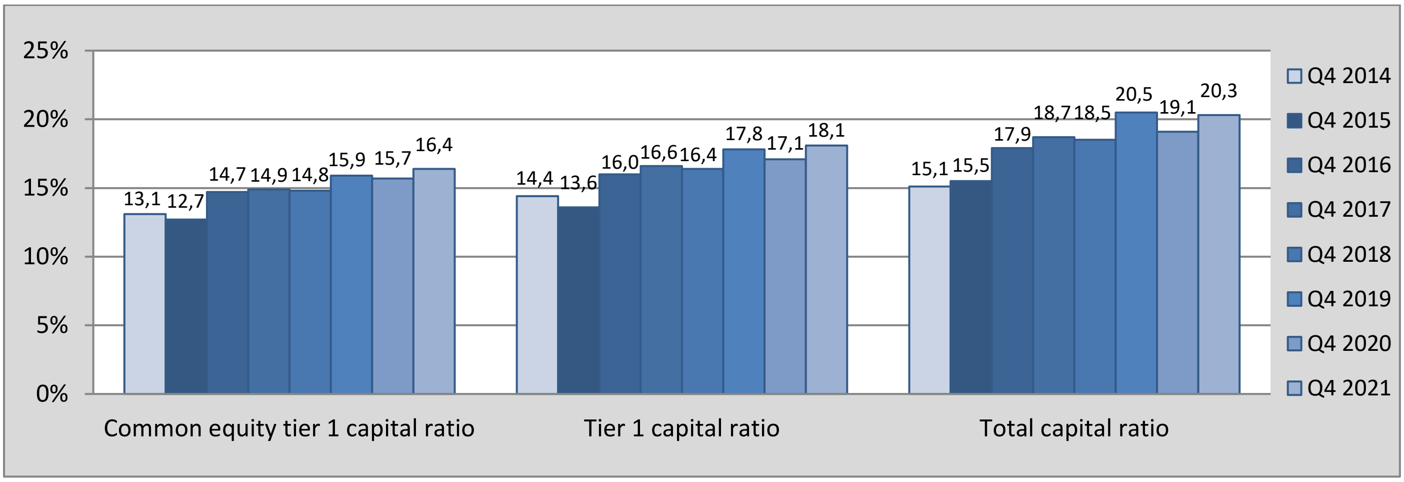


Figure: Fourth-quarter common equity Tier 1 capital ratio, total Tier 1 capital ratio and total capital adequacy (own funds) 2014-2021. Authority requirements for the various types of capital adequacy were all satisfied by a comfortable margin.

Leverage ratio

Leverage ratio is defined as a capital measure (the numerator) divided by an exposure measure (the denominator). The capital measure consists of tier 1 capital, and the exposure measure includes all balance sheet items and non-balance sheet items calculated without risk weighting. The minimum requirement for leverage ratio has been set at 3 per cent. All banks must also have a leverage ratio buffer of at least 2 per cent. Systemically important banks must have in addition to this a leverage ratio buffer of at least 1 per cent.

As of 31 December 2021, Sparebanken Sør had a leverage ratio of 9.4 per cent, which comfortably satisfies the minimum leverage ratio requirement of 5 per cent.

Bank Resolution and Recovery Directive (BRRD) – MREL

As a result of the Bank Resolution and Recovery Directive (BRRD), minimum requirements have been introduced for the sum of own funds and convertible debt (MREL). This involves new requirements for convertible and subordinated debt and also applies to Sparebanken Sør. The requirements are set by Finanstilsynet on the basis of capital requirements and on the current adjusted risk weighted assets. Based on capital demands and the adjusted risk weighted assets of 31 December 2020, the effective MREL requirement was set at 32.0 percent and amounted to NOK 20.2 billion.

The authorities have introduced a ceiling provision for share of subordinated debt, and the requirement must be met by 1 January 2024. From 1 January 2022, the company has to meet a minimum requirement for subordination of 20.0 percent of the adjusted risk weighted assets. This requirement will be considered to be the starting level for the linear phasing-in of the subordination requirements. The Bank sent an updated plan to Finanstilsynet for phasing in subordinated debt, before the deadline of 31 March 2022. At the end of 2021, the bank had issued a total of NOK 3.5 billion in senior subordinated bond loans (Tier 3).

4. RISK MANAGEMENT AND CAPITAL MANAGEMENT

4.1. Purpose

The purpose of risk management and capital management is to support the Bank's strategic goals and ambitions. This means that the risk management and capital management must be in line with the overarching strategy plan on the Group's long-term targets for: development, growth, financial solvency, profitability and risk profile.

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

4.2. Organisation and assignment of responsibilities

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

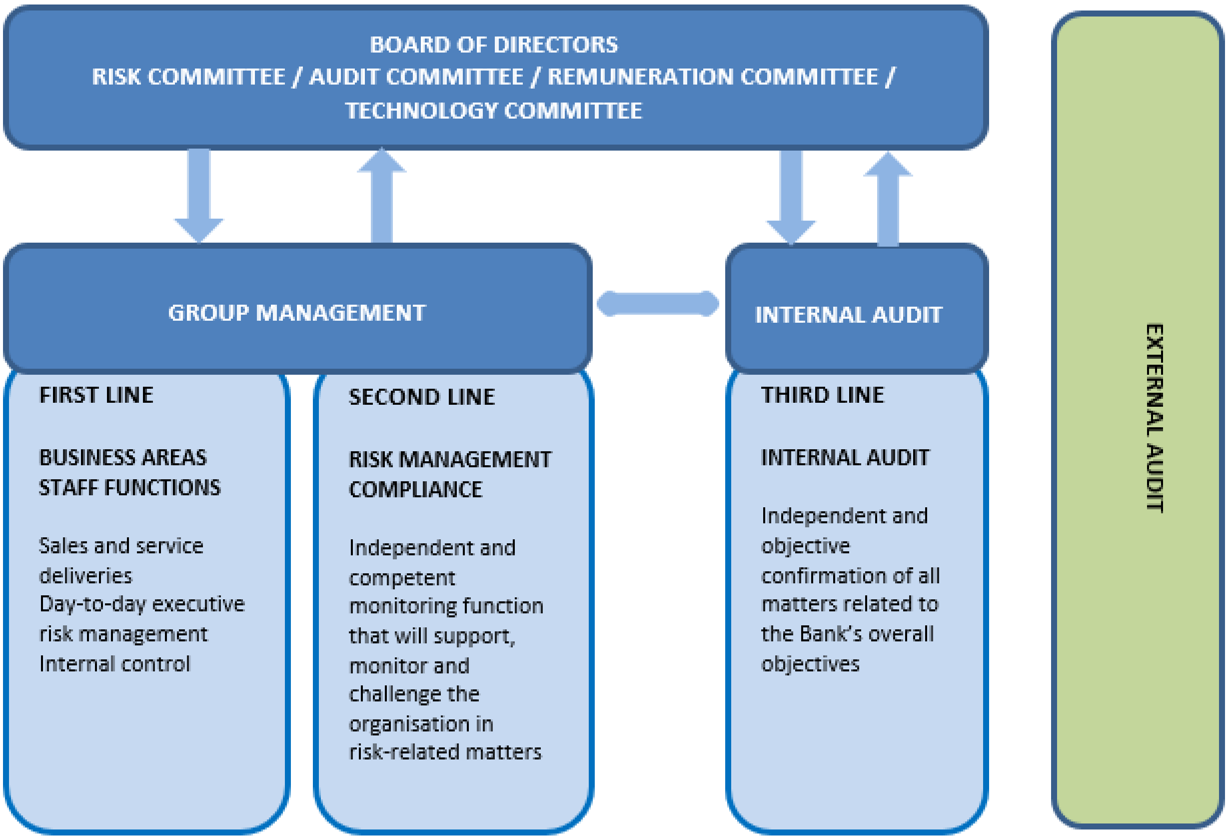
Risk management and capital management at Sparebanken Sør are split into the following functions:

There must be an allocation of functions and roles between the Bank's business areas and auditing authorities.

