SPAREBANKEN SØR

Annual report 2018

Sigve Knutson

WINNER OF SPAREBANKEN SØR ARTIST AWARD, 2018.

Sigve Knutson (b. 1999, from Lillesand) has, despite his young age, received a lot of attention for working in an innovative and playful way. His objects are often in a landscape between art, architecture and design, and even though they are reminiscent of sculptures, they are also meant for practical use. All his works are handmade, and the tools and methods used reveal themselves as traces in his works.

Knutson is educated at the architect and design college in Oslo and at the Design Academy in Eindhoven in the Netherlands. His career got a kick start in 2017 when his creation ended up on the New York Times list of 16 best things they had seen during the furniture fair in Milano.

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The year 2018

STRONG MARKET POSITION IN A REGION OF POSITIVE ECONOMIC DEVELOPMENT

Trade and industry in the region developed positively throughout 2018, and a number of businesses and sectors have experienced increasing economic growth. Businesses in the region have shown a high level of adaptability after the economic downturn that followed the fall in oil prices in 2014, and we are now seeing growth in production and investments, falling unemployment and growth in the employment rate. A continued low exchange rate for the Norwegian krone (NOK) has resulted in improved competitiveness and, together with a low level of interest rates and expansive financial policy, this has resulted in positive growth impulses in the region's trade and industry. Sparebanken Sør has maintained its leading market position in the region, and we are experiencing positive effects from an improved economic climate resulting in very low losses on loans, reduced level of default and increasing demand for credit, driven by growth in business investments.

LEADING IN CUSTOMER SATISFACTION

In the late autumn of 2018, Sparebanken Sør achieved very good results in the largest and most respected annual customer satisfaction survey in Scandinavia. The survey was carried out by EPSI. The Bank is among the best Norwegian and Scandinavian banks in the retail market, and came out on top in the corporate market. The Bank achieves very good results in important areas such as quality of service, value for money, product quality and reputation.

SATISFACTORY FINANCIAL RESULTS

Profit from Sparebanken Sør's ordinary operations is satisfactory, and in line with the good results achieved in the previous year. The profit of NOK 1 224 million (before tax) has come as a result of good lending growth and positive developments in net interest income, an increase in commission income and profit contributions from associated companies, as well as entries in losses on loans.

HISTORICALLY GOOD DEVELOPMENT IN LOSSES ON LOANS

Net losses on loans totalled NOK 50 million in 2016, and NOK 20 million in 2017. The equivalent figure in 2018 was an entry

of NOK 36 million. Along with a sharp decline in losses on loans in recent years, the quality of the loan portfolio has improved steadily, clearly visualised by a strong reduction in non-performing commitments.

SOLID CAPITAL ADEQUACY

Sparebanken Sør has substantially strengthened its equity through several years of solid profits. The Bank's unweighted leverage ratio of 9.1 percent places the Bank among the most solid of the major banks in Norway, and therefore among the best in Europe. The Bank's common equity tier 1 capital ratio (including partly-owned companies) at the end of the year amounted to 14.8 percent, exactly in line with the Bank's target and well within authorities' requirements and market expectations. Based on the Bank's high unweighted leverage ratio and the reduction in income from financial instruments, a return on equity of 8.5 percent in 2018 is considered satisfactory.

SATISFACTORY LENDING GROWTH

The Bank upheld its strong position in its main market through the year. The lending growth over the year was satisfactory, and in line with the national credit growth. Net loans to customers totalled NOK 103 billion, while deposits totalled NOK 56.5 billion. The deposit-to-loan ratio is therefore in line with the Bank's target of 55 percent. The Bank has good capacity for growth, and a long-term ambition for growth just above the rate of credit growth in our market area.

DIVERSIFIED FINANCING ENSURES STABLE FUNDING

The financial markets experienced a negative trend in 2018, with increased credit spreads in wholesale funding. At the same time, the NIBOR rate increased by a relatively large amount, resulting in higher funding costs. Over the course of the year, the Bank's funding structure was strengthened through issuances of subordinated bonds, and further diversified funding in EUR through issuances of new senior bonds and covered bonds.

AMONG THE MOST COST-EFFECTIVE BANKS

The Bank is upholding its position as one of the most cost-effective banks in the country. The cost-to-income ratio at year-end was 42.7 percent, compared with 38.7 percent at the end of the previous year. The increase was partly due to one-time expenses, and partly due to an investment in competence building and new digitalisation and analysis systems. Measured as a percentage of total assets, the cost ratio is 0.75 percent, which is in line with the previous year. The good cost position has been developed through continuous adaptation of the business and operational efficiency improvements, and the Bank is firmly resolved to continue this work in the future.

STRATEGIC MOVES WILL GIVE POSITIVE EFFECTS

The Bank implemented a strategic shift in competence through 2018. A number of new employees with top-level competence in digitalisation and analysis have been recruited, while the Bank's planned reduction in full-time equivalents has continued. The number of employees in the Bank is thus at the same level as in the previous year, while an extensive raising of skill levels in new focus areas has been implemented. Combined with investments in new technology, these strategic moves will safeguard our position with respect to the digitalised bank customers of the future, provide a better customer experience in all channels and strengthen the Bank's future profitability and ability to grow.

Sparebanken Sør has increased its ownership interest to 20 percent in the insurance company Frende in the second half of 2018, and after the turn of the year increased its shareholding to 20 percent of the leasing and financing company Brage. The Bank will in the future be able to consolidate its share of profits from both these companies. This will have a noticeably positive impact on the Bank's profit, underline the value creation deriving from these investments and result in a more diversified and robust earnings model.

In June 2018, we became the first Norwegian bank to be certified in the area of equality and diversity. The project measured the Bank's efforts in the area of equality, recruitment, equal pay, inclusive working environment, workplace adaptation, the number of full-time jobs offered and life-phase flexibility. There is still some work to be done before we reach our goals in equality and diversity, and new and better tools and instruments have been established through the certification process that makes it possible to achieve the goals more quickly.

We made significant advances in corporate social responsibility in 2018. Among other things, we have committed ourselves to supporting the UN's sustainability goals by signing the UN Global Compact, and have tightened our requirements with respect to ethics, anti-corruption and sustainability. A substantial element of the Bank's work in the area of corporate social responsibility is transparency and openness. The Bank's corporate social responsibility report, corporate social responsibility and equality balance sheets are attached to this annual report, and our climate balance sheet and key governing documents in the area of sustainability are published on the Bank's website.

The Bank aspires to be the relationship oriented bank of the region, with one of the best customer satisfaction ratings. A long-term approach, close proximity and local decision-making are characteristic features of our operation. At the same time, we will adapt to alterations in customer behaviour through continuous change and improvement, and exploit the opportunities presented by digitalisation and new technology for better customer experiences and a strengthened cost position.

With strong customer relations, cost-effectiveness, good credit quality, future-oriented digital solutions and a strong market position, Sparebanken Sør is well positioned to realise the Bank's vision of generating growth and development in the region.

Geir Bergskaug

Geir Bergskaug
CEO

Key figures group

NOK MILLION	31.12.2018	31.12.2017	31.12.2016	31.12.2015	31.12.2014*	31.12.2013*
Profit						**Proforma**
Net interest income	1 729	1 679	1 565	1 544	1 511	1 443
Net commission income	318	312	293	300	284	252
Net income from financial instruments	2	88	224	-66	184	201
Other operating income	23	18	28	14	23	22
Total net income	**2 072**	**2 097**	**2 110**	**1 792**	**2 002**	**1 918**
Total operating expenses before losses	884	811	787	817	834	800
Operating profit before losses	**1 188**	**1 286**	**1 323**	**975**	**1 168**	**1 118**
Losses on loans, guarantees and unused credit	-36	20	50	97	268	126
Profit before taxes	**1 224**	**1 266**	**1 273**	**878**	**900**	**992**
Tax expenses	285	282	284	231	215	219
Profit for the period	**939**	**984**	**989**	**647**	**685**	**773**
Profit as a percentage of average assets						
Net interest income	1.46 %	1.53 %	1.49 %	1.58 %	1.60 %	1.60 %
Net commission income	0.27 %	0.28 %	0.28 %	0.31 %	0.30 %	0.28 %
Net income from financial instruments	0.00 %	0.08 %	0.21 %	-0.07 %	0.20 %	0.22 %
Other operating income	0.02 %	0.02 %	0.03 %	0.01 %	0.02 %	0.03 %
Total net income	**1.75 %**	**1.92 %**	**2.01 %**	**1.83 %**	**2.12 %**	**2.13 %**
Total operating expenses before losses	0.75 %	0.74 %	0.75 %	0.83 %	0.88 %	0.89 %
Operating profit before losses	**1.00 %**	**1.17 %**	**1.26 %**	**0.99 %**	**1.24 %**	**1.24 %**
Losses on loans, guarantees and unused credit	-0.03 %	0.02 %	0.05 %	0.10 %	0.28 %	0.14 %
Profit before taxes	**1.03 %**	**1.16 %**	**1.21 %**	**0.90 %**	**0.96 %**	**1.10 %**
Tax expenses	0.24 %	0.26 %	0.27 %	0.24 %	0.23 %	0.24 %
Profit for the period	**0.79 %**	**0.90 %**	**0.94 %**	**0.66 %**	**0.73 %**	**0.86 %**
Key figures, income statement						
Return on equity after tax (adjusted for hybrid capital)	8.5 %	9.7 %	11.6 %	8.4 %	10.1 %	12.3 %
Costs as % of income	42.7 %	38.7 %	37.3 %	45.6 %	41.7 %	41.7 %
Costs as % of income, excl. Net income from financial instruments	42.7 %	40.4 %	41.7 %	44.0 %	45.9 %	46.6 %
Key figues, balance sheet						
Total assets	121 125	114 310	105 455	101 334	94 062	93 758
Average total assets	118 600	109 500	104 950	98 000	94 300	90 200
Net loans to customers	102 942	97 518	90 928	88 387	80 913	77 450
Growth in loans as % last 12 mths.	5.6 %	7.2 %	2.9 %	9.2 %	4.5 %	6.8 %
Customer deposits	56 537	55 580	51 562	48 349	48 250	43 740
Growth in deposits as % last 12 mths.	1.7 %	7.8 %	6.6 %	0.2 %	10.3 %	8.3 %
Deposits as % of net loans	54.9 %	57.0 %	56.7 %	54.7 %	59.6 %	56.5 %
Equity (incl. hybrid capital)	11 845	11 108	10 051	8 263	7 157	6 658
Losses on loans as % of net loans, annualised	-0.17 %	0.02 %	0.05 %	0.11 %	0.33 %	0.16 %
Gross non-performing loans > 90 days as % of gross loans	0.21 %	0.28 %	0.30 %	0.47 %	0.71 %	0.60 %
Other key figures						
Liquidity reserve (LCR) Group	159 %	139 %	128 %	108 %		
Liquidity reserve (LCR) Group - Euro	4727 %	3105 %				
Liquidity reserve (LCR) Parent Bank	180 %	134 %	119 %	71 %		
Common equity tier 1 capital ratio, including share of partly owned companies	14.8 %	14.9 %	14.7 %			
Tier 1 capital ratio	16.6 %	16.7 %	16.0 %	13.5 %	14.4 %	14.2 %
Total capital ratio	18.7 %	18.9 %	17.9 %	15.5 %	15.1 %	15.1 %
Core equity tier 1 capital ratio	10 517	9 890	9 114	7 700	7 092	6 376
Tier 1 capital ratio	11 591	10 965	9 939	8 210	7 792	7 076
Net total subordinated capital	13 096	12 347	11 121	9 388	8 170	7 522
Leverage ratio	9.1 %	9.2 %	8.6 %	7.0 %	7.0 %	
Number of branches	34	34	34	40	40	44
Number of FTEs in banking operations	434	432	439	449	454	489
Key figures, equity certificates						
Equity certificate ratio, (Weighted average over the period)	17.9 %	18.7 %	17.5 %	13.5 %	14.1 %	7.1 %
Number of equity certificates issued	15 663 944	15 663 944	15 663 944	4 768 674	4 768 674	1 250 000
Profit/diluted earnings per equity certificate (Parent bank)	7.7	8.9	8.5	10.6	12.2	10.3
Profit/diluted earnings per equity certificate (Group)	10.1	11.2	10.7	17.6	20.3	18.1
Dividend last year per equity certificate (Parent bank- propsed dividend 2018)	6.0	6.0	6.0	9.0	10.0	10.0
Book equity per equity certificate	123.2	120.0	115.2	219.0	212.0	187.0
Price/book value per equity certificate	0.8	0.9	0.8	0.6	0.9	0.8
Listed price on Oslo Stock Exchange at end of period	96.9	104.0	91.3	139.0	196.0	150.0

* Excl. negative goodwill

Board of Director's report 2018

Board of Director's report 2018

NATURE OF THE BUSINESS

Sparebanken Sør is an independent financial institution that engages in banking, securities and real estate brokerage activities in Vest-Agder, Aust-Agder, Telemark and Rogaland. The Group additionally engages in the sale of insurance, leasing, car loans, consumer credit and securities through partly owned product companies. The Bank also engages in mortgaging through the wholly owned subsidiary Sparebanken Sør Boligkreditt AS. The Bank has 34 branches, and the head office is located in Kristiansand.

HIGHLIGHTS

The Sparebanken Sør Group delivered a solid profit in 2018, and the Board would like to highlight the following:

- Positive development in net interest income
- Increased commission income
- Efficient operations and low expenses
- Net entry on losses
- Growth in lending of 5.6 percent
- Acquisition of shares in Frende Holding AS
- Growth in deposits of 1.7 percent
- Return on equity after tax of 8.5 percent
- Common equity tier 1 capital ratio of 14.8 percent and leverage ratio of 9.1 percent at the end of the year
- The Board will propose to distribute dividend for 2018 of NOK 6.00 per equity certificate.

FRAMEWORK 2018

Higher growth in the Norwegian economy

The Norwegian mainland economy experienced a further upturn in 2018. Growth in GDP for mainland Norway is, according to Norges Bank, estimated at 2.4 percent by the end the year, a rise of 0.4 percentage points from 2017. The year started somewhat better than it ended, the second half of the year are notable for lower oil prices and somewhat weaker growth prospects. The labour market situation improved over the course of the past year. The employment rate increased and there was a further reduction in unemployment. House prices in the Bank's main market have shown a moderate trend over several years.

Credit growth (C2) decreased over the course of 2018 to 5.4 percent at the end of the year. Growth in household and business loans was 5.5 and 5.1 percent respectively.

Key interest rate

The key interest rate was increased from 0.50 to 0.75 percent on 20 September 2018. The reason for the increase was the continued upturn in the Norwegian economy and underlying price growth, which was close to the inflation target of 2 percent. Norges Bank left the key interest rate unchanged at its interest rate meeting on 24 January 2019. Norges Bank's analyses suggest a gradual rise in interest rates over the next few years.

Developments in the financial markets

The Group has had good access to funding, in terms of both deposits and lending, throughissuance of senior and covered bonds. The capital markets have been well functioning in 2018, and credit spreads have been relatively stable.

BUSINESS SEGMENTS

Retail market

The Bank bolstered its position as the leading bank for retail customers, clubs and associations in the region in 2018. Gross loans to retail customers totalled NOK 67.3 billion at the end of year, equivalent to 65 percent of the Bank's total lending. The rate of growth was 5.3 percent. Deposits from retail customers rose by 3.3 percent to NOK 26.8 billion, and at year-end accounted for 47 percent of the Bank's total deposits.

The Retail Market Division made further adjustments to its organisation in 2018, with a simplified structure, smarter work processes and the use of new technology. This process is continuing unabated in 2019.

Employee skills have been enhanced through new certification schemes and the use of more targeted working methods and analytical tools. The implementation of CRM is expected to provide added value for both customers and staff.

Several branches have been closed since the merger in 2014, while others have been converted to advisory offices open to customers by appointment. The Division's workforce has been reduced by around 100 FTEs since the merger.

The Bank offers both life and general insurance to the retail market through Frende Forsikring and car financing through Brage Finans.

Corporate market

Over the course of 2018, the Bank upheld its position as the business bank of Southern Norway, and strengthened its position in Telemark. The Bank is now a natural first choice for businesses in large parts of the area where it operates.

Loans to corporate customers increased by NOK 1.9 billion to NOK 35.9 billion in 2018, equivalent to a growth of 5.5 percent.

Deposits from corporate customers increased by NOK 0.1 billion to NOK 29.7 billion. This is equivalent to a growth of 0.4 percent.

The Bank's corporate customers represent a balanced and solid portfolio that is a good reflection of the business community in the region.

In addition to fulfilling the role of bank for large parts of the region's trade and industry, as well as the public sector, the Bank also serves a national customer segment through its agreement with the Norwegian Christian organisation KNIF. This is a low-risk segment that includes private hospitals and other enterprises in the health sector, schools, nurseries, ecclesiastical enterprises, missionary organisations and organisations for children and youth.

The Bank offers general insurance, occupational pensions and group life insurance to the corporate market through Frende Forsikring and leasing through Brage Finans. Cooperation with Brage has been strengthened through an increased commitment to leasing, and this has yielded markable results.

EPSI has conducted customer satisfaction surveys for Norwegian banks for more than 15 years. These surveys have shown consistently satisfied customers inSparebanken Sør.. It was particularly pleasing that the 2018 survey showed the Bank to have the most satisfied corporate customers in Norway.

At year-end, the Bank established a separate customer service department for its corporate customers. The purpose of this was to bring together and enhance its skills in the area of payment services, as well as improving the overall service provided to corporate customers.

PROFIT FOR THE YEAR

Accounting policies

Sparebanken Sør's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The accounting policies are explained in more detail in the notes to the financial statements.

The annual financial statements are prepared under the assumption of a going concern. The Group has adequate earnings and equity, and in the Board of Directors view, there are no indications to anything other than a going concern.

The figures referred to in the Board of Directors report are consolidated figures unless it is specified that they concern the Parent Bank.

Profit for the year

Sparebanken Sør achieved a profit before tax of NOK 1 224 million in 2018, compared with NOK 1 266 million in 2017. This is equivalent to 1.03 percent of average total assets, compared with 1.16 percent in 2017.

The Group achieved a solid profit before tax in 2018 as a result of a positive development in net interest income, net commission income, low costs and net entry on losses on loans,

Profit after tax in 2018 totalled NOK 939 million, compared with NOK 984 million in 2017. This was equivalent to a return on equity, adjusted for interest on hybrid capital, of 8.5 percent in 2018, compared with 9.7 percent in 2017.

Other comprehensive income, which includes changes recognised directly through equity in the financial year, was NOK 924 million in 2018, compared with NOK 974 million in 2017.

Net interest income

Net interest income totalled NOK 1 729 million in 2018, compared with NOK 1 679 million in 2017, an increase of NOK 50 million. Net interest income in 2018 was equivalent to 1.46 percent of average total assets, compared with 1.53 percent of average total assets in 2017.

Interest on hybrid capital amounted to NOK 55.9 million in 2018, compared with NOK 46.6 million in 2017. Interest on hybrid capital has been accounted for through equity as surplus disposal.

Loan rates have been under pressure in the retail and corporate market in 2018. Market rates increased over the period, resulting in increased costs for the Bank's funding through bonds , where loan terms are tied to 3-month NIBOR. Growth in volume has contributed to an increase in net interest income.

In the third quarter of 2018, the Group increased the interest rate on loans and individual deposits. This was done following Norges Bank's interest rate meeting on 20 September 2018. The change in interest rate became fully effective from 5 November.

Commission income

Net commission income totalled NOK 318 million, compared with NOK 312 million in 2017. This was equivalent to 0.27 percent of average total assets, compared with 0.28 percent in 2017. The increase in NOK was due to increased income from payment services, increased income from insurance, increased commission income from Brage Finans AS and a non-recurring payment of NOK 5 million related to commission from sales of life insurance in 2018.

Financial instruments

Net income from financial instruments totalled NOK 2 million in 2018, compared with NOK 88 million in 2017.

The value of shares increased by NOK 45 million in 2018. In this respect, the merger between Vipps AS, BankAxept AS and BankID Norge AS represented a gain of NOK 37.0 million. The value of the Group's liquidity and share portfolios decreased in 2018, compared with an increase in the previous year. A loss associated with the buyback of own debt was also recognised in 2018. Basis swaps, which the Bank uses to hedge fixed-interest debt in EUR, showed a negative trend in 2018.

Associated companies

Income from associated companies totalled NOK 13 million in 2018. This income relates mainly to Balder Betaling AS, in which Sparebanken Sør has a shareholding of 22 percent. Balder Betaling AS owns 10.5 percent of the shares in Vipps. The Group did not have any income from associates in 2017.

In the second half of 2018, Sparebanken Sør entered into an agreement with Fana Sparebank for the purchase of 10.2 percent of the shares in Frende Holding AS. Following the acquisition, Sparebanken Sør owns 20.2 percent of the shares in Frende, and has classified Frende as an associated company. The shareholding was recognised according to the equity method from the fourth quarter.

In January 2019, Sparebanken Sør entered into an agreement to purchase 4.34 percent of the shares in Brage Finans AS. After the acquisition, Sparebanken Sør owns 19.87 percent of the company's shares. With effect from January 2019, this shareholding will be recognised as an investment in an associate according to the equity method.