Sparebanken Sør has a policy that employees in the executive function are to manage and measure the risk the Bank is exposed to in daily operations and report this according to procedures that have been adopted.

There must be within the various risk areas an appropriate organisation and independence between the employees who perform operational work and those responsible for monitoring and reporting financial key figures and management objectives.

In general, the Bank's corporate governance can be described schematically within the "three line model". Schematically the model can be described as follows:



Board of Directors

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

The Board establishes guidelines for the Group's risk taking, identification, monitoring and control of risk factors to which the Group is or may become exposed , including risks related to macroeconomic conditions, and the Board imposes requirements for reporting and information. The board must regularly be informed about the Group's risk management and risk exposure.

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

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

Risk Committee

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

The Board establishes instructions for and appoints members of the Risk Committee from among the Board's own members. The Risk Committee also functions as an ESG committee and is required to process and prepare ESG matters for the Board.

Chief Executive Officer and Group Management

The CEO and other members of Group management are responsible for implementing risk management and internal control. The CEO has established an advisory Group manager group which meets regularly.

The CEO has delegated duties in accordance with the formal responsibility for internal control and risk management. Responsibility for the basis for implementation of the annual assessment of risk and capital adequacy is delegated to the Risk Management division. Control tasks are further delegated to the various line managers within the framework of agreed principles, instructions and authorities.

The Group management shall ensure that the Bank has an organisation with the right expertise and sound, effective frameworks, processes, systems, models and procedures for managing risks to which the Bank is exposed.

Business areas and staff/technical functions

The business areas and the technical functions are responsible for operation and day-to-day management and monitoring of risk within their own areas of responsibility. The business areas are responsible for developing and maintaining processes, systems, guidelines and procedures for managing risk within their own areas of responsibility and for monitoring and verifying compliance with the same.

Risk Management

The Risk Management division covers the entire Group and does not perform activities which the control function is intended to monitor. The division is required to identify, measure and assess the Bank's total risk and has the overarching responsibility for capital management. The Risk Management division is responsible for regularly reporting to Group management, the Risk Committee and the Board on the Bank's total risk exposure.

Compliance

An independent compliance function has been established. The main responsibility of the Compliance function is to prevent, control and report any non-compliances with laws, regulations, directives and policy documents. The function of Compliance is to ensure that the Bank performs its tasks in accordance with the authorities' requirements and various standards. The prevailing regulatory requirements must be complied with at all times, and this is also important in order to take correct and sound decisions that will contribute to fulfilling the management objectives that have been adopted.

The compliance function is part of second-line control and carries out independent random sample checks, risk monitoring and reporting.

Internal Audit

The Group has an internal audit function with its own employees who report directly to the Board of Directors and are independent from the administration. Internal Audit is an independent verification and advisory activity intended to provide added value and improve the Group's operations. Internal Audit uses a systematic and structured method in order to evaluate and improve the effectiveness and appropriateness of the Group's processes for risk management, control and governance. In addition, Internal Audit will contribute through its audits to preventing and detecting any irregularities.

4.3. Risk Management

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

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

Key elements in the Group's risk management:

- Define and quantify the Group's risk
- Establish framework and guidelines for the Group's risk acceptance
- Determine risk strategies, risk appetite with appropriate risk targets and risk tolerance
- Maintain and develop a sound risk culture with a good balance between business goals and risk
- Have the best possible allocation of the Group's capital on the basis of strategic objectives and profitability
- Have risk strategies with appropriate management objectives
- Have good systems and procedures for identifying, measuring and analysing risk
- Have good systems and procedures for managing, monitoring, reporting and controlling risk

Risk culture

In the processes for risk management, the organisation's risk culture is a foundation on which the other elements of comprehensive risk management are based. Risk culture is a critical factor for achieving the desired level for the Bank's risk management.

"A good risk culture means that there is an environment in which there is awareness that the Bank is exposed to various risks in most activities, but where there is an understanding that risk is to be managed. There must be an openness in which respect and trust ensure that various viewpoints are heard in decision processes and where constructive engagement is encouraged."

The Bank's risk management is based on uniting sound practice with sound theory, and the Bank will have a culture for assessing and dealing with risk in all situations. The Bank will develop and maintain a sound risk culture through communication, information and training about the Bank's strategy, activities and desired risk profile.

All employees must be aware of their own responsibility with respect to risk management. Risk management is not limited to specialists in the second and third line, but is also an integrated part of daily business activities.

Compliance with adopted ethical guidelines plays an important role in helping the Group achieve its long-term goals.

The risk management shall ensure:

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

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

4.4. Capital management

Sparebanken Sør aims to be well capitalised at all times. The Bank's common equity Tier 1 capital ratio must satisfy the authorities' minimum requirements and be on a par with comparable banks. Sparebanken Sør is the only one of the large regional banks in Norway to use the standard method to calculate capital adequacy, and this must be taken into account in comparisons.

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

The capital management shall ensure:

- Regulatory requirements for capital are observed
- Market opportunities and ambitions are attended to
- Adequate operational buffers
- Rating objectives are met
- Requirements from the Norwegian and international financial markets are attended to
- Competitive return is realised

There is an objective for the return on equity in the business areas to be calculated as risk-adjusted return. To the extent that capital is a scarcity factor, capital is to be allocated on the basis of strategic and profitability considerations.

Risk analysis

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

4.4.1. ICAAP

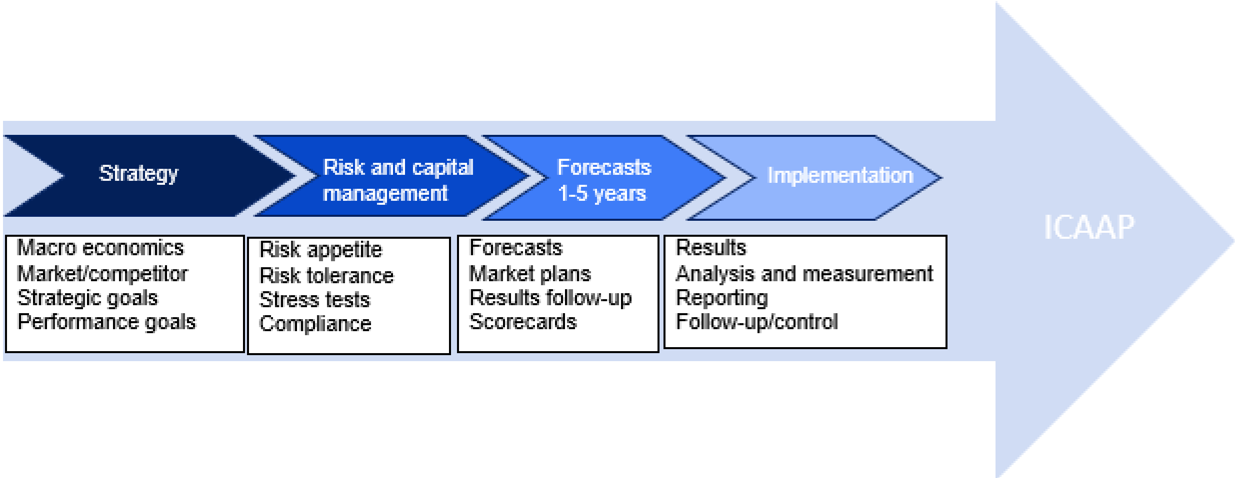
The Board of Directors is responsible for the Bank's internal risk and Capital Adequacy Assessment Process (ICAAP). The Board of Directors is further responsible for assessing the Bank's risk tolerance, capital requirements and capital planning. The Board of Directors also approves the choice of methods and results. The purpose of the ICAAP is to conduct a quantitative and qualitative assessment of the Group's risks in order to assess whether the Bank's capital adequacy and capital buffer are adequate in comparison with the Bank's risk profile.