Expenses

Group expenses totalled NOK 884 million in 2018, compared with NOK 811 million in 2017. As a percentage of average total assets, this was equivalent to 0.75 percent, compared with 0.74 percent in 2017. The cost-to-income ratio, excluding income from financial instruments, was 42.7 percent, compared with 40.4 percent in 2017.

Personnel expenses increased in comparison with 2017. The increase is mainly due to expenses being exceptionally low in 2017, as a result of the reorganisation of the defined-benefit pension scheme. Pension expenses in 2018 were at a normalised level. The increase in ordinary payroll expenses was due to salary growth, an increase in the number of full-time equivalent employees in the banking operation and a shift in expertise.

Depreciation and write-downs on fixed assets were on a par with the previous year, while other operating expenses increased by NOK 27 million in comparison with 2017. The increase was mainly due to non-recurring expenses related to renovation of the head office. Significantly more resources were used in 2018 than in 2017 in connection with the introduction of new digital solutions. This is expected to lead to increased income and reduced expenses over time.

Losses and non-performing loans

Net entry on losses on loans totalled of NOK 36 million. In 2017, net losses on loans totalled NOK 20 million.

As of 1 January 2018, the Group implemented the standard IFRS 9, which has been significant in calculating the Group's loss expense. IAS 39, which was applied in the financial statements for 2017, was based on loan impairment 'only taking place when there is objective evidence that a loss event has occurred'. With IFRS 9, a loan impairment must be based on losses expected to occur in the future.

A consequence of the implementation of the new standard is that the Bank has used a new model to calculate losses on loans. The impairment model is described in Note 7. For transitional effects, see the equity statement and Note 21.

The Bank's loan impairments totalled NOK 473 million at year-end, equivalent to 0.46 percent of gross lending. Impairments for 2017 totalled NOK 568 million, equivalent to 0.58 percent of gross lending.

Gross non-performing loans over 90 days totalled NOK 213 million, equivalent to 0.21 percent of gross lending. The equivalent figure in 2017 was NOK 273 million, representing 0.28 percent of gross lending.

BALANCE SHEET

Total assets

Total assets amounted to NOK 121.1 billion at the end of 2018, compared with NOK 114.3 billion in the previous year. This was equivalent to a growth of NOK 6.8 billion, or 6.0 percent.

Loans

Net loans to customers totalled NOK 102.9 billion, compared with NOK 97.5 billion in 2017. This represented a growth of NOK 5.4 billion, or 5.6 percent.

Gross loans to retail customers totalled NOK 67.3 billion, compared with NOK 63.9 billion in 2017. This represented a growth of NOK 3.4 billion, equivalent to 5.3 percent. On a national basis, household lending growth (C2) came to 5.5 percent. At the end of 2018, loans totalling NOK 38.7 billion were transferred to Sparebanken Sør Boligkreditt AS, which is an important instrument for the bank in achieving competitive terms in the retail banking market. Loans to private customers accounted for 65 percent of total lending, compared with 66 percent in 2017.

Gross loans to corporate customers totalled NOK 35.9 billion in 2018, compared with NOK 34.1 billion in the previous year. This represented a growth of NOK 1.9 billion, or 5.5 percent. On a national basis, lending (C2) to corporate customers increased by 5.6 percent.

Deposits

Deposits at the end of the year totalled NOK 56.5 billion, compared with NOK 55.6 billion in 2017. This represented a growth of NOK 1 billion, or 1.7 percent.

Deposits in the retail market totalled NOK 26.8 billion, compared with NOK 25.9 billion in 2017. This represented a growth of NOK 0.9 billion, or 3.3 percent. Deposits in the corporate market totalled NOK 29.7 billion, compared with NOK 29.6 billion in 2017. This represented a growth of NOK 0.1 billion, or 0.4 percent.

As at 31 December 2018, the deposit-to-loan ratio was 55.0 percent, compared with 57.0 percent in 2017.

Debt established through issuance of securities and debt to financial institutions

The Bank obtains funding in the capital market by issuing interest-bearing securities. The Group's debt from securities totalled NOK 48.3 billion at the end of 2018, compared with NOK 44.3 billion at the end of 2017. Long-term funding is established through covered and senior bonds. Covered bonds accounted for 63 percent of this funding at the end of 2018.

The Group has arranged for long-term funding from the international market by establishing EMTN (European Medium Term Bond Note) programmes for the Bank and Sparebanken Sør Boligkreditt AS. During the first half of 2018, Sparebanken Sør issued EUR 300 million to international investors. Sparebanken Sør Boligkreditt correspondingly issued EUR 500 million as covered bonds during the year. At the end of 2018, the Group had diversified funding from international investors of EUR 1.8 billion. Funding in foreign currency is hedged for interest rate and currency risk against floating Norwegian kroner (NOK).

The maturity structure of external funding has been well adapted to the Bank's operations, and is in accordance with regulatory guidelines and requirements adopted by the Board of Directors.

Securities

At year-end, the portfolio of certificates and bonds totalled NOK 14.6 billion.

The portfolio is part of the Bank's liquidity reserve, which has been established to safeguard the Bank's liquidity situation in turbulent market conditions. The securities portfolio can be used as collateral for any loans from Norges Bank, and is included in the Bank's high grade liquid securities portfolio held to fulfil its Liquidity Coverage Ratio (LCR) requirements.

The Group's indicator for long-term funding was 110.0 percent at the end of 2018.

The Group's liquidity reserve (LCR) was 159 percent at 31 December 2018 (180 percent in the Parent Bank).

Investments in shares and equity certificates totalled NOK 370 million.

Subordinated capital

The Bank strengthened its subordinated capital in 2018 through solid profit, adjusted growth in risk-weighted assets and issuance of subordinated loans totalling NOK 600 million.

Net subordinated capital totalled NOK 13.1 billion at year-end. Hybrid capital totalled NOK 1.1 billion and subordinated loans NOK 1.6 billion. The common equity tier 1 capital ratio at the end of 2018 was 15.0 percent. The tier 1 capital ratio was 16.6 percent and the total capital ratio was 18.7 percent, based on the standard method in the Basel II regulations.

Sparebanken Sør owns 15.5 percent of Brage Finans AS, and must consolidate its ownership interest proportionately when reporting capital adequacy for cooperating groups. The Group's common equity tier 1 capital ratio, including proportionate consolidation of cooperating groups, was 14.8 percent, the tier 1 capital ratio was 16.4 percent and total capital was 18.5 percent.

The figures for the Parent Bank were 15.2 percent common equity tier 1 capital ratio, 17.0 percent tier 1 capital ratio and 19.5 percent total capital ratio at the end of 2018.

The Group has fulfilled the capital requirements for financial institutions with effect as at 31 December 2018, with 14.0 percent for common equity tier 1 capital ratio, 15.0 percent for tier 1 capital ratio and 17.0 percent for total capital ratio.

The Group's leverage ratio was 9.1 percent at the end of 2018, compared with 9.2 percent at the end of 2017. The Bank's capital is considered as highly satisfactory with respect to applicable regulatory requirements.

ALLOCATION OF PROFIT

In the view of the Board, the presented financial statements give a fair view of the financial position and results of the Group and the Parent Bank. The Board of Directors is not aware of any circumstances that have arisen after the turn of the year which would alter this view.

The Parent Bank's profit totalling NOK 731 million is proposed allocated as follows:

Dividend:	NOK 94 million
Interest on hybrid capital:	NOK 56 million
Transfer to donation fund:	NOK 40 million
Transfer to equalisation fund:	NOK 27 million
Transfer to primary capital:	NOK 514 million
Total allocated:	**NOK 731 million**

EQUITY CERTIFICATES AND DIVIDEND

At 31 December 2018, the Bank had issued 15 633 944 equity certificates, each with a nominal value of NOK 50.

A summary of the 20 largest equity certificate owners at 31 December 2018 is presented in Note 36. Profit per equity certificate closed on NOK 7.7 for the Parent Bank and NOK 10.1 for the Group.

The ownership ratio was 17.9 percent in 2018. Hybrid capital classified as equity has been excluded when calculating the ownership ratio.

Through sound, stable and profitable operations, Sparebanken Sør will ensure that its equity certificate holders achieve a competitive return in terms of dividend and increase in value of their equity certificates.

The profit will be distributed between the equity certificate capital (equity certificate owners) and the subordinated capital in accordance with their share of the equity.

Sparebanken Sør's capital needs, including regulatory requirements, investors' expectations and the bank's strategic targets, will be considered when determining the annual dividend.

An ambition is that approximately half of the equity certificate capital share of annual profits after tax shall be awarded as dividend.

The Board of Directors will propose a dividend for 2018 of NOK 6 per equity certificate, equivalent to a payout ratio of approximately 59 percent of the Group's profit per equity certificate. In addition, the Board of Directors will propose an allocation of NOK 40 million to the donation fund.

The Bank's equity certificate ratio was 17.9 percent before allocation of profit. With the proposed dividend and allocation to the donation fund, the equity certificate ratio is reduced to 17.2 percent.

SUBSIDIARIES AND ASSOCIATED COMPANIES

Sparebanken Sør Boligkreditt AS

Sparebanken Sør Boligkreditt AS is a wholly-owned subsidiary of Sparebanken Sør, and the company is licensed to operate as a Sparbanken Sør Boligkreditt AS with the right to issue covered bonds. The main object of the company is to ensure stable and long-term funding on competitive terms.

At year-end, NOK 39 billion in loans had been transferred to the company. The average loan-to-value ratio was 57.0 percent. At year-end, NOK 36 billion in covered bonds had been issued. The volume of collateral, including interest-bearing securities and derivatives, was NOK 41 billion. The over-collateralisation ratio was 14.5 percent.

The company had a profit before tax of NOK 282 million. At year-end, the capital adequacy ratio was 19.5 percent. The company has entered into agreements with the Parent Bank, which include financing commitments and support services to the company, such as loan administration, as well as shared services and treasury functions.

In the first half of 2018 the company issued EUR 500 million in covered bonds under the company's EMTCN programme. At the end of 2018, the company had three outstanding benchmark loans in euros, totalling EUR 1.5 billion. The loans are swapped to floating-interest funding in Norwegian kroner. The derivatives contracts are entered into with reputable financial counterparties under ISDA/CSA agreements.

Sørmegleren

Sørmegleren is the Bank's real estate agency. During the five years the company has been in the market, it has become the leading real estate agency in Southern Norway, with a market share close to 30 percent. In the Grenland district, its cooperation with Porsgrunn Boligbyggelag (PBBL) has proved very successful, with a market share now approaching 15 percent. Sørmegleren holds a dominant position in the new-build market in Agder, and particularly in Kristiansand.

Sørmegleren has a total of 16 branches, of which the offices in Søgne and Evje opened in 2018. The company has 78 employees.

Other subsidiaries

The Bank's other subsidiaries mainly manage commercial properties where the Bank operates.

Frende Holding AS

Frende Holding AS is the parent company of Frende Skadeforsikring AS and Frende Livsforsikring AS, which offer general and life insurance to retail and corporate customers.

Sparebanken Sør entered into an agreement with Fana Sparebank in 2018 for the purchase of 10.2 percent of the shares in Frende Holding AS. The purchase price was NOK 246.2 million. The transaction price was somewhat lower than Sparebanken Sør's book value of the shares in Frende Holding AS, resulting in a NOK 18.9 million write-down of the shareholding. The agreement was approved by The Financial Supervisory Authority of Norway in the fourth quarter of 2018. After the acquisition of shares in Frende Holding AS, Sparebanken Sør owns 20.2 percent of the company, and from this time on has applied the equity method and recognised the Bank's share of profit in Frende Holding AS in the income statement. A dividend of NOK 6.5 million from Frende Holding AS was recognised in 2018.

Frende Holding AS achieved a profit before tax of NOK 84.7 million in 2018, compared with NOK 301 million in 2017, and a return on equity of 4.0 percent, compared with 19.9 percent in 2017. The first three quarters of the year were notable for a challenging claims situation at Frende Skade. This reversed in the latter part of the year, and the fourth quarter was the best quarter in the company's history in terms of insurance claims. The combined ratio for the quarter was 85.5 percent. Frende Livsforsikring AS had a year of good risk results, though developments in the fourth quarter were somewhat weaker.

Frende Skade achieved a profit before tax of NOK 10.9 million in 2018 after a year with many major fires and a high rate of claims, particularly in motor insurance, in the first three quarters, but with a positive trend in the fourth quarter. Profit before tax in 2017 totalled NOK 177.4 million. The company has a total of NOK 1 994 million in earned premiums, up NOK 205 million over the course of the year. The earned premiums are split between 164,000 customers. Return on equity for Frende Skade was 0 percent in 2018, compared with 15.7 percent in 2017.

The loss ratio for the year was 81.5 percent in 2018, compared with 76.9 percent in 2017, and the company's combined ratio was 100.4 percent. In 2017, the combined ratio closed on 96.2 percent. Return on financial assets totalled NOK 16.6 million in 2018, equivalent to 0.7 percent, compared with NOK 114.3 million in 2017.

The market share in general insurance increased by 0.2 percentage points to around 3.5 percent.

Frende Livsforsikring AS achieved a profit before tax of NOK 78.7 million in 2018, compared with NOK 127.2 million in 2017. The company achieved good risk results and a good development in decrease of costs. Earned premiums at the end of the year totalled NOK 895 million. Return on equity totalled 16.9 percent, compared with 34.2 percent in 2017.

Frende expects continued good growth in 2019. After a relatively weak year in 2018, both for the industry as a whole and for Frende, results in terms of claims and financial performance are expected to return to a normal level in 2019, which will in turn lead to a significant improvement in the Group's results.

PARTLY OWNED PRODUCT COMPANIES

Brage Finans AS

Brage Finans AS is a financing company which offers leasing, car financing and consumer credit. The company's headquarter are in Bergen, and it has offices in Ålesund, Stavanger and Kristiansand. The company's products are distributed mainly through owner banks, its own sales apparatus and dealers. Brage Finans is owned by 12 independent savings banks. Sparebanken Sør has a 15.5 percent ownership interest.

Brage Finans AS achieved a profit before tax of NOK 93.9 million in 2018, an improvement in earnings of NOK 35.7 million compared with 2017. Robust growth in loans in both the commercial and retail markets is one of the main reasons for the company's increase in profit, which produced a return on equity of 7.6 percent in 2018, compared with 6.5 percent for 2017.

Norne Securities AS

Norne Eierselskap AS is the parent company of Norne Securities AS. Norne Securities provide online trading, traditional brokerage and corporate finance services. The company is owned by 14 independent Norwegian savings banks, and Sparebanken Sør has an ownership interest of 17.6 percent.

In the fourth quarter 2018, stock markets experienced a sharp decline, which had a negative impact on Norne Securities AS's turnover from both online trading and ordinary stockbroking. It also contributed to the postponement of corporate finance projects. In 2018, Norne enhanced its role as the leading Norwegian adviser and facilitator for equity certificates in Norwegian savings banks with more than ten implemented issuances.

Balder Betaling AS

Balder Betaling AS was established in 2017 and has an ownership interest of 10.5 percent in Vipps AS. The company's objective is to further develop Vipps together with its other owners. Sparebanken Sør's ownership interest is22.0 percent, and the remaining shares are held by the banks in the Frende collaboration.

RISK MANAGEMENT

Risk is a fundamental feature of banking, and risk management is crucial to the Bank's day-to-day operations and follow-up by the Board of Directors.

The Bank's risk management and internal control activities must help ensure that risk is managed in a way that supports the Bank's strategic objectives and safeguards the Bank's long-term value creation. The overall framework for the Bank's risk management and exposure are assessed and determined annually by the Board of Directors in conjunction with maintenance of the Bank's internal strategy and policy documents. The Board of Directors establishes frameworks for risk appetite, including specified management objectives and limits on risk tolerance for the various categories of risk such as credit risk, market risk, liquidity risk and operational risk. Systems and structures are established for measurement, management, follow-up and control of risk, as well as authorisations involving systems used for reporting to management and the Board of Directors for the various categories of risk. The Bank's objective is to have a low level of risk exposure, and there is a continuous process aimed at enhancing and improving the Bank's management of risk.

The most significant risk factors can be classified as financial risk, operational risk (including risk of money laundering), compliance risk and strategic and business risk.

Financial risk covers credit risk, market risk (related to the Bank's exposure to the interest rate, foreign exchange and stock markets) and liquidity risk. Operational risk is the risk of losses due to inadequate or flawed internal processes or systems, human error or external events. Strategic risk relates to the strategies, plans and changes the Bank makes or intends to make, while business risk is the risk of unexpected income or expense fluctuations due to changes in external factors such as economic cycles, competition, customer behaviour, lack of business development and regulation by public authorities.

The Bank has an ongoing process relating to the monitoring and assessment of the different risk factors. Internal control processes are performed with respect to all main areas in accordance with the relevant regulations. The bank's group management processes cases related to risk management on an ongoing basis and submits periodic reports to the Board of Directors' risk management committee. In view of the Board of Directors, the bank's risk management is well functioning.

Credit risk

Credit risk is the most significant category of risk for the Bank. It is defined as the risk of losses due to customers or counterparties being unable to meet their obligations to the bank. Work on credit risk is therefore given high priority in the daily operations, and in the Board's follow-up activities. The Board of Directors approves the Bank's credit strategy and policy. Credit risk is also managed through credit management routines, credit assessment processes and credit allocation authorisations. The Board has established objectives and guidelines, as well as quantitative limits that specify constraints and limits for risk tolerance. Compliance with the Bank's credit policy is monitored by the Risk Management Division, which is an independent unit.

The Bank's risk classification system is used both in the credit rating process and in the ongoing follow-up of risk at portfolio level. Classification of customers is based on the probability of default over a 12-month period, where probability of default is calculated using various internal and external financial data. Score cards are used to divide the customers into 10 different risk classes, plus a risk class for non-performing commitments and commitments with impairment losses. Developments in the portfolio's level of risk and the need for migration are analysed and followed up.

The Bank's management and control of credit risk must be good, and on a par with comparable banks. The Bank's total credit risk must also be on a par with comparable banks.

Market risk

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

Sparebanken Sør shall have a low market risk. Activity with respect to financial instruments is intended primarily to cover the Bank's exposures relating to the Bank's ordinary customer activity and the funding of its operations.

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

The interest rate risk limit is determined as an upper limit on how large the loss on unhedged interest rate positions may be in case of shifts or twist in the yield curve. Interest rate risk limit is determined as an upper limit on losses on unsecured interest rate positions in case of a shift or twist in in the yield curve. Interest rate risk which arises in the group's ordinary operations in the form of fixed rate customer loans, fixed rate investments and funding, are identified on an ongoing basis. At year-end, the Group's net interest rate risk was measured at NOK 31.0 million. If the date on which the rate of interest for the Bank's market funding at floating 3-month NIBOR is set differs from the date on which the rate of interest for the Bank's lending volume is set, the Bank is exposed to a fixing risk.

Beyond the interest rate risk limit, an upper risk tolerance level has been set for credit spread risk, stated as the effect on profit or loss of an assumed change in the credit spread, which will lead to changes in the value of the Group's interest-bearing securities portfolio. The Financial Supervisory Authority of Norway's stress test model for credit spread risk is used to calculate risk exposure. The Bank's credit spread exposure is related to the liquidity portfolio. At year-end 2018, 86.0 percent of the limit adopted by the Board had been used.

The Group is subject to fluctuations in the foreign exchange market through its customer-related currency activities. Derivatives (currency futures, swaps and options) are used to hedge open currency exposures. Currency exposure is measured as a 10 percent change in the exchange rate on the currency position. Individual exposure limits have been set for foreign exchange.

For funding in foreign currencies, interest rate and foreign exchange risk arises as a result of the funding being undertaken on fixed-interest terms and in a currency other than NOK. The same applies to the purchase of debt securities in a foreign currency. The Bank hedges interest rate and currency exposure by entering into derivative contracts with reputable financial counterparties. The contracts are entered into under ISDA (International Swaps and Derivatives Association) with CSA (Credit Support Annex) agreements. For financing in foreign currencies and the hedging of currency risk, hedge accounting is applied in reporting changes in value.

At year-end, the Group's investments in shares totalled NOK 370.0 million. Apart from its ownership interest in Balder Betaling, the Bank's commercial investments in the product companies Frende Holding AS, Norne Eierselskap AS and Brage Finans AS were among its largest individual investments.

Liquidity risk

Liquidity risk is the risk of the Group being unable to meet its obligations, or being unable to fund ordinary lending growth.

Liquidity risk is managed through the Group's liquidity strategy, overall and Board-approved guidelines, routines, risk tolerance levels and limits Key operational management parameters are the requirement for deposit-to-loan ratio, indicator of long-term funding, stress indicator for liquidity disposals within 30 days (LCR) and, in addition, guidelines for survivability in situations where there is no access to market funding. Liquidity risk is also managed by securing funding from the capital market with various maturities, sources of funding and instruments. Liquidity risk is periodically stress tested, and contingency and recovery plans have been established for the Group.

Deposits from customers are the bank's most stable source of funding. The Board of Directors emphasises that the ratio between deposits from customers and lending must be tailored to the Group's overall funding situation. At 31 December 2018, the Group's deposit-to-loan ratio was 55.0%.

Sparebanken Sør Boligkreditt AS represents an important funding instrument for the Group, because it ensures access to long-term funding by issuing covered bonds. To be able to issue covered bonds, mortgages equivalent to 61.0 percent of all loans to the retail market were transferred from the Parent Bank to the Sparbanken Sør Boligkreditt AS in 2018.

Board-adopted target requirements for the bank's liquidity risk are in accordance with the guidelines given by the Financial Supervisory Authority. At year-end, the indicator values for Sparebanken Sør were within these requirements.

The indicator for long-term funding was 110.0 percent at the end of 2018.

The Bank has a liquidity reserve in the form of liquid interest-bearing securities that satisfy requirements imposed by the authorities and adopted by the Board for LCR holdings and liquidity stress testing. The Bank also has mortgages cleared for transfer to the Sparbanken Sør Boligkreditt AS. The Bank's interest-bearing liquidity portfolio consists of government securities, other zero-weighted securities, covered bonds and securities issued by Norwegian municipalities and county councils. The Bank's short-term liquidity risk is managed partly by adaptation to the Liquidity Coverage Requirement (LCR). At year-end 2018, the LCR indicator for Sparebanken Sør (Group and Parent Bank) and Sparebanken Sør Boligkreditt AS was sufficient to meet by a good margin all the projected liquidity maturities within the next 30 days under a stress scenario. The Group and parent company had an LCR ratio of 159 percent and 180 percent respectively at 31 December 2018. The regulatory requirement was 100 percent at the end of 2018.

In addition to LCR, the Bank analyses liquidity risk using stress tests. According to these analyses, the Group would be able to continue operating normally for 24 months in a stress scenario, where new market funding is assumed to be unavailable.

The Group's liquidity risk is reported periodically to the Board of Directors.

Counterparty risk

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

Derivative contracts are entered into to hedge the risk which arises in the Bank's ordinary operations in connection with funding at fixed interest rates and in a currency other than NOK, loans to customers at fixed interest and in a foreign currency and derivatives trading with customers. Derivative contracts must be established with reputable counterparties, with a good rating, and must be regulated by an underlying ISDA agreement. Derivative contracts must be distributed among various counterparties to avoid counterparty concentration risk.

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

The Bank's counterparty risk is regulated through the establishment of agreements on the furnishing of collateral (Collateral Support Annex) between the parties. Under CSA settlement, the value of derivatives is reconciled with the derivative counterparty and settlement of collateral takes place. By entering into an agreement on collateral settlement for changes in the value of derivatives, the Bank maintains the lowest possible counterparty risk. The Bank will arrange for implementation of derivative clearing.

Operational risk

Operational risk is the risk of losses due to inadequate or flawed internal processes or systems, human error or external events. These may be disruptions or interruptions of an operational nature, breach of procedures, faults in ICT systems or hardware, breach of rules, fraud, fire or criminal acts.

The Bank has procedures that cover all significant areas. Risk management and internal control means processes to identify, analyse, manage and follow up the risks in order for the combined risk exposure to be in accordance with strategic objectives, and to ensure compliance with applicable laws and regulations, as well as internal procedures and guidelines.. Internal control is an important tool for reducing operational risk, with respect to both its identification and follow-up.

The Bank aims to have low operational risk.

Compliance

The Group focuses on having good processes to ensure compliance with applicable laws and regulations. Compliance risk is the risk of the Group incurring legal or regulatory sanctions, financial losses or impaired reputation as a result of non-compliance with laws, regulations or policy documents. Efforts are constantly being made to assess how best to adapt to new rules and regulations in order to achieve both compliance and efficiency in the organisation. New rules and regulations are implemented in the Bank's policy documents and procedures.

The Bank's compliance function is organised independently of the business units.

The Bank shall have a low compliance risk.

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. Ownership is defined as companies in which Sparebanken Sør has a significant shareholding or influence.

The management and boards of subsidiaries comply with the provisions of the Limited Liability Companies Act. Several of the companies use managers and/or employees from the Group on their boards of directors or in other positions.

The Bank's ownership risk is considered low.

Capital management

The purpose of capital management is to ensure that the Group's capital adequacy meets regulatory requirements, and requirements from the financial markets. Capital management must also ensure that market opportunities are exploited and ambitions fulfilled, and that the Group achieves a satisfactory return in relation to the Bank's risk profile.

At the end of 2018, the common equity tier 1 capital ratio for the Group after proportionate consolidation of partly owned subsidiaries was 14.8 percent, tier 1 capital ratio was 16.4 percent and total capital ratio came to 18.5 percent. The Group met applicable minimum capital requirements for financial institutions as at 31 December 2018, with 14.0 percent for common equity tier 1 capital ratio, 15.0 percent for tier 1 capital ratio and 17.0 percent for total capital ratio.

The Bank's financial strength ratio is considered highly satisfactory in with respect to applicable regulatory requirements. This is substantiated by the Group's high leverage ratio, which was at 9.1 percent at year-end.

The Bank's capital requirements are assessed annually on the basis of an estimated total risk. The internal capital adequacy assessment process (ICAAP) enables the Bank to maintain good risk management and provides an overview of the risks to which it is exposed, while ensuring a sufficient subordinated capital has at all times.. In July 2018, the Bank received the Financial Supervisory Authority's assessment of the Group's capital requirement (SREP), the Pillar-2 requirement was set at 2.0 percent of the risk-weighted balance. The requirement is linked to an assessment of risk factors not covered by the Pillar-1 requirements and also includes a new method for calculating the capital requirement associated with the partly owned insurance company. The capital requirement linked to the ownership interest in Frende Holding AS alone is around 0.3 percentage points.

The Group has a publicly announced target of 14.8 percent common equity tier 1 capital ratio. The Ministry of Finance decided in December 2018 to increase the requirement for a countercyclical buffer by 0.5 percentage points with effect from 31 December 2019. The Group will adapt to the requirement during the course of 2019 and ensure necessary buffers above the minimum requirement.

In October 2018, The Financial Supervisory Authority of Norway proposed amendments to the regulations for identification of systemically important financial institutions. Under this proposal, Sparebanken Sør will be regarded as systemically important. The proposal has been referred for comment and has not yet been adopted.

In 2019, the Board will implement a process linked to future capital targets, where the requirement for a countercyclical buffer will be taken into account. If the proposed regulations for identifying systemically important financial institutions are adopted, this will be taken into account when establishing new capital targets.

An important part of the Group's objective is for the common equity tier 1 capital ratio to be on a par with that of comparable banks. Sparebanken Sør is the only one of the large regional banks to make use of the standard method when calculating capital adequacy. As a 'standard bank', the Bank will therefore have a higher baseline when calculating capital adequacy, in comparison to other regional banks that use IRB. Sparebanken Sør has begun a process to apply to The Financial Supervisory Authority of Norway for approval to use internal models for credit risk (IRB). The intention is to submit an application to The Financial Supervisory Authority of Norway during the course of 2020.

The Group's capital adequacy is followed up by means of periodic reporting to the Board of Directors.

RATING

In order to utilise the opportunities for funding, both internationally and from various investors, the Bank has an international rating from Moody's, one of the world's most recognised rating agencies. In addition to the fact that the rating outcome is of value to the Bank, the Board considers the actual rating process and maintenance of the rating to be of value in terms of raising the quality of various processes and procedures.

Sparebanken Sør has a long-term rating of A1 with 'Negative Outlook'. In 2017, the rating outlooks for five regional savings banks were changed at the same time from 'Stable Outlook' to 'Negative Outlook'. This was related to the ongoing work being done to implement the EU Bank Recovery and Resolution Directive in Norwegian legislation.

All covered bonds issued by Sparebanken Sør Boligkreditt AS have also been rated by Moody's, with a rating of 'Aaa'.

CORPORATE GOVERNANCE

Sparebanken Sør's principles and policy for corporate governance are based on the Norwegian Code of Practice for Corporate Governance, prepared by the Norwegian Corporate Governance Board (NUES). The Financial Supervisory Authority of Norway's model for evaluation of overall management and control, which reflects principles from the European Banking Authority (EBA), is used as far as these are relevant to the Group.

Sparebanken Sør principles and policy shall ensure that the bank's corporate governance is in line with generally accepted perceptions and standards, and applicable laws and regulations. Furthermore, corporate governance shall ensure good cooperation between the bank's different stakeholders, such as owners of equity certificates, lenders, customers, employees, governing bodies, management and the society at large. The Board believes that the bank's corporate governance is satisfactory and consistent with its principles and policy. See the full report attached to the annual report.

PERSONNEL AND WORKING ENVIRONMENT

At year-end 2018, the Bank had 434 full-time equivalent employees (FTEs) and the Group had 512 FTEs. The Bank's workforce has been reduced by 86 FTEs since the end of 2013.

Sickness absence has remained at a stable, low level in recent years and was 3.8 percent in 2018. This is on a par with the last few years, and sharply down on 2015, when the sickness absence rate was 4.6 percent. Most sickness absence is long-term absence. Participation in IA agreement makes it important for the Bank to work systematically to reduce and follow up on sick leave. The Bank has made arrangements for employees with disabilities. New constructions and refurbishments have been designed for universal access, which means that the buildings are arranged so that everyone can use them without any special adaptations or assistive devices.

The Bank continuously strives to ensure that the bank's employees have the skills they need for their position. In addition to regular training on products, systems and procedures, a number of training exercises were carried out in 2018. In 2018, the Bank decided to join the authorisation scheme for the retail credit market, and it has therefore prioritised courses and training in the area of credit. At the end of 2018, 155 managers and advisers had achieved credit authorisation.

The Bank has stable and good working conditions with a good working environment, and investments continue to be made in various social activities for employees in areas such as company sport and art clubs. The Bank's provision of staff holiday cabins and apartments is popular, and these are heavily used throughout the year.

Equality and diversity

At year-end, the Bank had a total of 454 employees, compared with 449 at the same time in 2017. Of the 454 employees, 225 were women and 229 were men. The proportion of women among the Bank's managers was 34.4 percent, up from 34.0 percent at the same time in the previous year. In the Bank's governing bodies, the proportion of women was 46.0 percent on the Board of Trustees and 50.0 percent on the Board of Directors. The Bank has prepared a separate sustainability report, including the Bank's equality balance sheet, which is attached to the annual report.

RESEARCH AND DEVELOPMENT

The Group does not carry out any research activity.

SOCIAL RESPONSIBILITY

Social responsibility is integral to Sparebanken Sør's business. Sparebanken Sør's corporate social responsibility is expressed in the Bank's business concept of contributing to growth and development in the region, and the goal of its corporate social responsibility activities is to help achieve this in a responsible and sustainable way. Work on social responsibility helps to strengthen the Bank's competitiveness, reduce risk, and attract good customers, investors and skilled employees. Sparebanken Sør also gives back some of its profits in the form of donations and initiatives that benefit the regional and local communities. The Bank has prepared a separate sustainability report, including the Bank's corporate social responsibility balance sheet, which is attached to the annual report.

Climate challenges and external environment

The Bank uses input factors or methods of production that directly pollute the external environment to only an insignificant degree. The Bank prepares an annual climate report to enable it to identify emissions, quantify pollution and enable the Bank to implement specifically targeted measures. The report, which is published on the Group's website, is based on the international 'A Corporate Accounting and Reporting Standard'. The report covers consumption related to transport, energy, waste and air travel. The Bank is not aware of any environmental impact other than consumption that can be converted to carbon equivalents, and therefore does not publish emission figures.

The Bank has a diversified business portfolio. Several of the bank's corporate customers have operations that will have an impact on the external environment. Through providing credit, the Group has indirect possibilities to impact the external environment. In 2018, the Bank established guidelines for the implementation of sustainability in the Bank's lending operations. These guidelines are published on the Bank's website.

Human rights

Sparebanken Sør respects and supports the protection of international human rights.

Human rights, workers' rights and social conditions follow what is standard and required for Norwegian businesses. The Bank is a member of Finance Norway and is bound by collective bargaining agreements within this area. The Bank has also entered into a separate collective bargaining agreement (company agreement) with employee representatives in the company. All the Bank's operations are within Norway. The few corporate customers registered as NUF or Ltd are subject to special review.

Money laundering and financing of terrorism

The Bank has its own measures to counteract money laundering and the financing of terrorism, and it aims to strengthen the quality of its compliance with laws and regulations. A new Money Laundering Act, implemented in 2018, strengthens the requirements banks must meet in the area of money laundering. In accordance with the change in requirements, the Bank has drawn up a new policy document for the area and has revised its money laundering procedures. Based on the emphasis placed on those with a reporting duty to adopt a risk-based approach to this issue, a comprehensive overall risk analysis of the money laundering area has been carried out. The risk analysis has identified various measures whose implementation is being assessed in order to strengthen the Bank's monitoring and efforts to counteract money laundering. A number of checks and reports to Økokrim (National Authority for Investigation and Prosecution of Economic and Environmental Crime) are made during the course of the year.

Anti-corruption, measures, code of conduct and procedures for internal alerts

Under the Bank's code of conduct, employees must act with caution and integrity, and endeavour to behave in a manner which inspires confidence and is in accordance with standards, laws and regulations applicable in society. This must characterise all activities, so the Bank gains trust in the market and safeguards its competitiveness and reputation. The code of conduct shows the expectations and requirements Sparebanken Sør has for how its employees act and behave. Management, employees, employee representatives, temporary personnel and hired consultants are all covered by the code of conduct. Everyone who is covered by these standards must act in such a way that the confidence in Sparebanken Sør is not weakened. A breach of the code of conduct has been identified in connection with criminal acts committed by a former employee at one of the Bank's branches. Except for this case, no breaches of the code of conduct were reported in 2018.

The Bank makes active efforts to prevent corruption linked to employees, customers and other partners. The Bank's internal ethical regulations deal specifically with this matter. No cases that can be defined as corruption were reported in 2018. The Bank has good procedures for reporting of undesirable events, situations worthy of criticism, threats, etc. The procedures are reviewed and revised annually by a broadly composed group of managers, employee representatives and employees from Risk, HR and Internal Auditing. Alerts are reported to a neutral body (internal auditor). The procedure for alerts is easily accessible for the Bank's employees. The Bank received one alert in 2018, linked to criminal acts committed by a former employee. For details see the section above.

DONATIONS FOR THE PUBLIC GOOD

Sparebanken Sør has defined donations as a strategic priority area. When making donations, the Bank strives to ensure that the projects which receive funding are of real benefit for the community. Consequently, the donations provide the Bank with an opportunity to promote growth and development in the region.

The Donations Committee reviewed 494 applications in 2018. 239 of these received a combined donation of NOK 40.0 million. Children and youth are a priority group for the Bank's donation strategy, and the funds have largely been provided to youth support projects, as well as projects in the areas of sport and culture. The Bank has prioritised broad rather than narrow target groups, and teams rather than individual performers. The Board of Directors proposes that NOK 40.0 million of the Bank's profit for 2018 be set aside for distribution in 2019.

OUTLOOK

The Board of Directors considers the results for 2018 to be satisfactory, despite pressure on margins and lower net financial income than in previous years. The prospects for the Norwegian economy and for Sparebanken Sør in the immediate future appear to be good.

House prices in the Bank's main markets have shown positive, but modest, growth over several years. The statistics for 2018 show weak positive growth in house prices in the Bank's market area. The Group's mortgage portfolio has a high collateralisation rate, and the Group is well prepared to respond to any fall in house prices. This is supported by the stress tests that have been carried out.

Norges Bank changed its key interest rate on 20 September 2018 from 0.5 to 0.75 percent. The Norwegian central bank's analyses suggest a gradual increase in interest rates over the next few years.

The Group has a requirement for common equity tier 1 capital, including a Pillar-2 supplement of 2.0 percent, of 14.0 percent. In December 2018, the Ministry of Finance decided to increase the requirement for a countercyclical capital buffer by 0.5 percentage points with effect from 31 December 2019, and the Group's requirement for common equity tier 1 capital will then increase to 14.5 percent. Prior to the increased requirement for a countercyclical capital buffer, the Group has a target common equity tier 1 capital ratio of 14.8 percent. In 2019, the Board of Directors will implement a process linked to future capital targets, where the requirement for a countercyclical capital buffer will be taken into account. If the proposed regulations for identifying systemically important financial institutions are adopted, this will be taken into account when establishing new capital targets. The common equity tier 1 capital ratio at the end of 2018 was 14.8 percent.

On 19 October 2018, The Financial Supervisory Authority of Norway sent a letter to the Ministry of Finance recommending amendments to regulatory criteria for systemically important institutions. If the regulatory amendments are approved, this will probably mean that Sparebanken Sør is regarded as systemically important and might consequently face greater requirements for common equity tier 1 capital. If the amendments are decided this will be taken into account when deciding on new capital targets.

The Group has a long-term aspiration for lending growth in excess of credit growth (K2), and a target for return on equity of 9.0 percent.

Investments through increased shareholdings in Frende and Brage, which are now defined as associates, are expected to make positive contributions to earnings in the future.

In 2018, the Group implemented the standard IFRS 9, which has been significant in calculating the Group's expenses on losses on loans. The Group makes provisions for expected losses, and somewhat larger fluctuations in expenses due to losses on loans are anticipated in the future. Based on the composition of the Bank's loan portfolio, the state of the economy and local market conditions, it is expected that losses on loans in Sparebanken Sør will be at a low level in 2019.

A crisis management directive, Bank Recovery and Resolution Directive (BRRD), entered into force in the EU in January 2016. The Directive is of EEA relevance, and in March 2018 the Norwegian Parliament (Stortinget) passed legislative amendments to implement the Directive in Norwegian law as of 1 January 2019. BRRD makes arrangements for banks, credit institutions and certain securities firms to be subject to crisis management or closed down without posing a threat to financial stability. Import considerations are that critical functions can be continued, and that losses are borne by owners and creditors, while deposits, client funds and public funds are protected. The Directive also makes arrangements for preparedness and preventive measures.

The Bank shall in accordance with its strategy focus on cost and long-term value creation. The Bank's investments in technology will continue, which will contribute to cost efficient operations and enable streamlining of the office structure. This, together with high quality in customer credit assessments, will contribute to a continued profitable growth and development for Sparebanken Sør.

CLOSING REMARKS

The Board of Directors wishes to express its gratitude to the Bank's employees for their valuable contributions to what has been a good year for Sparebanken Sør. At the same time, the Board of Directors wishes to thank the Bank's customers, equity certificate holders and other business associates for supporting the Bank and for the confidence they have shown in the Bank over the past year.

The board

From left: Marit Kittilsen, Stein Hannevik, Gunnhild T. Golid, Mette Ramfjord Harv, Knut Ruhaven Sæthre (deputy member), Jan Erling Tobiassen, Erling Holm, Inger Johansen and Tom Erik Jebsen.

Kristiansand, 5 March 2019

Stein A. Hannevik Chairman	Inger Johansen Deputy Chairman	Tom Erik Jebsen	Erling Holm	Marit Kittilsen

Mette Ramfjord Harv	Jan Erling Tobiassen	Gunnhild Tveiten Golid	Geir Bergskaug CEO

Income statement

PARENT BANK		NOK MILLION		GROUP	
2017	2018		Notes	2018	2017
1 878	1 291	Interest income from assets at amortised cost	15,33	2 778	2 614
327	1 012	Interest income from assets at fair value through profit and loss	15,33	367	339
884	951	Interest expenses	15,33	1 416	1 274
1 321	**1 352**	**Net interest income**	**5,15**	**1 729**	**1 679**
321	346	Commission income	16,34	380	370
58	62	Commission expenses		62	58
263	**283**	**Net commission income**		**318**	**312**
23	16	Dividend		7	15
121	19	Net income from other financial instruments	12,13,17	-5	73
144	**35**	**Net income from financial instruments**	**17**	**2**	**88**
	13	Income from associated companies		13	
16	9	Other operating income		10	18
16	**22**	**Total other income**		**23**	**18**
1 744	**1 692**	**Total net income**		**2 072**	**2 097**
374	415	Wages and other personnel expenses	18,35	499	453
29	29	Depriciation, amortization and impairment of non-current assets	30	30	30
309	338	Other operating expenses	19,34	355	328
712	**782**	**Total operation expenses before losses**	**5**	**884**	**811**
1 032	**910**	**Operating profit before losses**	**5**	**1 188**	**1 286**
20	-33	Losses on loans, guarantees and unused credit	5,7,8	-36	20
1 012	**943**	**Profit before taxes**	**5**	**1 224**	**1 266**
217	212	Tax expenses	20	285	282
795	**731**	**Profit for the period**		**939**	**984**
		Minority interests		1	1
795	**731**	**Majority interests**		**938**	**983**
47	56	Attributable to additional Tier 1 Capital holders		56	47
748	675	Attributable to ECC- holders and to the saving bank reserve		883	937
795	**731**	**Profit for the period**		**939**	**984**
8,9	7,7	Profit/diluted earnings per equity certificate (in whole NOK)	36	10.1	11.2

OTHER COMPREHENSIVE INCOME

PARENT BANK		NOK MILLION		GROUP	
2017	2018		Notes	2018	2017
795	**731**	**Profit for the period**		**939**	**984**
		Items that will not be reclassified subsequently to profit or loss			
-13		Recognized estimate deviation, pensions	18		-13
3		Tax effect	18,20		3
		Items that may be reclassified to profit or loss			
		Change in value, basis swaps		-20	
		Tax effect		5	
	0	Change in value, customer mortgages			
785	**731**	**Comprehensive income for the period**		**924**	**974**
		Miniority interests		1	1
785	**731**	**Majority interests**		**923**	**973**

Notes 1 to 40 form an integral part of the consolidated financial statements.