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

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

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

An outline of the Group's ICAAP process, integrated with strategy and budget, is shown in the figure below:



Quantitative analyses of risk are supplemented with qualitative assessments.

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

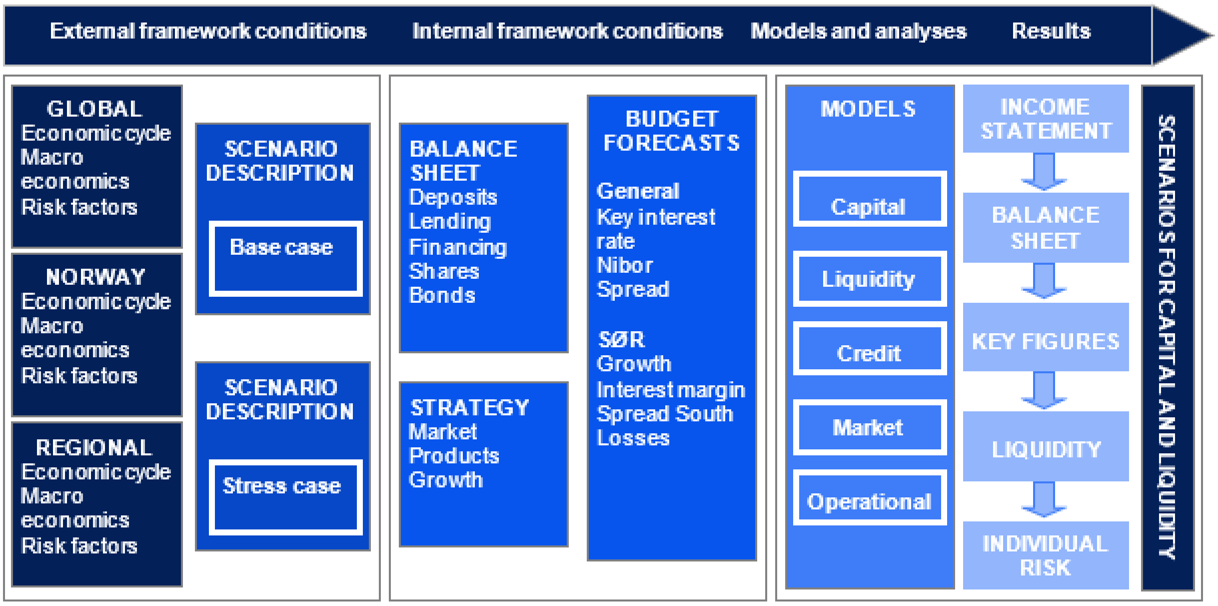


Figure: Model for scenario analyses and stress testing

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

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

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

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

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

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

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

Assessment of risk and capital requirements

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

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

Table: Methods for calculating capital requirements

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

Capital targets

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

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

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

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

Reporting

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

Recovery Plan

Sparebanken Sør has established a recovery plan to ensure that the bank can recover from an extremely serious financial crisis without extraordinary help from the authorities. The plan is an integral part of the Group's framework for risk management and capital management, and it will enter into force in the event of breaches of pre-defined indicators. The plan therefore encompasses identification of relevant indicators to ensure sufficiently early intervention and effective measures to be able to restore the Bank's financial position following a major financial crisis.

5. CREDIT RISK

Credit risk is the risk that a counterparty does not meet its obligations under an agreement. In a loan relationship, the credit risk consists of the borrower not fulfilling the loan agreement and established securities do not cover the exposure. Credit risk is the Group's greatest risk and the risk that requires the most capital.

Concentration risk is credit risk in the form of a risk of loss arising from highly concentrated exposure to an individual counterparty or related groups of counterparties (major commitments) or counterparties with operations in the same sector (industry concentration) or geographic area (geographic concentration)

5.1. Risk assessment

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

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

5.2. Management and control

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

In addition to being the largest bank in Agder, the Bank is also represented in Vestfold and Telemark and Rogaland. The Bank also operates in a national market segment, through retail customers who have moved away from the Bank's core area, and organisations that form part of KNIF and their employees.

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

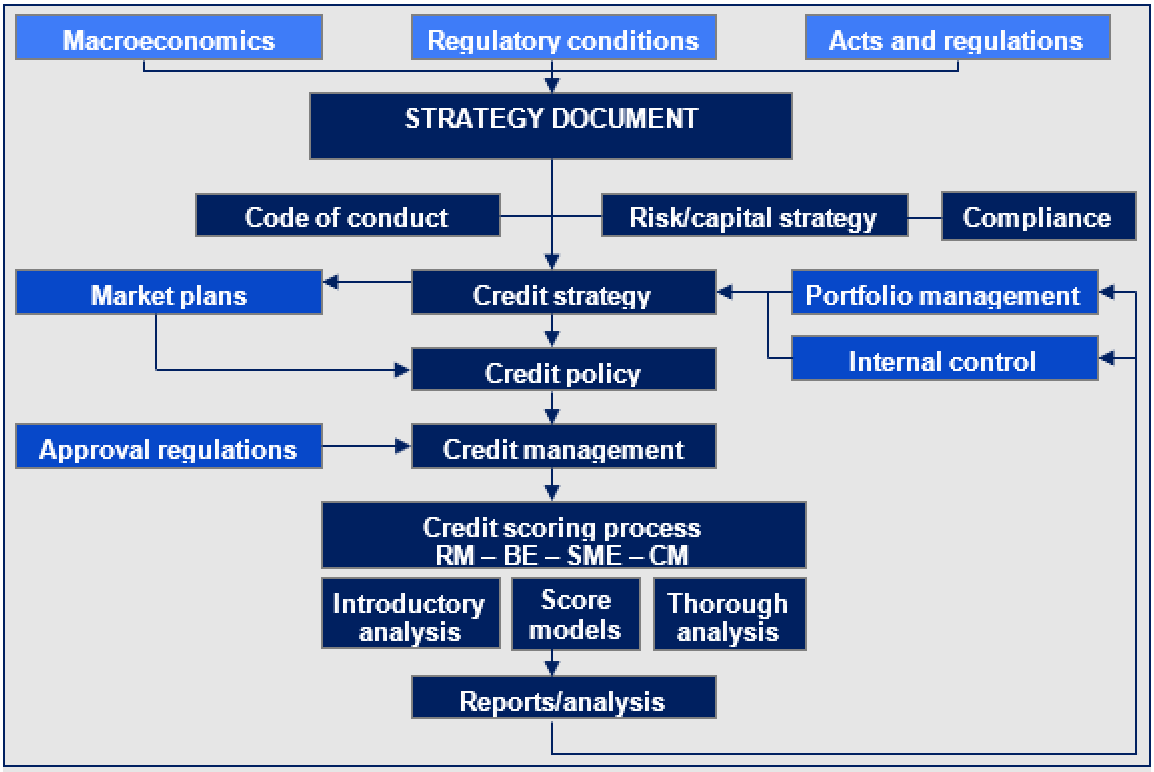


Figure: Credit risk management model

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

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

Credit strategy

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

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

Credit policy

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

Approval regulations

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

Credit management procedures

The credit strategy and credit policy as well as operational credit guidelines regulate various matters relating to the granting and monitoring of credit and dealing with non-performing exposures.