Balance sheet

PARENT BANK		NOK MILLION		GROUP	
31.12.2017	**31.12.2018**		**Notes**	**31.12.2018**	**31.12.2017**
Assets					
1 143	1 287	Cash and receivables from central banks	20,21	1 288	1 143
3 516	3 010	Loans to credit instituitions	20,21,29	119	236
66 595	64 263	Net loans to customers	5,6,9,10,11,21,22,34,35	102 942	97 518
12 660	17 691	Bonds and certificates	21,22,23	14 598	13 468
572	369	Shares	21,22,24	370	572
385	197	Financial derivatives	21,22,27	619	754
1 256	1 858	Shareholding in group companies	25		
39	584	Shareholding in associated companies	26	584	39
15	22	Intangible assets	30	22	15
387	387	Property, plant and equipment	30	413	416
81	90	Other assets		171	149
86 649	**89 758**	**TOTAL ASSETS**	**5**	**121 125**	**114 310**
Liabilities and equity capital					
974	2 261	Liabilites to credit institutions	14,21,22,29,33	1 918	902
55 593	56 546	Deposits from customers	5,14,21,22,31,33,34	56 537	55 580
17 848	18 027	Liabilities related to issue of securities	14,21,22,28,33	48 323	44 343
283	179	Financial derivatives	21,22,27	179	306
228	223	Payable taxes	20	309	299
219	288	Other liabilities	32	328	256
87	61	Provisions for commitments	18	61	87
43	51	Deferred tax	20	21	25
1 404	1 604	Subordinated loan capital	4,14,21,22,28	1 604	1 404
76 679	**79 240**	**Total liabilities**	**5,14**	**109 280**	**103 202**
1 575	1 603	Equity certificate capital	4,36	1 603	1 575
1 075	1 075	Hybrid capital	4	1 075	1 075
7 320	7 840	Other equity	4	9 167	8 458
9 970	**10 518**	**Total equity**	**4**	**11 845**	**11 108**
86 649	**89 758**	**TOTAL LIABILITIES AND EQUITY**	**5**	**121 125**	**114 310**

Notes 1 to 40 form an integral part of the consolidated financial statements.

Kristiansand, 31 December 2018 / 5 March 2019

Stein A. Hannevik
Chairman

Inger Johansen
Deputy Chairman

Tom Erik Jebsen

Erling Holm

Marit Kittilsen

Mette Ramfjord Harv

Jan Erling Tobiassen

Gunnhild Tveiten Golid

Geir Bergskaug
CEO

Statement of changes in equity

NOK MILLION	Equity certificates	Premium fund	Dividend equalization-fund	Hybrid capital	Primary capital	Gift fund	Other equity	Minority interests	TOTAL
GROUP									
Balance 31.12.2016	**783**	**451**	**297**	**825**	**6 606**	**42**	**1 044**	**3**	**10 051**
Dividend distributed for 2016							-94		-94
Issue of hybrid capital				450	-1				449
Buyback of hybrid capital				-200					-200
Interest on hybrid capital				-47					-47
Profit 2017			46	47	568	40	282	1	984
Recognised estimate deviation, pension			-2		-11				-13
Tax effect estimates deviation, pension					3				3
Allocated from gift fund						-21			-21
Other changes							-2	-2	-4
Balance 31.12.2017	**783**	**451**	**341**	**1 075**	**7 165**	**61**	**1 230**	**2**	**11 108**
Dividend distributed for 2017							-94		-94
Accounting effects on transistion to IFRS9			1		4		-3		2
Interest on hybrid capital				-56					-56
Profit 2018			27	56	514	40	302		939
Other comprehensive income							-15		-15
Allocated from gift fund						-39			-39
Other changes							1	-1	0
Balance 31.12.2018	**783**	**451**	**369**	**1 075**	**7 683**	**62**	**1 421**	**1**	**11 845**
PARENT BANK									
Balance 31.12.2016	**783**	**451**	**297**	**825**	**6 606**	**42**	**94**	**0**	**9 098**
Dividend distributed for 2016							-94		-94
Issue of hybrid capital				450	-1				449
Buyback of hybrid capital				-200					-200
Interest on hybrid capital				-47					-47
Profit 2017			46	47	568	40	94		795
Recognised estimate deviation, pension			-2		-11				-13
Tax effect estimates deviation, pension					3				3
Allocated from gift fund						-21			-21
Balance 31.12.2017	**783**	**451**	**341**	**1 075**	**7 165**	**61**	**94**	**0**	**9 970**
Dividend distributed for 2017							-94		-94
Accounting effects on transistion to IFRS9			1		4				5
Interest on hybrid capital				-56					-56
Profit 2018			27	56	514	40	94		731
Allocated from gift fund						-39			-39
Balance 31.12.2018	**783**	**451**	**369**	**1 075**	**7 683**	**62**	**94**	**0**	**10 518**

Notes 1 to 40 form an integral part of the consolidated financial statements.

See Note 36 concerning equity certificates, equity capital and proposed dividend.

Cash flow statement

PARENT BANK		NOK MILLION	GROUP	
31.12.2017	**31.12.2018**		**31.12.2018**	**31.12.2017**
2 212	2 417	Interest received	3 258	2 951
-922	-1 059	Interest paid	-1 518	-1 317
312	348	Other payments received	380	337
-677	-716	Operating expenditure	-823	-794
11	8	Loan recoveries	8	11
-185	-225	Tax paid for the period	-291	-259
-21	-27	Gift expenditure	-27	-21
4 006	954	Change in customer deposits	958	4 008
-3 790	2 286	Change in loans to customers	-5 464	-6 650
-1 305	506	Change in loans to credit institutions	117	-80
21	246	Change in deposits from credit institutions	-41	35
-338	**4 738**	**Net cash flow from operating activities**	**-3 443**	**-1 779**
8 179	15 353	Payments received, securities	17 414	8 278
-9 826	-20 473	Payments made, securities	-18 568	-9 874
30	6	Payments received, sale of property, plant and equipment	11	66
-24	-50	Payments made, purchase of property, plant and equipment	-51	-28
	-246	Investments in subsidiaries and associated companies	-246	
62	-474	Change in other assets	-3	-178
-1 579	**-5 884**	**Net cash flow from investing activities**	**-1 443**	**-1 736**
721	1 039	Change in deposits from credit institutions	1 055	689
4 550	3 900	Payments received, bond debt	13 770	10 810
-3 174	-3 656	Payments made, bond debt	-10 052	-8 069
-141	-150	Payments made, dividends and interest on hybrid capital	-150	-141
450	0	Issue of hybrid capital	0	450
-200	0	Buyback of hybrid capital	0	-200
200	600	Issue of subordinated loan capital	600	200
	-400	Buyback of subordinated loan capital	-400	
-143	-43	Change in other liabilities	208	122
2 263	**1 290**	**Net cash flow from financing activities**	**5 031**	**3 861**
346	**144**	**Net change in liquid assets**	**145**	**346**
797	**1 143**	**Cash and cash equivalents as at 1 Jan**	**1 143**	**797**
1 143	**1 287**	**Cash and cash equivalents at end of period**	**1 288**	**1 143**

The cash flow statement shows receipts and payments of cash and cash equivalents during the year. The statement has been prepared in accordance with the direct method. Cash flows are classified as operating activities, investing activities and financing activities. Cash is defined as cash and receivables with central banks.

Notes 1 to 40 form an integral part of the consolidated financial statements.

Notes 2018 - Sparebanken Sør

NOTE 1 – ACCOUNTING POLICIES

GENERAL INFORMATION

The Sparebanken Sør Group consists of the Parent Bank Sparebanken Sør and the subsidiaries Sparebanken Sør Boligkreditt AS, Sørmegleren Holding AS, AS Eiendomsvekst, Prosjektutvikling AS and Transitt Eiendom AS. The Group conducts banking operations at 34 locations and provides real estate services at 16 locations in the Agder counties, Telemark and Rogaland.

Within the framework of its articles of association and whatever legislation is applicable at any given time, the Bank may perform all business and services that banks in general are licensed to undertake. The Bank is licensed as a securities company. Sparebanken Sør Boligkreditt AS is a wholly owned subsidiary of the Sparebanken Sør Group. Sparebanken Sør Boligkreditt AS was established to offer mortgages within 75% of the property value.

Sparebanken Sør is an equity certificate bank. The registered office of the bank and the real estate agency business is in Kristiansand.

The consolidated financial statements for 2018 were submitted by the Board of Directors on 5 March 2019 and will be finally approved by the Board of Trustees on 28 March 2019. The Board of Trustees is the bank's highest governing body.

BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

Application of IFRS

The consolidated and parent company financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, in addition to the Norwegian disclosure requirements pursuant to the Norwegian Accounting Act. Sparebanken Sør prepares its financial statements in Norwegian kroner (NOK), which is the functional currency for all entities in the Group. Unless stated otherwise, all amounts in the financial statements have been rounded to the nearest million.

The consolidated financial statements are based on the principles of historical cost accounting, with the exception of the following accounting items:

- Buildings, which are measured at adjusted amount
- Financial instruments at fair value through profit or loss and financial instruments through other comprehensive income

The consolidated accounts have been prepared according to uniform accounting policies for identical transactions and events under otherwise identical conditions.

Consolidation and Group companies

The consolidated financial statements cover the Parent Bank and subsidiaries in which the Bank alone, or together with subsidiaries, has a controlling influence, usually as a result of a shareholding of more than 50%. Internal transactions and balances are eliminated.

When subsidiaries are acquired, the cost price of shares in the parent company is eliminated against the equity in the subsidiary at the time of acquisition. The difference between the cost price and net book value of assets in the subsidiary at the time of the acquisition is added to the assets to which the excess value relates within the market value of these assets. The portion of the cost price that cannot be attributed to specific assets represents goodwill. If the value of the acquired assets exceeds the cost price, the difference is recognised as income.

In the Parent Bank's accounts, shareholdings in consolidated companies are recognised at cost price on initial recognition. The shareholdings are tested annually for impairment, and if necessary are written down to the recoverable amount.

Associates

Associates are companies in which the Bank has significant influence, but not control or joint control, of financial and operational management. Significant influence normally exists when the Bank has a shareholding of between 20% and 50%. Associates are recognised in the consolidated financial statements in accordance with the equity method. This means that on initial recognition the shareholdings are recognised at cost price and are then adjusted for the Bank's share of earnings in the associate.

In the Parent Bank's accounts, the shareholdings are recognised at cost price on initial recognition. The shareholdings are tested annually for impairment, and if necessary are written down to the recoverable amount.

REVENUE

Interest income and expenses related to assets and liabilities, which are measured at amortised cost, are recognised as incurred using the effective interest method. All charges related to interest-bearing borrowings and lendings are included in the calculation of the effective interest rate and are amortised over the expected term. Interest income and expenses related to instruments measured at fair value through profit or loss are presented as part of net interest income. Changes in value, including changes in value related to the interest element, are recognised as net income from other financial instruments.

Commission income and expenses which are a direct payment for services provided are recognised when the services have been delivered. Charges for establishing loan agreements are amortised over the loan's anticipated term.

Charges associated with loans measured at fair value are recognised directly in the income statement.

Dividends are recognised in the income statement when the right to receive the dividend has been approved, which normally takes place when the entity (issuer) holds its annual general meeting.

FINANCIAL INSTRUMENTS

A new accounting standard, IFRS 9, was implemented on 1 January 2018. The standard was implemented in the financial statements at the same time. The Group chose not to make use of early adoption of IFRS 9, and this means that all comparative figures from earlier periods have been prepared according to IAS 39. The standard was implemented retrospectively. Hedge accounting was exempted. Retrospective application means that Sparebanken Sør prepared the opening balance on 1 January 2018 as though the new policies had always been applied.

The effect of the new policies in the opening balance sheet for 2018 was recognised in equity.

Accounting policies applicable before 1 January 2018 are reproduced in Note 40.

Recognition and derecognition

Financial assets and liabilities are recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the instrument.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire, or the Bank transfers the financial asset in such a way that the majority of the risk and earnings potential of the asset concerned is transferred.

A financial liability is derecognised when the liability has been discharged, cancelled or has expired. When an existing financial liability is replaced by a new liability from the same lender under terms that have been materially changed, or the terms of an existing liability have been materially modified, the original liability is derecognised and a new liability is recognised. The difference in capitalised value is recognised through profit or loss.

Classification and measurement

Measurement of the financial asset is determined on initial recognition of the asset.

IFRS 9 has a more principle-based approach than IAS 39 with regard to assessing whether financial assets are to be measured at amortised cost or at fair value. The categories of measurement for financial assets in IAS 39 (fair value through profit or loss, available for sale, held to maturity and amortised cost) have been replaced by the following three categories in IFRS 9:

- Fair value with changes in value recognised through profit or loss.
- Fair value with changes in value recognised through other comprehensive income (OCI).
- Amortised cost.
- Derivatives designated as hedging instruments recognised at fair value.

Classification on initial recognition is based on the instruments being held in a business model both to receive contractual cash flows and for sale, and whether contractual cash flows solely consist of payments of interest and principal on given dates.

Financial instruments that are held to receive contractual cash flows are in principle to be measured at amortised cost.

Financial assets that are held to receive contractual cash flows and for resale are in principle to be measured at fair value through other comprehensive income (OCI).

Instruments with cash flows that are not only payments of interest and principal or where the purpose of owning the instrument is not to receive contractual cash flows are to be measured at fair value with changes in value recognised through profit or loss.

The policies for financial liabilities are mainly identical, with some exceptions. These include changes in value from own credit risk, where the liability is measured using a fair value option and recognised through other comprehensive income (OCI).

Derivatives used in connection with hedge accounting are measured according to the policies for hedge accounting. See separate section.

Implementation of IFRS 9 in the Sparebanken Sør Group with effect from 1 January 2018 resulted in a reduction in total impairment losses of NOK 2 million (NOK 7 million in the Parent Bank). Implementation of IFRS 9 had a positive effect on the Group's subordinated capital, and the Group has not made use of the transitional rule for calculation of capital adequacy. The equity effect is also apparent from the statement of changes in equity. Changes in classification are stated in Note 21 – Financial instruments by category. All transitional effects were presented in Note 38 in the annual financial statements for 2017.

The Group's financial assets which were measured at fair value under IAS 39 are also measured at fair value under IFRS 9. The mortgage portfolio in the Parent Bank was measured at amortised cost under IAS 39. This is valued under IFRS 9 at fair value through OCI. For the Group, the mortgage portfolio is measured identically under IAS 39 and IFRS 9, namely at amortised cost. There are no changes in the classification and measurement of the Group's financial liabilities.

Fair value with change in value recognised through profit or loss

All derivatives are to be measured at fair value with changes in value recognised through profit or loss. However, derivatives designated as hedging instruments are to be recognised in accordance with the principles of hedge accounting.

On transition to the new standard, Sparebanken Sør has chosen to recognise holdings of interest-bearing liabilities, certificates and shares at fair value through profit and loss. These are assets and liabilities that are managed, measured and reported to management at fair value.

Fixed-interest loans can be redeemed before maturity against payment for premiums or discounts arising as a result of movements in the interbank interest rate. Sparebanken Sør hedges the interest rate risk for this balance sheet item through derivatives. Derivatives are always measured at fair value. As changes in the value of the derivatives are recognised in profit and loss, recognition of fixed-interest loans at amortised cost will lead to significant fluctuations in profit. Recognition at fair value through profit or loss will therefore lead to a more harmonised comparison of the profit or loss on the derivative and changes in the value of fixed-interest loans.

This category additionally covers interest rate swaps and currency swaps established before 1 January 2018 and used as instruments for the fair-value hedging of bonds issued at fixed interest rates. Hedge accounting is discussed further in a separate section below.

Fair value through other comprehensive income (OCI)

Loans to retail customers secured by property will be classified in the Parent Bank at fair value through other comprehensive income under IFRS 9. This is a consequence of the fact that the loans can be sold at a later date to the Bank's wholly owned mortgage company. The purpose is therefore not solely to receive contractual cash flows but also resale.

This category further covers interest rate and currency swaps used as hedging instruments and entered into after 1 January 2018. Here, changes in value due to changes in exchange rates are recognised through other comprehensive income (OCI). Hedge accounting is discussed further in a separate section below.

Amortised cost

The Group measures financial assets at amortised cost if the following conditions are met:

- The financial asset is held in a business model whose purpose is to receive contractual cash flows, and
- The contractual terms for the financial asset lead to cash flows which consist exclusively of payments of principal and interest on given dates.

Debt instruments whose sole purpose is to hold the instrument in order to collect contractual cash flows are to be recognised at amortised cost. In the Group, all borrowings and lendings at variable interest rates are classified at amortised cost.

There is an exception in the Parent Bank's accounts relating to loans to retail customers secured by property. Under IAS 39, such loans were classified at amortised cost, while under IFRS 9 the loans are classified at fair value through other comprehensive income.

Derivatives designated as hedging instruments recognised at fair value

Interest rate swaps and currency swaps used as instruments for the fair-value hedging of bonds issued at fixed interest rates. Hedge accounting is discussed further in a separate section.

Subsequent measurements

Measurement at fair value with changes in value recognised through profit or loss

Fair value is the price that would be obtained upon the sale of an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the time of valuation.

Measurement of financial instruments traded on an active market

Financial instruments traded on an active market are valued at observed market prices.

Measurement of financial instruments not traded on an active market

The fair value of financial instruments not traded on an active market is determined using a suitable valuation method. Valuation techniques are based on recently signed transactions between independent parties, by referencing instruments with approximately the same content or by discounting cash flows. As far as possible, valuations are based on externally observed parameters.

The fair value of interest-bearing securities is determined on the basis of established market values reported by leading external market players, or by calculating the fair value on the basis of current market yield and credit spread curves at any time.

In calculating the fair value of swaps entered into, the market value of the relevant prevailing inter-bank interest rate curve is used.

For shares that are not listed or actively traded, the change in value is based primarily on valuations carried out by others. If this is not available, the value of the shares is based on published financial statements.

Fixed-interest loans are not traded on an active market. The Bank must therefore establish a market spread to estimate the loans' fair value at 31 December. For fixed-interest loans in the retail market, the average of the 10 best mortgages published at www.finansportalen.no is used to represent the market interest rate.

Measurement at fair value with changes in value recognised through other comprehensive income

Loans to retail customers secured by residential are measured continuously at fair value, and any changes in value are recognised through other comprehensive income. This applies only in the Parent Bank.

Measurement at amortised cost

Subsequent measurement of financial instruments measured at amortised cost is performed using the effective interest method and is subject to impairment losses. Gains and losses are recognised through profit or loss when the asset is derecognised, modified or impaired.

Group financial assets at amortised cost include receivables from customers and loans to customers, with the exception of fixed-interest rate loans.

Amortised cost is defined as the carrying amount on initial recognition, less received/paid interest and instalments, plus accrued effective interest, adjusted for net impairment losses and the net recognised effect of any hedging.

The effective interest method is a method that calculates amortised cost and accrues interest income/expenses for the relevant period. Interest income is recognised using the effective interest method. The effective interest rate is the interest rate that by discounting the loan's cash flows over the anticipated term gives a value equal to the loan's amortised cost on the date of its establishment.

Derivatives designated as hedging instruments recognised at fair value

Interest rate and currency swaps are measured at fair value in the balance sheet. Changes in value are recognised through profit or loss with the exception of interest rate and currency swaps entered into on or after 1 January 2018. Here, the changes in value due to changes in spreads will be recognised through other comprehensive income as a hedging effect.

Offsetting

Financial assets and financial liabilities are offset and presented net in the balance sheet only when the company has a legally enforceable right to offset and intends to realise the asset and settle the liability simultaneously.

Modification

When the contractual cash flows from a financial asset are renegotiated or changed in some other way, and the renegotiation or change does not lead to derecognition of the financial asset, the gross recognised value of the financial asset is recalculated and any gain or loss on the change is recognised through profit or loss.

The gross recognised value of the financial asset is recalculated as the present value of the renegotiated or changed cash flows, discounted at the original effective interest rate of the financial asset. Any incurred expenses and fees adjust the recognised value of the changed financial asset and are depreciated over the remaining life of the changed financial asset.

Impairment of financial assets

Provision is made for expected losses based on relevant information available at the time of reporting, including historical, current and future information.

Impairment losses are calculated on the basis of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The principal rule is that a loss provision is calculated on the basis of the expected credit loss over the next 12 months or expected credit loss over the whole term. Expected credit loss over the whole term is calculated for assets where the credit risk has increased significantly since initial recognition, with the exception of assets which are nevertheless assessed as having a low absolute credit risk on the reporting date. If there has not been a significant increase in credit risk since initial recognition, the loss provision will be calculated on the basis of the expected credit loss over the next 12 months.

Impairment losses on loans reduce their book value in the balance sheet. In the income statement, losses on loans consist of confirmed losses, changes in impairment losses, income on loans and provisions for guarantees and unused credits, as well as receipts relating to previously confirmed losses. Losses on loans are based on a loss model, but also qualitative assessments regarding the Bank's loan and guarantee portfolio in accordance with IFRS 9.

For a further description, refer to Note 7.

Provisions for losses on loans

The transition to IFRS 9 has changed the way the Group recognises loss provisions for financial assets, by moving from objective evidence that a loss event has occurred in IAS 39 to a model based on expected credit loss (ECL). IFRS 9 requires the Group to recognise a provision for expected credit loss for all debt instruments not held at fair value through profit or loss.

The impairment model under IFRS 9 is described in Note 7.

Reduction in the value on loans as a result of qualitative assessments

An impairment loss is recognised when a qualitative assessment provides objective evidence that a loan is impaired as a result of credit loss. An impairment loss is reversed when the loss is reduced and the reduction is objectively attributable to an event occurring after the date on which the impairment loss was recognised. All loans that are considered material will be assessed to see whether there is objective evidence of weakened creditworthiness, and the objective indication is likely to result in reduced future cash flows for the servicing of the commitment. Objective evidence may be default, bankruptcy, debt restructuring, lack of liquidity or other material financial problems.

The Group assesses a financial asset as non-performing if contractual payments are overdrawn by more than NOK 1,000 for more than 90 days.

Reduction in the value of loans, guarantees and unused credit facilities as a result of model-based calculations

Loans for which a qualitative impairment has not been recognised are included in the basis of calculation for model-based impairments. The same applies to guarantees and unused credit facilities.

The model for calculating the impairment of financial assets under IFRS 9 applies to financial assets measured at amortised cost and financial assets measured at fair value through other comprehensive income. The new standard also contains requirements for loss provisions on new loans, by stating that an impairment must be recognised for expected credit losses resulting from default in the next twelve months. The model calculates losses for all customers at account level. The model also includes loan approvals, guarantees and unused credits. For loans where the credit risk has increased significantly after initial recognition, an impairment loss corresponding to the expected credit loss over the term of the loan is recognised.

Confirmed losses

When it is highly probable that a loss is final, it is recognised as a confirmed loss. Some confirmed losses will be covered by previously recognised, individual impairment losses on loans, and will therefore be posted against the previous provision. Confirmed losses, not already covered by a previously recognised, individual impairment loss, as well as any surplus or deficit in relation to previous impairment losses, are posted to profit or loss.

Presentation in the balance sheet and income statement

Loans

Loans are recognised in the balance sheet as either loans and receivables from credit institutions or as net loans to customers. Interest is included in the income statement under interest income from assets valued at amortised cost. Changes in value due to impairment are included in the income statement under losses on loans, guarantees and unused credits.

Changes in value of fixed-interest rate loans, which are measured at fair value, are included in the income statement under net income from financial instruments. Interest is included in the income statement under interest income from assets valued at fair value.

Changes in the value of loans to retail customers secured by residential (Parent Bank) are presented through other comprehensive income.

Bonds and certificates

This balance sheet item includes the Group's certificate and bond portfolio. Interest is included in the income statement under interest income from assets at fair value. All changes in value are recognised in the income statement under net income from financial instruments.

Shares

The balance sheet includes the Group's shares recognised at fair value. All changes in value are recognised in the income statement under net income from financial instruments.

Financial derivatives (assets and liabilities)

This balance sheet item includes financial derivatives. Changes in value related to derivatives are recognised in the income statement under net income from financial instruments.

Debt to credit institutions, and deposits from customers

This balance sheet item includes debt to credit institutions and liabilities to customers. Interest is recognised under interest expenses in the income statement.

Liabilities from the issuance of securities

This balance sheet item includes issued securities debt. Interest is recognised under interest expenses in the income statement. In case of early redemption or repurchase of issued bonds, any gains and losses are entered under net changes in value from financial instruments.

Subordinated capital

This balance sheet item includes issued subordinated loans. Interest is recognised under interest expenses in the income statement.

HEDGE ACCOUNTING

Sparebanken Sør uses hedge accounting in relation to the bank's funding at fixed-interest terms and foreign currency. Hedge accounting covers the bond-related interest rate risk and currency risk.

The bank's criteria for classifying a derivative as a hedging instrument are:

- The hedging is expected to be very effective, in that it counteracts changes in the fair value of the bond issued.
- Among other things, there must be an economic relationship between the hedging instrument and the hedged object, and the effect of credit risk must not dominate any changes in value in the hedging relationship.
- It must be possible to reliably measure the effectiveness of hedging.
- Satisfactory documentation has been established prior to hedging that, among other things, shows that hedging is effective and is expected to remain effective throughout the period.

Sparebanken Sør uses fair value hedging. Hedging is measured and documented every quarter to ensure that it is effective. The dollar-offset method is used to measure the effectiveness of hedging. When hedging has been established and is effective, interest rate swaps and currency swaps will be recognised in the balance sheet at fair value and in the income statement under net income from financial instruments.

The hedged object is recognised in the balance sheet at amortised cost. Changes in fair value associated with the hedged risk are recognised as an addition or deduction in the carrying value of the bond debt and posted to net income from financial instruments in the income statement.

IFRS 9 has simplified the requirements for hedge accounting by linking hedging effectiveness more closely to risk management activities, and consequently provides greater opportunities for assessments. The requirement for a hedging effectiveness of 80-125% has been removed and replaced by more qualitative requirements.

Under IFRS 9 a prospective (future-oriented) effectiveness test is sufficient, while hedging effectiveness under IAS 39 had to be viewed both retrospectively and prospectively.

Ineffectiveness in hedging, defined as the difference between changes in the value of hedging instruments and in the value of the hedged object, is recognised in the income statement as it arises. The exception is that portion of the change in value which is due to a change in the basis spread linked to the hedging instruments.

For interest rate and currency swaps established on or after 1 January 2018, changes in value due to changes in spreads will be recognised through other comprehensive income as a hedging effect. Interest rate and currency swaps created before 1 January 2018 are recognised at fair value through profit or loss until these falls due.

If circumstances should occur in which the hedging is not effective, the Bank/Group will amortise the change in value associated with the hedged object over the remaining period. The associated hedging instrument will continue to be measured at fair value through profit or loss.

ACCOUNTING OF EXCHANGE-RATE EFFECTS

Income and expenses in foreign currencies are translated into Norwegian kroner (NOK) at the exchange rates prevailing on the transaction date.

Balance sheet items denominated in foreign currencies are hedged by corresponding items on the opposite side of the balance sheet, or through hedging transactions. Currency derivatives (currency futures) traded with customers are hedged in a similar manner against another external party. Assets and liabilities in foreign currencies are translated into Norwegian kroner at the banks' median rates on the balance-sheet date. Foreign exchange gains and losses are recognised in the income statement under net income from other financial instruments.

FIXED ASSETS

Fixed assets are recognised at cost less accumulated depreciation and amortisation. Depreciation is computed on a straight-line basis over the expected useful economic life of the asset. The remaining economic life and residual values for each asset is reassessed annually.

At each reporting date, an assessment is made as to whether there are any indications of impairment. If there are indications of impairment of an asset, the Bank will obtain valuations or calculate the utility value of the asset. The asset is written down to the higher of fair value and utility value. The basis for previous write-downs is considered at the same time.

There has been decomposition in the estimated value of property, plants and building. Property is not depreciated. Buildings and technical facilities are depreciated over their estimated useful life and are not considered to have any residual value. Improvements and periodic maintenance are amortised over the estimated useful life.

PENSION EXPENSES AND LIABILITIES

Defined-benefit pension scheme

In accordance with IAS 19, both obligations related to collective schemes in life insurance companies and unsecured obligations contained in the financial statements in accordance with the calculations performed by an external actuary. Net pension expense consists of the present value of net pension and interest cost on pension obligations, net of expected return on pension plan assets. Net pension expenses are included in the balance sheet item "wages and other personnel expenses". Changes in estimate deviations are accounted for through other comprehensive income and plan changes will be added to the income statement consecutively. The defined benefit pension scheme in the life insurance company is closed. The arrangement was concluded in 2016 with the conversion to the defined contribution scheme.

Defined-contribution scheme

Under the defined-contribution scheme the Bank does not guarantee a future pension. The Bank pays an annual contribution to the employees' collective pension plan. Payments into the scheme are directly recognised as an expense.

INCOME TAX

Income tax is accrued as a cost, irrespective of when payment is made. The tax expense therefore reflects the year's tax and future taxes payable as a result of the year's activities. The tax expected to offset net income is included in the year's tax expense and is designated as tax payable. Deferred tax is calculated on the basis of differences between the reported results for tax and accounting purposes that will be offset in the future. Tax-increasing and tax-reducing temporary differences within the same time interval are offset against each other.

Any net deferred tax assets are recognised as an asset in the balance sheet when it is probable that the tax-reducing differences will be realised. The company will likewise reduce the deferred tax asset to the extent that the company no longer considers it probable that it can make use of the deferred tax asset.

Wealth tax is calculated and recognised under other operational expenses in the income statement, and tax payable in the balance sheet.

EQUITY

Sparebanken Sør has issued equity certificates on the Oslo Stock Exchange. The equity is divided into equity certificates, premium fund dividend, equalisation fund, subordinated capital fund, gift fund and other equity.

To calculate the share of equity, equity certificates, share premium accounts and equalisation fund are divided by total equity, less other equity and hybrid capital.

The gift fund is part of equity. When gifts are awarded by the bank's gifts committee, the bank's gift fund is charged and this is entered as a liability in the balance sheet.

The proposed distribution of dividend is presented as other equity until a final decision on distribution has been made. Distribution is then presented as allocated dividend until payment has been made.

LEASES

The Group as lessee

Leases where a significant part of the risk and return associated with ownership of the asset is not transferred are classified as operating leases. Lease payments are classified as operating expenses and recognised through profit or loss on a straight-line basis over the term of the lease. Sparebanken Sør has not entered into financial leasing agreements.

The Group as lessor

The Group presents assets that have been leased out as fixed assets in the balance sheet. Leasing revenue is recognised through profit or loss on a straight-line basis over the term of the lease. Direct expenses incurred to establish the operating lease are added to the carrying amount of the asset leased out, and are recognised as an expense in the leasing period on the same basis as leasing revenue.

SEGMENTS / SEGMENT REPORTING

Segments are reported in the same way as the different areas of activity are reported and monitored internally by the Management and the Board.

Sparebanken Sør has two operating segments:

- RM – Retail market, including loans transferred to Sparebanken Sør Boligkreditt AS.
- CM – Corporate market, including loans transferred to Sparebanken Sør Boligkreditt AS.

The Bank's staff departments, including capital market, and real estate agency are not a separate reportable segment and are reported as undistributed.

CASH FLOW STATEMENT

The cash flow statement shows receipts and payments of cash and cash equivalents during the year. Cash and cash equivalents are defined as cash and receivables with central banks.

HYBRID CAPITAL

Hybrid capital (mutual fund bonds) is a bond with an agreed upon interest rate. Hybrid capital has no maturity date, and the Bank has a unilateral right to refrain from paying interest to investors under specified conditions. Hybrid capital does not satisfy the definition of a financial liability in accordance with IAS 32 and is classified as equity. Interest is not presented as an interest expense in the income statement, but as a reduction in other equity.

CHANGES IN ACCOUNTING POLICIES AND NOTE DISCLOSURES

The Bank has started to apply the following standards and changes to standards with effect from 1 January 2018.

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments has replaced IAS 39 Financial Instruments: Recognition and Measurement, and came into effect on 1 January 2018. IFRS 9 has consequences with recognition, classification and measurement, loss provision, derecognition and hedge accounting.

The Group has implemented IFRS 9 retrospectively, with the exception of hedge accounting, which the Group has implemented prospectively from the date of transition to IFRS 9.

The Group has not prepared comparative figures for the period which began on 1 January 2017. See separate section on financial instruments for a description of policies and Note 7 for qualitative model descriptions.

IFRS 15 Revenue from contracts with customers

The standard came into effect for accounting purposes on 1 January 2018 and replaces the previous IAS 18 Revenue with associated interpretations. The core principle of IFRS 15 is that revenue is recognised to reflect the transfer of contracted goods or services to customers, and in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods or services. The standard applies with a few exceptions to all income-generating contracts with customers and provides a model for recognition and measurement of the sale of certain non-financial assets (for example sales of property, plant and equipment).

IFRS 15 requires businesses to use their best judgment and take account of all relevant facts and circumstances when customer contracts are valued in the model's various stages. The standard also specifies how the marginal expenditure related to fulfilment of a contract and the expenditure incurred by the entity in fulfilling this contract should be recognised. In addition, the standard requires extensive note disclosures.

Sparebanken Sør is affected to a small extent by the implementation of IFRS 15, and no adjustments have been made to the financial statements for the financial year 2018, as a result of the large proportion of financial assets in the balance sheet and income statement that are treated in accordance with IFRS 9. Changes are regarded as not being material for the company and the consolidated financial statements.

STANDARDS AND INTERPRETATIONS THAT HAVE BEEN APPROVED, BUT NOT YET ADOPTED

Management has decided against the early adoption of the following new standards and interpretations of existing standards, which have been published and will be mandatory for company and the consolidated financial statements in future accounting periods:

IFRS 16 Leases

IFRS 16 Leases replace the existing standard for leases, IAS 17 Leases with effect from 1 January 2019. IFRS 16 sets out the principles for recognition, measurement, presentation and disclosures on leases for both parties to a lease, i.e. the customer (lessee) and provider (lessor).

Note 38 presents a more detailed account of principles, assessments and effects with regard to implementation of IFRS 16 from 1 January 2019.

In addition to the new standards and interpretations mentioned above, changes to other standards could also affect the Group's future reporting. The effect of the changes to these standards has been assessed by management as being of little significance to the company and consolidated accounts.

Changes to IFRS 9 - Prepayment Features with Negative Compensation

The changes to IFRS 9 permit companies to measure specific financial assets with early redemption with what is known as negative compensation at amortised cost or at fair value through other comprehensive income if a specific condition is fulfilled, instead of fair value through profit or loss.

The changes should be implemented retrospectively and enter into force on 1 January 2019, with an option for early implementation. The Group will not make use of early implementation.

It is anticipated that the changes will be of little significance to the company and consolidated financial statements.

NOTE 2 – DISCRETIONARY JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

In preparing financial statements, management makes estimates and discretionary judgements. Areas largely comprised of discretionary estimates, with a high degree of complexity, and where assumptions and estimates are significant to the accounts of the Parent Bank and the Group, are presented below.

General

In applying the Group's accounting policies, the company's management has exercised discretion in some areas and made assumptions about future events. There will naturally be an inherent uncertainty related to accounting items based on the use of discretion and assumptions about future events. When exercising discretion and making assumptions about future events, management will use information available at the balance-sheet date, previous experience with similar assessments, as well as market and third-party assessments of current conditions. Although management exercises its best judgement and bases itself on the best estimates available, it must be anticipated that the actual outcome may, in some cases, differ materially from the accounting estimates. Estimates, assumptions and conditions that represent a significant risk of material changes in the carrying value of assets and liabilities within the next financial year are discussed below.

Write-down of loans

Assessment of write-downs, where there is objective evidence of impairment, will always be based on a significant degree of discretion. Predictions based on historical information may prove to be incorrect because it can never be known with certainty what relevance historical data has as a basis for making decisions. When the value of collateral relates to specific objects or industries that are in crisis will have to be realised in markets with low liquidity, and any assessment of the collateral's value in such situations will be subject to significant uncertainty.

With effect from 1 January 2018, the Group has introduced model-based loss assessment in accordance with the new standard IFRS 9 Financial Instruments, which has replaced IAS 39 Financial Instruments – Recognition and Measurement. This has led to losses being calculated on loans where there is no objective evidence of losses when a combined model is used. See Note 7 for model descriptions. The model contains data for macroeconomic conditions, and relevant parameters must be adjusted to take account of any changes in the economic climate or macroeconomic conditions. The timing and selection of to be updated depends in part on discretionary assessments and may vary between the different banks.

Fair value of financial instruments

Fair value of financial instruments is based partly on underlying factors that are not observable in the market. This applies in particular to the establishment of relevant premiums for credit risk, in fair value determination for fixed-interest securities in the form of borrowings, lendings and securities issued by others. Management has based its assessments in such cases on the information available in the market, combined with a best estimate. Such information will include credit scoring by leading market players.

NOTE 3 – RISK MANAGEMENT

Sparebanken Sør shall maximise its long-term value creation, and with this objective it is essential that the risk is subject to active and satisfactory management. Part of the Group's business strategy is to keep a low to moderate risk profile for the whole enterprise. Taking risks is a fundamental feature of banking, and risk management is therefore a key area in both day-to-day operations and the general work of the Board. We also refer to the Bank's Pillar 3 disclosure document, which is available on the Bank's website.

ORGANISATION

Board of Directors

The Board has overall responsibility for the Bank's total risk management and aims to ensure that the Bank has appropriate systems in place for risk management and internal control. The Board of Directors determines risk strategies, framework for risk appetite, risk profile and risk tolerance. The Board of Directors also determines the strategy and guidelines for the capital plan and composition of the capital, and approves the process to ensure the Bank at all times has an adequate level of capital (Internal Capital Adequacy Assessment Process, ICAAP).

Audit committee and risk committee

The Board has appointed an audit committee and a risk committee as sub-committees of the Board. The objective is to make a more thorough assessment of relevant matters, including strengthening work on monitoring of risk and financial reporting and internal control.

The Bank's management

The CEO and other members of the management team are responsible for implementing risk management and internal control. Matters pertaining to changes or the implementation of new policies and strategies within the Group should always be presented to the management team for discussion and decision. Management considers the risk situation continuously, and evaluates the overall risk situation and the associated capital requirement at least once a year (ICAAP). These assessments are then presented to the Board.

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

Risk management covers the entire Group and does not perform activities which the control function is intended to monitor. The unit is to identify, measure and evaluate the Bank's overall risk and have the responsibility for compliance.

Internal auditor

The Bank has appointed internal auditors. This is a monitoring function independent of the administration in general, and designed to perform risk assessments, controls and investigations of the Bank's internal control and governance processes to assess whether they are appropriate and proper.

Risk management process

The Bank has expedient and appropriate strategies and processes for risk management, the assessment of its capital requirement and how this can be maintained. The collective term for this is ICAAP.

RISK CATEGORIES

All risks are managed through a framework for risk appetite. Targets have been established for the different risk parameters. Sparebanken Sør operates with the following risk categories:

Credit risk

Credit risk is the risk of loss due to the Group's counterparties or customers not having the ability or willingness to meet their payment obligations to the Sparebanken Sør Group. Credit risk concerns all receivables from counterparties/customers. Credit risk arises when the borrower does not fulfil the loan agreement, and when the established collateral does not cover the commitment.

Credit risk is the Group's highest risk, and the risk that requires the most capital. The Bank's objective is for its credit exposure to be low to moderate. The Board approves the Group's credit strategy and credit policy, and credit is controlled by fixed tolerance limits and targets associated with the risk profile and exposure at portfolio level.

The Board, management and supervisory bodies receive regular credit risk reports. Central to this is the trend in loans divided into different risk classes and movement between classes.

Settlement risk

Settlement risk is a form of credit risk, where a contracting party fails to fulfil its obligations regarding settlement in the form of cash or securities, after the Bank has given notice of payment or transfer of a security or collateral. The settlement risk that the Group is exposed to is considered low.

Counterparty risk

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

Derivative contracts are entered into to hedge risk which arises in the Bank's ordinary operations, in connection with funding at fixed interest rates and in a currency other than NOK, loans to customers at fixed interest rates and in foreign currencies, and derivatives trading with customers. Derivative contracts must be established with reputable counterparties with a good rating and must be regulated by an underlying ISDA agreement. Derivative contracts must be spread across various counterparties to avoid counterparty concentration.

The Bank follows the regulations for derivatives trading under EMIR (European Market Infrastructure Regulation) regarding settlement, confirmations, documentation and reporting to authorities.

The Bank's counterparty risk is regulated through the establishment of agreements on the furnishing of collateral (Collateral Support Annex) between the parties. Under CSA settlement, the value of derivatives is reconciled with the derivative counterparty, and settlement of collateral takes place. In entering into an agreement for collateral settlement for changes in the value of derivatives, the Bank maintains the lowest possible counterparty risk. The Bank will arrange for implementation of derivative clearing during the course of 2019.

Concentration risk

Concentration risk is a credit risk constituting the risk of loss due to a large combined exposure to a single counterparty, groups of related counterparties (large exposures), counterparties operating in the same sector (industry concentration) or geographical area (geographical concentration).

The Bank must maintain a moderate combined concentration risk. Although additional risk due to debtor concentration does exist, it does not, in the Bank's opinion, represent a significant risk for the Group. This is a result of low exposure when taking into account the quality of the collateral. Similar reasoning can be applied in relation to lessee concentration.

The greatest concentration risk facing Sparebanken Sør relates to "Real estate". This part of the portfolio will thus be exposed to risk factors that affect property companies specifically. These risk factors are primarily vacancy, rental prices and interest rates. The latter is a general macro-variable, but property companies are more heavily exposed to interest rate levels than many other sectors because they are highly leveraged and because property is an asset with a longevity.

Individual commitments will vary considerably in terms of sensitivity to these factors, and how it therefore contributes to the portfolio's concentration risk. This depends, among other things, on tenancy, property location and type of building. In addition, the debtor's financial situation has a major impact.

The Bank has set aside additional capital under ICAAP to cover concentration risk.

Liquidity risk

Liquidity risk is defined as the risk of the Group not being able to meet its obligations or fund its assets, and also of it not being able to obtain funding without incurring significant additional costs, in the form of a reduction 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 which the Bank wishes to use are not functioning.

Sparebanken Sør shall have a moderate to low liquidity risk. Liquidity risk should be on par with comparable banks, but be reconciled with the Bank's overall risk profile and the Board's approved capital requirements. The risk profile should be adapted to the current market situation and outlook.

Liquidity risk is monitored by checking exposure in relation to approved limits and by checking of the qualitative requirements.