Credit scoring process

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

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

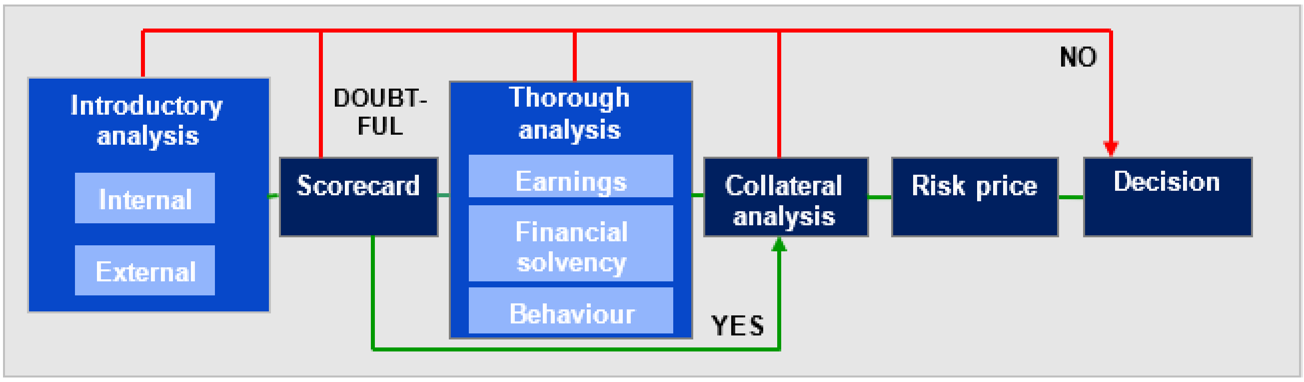


Figure: Credit scoring process

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

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

Security coverage calculations are based on expected realisable values.

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

Internal control

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

Exposure monitoring

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

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

Non-performing exposures in the corporate market are subject to separate monitoring procedures, including the involvement of the Bank's central credit department.

Reports/analyses

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

Risk classification system

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

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

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

Figure: Risk classification system

Probability of default

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

Risk class	Lower limit for default, per cent	Upper limit for default, per cent
A	0.00	0.10
B	0.10	0.25
C	0.25	0.50
D	0.50	0.75
E	0.75	1.25
F	1.25	2.00
G	2.00	3.00
H	3.00	5.00
I	5.00	8.00
J	8.00	99.99
K	100	

Table: Risk classes

Risk classes Retail market

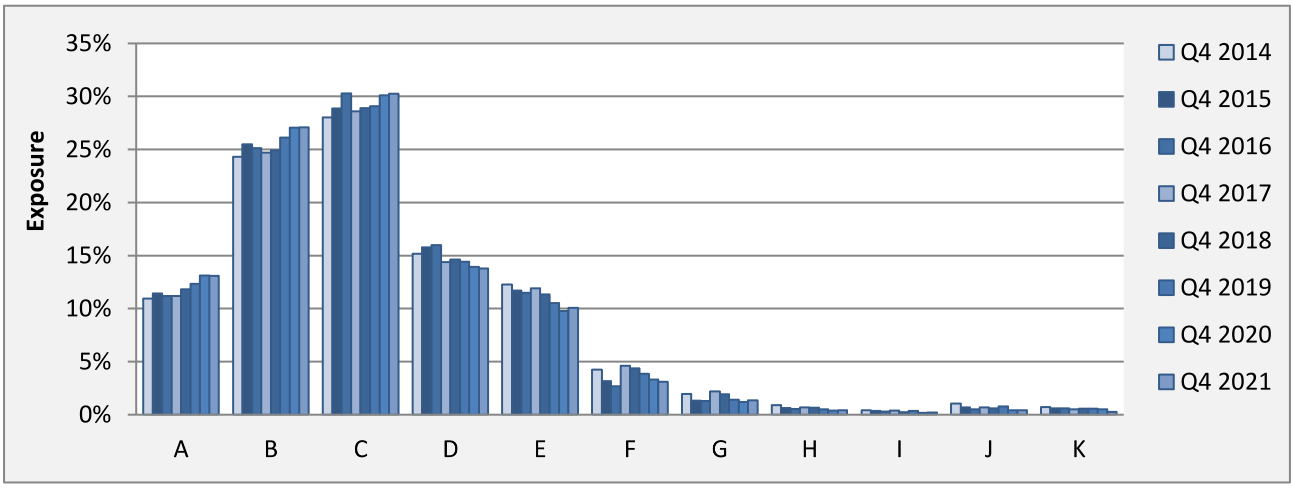


Figure: Risk *classes Retail market*

The figure shows the retail market portfolio by risk class. In Q4 quarter of 2021, customers with low risk (A – D) accounted for 84.2 per cent. Customers with medium risk (E–G) accounted for approximately 14.5 per cent, while customers with high risk (H – J) including category K, which is default, accounted for 1.3 per cent.

Risk classes Corporate market

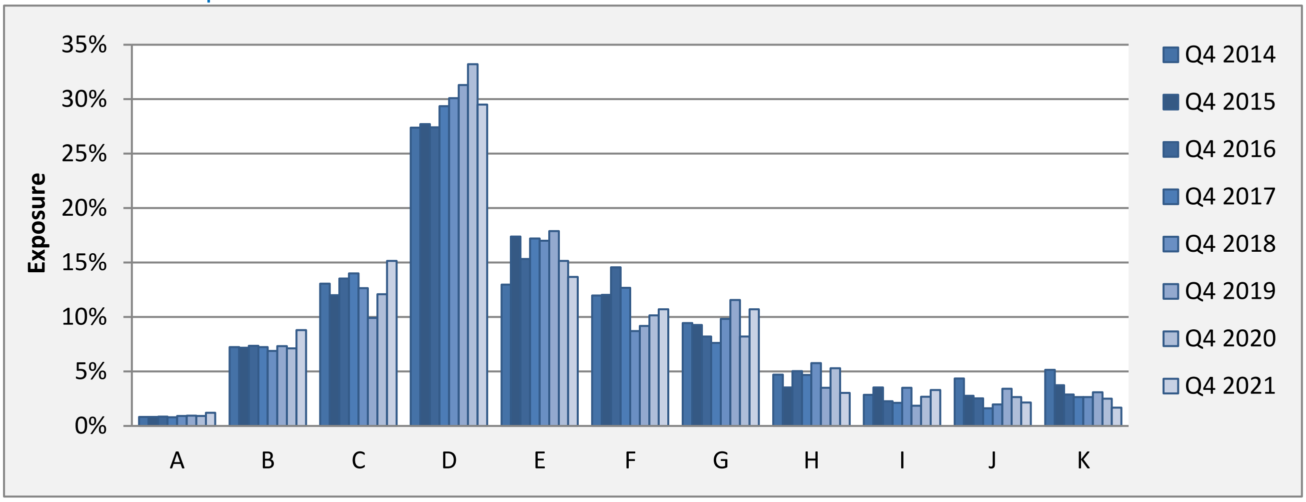


Figure: Risk *classes Corporate market*

The figure shows the corporate market portfolio by risk class. In Q4 2021, customers with low risk (A – D) accounted for 54.7 per cent. Customers with medium risk (E–G) accounted for approximately 35.1 per cent, while customers with high risk (H – J) including category K, which is default, accounted for 10.2 per cent.