Market risk

Market risk includes risks related to profit variations on unsecured interest, currency and equity transactions due to changes in interest and exchange rates and adjustments in share prices, and can be divided into interest rate risk, exchange rate risk, share risk and credit spread risk. Sparebanken Sør must have a low market risk.

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 assets on and off the balance sheet do not coincide.

The interest rate risk limit is determined as an upper limit on how large the loss on unsecured interest rate positions may be in case of shifts or distortions in the interest rate curve.

Exchange rate risk

Exchange rate risk is the risk of financial loss arising from a disadvantageous change in the value of asset and liability items (on and off the balance sheet) measured in the base currency (NOK) due to changes in exchange rates. Exposure is measured as the size of the potential losses in a stress scenario, where exchange rates change by 10% and the exchange rate risk is regulated by limits for the maximum aggregated exchange rate position. Limits have been set for exposure in the individual currencies.

Share price risk (share risk)

Share price risk (share risk) consists of market risk associated with positions in equity instruments, including derivatives with underlying equity instruments. Exposure is measured as the size of the potential loss, where the market value of the shares falls by 30% and the exchange rate risk is regulated by limits for the maximum aggregated position in a share portfolio.

Credit spread risk

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

Business risk

Business risk is defined as the risk of unexpected fluctuations in revenue and expenses, based on changes in external factors such as cyclical fluctuations, competitive situation, customer behaviour, inadequate business development and regulations issued by public authorities, i.e. factors other than credit risk, market risk and operational risk. This risk also includes reputational risk, which is the risk associated with increased losses, reduced income and/or increased costs as a result of damage to the Bank's reputation.

Strategic risk

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

Operational risk

Operational risk for the Group is the risk of financial loss due to inadequate or failing internal processes or systems, human error or external events. Operational risk includes the risk of default. Examples of operational risk include various types of adverse actions and events, including money laundering, corruption, embezzlement, insider trading, fraud, robbery, threats against employees, non-compliance with authorisations and adopted procedures, failure of IT systems among other things.

Operational risk is monitored by regular qualitative assessments. The capital requirement for operational risk is calculated in accordance with the basic method, and the adequacy of these capital calculations is assessed as part of the ICAAP process. The Group is considered to have a low operational risk.

HEDGING INSTRUMENTS

The Group uses the following hedging instruments:

- Interest-rate swaps – agreements to swap interest rates for a particular nominal amount over a specified number of periods.
- Currency futures – agreements to buy or sell foreign currencies with settlement at a specified future date.
- Cross-exchange rate interest rate swaps – agreements to swap both interest and exchange rates.

The purpose of using interest rate and currency instruments is to cover the Bank's interest and exchange rate exposure.

NOTE 4 – CAPITAL ADEQUACY

Sparebanken Sør aims to maximise its long-term value creation. The Group also aims to maintain a moderate to low risk profile. This means that effective risk and capital management is a key strategic element.

Sparebanken Sør has established a strategy and process for risk measurement, management and control that provides an overview of the risks the Bank is exposed to. This therefore provides the basis for the assessment and calculation of the Bank's total capital requirement, and how this can be maintained to meet the specific risks in an adequate manner. The process is described as ICAAP (Internal Capital Adequacy Assessment Process). The assessment of capital required includes size, composition and distribution of equity and subordinated loan capital in relation to the risks the Bank is or may be subjected to. This is based on the results of stress tests that show the negative effects of changes in macro-variables on bank losses.

The Board of Directors establishes a capital plan to ensure that the Bank at all times has a total capital ratio which meets regulatory requirements and expectations. In order to have better flexibility in terms of strategic choices and business opportunities, the Bank maintain a higher level of capital than the requirement calculated on the basis of ICAAP.

The minimum requirement for the Bank's core tier 1 capital ratio was 12.0%, tier 1 capital ratio 13.5% and total capital ratio 15.5% as at 31 December 2018. In addition, the Bank must meet the Financial Supervisory Authority of Norway's assessment of the Group's capital requirement (SREP), which concluded with a pillar-2 addition of 2.0% in 2018. (2.1% as at 31 December 2017).

The capital requirements, including a pillar-2 addition of 2.0%, are 14.0% for core tier 1 capital ratio, 15.5% for tier 1 capital ratio and 17.5% for total capital ratio.

The Norwegian Ministry of Finance decided in December 2018 to increase the requirement for a countercyclical capital buffer from 2.0% to 2.5% with effect from 31 December 2019. The increase is in line with a recommendation issued by Norges Bank.

Prior to the increased requirement for a countercyclical capital buffer, the Group aimed to have a core tier 1 capital ratio of 14.8%. In 2019, the Board will implement a process linked to future capital targets, where account will be taken of the requirement for a countercyclical capital buffer.

In October 2018, the Financial Supervisory Authority of Norway proposed amendments to the regulations for identification of systemically important financial institutions. Under this proposal, Sparebanken Sør is to be regarded as systemically important. The proposal has been referred for comment and has not yet been adopted.

If the proposed regulations for identifying systemically important institutions are adopted, this will be taken into account when establishing new capital targets.

Sparebanken Sør uses the standard method for credit and market risk and the basic method for operational risk to calculate capital adequacy in accordance with the current capital adequacy rules – Basel II.

PARENT BANK		NOK MILLION	GROUP	
31.12.2017	31.12.2018		31.12.2018	31.12.2017
9 970	**10 518**	**Total equity**	**11 845**	**11 108**
		Tier 1 capital		
-1 074	-1 075	Equity not eligible as common equity tier 1 capital	-1 075	-1 088
-94	-189	Share of profit not eligible as common equity tier 1 capital	-189	-94
-15	-22	- Deduction for intangible assets and deferred tax assets	-22	-15
-20	-24	- Deduction for aditional value adjustments (AVA)	-21	-21
	-37	Other deductions	-21	
8 767	**9 171**	**Total common equity tier 1 capital**	**10 517**	**9 890**
		Other tier 1 capital		
1 075	1 075	Hybrid capital	1 075	1 075
0	0	Deduction in other tier 1 capital	0	
9 842	**10 246**	**Total tier 1 capital**	**11 591**	**10 965**
		Additional capital over tier 1 capital		
1 404	1 604	Subordinated loan capital	1 604	1 404
-22	-99	Deduction in additional capital	-99	-22
1 382	**1 505**	**Total additional capital**	**1 505**	**1 382**
11 224	11 751	**Net subordinated capital**	**13 096**	**12 347**
		Minimum requirement for subordinated capital Basel II calculated according to the standard method:		
3	3	Engagements with local and regional authorities	3	3
59	51	Engagements with institutions	20	17
168	148	Engagements with enterprises	150	170
475	452	Engagement with mass market	537	498
3 048	3 104	Engagement secured in property	4 213	3 991
47	76	Engagement which have fallen due	80	47
0	2	Engagement which are high risk	2	0
284	403	Engagement in covered bonds	86	79
143	299	Engagement in collective investment funds	151	43
43	49	Engagement, other	62	44
4 270	**4 587**	**Capital requirements for credit- and counterparty risk**	**5 304**	**4 892**
1	**1**	**Capital requirements for position-, currency- and product risk**	**1**	**1**
219	**240**	**Capital requirements for operational risk**	**298**	**280**
23	**0**	**CVA addition**	**0**	**65**
0	**0**	**Deduction from the capital requirement**	**0**	**0**
4 513	**4 828**	**Total minimum requirement for primary capital**	**5 603**	**5 238**
56 401	60 354	Risk-weighted balance (calculation basis)	70 036	65 475
15.5 %	15.2 %	Common equity tier 1 capital ratio, %	15.0 %	15.1 %
17.5 %	17.0 %	Tier 1 capital ratio, %	16.6 %	16.7 %
19.9 %	19.5 %	Total capital ratio, %	18.7 %	18.9 %
8.4 %	7.9 %	Leverage ratio	9.2 %	9.2 %

With effect from 2017, the Group also reported capital adequacy where cooperating groups were consolidated proportionately. For Sparebanken Sør, this applies to Brage Finans AS, in which the Bank has a shareholding of more than 10%.

	COOPERATIVE GROUPS	
NOK MILLION	31.12.2018	31.12.2017
Proportion of common equity tier 1 capital	184	111
Proportion of tier 1 capital	199	126
Proportion of net primary capital	226	**140**
Deductions from internal eliminations	-187	-124
Common equity tier 1 capital after proportionate consolidation	**10 514**	**9 877**
Tier 1 capital after proportionate consolidation	**11 604**	**10 967**
Net primary kapital after proportionate consolidation	**13 135**	**12 363**
Porportion of risk weighted balance	1 336	793
Deductions from internal eliminations	-484	-147
Risk weighted balance after proportonate consolidation	**70 888**	**66 121**
Common equity tier 1 capital ratio after proportionate consolidaton, %	14.8 %	14.9 %
Tier 1 capital ratio after proportionate consolidation, %	16.4 %	16.6 %
(Total) capital ratio after proportionate consolidation, %	18.5 %	18.7 %
Leverage ratio after proportionate consolidation, %	**9.1 %**	**9.2 %**

NOTE 5 – SEGMENT REPORTING

Sparebanken Sør has two operating segments: Retail Market (RM) and Corporate Market (CM). The Bank's own investment activities are not a separate reporting segment and are included under 'Undistributed'. For more information about the segments, refer to accounting policies. Retail Market (RM) and Corporate Market (CM) deviate in this context from retail customers and corporate customers in reporting on sectors and industries.

The different segments recognise actual revenue and expenses related to loans and deposits as revenue and expenses in the balance sheet. All employees are related to the different segments. When there is a liquidity shortfall in the segments, an interest expense is calculated based on an internal rate, which is determined each month.

The Group's branch offices are located in the Agder counties, Telemark and Rogaland. The Group also has customers in other geographical areas, who are served by the established offices. Loans are broken down geographically in Note 10.

None of the Group's customers individually account for more than 10% of turnover. This applies to both 2018 and 2017.

Report per segment	**GROUP 31.12.2018**				**GROUP 31.12.2017**			
NOK MILLION	RM	CM	Undistrib. and elimin.	Total	RM	CM	Undistrib. and elimin.	Total
Net interest	1 000	686	43	1 729	1 021	653	5	1 679
Net other operating income	194	73	76	343	187	67	164	418
Operating expenses	383	99	402	884	371	95	345	811
Profit before losses per segment	**811**	**660**	**-283**	**1 188**	**837**	**625**	**-176**	**1 286**
Losses on loans and guarantees	12	-25	-23	-36	7	46	-33	20
Profit before tax per segment	**799**	**685**	**-260**	**1 224**	**830**	**579**	**-143**	**1 266**
Net loans to customers	68 206	34 819	-84	102 942	64 545	33 025	-51	97 518
Other assets			18 183	18 183			16 792	16 792
Total assets per segment	**68 206**	**34 819**	**18 099**	**121 125**	**64 545**	**33 025**	**16 741**	**114 310**
Deposits from customers	28 719	21 208	6 610	56 537	27 771	21 387	6 423	55 580
Other liabilities	39 488	13 611	-355	52 744	36 774	11 638	-790	47 622
Total liabilities per segment	**68 206**	**34 819**	**6 254**	**109 280**	**64 545**	**33 025**	**5 633**	**103 202**
Equity			11 845	11 845			11 108	11 108
Total liabilities and equity per segment	**68 206**	**34 819**	**18 099**	**121 125**	**64 545**	**33 025**	**16 741**	**114 310**

The Sparebanken Sør Group does not report segments in the Parent Bank separately. Since Sparebanken Sør Boligkreditt AS is an integral part of the Group's retail banking market, it would be misleading to report segments in the Parent Bank in isolation.

NOTE 6 – CREDIT AND CREDIT RISK

Credit risk represents the largest area of risk for the Group. The Board defines the Group's credit strategy which, together with the Bank's credit policies and guidelines for credit processes, are intended to ensure that the customer portfolio has an acceptable risk profile and helps the Group maximise long-term value creation.

Sparebanken Sør has the Agder counties, Telemark and Rogaland as its principal market. In addition, the Bank has a national market segment, encompassing organisations that form part of KNIF (Kristen-Norges Innkjøpsfellesskap) and their employees.

The Bank's risk classes are as follows:

Risk classes	Lower limit of default, %	Upper limit of default, %
A	0.00	0.10
B	0.11	0.25
C	0.26	0.50
D	0.51	0.75
E	0.76	1.25
F	1.26	2.00
G	2.01	3.00
H	3.01	5.00
I	5.01	8.00
J	8.01	99.99
K	100.00	

Loans distributed in risk classes

The models used to calculate the probability of default (PD) in the next 12 months and expected losses (EL) at the customer and portfolio level are based on internal and external data. Retail customers and corporate customers are scored each month, and are divided into 11 classes (A – K) based on their probability of default. Class K comprises non-performing loans and loans with qualitatively assessed impairments. Default is also deemed to exist when debt settlement proceedings have been opened, bankruptcy declared, or when legal steps have been taken to collect the debt. The table below shows the intervals for the different risk classes based on the probability of default.

Probability of default	
Low risk (A-D)	0.00 - 0.75%
Medium risk (E-G)	0.76 - 3.00 %
High risk (H-J)	3.01 - 99.99 %
Default (K)	100 %

TOTAL COMMITMENTS DISTRIBUTED BY RISK CLASSES

Total commitments includes the balance of approved loans and credit to customers, any unused portion of approved loans, guarantee limits and granted guarantees.

PARENT BANK					GROUP			
31.12.2017		31.12.2018		NOK MILLION	31.12.2018		31.12.2017	
				Retail banking customers:				
28 648	78.0 %	25 105	78.2 %	Low risk	59 917	80.9 %	55 933	79.8 %
7 062	19.2 %	5 958	18.6 %	Medium risk	12 635	17.1 %	12 603	18.0 %
771	2.1 %	647	2.0 %	High risk	1 088	1.5 %	1 209	1.7 %
36 481		**31 710**		**Total non-matured or written down**	**73 639**		**69 745**	
334	0.9 %	384	1.2 %	Commitment in default and write-downs comm.	409	0.6 %	348	0.5 %
36 815	**100 %**	**32 094**	**100 %**	**Total retail banking customers**	**74 048**	**100 %**	**70 094**	**100 %**
				Corporate customers:				
21 128	52.0 %	21 924	51.0 %	Low risk	21 917	51.0 %	21 122	51.9 %
15 138	37.2 %	15 116	35.2 %	Medium risk	15 111	35.2 %	15 134	37.2 %
3 408	8.4 %	4 778	11.1 %	High risk	4 777	11.1 %	3 407	8.4 %
39 674		**41 818**		**Total non-matured or written down**	**41 805**		**39 663**	
1 071	2.6 %	1 134	2.6 %	Commitment in default and write-downs comm.	1 134	2.6 %	1 071	2.6 %
40 745	**100 %**	**42 952**	**100 %**	**Total corporate customers**	**42 938**	**100 %**	**40 734**	**100 %**
77 560		**75 046**		**Total commitments**	**116 986**		**110 827**	

GROSS LOANS BROKEN DOWN BY RISK CLASS

PARENT BANK					GROUP			
31.12.2017		31.12.2018		NOK MILLION	31.12.2018		31.12.2017	
				Retail banking customers:				
25 077	76.2 %	22 034	77.0 %	Low risk	53 744	79.8 %	50 150	78.6 %
6 799	20.7 %	5 687	19.9 %	Medium risk	12 227	18.2 %	12 229	19.2 %
752	2.3 %	634	2.2 %	High risk	1 074	1.6 %	1 184	1.9 %
32 629		**28 354**		**Total non-matured or written down**	**67 044**		**63 563**	
268	0.8 %	276	1.0 %	Commitments in default	290	0.4 %	281	0.4 %
32 897	**100 %**	**28 630**	**100 %**	**Total retail banking customers**	**67 334**	**100 %**	**63 844**	**100 %**
				Corporate customers:				
17 260	50.6 %	18 133	50.4 %	Low risk	18 104	50.4 %	17 235	50.6 %
12 990	38.1 %	12 788	35.6 %	Medium risk	12 768	35.6 %	12 970	38.1 %
2 949	8.6 %	4 329	12.0 %	High risk	4 322	12.0 %	2 944	8.6 %
33 199		**35 249**		**Total non-matured or written down**	**35 193**		**33 150**	
918	2.7 %	699	1.9 %	Commitments in default	699	1.9 %	917	2.7 %
34 117	**100 %**	**35 948**	**100 %**	**Total corporate customers**	**35 892**	**100 %**	**34 067**	**100 %**
144		**135**		Accrued interest	**173**		**175**	
67 158		**64 714**		**Total gross loans**	**103 400**		**98 086**	

MIGRATION BETWEEN RISK CLASSES DURING THE YEAR

For the Group as a whole, there has been a slight positive migration in the retail market portfolio. The overall risk to the retail market portfolio is assessed as highly satisfactory.

There was a minor negative migration in the corporate portfolio. Gross loans with low to medium risk account for approximately 85.4% of the portfolio.

The classification does not take collateral into account, only solvency.

Maximum credit risk

Maximum exposure to credit risk, for the components of the balance sheet, including derivatives. Exposure is shown gross before any pledged security and permitted offsets.

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Assets		
3 516	3 010	Loans and advances to credit institutions	119	236
66 595	64 263	Net loans to costumers	102 942	97 518
12 660	17 691	Bonds and certificates	14 598	13 468
385	197	Financial derivatives	619	754
83 156	**85 161**	**Total credit risk exposure from balance sheet**	**118 278**	**111 976**
		Financial guarantee commitments, unutilised credits and loan approvals		
1 504	1 432	Guarantees	1 432	1 504
640	1 109	Unutilised credits to credit institutions		
8 899	8 901	Unutilised credits	12 155	11 238
1 275	325	Loan approvals	325	1 275
12 318	**11 767**	**Total financial guarantee commitments, unutilised credits and loan approvals**	**13 912**	**14 017**
95 474	**96 928**	**Total credit risk exposure**	**132 190**	**125 993**

Collateral

The Group uses a variety of collateral to reduce risk depending on the market and type of transaction. The main principle for assessing collateral is that the value is estimated to what it would be in a situation where the bank has need for the collateral. With the exception of commitments where impairments have been recognised, the value of collateral is calculated on a going concern basis. The valuation of collateral takes into account the estimated sales-cost. The main types of collateral used are mortgages secured on dwellings (residential/commercial), personal guarantees (consumer guarantees and surety), registrable movable property (inventory, plant and machinery) and receivables. The estimated value of residential as collateral for loans transferred to Sparebanken Sør Boligkreditt AS is updated quarterly, while collateral for other loans is updated when new credit applications are processed or commitments followed up, at the very least. The Group's loans generally have very good collateral.

Collateral in the retail market

Mortgages constitute the major part of the retail market portfolio, and the group's mortgage portfolio has the following LTV (Loan to Value) distribution.

Loan to value ratio (LTV) loans secured by permanent housing as at 31.12.2018

	PARENT BANK		GROUP	
LTV 31.12.2018	NOK MILLION	%	NOK MILLION	%
Under 40 %	1 494	7.0 %	7 835	12.9 %
40 - 50 %	1 258	5.9 %	6 200	10.2 %
50 - 60 %	2 309	10.7 %	10 349	17.1 %
60 - 70 %	3 963	18.5 %	17 383	28.7 %
70 - 75 %	2 153	10.0 %	6 923	11.4 %
75 - 80 %	2 765	12.9 %	3 929	6.5 %
80 - 85 %	2 814	13.1 %	3 154	5.2 %
85 - 90 %	1 699	7.9 %	1 711	2.8 %
90 - 95 %	1 191	5.5 %	1 203	2.0 %
95 - 100 %	902	4.2 %	919	1.5 %
Over 100 %	930	4.3 %	931	1.5 %
TOTAL	**21 477**	**100 %**	**60 537**	**100 %**

Loan to value ratio (LTV) loans secured by permanent housing as at 31.12.2017

	PARENT BANK		GROUP	
LTV 31.12.2017	NOK MILLION	%	NOK MILLION	%
Under 40 %	2 322	8.9 %	7 542	13.2 %
40 - 50 %	1 869	7.2 %	5 679	10.0 %
50 - 60 %	3 175	12.2 %	9 180	16.1 %
60 - 70 %	5 688	21.8 %	15 574	27.3 %
70 - 75 %	2 927	11.2 %	7 054	12.4 %
75 - 80 %	2 571	9.9 %	3 889	6.8 %
80 - 85 %	2 614	10.0 %	3 065	5.4 %
85 - 90 %	1 779	6.8 %	1 850	3.2 %
90 - 95 %	1 229	4.7 %	1 257	2.2 %
95 - 100 %	1 027	3.9 %	1 056	1.9 %
Over 100 %	842	3.2 %	847	1.5 %
TOTAL	**26 044**	**100 %**	**56 993**	**100 %**

It should be noted that the LTV ratio is based on a traditional ratio where the entire loan is placed in the interval where the "last part" of the loan belongs. This means that the real LTV ratio will be lower than shown in the table. For a loan that is embedded with a high loan-to-value ratio, only part of this loan volume will be in the interval with a high loan-to-value ratio, while most of the loan will be in the lower intervals.

Collateral in the commercial market

The measurement and assessment of collateral for corporate loans are more complex than for the retail market, and will be subject to greater uncertainty in estimates at the portfolio level. However, the bank frequently reviews the collaterals in its loan portfolio on an individual level.