Loss ratio

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

Exposure in the event of default

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

Expected loss

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

Risk-adjusted capital

The Bank reports the capital requirement for capital adequacy using the standard method. With respect to risk pricing, tied-up capital is calculated at product and customer level as risk-adjusted capital.

Validation

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

Non-performing exposures

Sparebanken Sør's definition of default is according to the EU's regulation on the use of the definition of default (575/2013, Article 178). The Bank defines default at the customer level for both the mass market and corporates. If a customer is defined as being in default, the customer's commitment is to be included in the Bank's public reporting of non-performing exposures.

Default is the failure of a borrower to fulfil the borrower's obligations to the Bank. A borrower's obligations include financial requirements (failure to pay) and other obligations that the borrower is unlikely to fulfil.

- A customer's commitment is defined as in default if a claim is overdue by more than 90 days and the amount exceeds 1 per cent of the balance sheet exposure and NOK 1000 for the mass market and NOK 2000 for corporates (failure to pay).
- A customer's commitment is defined as in default if it is likely that the borrower will not fulfil the borrower's obligations because of objective requirements:
    - A loss write-down has been recorded on the customer's commitment
    - Ascertained amounts have been recorded on the customer
    - A bankruptcy petition has been submitted or bankruptcy has been recorded on the customer
    - The customer has sought or is in a debt settlement
    - Involuntary dissolution of a company has been requested or involuntary dissolution has been decided
    - Sales of credit owing to impaired credit quality
- A customer's commitment is defined as in default if qualitative assessments are made indicating that the borrower will not fulfil the borrower's obligations. Qualitative assessments are made when observable data is available relating to the exposure of, for example, significant financial difficulties at the issuer or borrower. When the borrower's lender, due to financial or contractual grounds relating to the borrower' financial difficulties, has granted the borrower concessions that the lender would not otherwise have considered and when it becomes probable that the borrower will enter bankruptcy or undergo another form of financial reorganisation.

All defaults are followed by a waiting period which starts when all the customer's default triggers have ceased. During the waiting period, the customer is considered to be in default and the period lasts for 3 months or 12 months depending on the reason for default.

Forbearance

Commitments with forbearances are debt contracts in which forbearances have been granted to a debtor who has, or is in the process of having, problems with meeting the debtor's financial obligations. Commitments with forbearances include both healthy and non-performing commitments. If a customer is granted forbearances, this results in the customer's commitment being marked with a forbearance. Factors that result in customers being marked with forbearances will be changes in repayments, e.g. postponement of instalments and refinancing as a result of payment problems. When a customer or account is marked with a forbearance, the customer or account is automatically moved to stage 2, if it is in stage 1, see the 3-step model in IFRS 9. If the customer is in stage 3 initially, no transfers will take place. If a commitment is marked with a forbearance, there is a probationary period before the loan can be declared healthy and then migrate back to stage 1.

5.2.1. Use of collateral

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

- Mortgages on property (homes, holiday homes)

- Bank deposits

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

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

- Guarantees from the government, county authorities and municipalities

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

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

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

Procedures and guidelines for valuation of security

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

6. COUNTERPARTY RISK

Counterparty risk is the risk that the Bank's business partners/suppliers in the financial area are unable to fulfil their contractual obligations to the Bank.

Counterparty risk is reduced by diversifying among different providers of financial services, as well as implementing risk-reducing measures such as contractually exchanging security between the parties, immediate counterparty clearing and reporting to central reporting authorities.

6.1 Risk assessment

The counterparty risk is considered low.

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

6.2 Management and control

The Board has determined that counterparty risk is to be low. The Bank's business partners in the financial area must have a rating classification of at least investment grade, as well as a good reputation among borrowers and investors. It is essential when choosing business partners that they are willing and able to assist the Bank in financing the Bank's operations, including access to a large investor base, which ensures the Bank of adequate access to financing at competitive prices. The Bank's business partners must also be able to offer professional products and services in other financial services that the Bank seeks.

The Bank's requirement for low counterparty risk means that risk-reducing measures must be established. In order to manage the counterparty risk from financial institutions, frameworks have been established per counterparty for various products. The setting of frameworks is intended to ensure the Bank's diversification objective. Frameworks for counterparty risk will cover exposures that arise with respect to liquidity investments, derivative positions, interest-bearing security portfolio and REPO transactions.

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

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

Transactions in financial instruments with the Bank's counterparties shall be regulated by a satisfactory legal agreement. The agreement terms shall include requirements for providing security when exchanging security and shall have the objective of reducing the exposure to a financial counterparty. The terms for short-term lending to a financial counterparty in exchange for collateral (repurchase transactions) shall normally be governed by a standard contract (Global Master Repurchase Agreement). Derivative transactions with financial counterparties shall be governed by standardised agreements (ISDA Master with Credit Support Annex) or equivalent agreements. An agreement on clearing through a Clearing House approved by the authorities is also a risk-reducing measure.

When choosing financial counterparties, investment objects and business partners in the financial area, the Bank's policies and guidelines for sustainability are emphasised. The Bank seeks through its management and selection of providers to affect social development in a sustainable direction, including actively not choosing exposures that may result in infringement of human rights, corruption, financing of terrorism, etc.

7. MARKET RISK

Market risk includes risk associated with fluctuations in the value of unhedged interest rate, currency and equity positions as a result of changes in interest rates and credit spreads, as well as variation in foreign exchange rates and share prices. Market risk can be divided into interest rate risk, credit spread risk, foreign exchange risk and share price risk. In addition, the valuation of hedge transactions (basis swaps), which are used to hedge interest rate and foreign exchange risk arising when the Bank carries out financing in foreign markets, will also have a temporary impact on profit or loss.

7.1 Risk assessment

The market risk is considered low. At the end of the year, the levels of market risk were within the requirements adopted by the Board.

7.2 Management and control

Market risk is managed through management objectives given in board-adopted guidelines and procedures. The Board has determined that the Group is to have a low market risk. The Board sets annual risk tolerance levels for loss potential for interest rate risk, credit spread risk, foreign exchange risk and share price risk, respectively, as well as aggregate loss potential for market risk. The frameworks for the management objectives will limit the risk and ensure that the Bank at all times meets the Board's requirement for a prudent risk profile.

The market risk shall be on par with comparable banks, but it shall be reconciled with the Bank's risk profile when viewed overall and board-adopted requirements for capital adequacy. The risk profile shall be adapted to the current market situation and the prospects for the future. Management and control of the market risk shall be attended to in such a way that the Bank is able to withstand a long period of market stress.

When hedging market risk (interest rate and currency risk), interest rate and currency derivatives are used, as well as asset-liability matching.

The Group's Method Document for Market Risk contains assumptions and model options for measuring exposure to interest rate risk, credit spread risk, foreign exchange risk and share price risk. The models are based on Finanstilsynet's module for market risk.

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

7.3 Interest rate risk

Interest rate risk is defined as the risk of financial losses arising from changes in interest rates if the fixed-interest period for the Bank's liabilities and receivables do not coincide. Interest rate risk arising in the Group's ordinary operations in the form of fixed-interest customer loans, interest rate derivatives relating to customers, fixed-interest investments and funding at fixed rates of interest and in foreign currencies is hedged on an ongoing basis. The interest rate risk exposure is measured by taking into account unhedged balance sheet and derivative positions.

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

Interest rate risk is assessed on the basis of a stress test scenario in which the entire yield curve has a parallel shift of 2 percentage points, as well as an assessment of how 6 stress test scenarios with various distortions in the yield curve affect the Group's position. The scenario with the greatest loss potential is taken as a basis for measuring interest rate risk.

At Group level, the Board has adopted a risk targets for interest rate risk under 3 months and a risk tolerance for interest rate risk greater than 3 months. The framework also includes interest rate risk in foreign currency.

At the end of 2021, Sparebanken Sør's interest rate risk was NOK 82 million measured with the EVE approach.

7.4 Credit spread risk

Credit spread risk is the risk of changes in the market value of interest-bearing securities as a result of general changes in credit spreads. A general increase in credit spreads would lead to a reduction in the value of a portfolio of interest-bearing securities. Changes in credit spreads are a consequence of changes in investors' requirements for a risk premium.

Finanstilsynet's stress test model for credit spread risk is used to calculate loss potential. The loss potential is calculated for various risk classes based on rating, with set changes in spreads. The calculation takes into account the Group's actual positions measured at market value and remaining duration. Total loss potential constitutes the Group's credit spread risk. Holdings of government bonds in the OECD and other counterparties with a capital weight of 0 are excluded from the calculation basis.

The Group's credit spread risk is also adjusted indirectly via limits for maximum investments in different sectors.

At the end of 2021, Sparebanken Sør's credit spread risk was NOK 209 million.

7.5 Foreign exchange risk

Foreign exchange risk consists of the risk of loss when the exchange rate changes. All financial instruments and other positions with foreign exchange risk shall be included in the assessment.

Foreign exchange risk at Sparebanken Sør arises as a result of financing and investment activity, international payment transactions and/or customer transactions. Foreign exchange exposure is hedged on an ongoing basis using different instruments including currency futures and swaps.

The loss potential is measured on the basis of a stress scenario where the exchange rates change by 25 per cent. The calculation is based on the Group's overall net foreign exchange position.

At the end of 2021, Sparebanken Sør's foreign exchange risk was NOK 0.4 million.

7.6 Share price risk

Share price risk consists of market risk associated with positions in equity instruments, including investments in hedge funds, private equity funds, venture capital funds and seed funds. Shares in subsidiaries and/or strategic shareholdings in the financial sector are not included.

The loss potential is measured on the basis of a stress scenario where the market value of the shares declines by 45 per cent. The calculation must be based on market rates, to the extent that these are available for the instrument.

At the end of 2021, Sparebanken Sør's share price risk was NOK 39 million.

8. OPERATIONAL RISK

Operational risk is the risk of loss as a result of inadequate or defective internal processes or systems, human error or external events. These may be disruptions or interruptions of an operational nature, breach of procedures, faults in IT systems or hardware, regulatory violations, fraud, fire and terrorist attacks. This includes legal risk, but not strategic risk or reputation risk.

8.1 Risk assessment

The Bank's operational risk is considered low.

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

8.2 Management and control

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

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

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

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

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

Management objectives, status, trend and registered incidents in operational risk are included as part of quarterly risk report to the Board.

8.3 Economic crime, money laundering and financing of terrorism

Detecting and preventing economic crime, including money laundering and terrorist financing, is a very important social responsibility that is taken very seriously in Sparebanken Sør. The Bank has a comprehensive framework of management documents, policies and guidelines to ensure compliance with the applicable legal requirements at all times, and significant resources are invested in fulfilling the Bank's role in protecting the Bank's customers, the financial system and society as a whole. Based on a business-oriented risk analysis, the Bank has a risk-based approach under which adequate measures are implemented to manage the risk to which the Bank is exposed. The risk analysis is regularly updated to strengthen and develop efforts through adaptation of measures. The Bank's "Anti-Money Laundering and Anti-Terrorism Financing Policy" provides guidance for the Bank's attitude towards and work on corruption, influence peddling, bribes and use of facilitation payments.

The Bank is active in a number of national networks in the fight against financial crime. In the Bank's experience, there is a low threshold for sharing experience and expertise across industry players, supervisory authorities and public bodies. There are detailed checks on a considerable number of suspect transactions in the course of the year. If suspicions are not dispelled by the Bank's investigation, the suspicion is reported to the National Authority for Investigation and Prosecution of Economic and Environmental Crime (Økokrim). The activities in the Bank's work against financial crime are described in more detail in the sustainability report published under Corporate Social Responsibility on the Bank's website.

9. INFORMATION SECURITY RISK

Information security risk is related to the confidentiality, integrity and availability of information assets.

9.1 Risk assessment

The Board has set a goal that Sparebanken Sør is to have low information security risk. This requires effective management and control of information security risk and minimal information security violations.

There is a constantly intensifying threat picture, both in general and for the financial sector in particular – resulting in the need for a permanent focus over time on information security.

Sparebanken Sør is undergoing a period of rapid change. New products, new systems, system changes and new and departing employees: Such changes have an inherent risk of information security breaches. New digital solutions also entail risk, and the consequence of errors in digital solutions is often greater than from individual human errors.

All of this requires ongoing maintenance of the expertise and training of all employees in the information security area.

9.2 Management and control

In order to manage and control the work on information security at Sparebanken Sør, an Information Security Management System (ISMS) has been established. This system is based on ISO 27001 and is supplemented with guidelines from the EBA (European Banking Authority) and NSM (the Norwegian National Security Authority).

The Group's ISMS should ensure that work on information security is a continuous process that is performed in a systematic and documented manner. The management system is adapted to the Group's size, individual character and activities, the nature, scope and purpose of the processed information and the context in which the system is implemented. The ISMS is an integral part of the Group's internal control system.

Leadership

In introducing the Group's ISMS, the Group's executive management, the Board of Directors and Group management have demonstrated their leadership and a commitment to information security by:

- Ensuring that the Bank's information security policy and goals are compatible with the Group's strategic direction by adopting an official board resolution.
- Ensuring that the requirements set out in this ISMS are integrated in the Group's processes.
- Ensuring that the resources required to maintain and further develop the ISMS are available
- Communicating the importance of effective information security management and compliance with the requirements established in the security instructions for the ISMS.
- Helping other relevant management functions demonstrate their leadership in an appropriate way for their area of responsibility.

Roles, responsibilities and authorities

- Executive management is responsible for assigning and communicating responsibilities and authorities for roles relevant to information security.
- The CISO is responsible for establishing, reviewing and further developing the ISMS and for regularly reporting on the performance of the ISMS to Group management.
- Managers at various levels, based on their area of responsibility, are responsible for ensuring that their own routines and work procedures reflect the established security instructions for the ISMS.
- All employees are responsible for carrying out their work in accordance with established guidelines.

10. LIQUIDITY RISK

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

10.1. Risk assessment

The liquidity risk is considered moderate to low. At the end of the year, the levels of liquidity risk were within the limits adopted by the Board.