NOTE 7 – DESCRIPTION OF THE LOSS MODEL UNDER IFRS 9

IMPAIRMENT MODEL

The model assessing the impairment of financial assets under IFRS 9 applies to financial assets measured at amortised cost and financial assets measured at fair value through other comprehensive income. The new standard was implemented on 1 January 2018. See Note 1 for a discussion of accounting policies implemented to comply with the new standard. The same calculation model is used for the Group, mortgage company and Parent Bank, but with different dates being defined for initial recognition.

Under IFRS 9, provision must be made for expected losses, based on relevant information available at the time of reporting, including historical, current and future information. The difference compared with the previous standard is that the loss is shown in the accounts before a loss event has occurred, and that future expectations are included in the calculations.

Impairment losses are calculated on the basis of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The principal rule is that the loss provision is calculated on the basis of expected credit loss over the next 12 months or expected credit loss over the whole term. Expected credit loss over the whole term is calculated for assets where the credit risk has increased significantly since initial recognition, with the exception of assets which are nevertheless assessed as having a low absolute credit risk on the reporting date. If there has not been a significant increase in credit risk since initial recognition, a loss provision will be calculated for expected credit loss in the next 12 months. IFRS 9 also introduces requirements for loss provisions on new loans, by stating that an impairment must be recognised for expected credit losses resulting from default in the next 12 months.

Assessment of a significant increase in credit risk

A significant increase in credit risk is assessed on the basis of both the relative increase in PD and the absolute change. It requires the relative change to be significant and the level of risk itself to be not insignificant compared with that considered to be a low risk. In addition, any large absolute change must, under any circumstances, be regarded as a significant increase.

The limits for significant increase and PD checks are summarised in the table below:

Parameter	RM	CM
Absolute limit (a)	0.75 %	0.75 %
Relative change (b)	2	2
Absolute change (c)	5 %	5 %

The absolute limit corresponds to risk class D. Risk class D for CM corresponds to 0.625%, but some customers are scored according to the RM model, and can then receive up to 0.75%. Risk class D for RM corresponds to the range 0.5% to 0.75%.

If the economic cycle or national/regional development trends indicate that there is a higher risk in individual sectors/ industries, this is taken into account by changing the PD level of customers in the sectors/industries concerned.

PD as basis for expected loss

The Bank's PD model gives PD at customer level, 12 months ahead. The Bank does not have a lifetime PD model.

When calculating the expected credit loss over the lifetime of the commitment, it is the probability of default over the same lifetime that should be used. A methodology has been developed to estimate PD over a commitment's lifetime. This is based on breaking lifetime down into separate years and estimating PD for each year ahead in time.

The Bank's PD models are validated each year.

Population

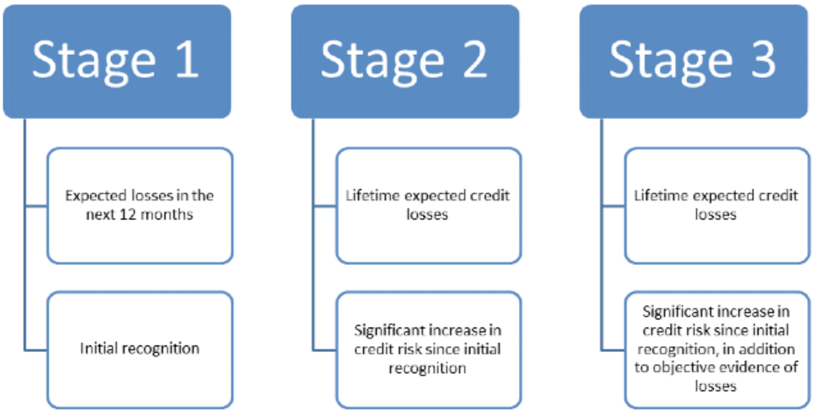
The model is intended to calculate expected loss for all customers, at the account level and not already recognised losses. The model also includes loan approvals, guarantees and unused lines of credit. For loans where the credit risk has increased significantly after initial recognition, an impairment loss must be recognised for expected credit losses over the term of the loans. The calculation of impairment losses under IFRS 9 is based on status extracts at the end of the previous month for all the Bank's customers. All model calculations are made at account level. Data that exists only at customer level is linked to individual accounts. For example, risk class is allocated at the customer level so that all the customer's accounts have the same score. The most important variables in the extract are risk class and PD with associated interest, balance, approval and collateral at the time of calculation.

Loans approved but not discounted at the calculation date must also be included in the basis of calculation.

Under IFRS 9, an expected loss must also be calculated on receivables from central banks and credit institutions. The Group has no loss provisions with respect to these receivables for the financial year 2018. This is because the bulk of its loans to credit institutions relates to Norwegian banks. These are allocated to risk class B and have a PD of 0.175%. LGD are regarded as being low as they have a high rating from external agencies. The Group considers the requirements for low credit risk to have been met as of the balance sheet date.

After the dataset has been defined, the various account commitments are noted and allocated to the different stages. Allocation to one of the three "stages" in the model is based on their change in risk since approval (change of credit risk). For a description of the individual "stages", see the subsequent explanations. All commitments are placed in stage 1 upon initial recognition, and are subsequently moved to stage 2 or 3 if there has been a significant increase in credit risk. Commitments for which qualitatively assessed impairment losses have been recognised are excluded from the model-based calculation of impairment losses. Qualitatively assessed impairment losses are added to those in stage 3.

Non-performing account commitments are defined in the model as all account commitments where the customer has risk class K. For an overview of the Bank's risk classes, refer to Note 6 –Credit and credit risk. A customer's commitment is assessed as being non-performing if an instalment has not been paid 90 days after its due date, or a line of credit has been overdrawn for more than 90 days. Where a customer has one or more non-performing loans, it is the customer's total commitment that is reported as being in default and not just the individual loan. See also Note 11.



Stage 1

In most cases, this is starting point for all financial assets that come under the general impairment model. Financial instruments that have the same credit risk as at initial recognition and which have not been classified in stage 2 or 3 are covered by this stage. The estimated expected losses recognised in the balance sheet are equivalent to the expected losses over the next 12 months.

Stage 2

Financial assets that have had a significant increase in credit risk since initial recognition are placed in stage 2. Whether an account commitment has had a significant change or not, is defined as a function of the probability of default (PD) on the measurement date and the probability of default on the date of loan approval. Expected losses on assets in stage 2 are calculated over the remaining term of the asset.

The model has the following additional indicators and overriding rules for customer commitments (loans to customers):

- For commitments that qualify for a one-year loss calculation (stage 1), a check will be made of whether there is a 30-day default/account overdrawn. If so, the commitment will be transferred to lifetime calculation (stage 2). This applies to overdrawn accounts from the first Norwegian krone, but older than 30 days.

- For commitments that qualify for a one-year loss calculation (stage 1), a check will be made of whether there is a larger overdraft. If so, the commitment will be transferred to lifetime calculation (stage 2). This applies to overdrawn amounts that are relatively larger than the credit limit, starting from the first day.
- Commitments with changed payment obligations or refinancing (forbearance) are automatically moved to stage 2.
- The commitments are also checked against an internal watch list that will detect commitment-specific forward-looking risk.

Stage 3

Stage 3 of the impairment model includes assets that have had a significant change in credit risk since initial recognition and where there is objective evidence of loss at the time of reporting. In this stage, the model calculates an expected loss over the remaining term of the asset. If individual impairment losses have been recognised, these override the model-based calculation.

The same model is used for the Group, Parent Bank and a wholly owned mortgage company, but with different date being defined for initial recognition. At Group level, the account's approval date is used, while the transfer date is used for the mortgage company. As a general rule, the approval date will be used for the Parent Bank, unless the account has been registered in the mortgage company. If so, the date of transfer to the Parent Bank is used.

Estimated losses will be calculated on the basis of 12 months' probability of default (PD), loss given default (LGD) and exposure at default (EAD). The dataset contains historical data about the observed probability of default (PD) and loss given default (LGD). This will form the basis for producing estimates of future PD and LGD values. The Bank's PD model gives PD at customer level, one year ahead. The Bank does not have a lifetime PD model. When calculating expected credit loss over the lifetime of the commitment, it is the probability of default over the same lifetime that should be used.

Migration to a lower stage

A commitment that has migrated to stage 2 can migrate back to stage 1 if it no longer fulfils the criteria for migration stated above. Migration to a lower stage is not subject to any explicit quarantine period. Commitments that have gone into default will migrate to stage 1 or 2 when they are no longer in default.

Macroeconomic conditions and scenarios

The model contains data for macroeconomic conditions, and relevant parameters must be adjusted to take account of any changes in economic climate or macro conditions before the model can be run. The parameters are mostly set on the basis of empirical evidence.

The company has made use of 9 macro-variables in the model for 2018. These are based on a monetary policy report / financial stability assessment, obtained from Norges Bank. The macro-variables include national and international growth in GDP, growth in house prices, growth in unemployment, level of key interest rate and oil prices.

Three scenarios are defined in the model, realistic (base) scenario, optimistic scenario and pessimistic scenario. All scenarios are applicable with effect from the date of calculation. This means that the first scenario period is in progress at the time of calculation. This is done so that the scenarios will have an impact on the whole calculation, including stages 1 and 3. The background to the assessments is an overall assessment of all the central elements affecting the development of the Norwegian and regional economy, and whether these factors suggest that changes should be made to the PD and/or LGD level in individual sectors, product and market segments or the whole portfolio.

The realistic (base) scenario is a macroeconomic scenario that represents expected future economic growth over the next 5 years. The realistic scenario is comparable to the ICAAP scenario Base Case. The scenario is based on an expectation of stable and moderate global economic growth, as well as stable growth in the Norwegian economy over the next 5 years. It is further expected that regional economic growth over the next 5 years will be on a par with the rest of the country.

The optimistic scenario is a macroeconomic scenario that represents an economic upturn with strong economic growth. In year 5, the scenario converges towards balance with the realistic scenario. Positive development and strong economic growth over the next 5 years are expected in this scenario. Oil prices will rise and the Norwegian economy will experience strong economic growth. Regional economic growth is expected to be on a par with the rest of the country.

The pessimistic scenario represents a downturn, with weak economic growth. The pessimistic scenario may represent an economic downturn based on a 25-year cycle, but one that will be considerably milder than the credit crisis in the early 1990s. In year 5, the scenario converges towards balance with the realistic scenario. In this scenario, it is expected that growth in emerging markets will decline. Increased protectionism will create barriers to trade and global economic growth will stall. Oil prices fall and, taken together with weak economic growth among our most important trading partners, this will lead to weak development and growth in the Norwegian economy. Regional economic growth is expected to be on a par with the rest of the country.

Sensitivities

To a large extent, Sparebanken Sør has loans secured by property. This is considered to be one of the parameters that affect LGD the most. Another important parameter that significantly affects the loss expense relates to the probability of default (PD). A sensitivity analysis relating to changes in the portfolio's collateral and increased probability of default was therefore performed as at 31 December 2018.

The analysis has been carried out by assuming a reduction in collateral of 30% and a doubling of PD over the coming year. The changes have the following impact on the Group's loss expense:

	GROUP 31.12.2018		PARENT BANK 31.12.2018	
Loan loss provisions	30 percent reduction in collateral	A doubling of PD in realistic scenario	30 percent reduction in collateral	A doubling of PD in realistic scenario
- loan loss provisions, CM	107	77	107	77
- loan loss provisions, RM	40	13	25	9
Total	**147**	**90**	**132**	**86**

The Bank has further assessed the scenarios described above and weighted them to determine ECL. Weighting was performed on the basis of an expectation that a realistic scenario will occur in 3 out of 5 years (60% probability), while the other two scenarios will occur in 1 out of 5 years (20% probability each).

Parameter	RM	CM
Weighted optimistic scenario	20.00%	20.00%
Weighted realistic scenario	60.00%	60.00%
Weighted pessimistic scenario	20.00%	20.00%

NOTE 8 – LOSSES ON LOANS, GUARANTEES AND UNUSED CREDIT FACILITIES

Losses on loans

Provisions for losses and loss expense for the period are calculated according to the new accounting standard IFRS 9 and are based on expected credit loss (ECL) using the 3-stage model described in Note 7 to the financial statements.

Figures for the corresponding period last year are stated in accordance with IAS 39, using the previously applied loss model. Figures for the current period will thus not be directly comparable with previous periods.

The various elements contained in losses and write-downs on loans, guarantees and unused credit facilities are discussed under Accounting Policies. Reference is also made to a note on Risk Management in Sparebanken Sør and to Note 6 on Credit and credit risk.

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
	-3	Change in impairment losses for the period, stage 1	-3	
	-3	+ Change in impairment losses for the period, stage 2	-7	
	-44	+ Change in impairment losses for the period, stage 3	-43	
	22	+ Confirmed losses for the period	22	
3		Change in individual impairment losses during the period		3
-30		+ Change in collective impairment losses during the period		-30
50		+ Confirmed losses for the period included in individual impairment losses previous years		50
8		+ Confirmed losses for the period not included in individual impairment losses previous years		8
4	4	+ Recognised as interest income	4	4
11	8	- Periods recoveries relating to previous losses	8	11
-4	-1	+ changes in impairment losses on guarantees	-1	-4
20	**-33**	**= Loss expenses during the period**	**-36**	**20**

The balance of confirmed losses as at 31December 2018 was NOK 119 million. The equivalent figure as at 31 December 2017 was NOK 154 million. This applies to loans which have been derecognised and which the Group is still working to collect.

GROUP	Stage 1	Stage 2	Stage 3	
NOK MILLION	Expected losses in the next 12 months	Lifetime expected credit losses	Lifetime expected credit losses	Total
Provisions for loan losses as at 01/01/2018	**51**	**99**	**416**	**566**
Transfers				
Transferred to stage 1	35	-32	-3	0
Transferred to stage 2	-5	5	0	0
Transferred to stage 3	0	-1	1	0
Losses on new loans	19	16	29	64
Losses on derecognised loans *	-10	-17	-83	-110
Losses on older loans and other changes	-44	23	-24	-46
Provisions for loan losses as at 31/12/2018	**45**	**94**	**335**	**473**
Provisions for loan losses	39	88	331	458
Provisions for losses on guarantees and undrawn credits	6	6	3	16
Total provision for losses as at 31/12/2018	**45**	**94**	**335**	**473**

* Losses on derecognised loans relate to losses on loans redeemed or transferred between the parent bank and Sparebanken Sør Boligkreditt AS.
The table also includes write-downs on off-balance sheet items (unused credit facilities and guarantees). These are presented as other liabilities in the balance sheet.

PARENT BANK	Stage 1	Stage 2	Stage 3	
NOK MILLION	Expected losses in the next 12 months	Lifetime expected credit losses	Lifetime expected credit losses	Total
Provisions for loan losses as at 01/01/2018	**49**	**91**	**415**	**555**
Transfers				
Transferred to stage 1	31	-28	-3	0
Transferred to stage 2	-5	5	0	0
Transferred to stage 3	0	-1	1	0
Losses on new loans	18	15	29	62
Losses on deducted loans *	-10	-15	-83	-108
Losses on older loans and other changes	-39	23	-29	-44
Provisions for loan losses as at 31/12/2018	**44**	**91**	**330**	**466**
Provisions for loan losses	38	85	327	450
Provisions for losses on guarantees and undrawn credits	6	6	3	16
Total provision for losses as at 31/12/2018	**44**	**91**	**330**	**466**

* Losses on derecognised loans relate to losses on loans that have been repaid.
The table also includes write-downs on off-balance sheet items (unused credit facilities and guarantees). These are presented as other liabilities in the balance sheet.

For changes in balance sheet items from 31 December 2017 to 1 January 2018 which follow from transition to the new accounting standard, see Note 21 and Note 38 to the annual financial statements for 2017. The following table shows reported figures for the corresponding period last year and as at 31 December 2017 in accordance with IAS 39.

PARENT BANK 31.12.2017	NOK MILLION	GROUP 31.12.2017
	Individual impairment losss	
385	Individual impairment losses at start of period	385
50	- Confirmed losses in the period previosly included in individual impairment losses	50
27	+ Increase in individual impairment losses during the period	27
50	+ New individual impairment losses during the period	50
24	- Reversal of individual impairment losses during end of the period	24
388	**= Individual impairment losses at the end of the period**	**388**
	Collective impairment losses on loans	
204	Collective impairment losses on loans at the start of the period	210
-30	+ Change in collective impairment losses during the period	-30
174	**Collective impairment losses on loans at the end of period**	**180**

IMPAIRMENT BY SECTOR, INDUSTRY AND STAGE

PARENT BANK					GROUP			
Stage 1	Stage 2	Stage 3	Total losses at 31.12.18	NOK MILLION	Total losses at 31.12.18	Stage 3	Stage 2	Stage 1
3	11	31	44	Retail customers	52	31	17	5
0	0	0	0	Public administration	0	0	0	0
0	0	1	2	Primary industry	2	1	0	0
1	2	35	38	Manufactoring industry	38	35	2	1
11	9	36	56	Real estate development	56	36	9	10
1	5	90	95	Building and construction industry	96	91	4	1
22	52	100	174	Property management	173	101	50	22
1	2	7	9	Transport	9	7	1	1
1	4	20	25	Retail trade	25	20	4	1
0	1	0	1	Hotel and restaurants	1	0	0	0
1	1	0	2	Housing cooperatives	2	0	1	0
1	3	9	13	Financial/commercial services	13	9	3	1
3	2	3	7	Sosial services	7	3	2	3
44	**91**	**330**	**466**	**Total impairment losses on loans, guarantees and undrawn credit**	**473**	**335**	**94**	**45**
38	85	327	450	Impairment losses on lending	457	331	88	39
6	6	3	16	Impairment losses on unused credits and guarantees	16	3	6	7
44	**91**	**330**	**466**	**Total impairment losses**	**473**	**335**	**94**	**45**

Individual impairments for 2017 were reported by sector and industry. This was in line with the original standard IAS 39, and not the present-day standard IFRS 9. Individual impairments as a concept are not used under the new standard. Corresponding impairments, based on objective evidence of loss, are accordingly included in stage 3. The tables will thus not be comparable.

NOK MILLION	31.12.2017
Retail banking costumers	32
Corporate costumers	356
Total individual write-downs	**388**
Public administration	0
Primary industry	2
Manufacturing industry	35
Real estate development	72
Building and construction industry	58
Property management	143
Transport	1
Retail trade	11
Hotel and restaurant	4
Housing cooperatives	0
Financial/commercial services	25
Social services	5
Total corporate costumers	**356**

The presentation of industries is based on official industrial codes and is grouped as the Group reports these internally.

Calculated loss as at 31 December 2018 based on the different stages in the loss model

NOK MILLION	Stage	Commitment	In %	Calculated loss	In %
GROUP					
Corporate market	1	34 407	30.1 %	40	8.4 %
	2	5 787	5.1 %	79	16.6 %
	3	781	0.7 %	304	64.2 %
Corporate market total		**40 974**	**35.8 %**	**422**	**89.2 %**
Retail market	1	68 055	59.5 %	5	1.0 %
	2	5 205	4.5 %	15	3.2 %
	3	229	0.2 %	31	6.6 %
Retail market total		**73 489**	**64.2 %**	**51**	**10.8 %**
Total		**114 463**	**100.0 %**	**473**	**100.0 %**

NOK MILLION	Stage	Commitment	In %	Calculated loss	In %
PARENT BANK					
Corporate market	1	34 402	45.8 %	41	8.8 %
	2	5 787	7.7 %	80	17.3 %
	3	781	1.0 %	300	64.4 %
Corporate market total		**40 970**	**54.5 %**	**421**	**90.5 %**
Retail market	1	30 518	40.6 %	3	0.7 %
	2	3 460	4.6 %	11	2.3 %
	3	215	0.3 %	31	6.6 %
Retail market total		**34 192**	**45.5 %**	**44**	**9.5 %**
Total		**75 162**	**100.0 %**	**466**	**100.0 %**

Amount of commitment and loss provision per stage

NOK MILLION	Stage 1	Stage 2	Stage 3	Total
GROUP				
Commitments at 1.1.2018	97 718	11 921	1 189	110 827
Provisions for loan losses at 1.1.2018	51	99	416	566
Losses as % of commitments	0.05 %	0.83 %	34.99 %	0.51 %
Commitments at 31.12.2018	102 462	10 992	1 010	114 463
Provisions for loan losses at 31.12.2018	45	94	335	473
Losses as % of commitments	0.04 %	0.86 %	33.17 %	0.41 %

NOK MILLION	Stage 1	Stage 2	Stage 3	Total
PARENT BANK				
Commitments at 1.1.2018	67 551	8 904	1 105	77 560
Provisions for loan losses at 1.1.2018	49	91	415	555
Losses as % of commitments	0.07 %	1.02 %	37.56 %	0.72 %
Commitments at 31.12.2018	64 920	9 247	996	75 162
Provisions for loan losses at 31.12.2018	44	91	330	466
Losses as % of commitments	0.07 %	0.98 %	33.13 %	0.62 %

Expected annual average net loss

Impairment losses totalling NOK 473 million were recognised in connection with losses on loans, guarantees and unused credit facilities as at 31 December 2018 (NOK 388 million in individual impairments and NOK 180 million in collective impairments as at 31 December 2017). These relate to different risk classes.

All commitments to the corporate market are priced individually on the basis of, among other things, risk, profitability requirement and competitive situation. The pricing therefore reflects the risk relating to the commitment, and margins obtained are generally greater at higher risk.