10.2. Management and control

Sparebanken Sør's liquidity risk must comply with the authorities' and board-imposed requirements. The Board has determined that the Sparebanken Sør Group is to have a moderate to low liquidity risk. The Board has set risk tolerance levels for various management objectives that indicate maximum and minimum limits for risk appetite. In addition, the Board has set risk targets that indicate a long-term objective or desired trend.

The liquidity risk shall be on par with comparable banks, but it shall be reconciled with the Bank's risk profile when viewed overall and board-adopted requirements for capital adequacy. The risk profile shall be adapted to the current market situation and the prospects for the future. Financing and liquidity buffers shall be arranged in such a way that the Bank is able to withstand a long period of stress.

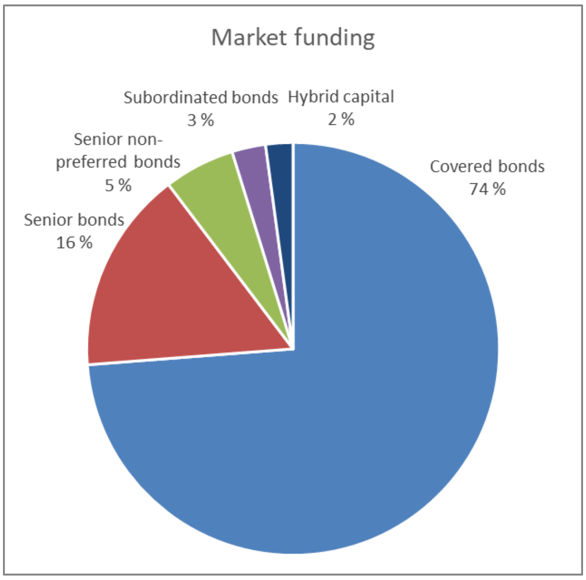
In addition to ordinary deposits and own funds, the Group's financing may be carried out by issuing senior bonds, covered bonds issued by Sparebanken Sør Boligkreditt AS, senior non-preferred bonds and loans from other financial institutions.

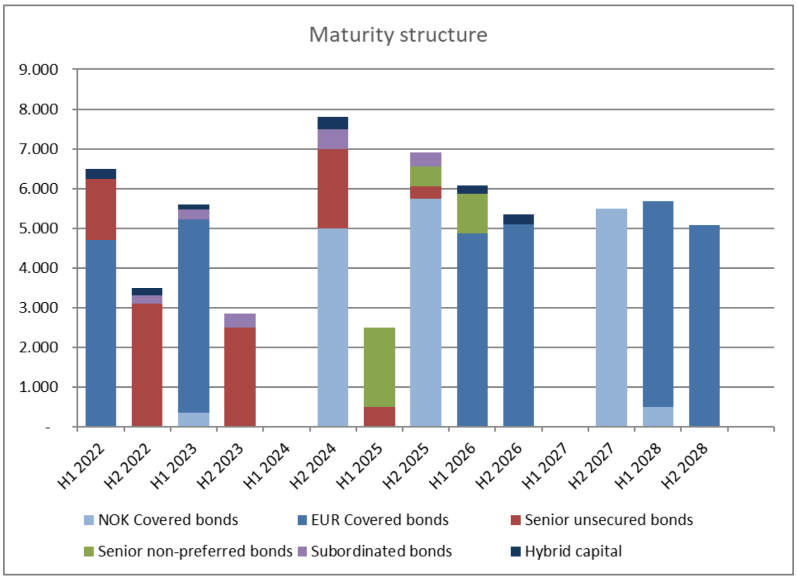
Deposits from customers are the Group's most stable source of funding. The Board of Directors emphasises that the ratio between deposits from customers and lending must be tailored to the Group's overall funding situation. The Group's deposit-to-loan ratio was 54 per cent at year end.

In addition, Sparebanken Sør Boligkreditt AS is an important funding instrument, ensuring access to long-term funding through the issuance of covered bonds. To be able to issue covered bonds, mortgage loans equivalent to 64 per cent of all loans to the retail market were transferred from the parent bank to the mortgage company.

The Group attaches importance to diversifying market funding. EMTN (European Medium Term Note) programmes have been established for both the Bank and mortgage company that facilitate market funding from sources outside the Norwegian bond market. At the end of 2021, Sparebanken Sør Boligkreditt had issued covered bonds corresponding to EUR 3 billion, of which EUR 500 million was issued as Green Covered Bonds. See our website for more information on Sparebanken Sør's Green & Sustainability Bond Framework.

Market funding is diversified among various instruments and maturities as shown in the figures below. The average maturity for long-term market funding (maturity greater than 12 months) was 4.1 years at year end, and the liquidity indicator for long-term funding (NSFR) was 116 per cent.





The Group's liquidity portfolio consists of interest-bearing securities and/or other liquid financial instruments that satisfy liquidity requirements specified in the LCR regulations, including government bonds and other interest-bearing securities with zero capital weighting, covered bonds and securities issued by Norwegian municipalities and county authorities. The Group's expanded liquidity buffer takes into account the capacity to issue additional covered bonds and consists of the available cover pool at the mortgage company, mortgage loans on the Parent Bank's balance sheet that qualify as cover pool and holdings of own covered bonds.

The liquidity portfolio is intended to assist the Group in fulfilling its overarching ESG strategy. It will be investments in the liquidity portfolio that qualify to be included in the ESG mandate, and there is an objective to increase the Group's portfolio in green, social and sustainable investments.

Management of short-term liquidity risk includes adjustment to the Liquidity Coverage Requirement (LCR). At the end of 2021, the total LCR indicator for Sparebanken Sør Group, the Parent Bank and Sparebanken Sør Boligkreditt AS was sufficient to comfortably satisfy all the projected liquidity maturities within the next 30 days under a stress scenario. The Group's LCR indicator amounted to 140 per cent as of 31 December 2021. The regulatory requirement was 100 per cent.

Stress testing is utilised to reveal whether established liquidity buffers are sufficient to meet predicted liquidity outflows. Stress testing is carried out in line with the Group's Method Document for Liquidity Stress Test and shows the utilisation of the liquidity buffers for four scenarios (Base Case scenario, Systemic Crisis scenario, Institution-Specific scenario and Combination of Institution-Specific scenario and Systemic Crisis scenario). The stress scenarios include various assumptions regarding outflows of deposits and possibilities for refinancing.

In order to aggregate the risk exposure across the management objectives, the Group's ability to survive is used as an overarching management objective. The ability to survive is measured by estimating how long the liquidity coverage is positive by only using established liquidity buffers, before the Group is unable to meet its obligations. The calculation ignores market-based refinancing. At the end of the year, the ability to survive was greater than 12 months.

An contingency plan has been established for liquidity which describes which events may trigger the contingency plan, how the Group is to organise itself and which measures can or must be taken in situations in which the Bank's liquidity may be threatened.

Measurement of liquidity risk is based on Finanstilsynet's module for liquidity risk.

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

11. BUSINESS RISK

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

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

11.1. Risk assessment

The Bank's business risk is considered low.

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

11.2. Management and control

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

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

12. STRATEGIC RISK

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

12.1. Risk assessment

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

12.2. Management and control

Strategic risk is managed through Board and Group management processes for implementing and monitoring the Bank's strategy. No performance targets have been adopted for strategic risk.

13. OWNERSHIP RISK

Ownership risk is the risk of the Group incurring negative results from ownership interests in subsidiaries and associates and/or having to contribute new equity to these companies.

13.1. Risk assessment

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

13.2. Management and control

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

Sparebanken Sør ownership risk is based upon strategic aims, where profitability is in proportion to risk. The Group must not be involved in companies or activities that can threaten reputation or strategic goals.

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

A list of subsidiaries is presented in Chapter 2.

No performance targets have been adopted for ownership risk.

14. COMPLIANCE RISK

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

14.1 Risk assessment

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

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

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

The compliance culture in operational activities is deemed to be good, but ensuring timely, continuous implementation and compliance with an increasing scope of Norwegian and international regulations is an ever-greater challenge.

14.2 Management and control

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

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

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

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

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

The various compliance functions present their assessment of compliance in a quarterly Compliance Report that is reviewed by Group management, the Risk Committee and the Board. The Compliance function summarises its assessments in a separate annual report that is presented to the boards of the various companies in the Group. The Compliance function has an opportunity to report directly to the CEO and the Board as needed.

15. ESG RISK

ESG risk (Environmental, Social & Governance) encompasses risk related to climate and the natural environment, social conditions and corporate governance.

ESG risk is defined as the risk of loss as a result of the Group's exposures to counterparties being negatively affected by ESG factors. ESG risk is not a separate risk but is instead a risk driver for the other types of risk such as credit risk, market risk, operational risk, etc.

Sparebanken Sør's approach to ESG risk is twofold:

- Direct influence from the Bank's own operations.
- Indirect effect from the Bank's business areas.

Climate risk represents the greatest ESG risk, but risks related to environmentally-related challenges will also become more and more crucial with respect to risk in the business areas.

Climate risk represents three types of risk:

- Transition risk: Risk during transition to zero-emissions society, which includes political and regulatory matters, technology, market and reputation.

- Physical risk: Acute risks due to extreme weather that leads to hurricanes, flooding, etc. Chronic risk, which is long-term climate changes that affect temperature, sea level, etc.
- Liability risk: Companies may be held liable for damage caused because of climate changes and regulations that are not observed.

It is particularly the first two risk types mentioned that affect the Group.

More information about this and climate risk in general appears in our climate report, Task Force on Climate-related Financial Disclosures (TCFD), which is available on the Bank's website.

15.1. Risk assessment

Climate and environmentally-related challenges constitute a major risk to society and the Group. The Group's strategy, business models and financial development are affected by climate and environmentally-related risks and opportunities. Climate and environmental risks have to do with how the Group's business operations are affected by climate and the environment, but also how the Group's business operations affect climate and the natural environment.

Up to this point most of the focus has been on climate, but in the future, focus on challenges related to the natural environment, including the use of the natural environment, biodiversity and environmental contamination, will increase. This will be reinforced through a "Nature Agreement" that is coming in 2021, similar to the climate's "Paris Agreement". Climate and the natural environment are strongly integrated matters, and the natural environment will have its natural place in the work on ESG in the future.

In short, the climate challenges have to do with which measures we must take with respect to both direct internal greenhouse gas emissions and indirect greenhouse gas emissions from our business areas, in order to reduce the greenhouse gas emissions to a level that means the Paris Agreement's goal of a temperature increase of 1.5 degrees, at most 2.0 degrees, can be met.

For the Group, we consider the conversion risk to be the greatest, as we in Norway, in any event in the short term, are less exposed to physical risk due to serious climate changes.

The relationship between climate risk and the most significant risk categories is shown below.

Risk type	Transition risk	Impact risk		Physical risk	Impact risk	
		Short term (0–10 years) now–2030	Long term (10–30 years) 2030–2050		Short term (0–10 years) now–2030*	Long term (10–30 years) 2030–2050
Credit risk	Regulations and changes in customer behaviour related to climate change can trigger impaired servicing capacity (PD) and reduced pledged security (LGD) from customers and can lead to increased losses (EL).	Moderate	High	Increased losses (EL) on customers, industries and sectors that are exposed to reduced values on pledged security and assets due to climate change.	Low	Moderate
Market risk	Transition risks such as regulations, technology, products and customer behaviour can generate "stranded assets" and repricing of securities and other assets.	Moderate	High	Climate disasters can lead to rapid repricing, changes in volatility and loss of values on assets and asset items.	Low	Moderate
Operational risk	Negative effects of regulatory changes on internal processes and suppliers can lead to increased losses.	Low	Moderate	Damage from extreme weather to property, infrastructure and input factors and harm to people can result in increased losses.	Very low	Low
Liquidity risk	Lack of restructuring and a low proportion of sustainable activities affect rating, access to and price of financing. A rapid repricing of securities can reduce the value of the bank's liquidity buffer.	Low	Moderate	Impaired servicing capacity and costs for the prevention and repair of climate-related events can affect customers' deposits.	Very low	Low
Business risk	Reduced income due to lack of restructuring to a low-emission society. High costs due to lack of digitalisation and technology development. Increased volatility in results due to rapid changes in regulations and customer behaviour.	Low	Moderate	Physical damage to property and data and harm to people due to serious climate events can lead to increased costs and reduced income.	Very low	Low
Strategic risk	Lack of restructuring and adaptation to low-emission societies will affect profitability and the bank's standing.	Moderate	Moderate	Risk of loss of assets exposed to serious climate events.	Very low	Low

15.2. Management and control

The Board has the overarching responsibility for ESG, including the climate. ESG and the climate are included in the Group's strategy plan as one of the prioritised areas. The Board considers various policy documents, reports and action plans related to ESG and climate-related risks and opportunities. The Board also considers major credit cases where ESG and the climate are integrated in the credit processes. The Board determines overarching objectives and risk frameworks for climate-related risks and opportunities in the Group's framework for risk management.

Measurement indicators and performance targets for risk tolerance for ESG and climate risk will be developed on an ongoing basis.

ESG risk from own activities

Greenhouse gas emissions from internal activities at the Group are low, but goals have also been set here for reduction of greenhouse gas emissions. The Group has a goal of reducing greenhouse gas emissions by 55 per cent by 2030 and being climate-neutral in 2050 in line with the Paris Agreement. The Group monitors climate and the natural environment through an environmental management system and is certified as an Eco-Lighthouse under the Head Office model and the new criteria for the financial sector. The Group keeps an annual climate account.

ESG and climate risk from our own activities are considered low.

More details on the Bank's climate account appear on the Bank's website.

ESG risk from the business areas

We consider ESG and climate risks to be greatest in the following business areas:

- Lending: Increased probability of default (PD), reduced loss given default (LGD) and increased expected losses (EL). Higher capital requirements for "non-sustainable activities and products".
- Investments: Repricing of assets and "stranded assets".
- Financing: Access to and price of financing owing to lack of "sustainable activities".
- Increased competition, reduced revenues and high costs related to converting to a low-emissions society through climate-friendly technology, products and changes in consumption patterns.

Among these, lending and credit risk represent the greatest risk with respect to both ESG and climate risk.

The Group has established policy documents, policies and procedures for managing ESG risk from the various business areas. These are available on the Bank's website.

With respect to lending and credit risk, the Bank has incorporated a module for ESG analysis in credit processes for the corporate market. The ESG module has a particular focus on climate but also covers the other relevant ESG areas.

The ESG module, which is included as a separate module, identifies the customer and the ESG risk in the matter and assigns a risk score to the customer and matter with respect to ESG risk. This creates a basis for managing process, authorities and price. Data from the ESG module will be utilised in connection with reporting on case, customer and portfolio.

APPENDIX

See separate Excel appendix which is updated quarterly.

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