Mortgage loans are priced using a price matrix which reflects both loan to value and risk classification.

The Group implemented the IFRS 9 standard in 2018. The implementation has had an impact on the calculation of the Group's loss expense. The Group has made provisions for expected losses, which has led to somewhat greater fluctuations in the loss expense over the year. Fluctuations in loss expenses are also expected in the future. Based on the composition of the Bank's loan portfolio, the state of the economy and local market conditions, it is expected that losses in Sparebanken Sør overall will remain at a low level in 2019. The Bank's goal of keeping its total loss level below 0.20% of gross loans is maintained for the period 2019–2021.

NOTE 9 – LOANS BROKEN DOWN BY TYPE

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Loans valued at amortised cost		
7 273	6 334	Overdraft- and working capital facilities	14 548	14 791
3 974	3 845	Building loans	3 845	3 974
49 449	27 788	Repayment loans	79 120	72 830
60 696	**37 967**	**Total loans valued at amortised cost**	**97 513**	**91 595**
		Loan designated at fair value through income statement		
	20 893	Mortgages		
6 316	5 714	Fixed rate loans	5 714	6 316
6 316	**26 607**	**Total loans designated at fair value through income statement**	**5 714**	**6 316**
145	139	Accrued interest	173	175
67 157	**64 713**	**TOTAL GROSS LOANS**	**103 400**	**98 086**
-562	-450	Impairment losses on lending	-458	-568
66 595	**64 263**	**TOTAL NET LOANS**	**102 942**	**97 518**

For impairments, see Note 8 Losses on loans, guarantees and unused credit facilities.

NOTE 10 – LOANS BROKEN DOWN BY GEOGRAPHICAL AREA, SECTOR AND INDUSTRY

Gross loans by georaphical area

PARENT BANK					GROUP			
31.12.2017		31.12.2018		NOK MILLION	31.12.2018		31.12.2017	
31 635	47.1 %	31 913	49.3 %	Vest-Agder	46 322	44.8 %	45 306	46.2 %
16 299	24.3 %	15 482	23.9 %	Aust-Agder	25 003	24.2 %	24 906	25.4 %
7 418	11.0 %	7 957	12.3 %	Telemark	11 384	11.0 %	10 466	10.7 %
5 616	8.4 %	4 991	7.7 %	Oslo	8 651	8.4 %	7 936	8.1 %
1 119	1.7 %	1 687	2.6 %	Akershus	2 716	2.6 %	2 393	2.4 %
1 616	2.4 %	991	1.5 %	Rogaland	2 593	2.5 %	2 240	2.3 %
3 311	4.9 %	1 557	2.4 %	Others	6 559	6.3 %	4 664	4.8 %
145	0.2 %	135	0.2 %	Accrued interest	173	0.2 %	175	0.2 %
67 157	**100.0 %**	**64 713**	**100.0 %**	**TOTAL GROSS LOANS**	**103 400**	**100.0 %**	**98 086**	**100 %**

The geographical breakdown is based on the customer's home/business address.

Gross loans by sector and industry

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
32 896	28 575	Retail customers	67 282	63 844
413	550	Public administration	551	413
858	947	Primary industry	948	858
1 136	971	Manufacturing industry	972	1 136
4 162	4 756	Real estate development	4 663	4 113
1 516	1 516	Building and construction industry	1 518	1 516
16 282	18 019	Property management	18 039	16 280
667	668	Transport	669	667
1 148	1 051	Retail trade	1 052	1 148
611	301	Hotel and restaurant	301	611
1 439	1 095	Housing cooperatives	1 096	1 438
1 072	1 150	Financial/commercial services	1 151	1 072
4 814	4 978	Social services	4 983	4 814
144	135	Accrued interests	173	175
67 157	**64 713**	**TOTAL GROSS LOANS**	**103 400**	**98 086**
562	450	Impairment losses on lending	458	568
66 595	**64 263**	**TOTAL NET LOANS**	**102 942**	**97 518**

Guarantees by sector and industry

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
27	19	Retail customers	19	27
1	2	Public administration	2	1
20	13	Primary industry	13	20
234	208	Manufacturing industry	208	234
375	393	Real estate development	393	375
262	259	Building and construction industry	259	262
230	153	Property management	153	230
100	93	Transport	93	100
175	180	Retail trade	180	175
8	9	Hotel and restaurant	9	8
37	62	Financial/commercial services	62	37
35	40	Social services	40	35
1 504	**1 432**	**TOTAL GUARANTEES**	**1 432**	**1 504**

Unutilised credit by sector and industry

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
3 823	3 442	Retail customers	6 636	6 111
311	323	Public administration	322	311
122	156	Primary industry	154	122
386	404	Manufacturing industry	403	386
956	1 327	Real estate development	1 420	1 004
530	514	Building and construction industry	512	530
1 326	1 372	Property management	1 352	1 327
64	68	Transport	67	64
361	485	Retail trade	484	362
52	45	Hotel and restaurant	45	52
11	11	Housing cooperatives	10	12
157	216	Financial/commercial services	215	157
800	540	Social services	535	800
8 899	**8 901**	**TOTAL UNUSED CREDIT**	**12 155**	**11 238**

Commitments by sector and industry

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
36 747	32 036	Retail customers	73 938	69 983
726	875	Public administration	875	726
1 000	1 116	Primary industry	1 116	1 000
1 756	1 584	Manufacturing industry	1 584	1 756
5 493	6 476	Real estate development	6 476	5 493
2 308	2 289	Building and construction industry	2 289	2 308
17 837	19 544	Property management	19 544	17 837
830	829	Transport	829	830
1 684	1 716	Retail trade	1 716	1 684
671	355	Hotel and restaurant	355	671
1 450	1 106	Housing cooperatives	1 106	1 450
1 266	1 428	Financial/commercial services	1 428	1 266
5 649	5 558	Social services	5 558	5 649
144	135	Accrued interests	173	175
77 560	**75 046**	**TOTAL COMMITMENTS**	**116 986**	**110 827**

NOTE 11 – NON-PERFORMING LOANS

With effect from 31 December 2018, the Group has changed its treatment of non-performing loans in accordance with IFRS 9. Reported figures for 2017 follow previously applied principles and are shown in a separate table. Non-performing loans are defined in Note 6.

Non-performing loans as at 31.12.2018

PARENT BANK		GROUP
31.12.2018	NOK MILLION	31.12.2018
213	Gross non-performing loans	213
762	Other non-performing loans	776
975	**Total non-performing loans (Stage 3)**	**989**
327	Stage 3 impairment losses	331
648	**Net non-performing loans**	**658**
33.5 %	Provision ratio impairment losses	33.5 %
0.33 %	**Gross non-performing loans in % of gross loans**	**0.21 %**

Gross non-performing loans by sector and industry

PARENT BANK		GROUP
31.12.2018	NOK MILLION	31.12.2018
276	Retail banking customers	290
699	Corporate customers	699
975	**Total defaulted loans**	**989**
0	Public administration	0
17	Primary industry	17
26	Manufacturing industry	26
159	Real estate development	159
179	Building and construction industry	179
208	Property management	208
38	Transport	38
22	Retail trade	22
8	Hotel and restaurant	8
0	Housing cooperatives	0
26	Financial/commercial services	26
16	Social services	16
699	**Total corporate customers**	**699**

The weighted average collateral coverage was 79% for non-performing loans as at 31 December 2018. Collateral coverage is the extent of the pledged security linked to each loan, and cannot exceed 100%.

Non-performing commitments as at 31.12.2017

According to previously applied principles, a customer's commitment is considered to be non-performing if an instalment has not been paid 90 days after its due date, or a line of credit has been overdrawn for more than 90 days. Where a customer has one or more non-performing loans, it is the customer's total commitment that is reported as being in default and not just the individual loan.

Total non-performing loans

PARENT BANK		GROUP
31.12.2017	NOK MILLION	31.12.2017
273	Gross non-performing loans	273
60	Individual write-downs	60
	Stage 3 impairment losses	
213	**Net non-performing loans**	**213**
22.0 %	Provision ratio defaulted loans	22.0 %
0.41 %	**Gross non-performing loans in % of gross loans**	**0.28 %**

Gross non-performing loans by sector and industry

PARENT BANK		GROUP
31.12.2017	NOK MILLION	31.12.2017
90	Retail banking customers	90
183	Corporate customers	183
273	**Total defaulted loans**	**273**
0	Public administration	0
17	Primary industry	17
0	Manufacturing industry	0
21	Real estate development	21
41	Building and construction industry	41
82	Property management	82
2	Transport	2
0	Retail trade	0
0	Hotel and restaurant	0
0	Housing cooperatives	0
15	Financial/commercial services	15
5	Social services	5
183	**Total corporate customers**	**183**

The fair value of associated collateral on non-performing loans to customers at 31 December 2017 was NOK 214 million.

NOTE 12 – EXCHANGE RATE RISK

The table states the net currency position for Sparebanken Sør, including financial derivatives. Under the Bank's internal rules, net positions in each individual currency must not exceed NOK 20 million and the maximum effect on profit in the event of a 10% movement in exchange rates must not be more than NOK 10 million.

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
1	2	Net total foreign currency position	2	1
0	0	Income effect at 10% change	0	0

NOTE 13 – INTEREST RATE RISK

Interest rate risk occurs in connection with the Bank's ordinary lending and borrowing activities, and in relation to activity in the Norwegian and international money and capital markets. Interest rate risk is a result of the fixed-interest period for the Bank's assets and liabilities, as well as for off-balance sheet items, not coinciding. Interest rate risk must be assessed on the basis of a stress test scenario where there is a 2-percentage point parallel shift in the yield curve. An assessment must also be made on how stress test scenarios (six scenarios) with various distortions in the yield curve affect the Bank's positions. The scenario with the greatest loss potential is taken as a basis for measuring interest rate risk. The interest rate risk framework also includes interest rate risk in foreign currency. The Bank's Board of Directors has adopted limits for maximum interest rate risk, and receives quarterly reports thereon. The Bank's interest rate risk was well within approved limits at year-end.

The Group's interest rate position meant that a possible increase in interest rates of 2 percentage points was estimated to be capable of making a positive contribution to profit of NOK 31 million at 31 December 2018. The equivalent figure for the Bank is NOK 45 million.

Interest rate risk is managed through the choice of fixed interest on asset and liability items and the use of financial derivatives.

Interest rate sensitivity

The table indicates the effect on the Bank's earnings of a 2-percentage point parallel shift or a distortion in the interest rate curve for the Bank's total interest positions. Under the Bank's internal rules, this effect must not exceed NOK 125 million. The table shows the outcome for the past two years.

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
17	45	Parallel shift and twist in the yield curve	31	24

NOTE 14 – LIQUIDITY RISK

Liquidity risk is the risk of the Group being unable to meet its obligations, or being unable to fund ordinary lending growth.

Liquidity risk is managed through the Group's liquidity strategy, general guidelines and procedures, and through established loan approval authorisations. Key operational management parameters are the requirement for deposit-to-loan ratio, indicator value of long-term funding, stress indicator for liquidity coverage within 30 days (LCR) and, in addition, guidelines for ability to survive in situations where there is no access to market funding. The liquidity risk is also managed by securing funding from the capital market with various maturities, funding sources and instruments.

Deposits from customers are the Bank's most stable source of funding. The Board of Directors emphasises that the ratio between deposits from customers and lending must be adapted to the Group's overall funding situation. As at 31 December 2018, the Group's deposit-to-loan ratio was 55%, down from 57% at 31 December 2017.

In addition, Sparebanken Sør Boligkreditt AS is an important funding instrument, ensuring access to long-term funding through the issuance of covered bonds. In order to issue covered bonds, mortgage loans equivalent to 58% of the total mortgage volume were transferred from the Bank to the mortgage loan company as at 31 December 2018 (52% as at 31 December 2017).

Target requirements adopted by the Board of Directors for the Bank's liquidity risk comply with guidelines issued by the Financial Supervisory Authority of Norway. At year-end, Sparebanken Sør fulfilled the Board-adopted requirements.

The Group has an extensive liquidity reserve in the form of liquid interest-bearing securities. The Bank also has mortgages cleared for transfer to the mortgage company. At year-end, the Bank's interest-bearing liquidity portfolio, composed of government securities, other zero-weighted securities, covered bonds and municipal bonds, totalled NOK 14.6 billion.

The Bank's short-term liquidity risk is managed partly through the Liquidity Coverage Requirement (LCR) imposed by the authorities. At the end of 2018, the LCR indicator for Sparebanken Sør was 159% (139% at 31 December 2017). This is sufficient to meet all projected liquidity maturities within the next 30 days under a stress scenario. The requirement was 100% at 31 December 2018. The requirement is applicable at all times.

The Group's liquidity risk is followed up through periodic reporting to Group Management and the Board of Directors.

LIQUIDITY RISK

The tables show cash flows including contractual interest payments. Consequently, the size of the figures cannot be reconciled with the balance sheet.

GROUP 31.12.2018

NOK MILLION	TOTAL	Up to 1 mth.	From 1 mth. to 3 mths.	From 3 mths. to 1 year	From 1 year to 5 years	Over 5 years
Liabilities /non-derivative obligations						
Debts to credit institutions	1 929	171	8	0	750	1 000
Deposits from customers	56 583	45 943	8 029	2 610		
Debt incurred due to issue of securities	49 283	20	187	4 877	39 228	4 971
Other liabilities	662	138	96	350	8	70
Subordinated loan capital	2 749	5	22	15	2 708	
Loan commitments and unused credit facilities	12 480	12 480				
Total liabilities	**123 686**	**58 757**	**8 343**	**7 852**	**42 694**	**6 041**
Derivative obligations						
Financial derivatives gross settlement						
Payment	-18 744	-396	-190	-104	-18 055	
Payment received	18 281	196	568	104	17 413	
Total derivative obligations	**-464**	**-200**	**378**	**0**	**-642**	**0**

PARENT BANK 31.12.2018

NOK MILLION	TOTAL	Up to 1 mth.	From 1 mth. to 3 mths.	From 3 mths. to 1 year	From 1 year to 5 years	Over 5 years
Liabilities /non-derivative obligations						
Debts to credit institutions	2 235	477	8	0	750	1 000
Deposits from customers	56 592	45 953	8 029	2 610		
Debt incurred due to issue of securities	18 731	0	79	3 054	13 727	1 871
Other liabilities	570	134	92	266	8	70
Subordinated loan capital (incl. hybrid capital)	2 749	5	22	15	2 708	
Loan commitments and unused credit facilities	9 226	9 226				
Total liabilities	**90 104**	**55 794**	**8 230**	**5 946**	**17 193**	**2 941**
Derivative obligations						
Financial derivatives gross settlement						
Payment	-3 846	-396	-190	-104	-3 157	
Payment received	3 956	196	568	104	3 089	
Total derivative obligations	**110**	**-200**	**378**	**0**	**-68**	**0**

GROUP 31.12.2017

NOK MILLION	TOTAL	Up to 1 mth.	From 1 mth. to 3 mths.	From 3 mths. to 1 year	From 1 year to 5 years	Over 5 years
Liabilities /non-derivative obligations						
Debts to credit institutions	935	163	11	11	750	
Deposits from customers	55 580	53 665	1 403	512		
Debt incurred due to issue of securities	46 327	905	553	2 740	38 745	3 384
Other liabilities	614	94	85	336	6	93
Subordinated loan capital (incl. hybrid capital)	2 807	1	19	469	2 185	133
Loan commitments and unused credit facilities	12 513	12 513				
Total liabilities	**118 776**	**67 341**	**2 071**	**4 068**	**41 686**	**3 610**
Derivative obligations						
Financial derivatives gross settlement						
Payment	-10 681	-123	-545	-159	-9 854	
Payment received	9 913	134	160	158	9 461	
Total derivative obligations	**-768**	**11**	**-385**	**-1**	**-393**	**0**

PARENT BANK 31.12.2017

NOK MILLION	TOTAL	Up to 1 mth.	From 1 mth. to 3 mths.	From 3 mths. to 1 year	From 1 year to 5 years	Over 5 years
Liabilities /non-derivative obligations						
Debts to credit institutions	1 007	235	11	11	750	
Deposits from customers	55 593	53 678	1 403	512		
Debt incurred due to issue of securities	18 886	885	481	1 897	13 223	2 400
Other liabilities	538	89	82	268	6	93
Subordinated loan capital	2 807	1	19	469	2 185	133
Loan commitments and unused credit facilities	10 174	10 174				
Total liabilities	**89 005**	**65 062**	**1 996**	**3 157**	**16 164**	**2 626**
Derivative obligations						
Financial derivatives gross settlement						
Payment	-834	-123	-545	-159	-7	
Payment received	459	134	160	158	7	
Total derivative obligations	**-375**	**11**	**-385**	**-1**	**0**	**0**

Maturity structure of issued bonds as at 31.12.2018

NOK MILLION

ISIN Number	Ticker	Currency	Nominal	Of which owned by the bank	Recognised value	Fair value	Reference rate	Repayment - structure	Final maturity
NO0010731128	SOR32 PRO	NOK	13		13	13	NIBOR 3 mths	No installment	20.02.2019
NO0010675358	SOR15 PRO	NOK	400		410	411	Fixed rate	No installment	17.06.2019
NO0010742992	SOR37 PRO	NOK	1 446		1 448	1 453	NIBOR 3 mths	No installment	12.08.2019
NO0010680093	SOR26 PRO	NOK	1 000		1 017	1 022	Fixed rate	No installment	16.09.2019
NO0010708027	SOR02 PRO	NOK	650		676	679	Fixed rate	No installment	19.03.2020
NO0010708019	SOR01 PRO	NOK	1 500		1 501	1 509	NIBOR 3 mths	No installment	19.03.2020
NO0010729502	SOR30 PRO	NOK	1 665		1 662	1 675	NIBOR 3 mths	No installment	21.08.2020
NO0010724081	SOR29 PRO	NOK	1 100		1 108	1 114	Fixed rate	No installment	24.11.2020
NO0010692189	SOR16 PRO	NOK	300		319	322	Fixed rate	No installment	28.04.2021
XS1815076838		EURO	300		2 991	2 989	NIBOR 3 mths	No installment	03.05.2021
NO0010736960	SOR35 PRO	NOK	500		511	513	Fixed rate	No installment	26.05.2021
NO0010782253	SOR45 PRO	NOK	500		501	504	NIBOR 3 mths	No installment	17.02.2022
NO0010781214	SOR44 PRO	NOK	550		558	562	Fixed rate	No installment	22.03.2022
NO0010735327	SOR33 PRO	NOK	500		511	512	Fixed rate	No installment	06.05.2022
NO0010807910	SOR48 PRO	NOK	1 500		1 500	1 503	NIBOR 3 mths	No installment	11.11.2022
NO0010805385	SOR50 PRO	NOK	1 500		1 483	1 480	Fixed rate	No installment	13.09.2023
NO0010830631	SOR52 PRO	NOK	1 000		1 009	1 001	Fixed rate	No installment	28.08.2024
NO0010735418	SOR34 PRO	NOK	500		513	508	Fixed rate	No installment	12.05.2025
NO0010754849	SOR41 PRO	NOK	300		297	310	Fixed rate	No installment	23.12.2025
Issued by Parent bank				**-**	**18 027**	**18 081**			
NO0010679806	SORB10	NOK	5 000	3 211	1 793	5 019	NIBOR 3 mths	No installment	22.05.2019
NO0010664659	SORB07	NOK	28		28	28	NIBOR 3 mths	No installment	27.11.2019
NO0010714058	SORB24	NOK	5 000		4 983	5 018	NIBOR 3 mths	No installment	24.06.2020
XS1383921803		EURO	500		4 988	5 011	Fixed rate	No installment	22.03.2021
NO0010778954	SORB27	NOK	5 000		5 010	5 057	NIBOR 3 mths	No installment	22.11.2021
XS1622285283		EURO	500		4 986	4 976	Fixed rate	No installment	30.05.2022
NO0010671597	SORB09	NOK	350		384	387	Fixed rate	No installment	13.02.2023
XS1775786145		EURO	500		5 054	5 020	Fixed rate	No installment	20.02.2023
NO0010832637	SORB28	NOK	5 000	2 500	2 494	4 989	NIBOR 3 mths	No installment	24.09.2025
NO0010670409	SORB08	NOK	500		576	576	Fixed rate	No installment	24.01.2028
Issued by Subsidiary				**-**	**30 296**	**36 080**			
Total bonds				**-**	**48 323**	**54 160**			

Sparebanken Sør Boligkreditt AS is entitled to extend the term of all issued bonds by 1 year.

Accrued interest is added to fair value in order to be comparable with carrying amount.

At year-end 2018, the average remaining term to maturity of the portfolio of senior bond debt and covered bonds was 3.0 years, compared with 3.0 years at year-end 2017.

Maturity structure of issued subordinated loans as at 31.12.2018

NOK MILLION

ISIN Number	Ticker	Nominal	Recognised value	Fair value	Reference rate	Repayment - structure	Final maturity
NO0010730112	SOR31 PRO	200	201	202	NIBOR 3 mths	No installment	30.01.2025
NO0010737026	SOR36 PRO	300	301	302	NIBOR 3 mths	No installment	03.06.2025
NO0010743255	SOR38 PRO	300	301	303	NIBOR 3 mths	No installment	25.08.2025
NO0010809460	SOR49 PRO	200	201	199	NIBOR 3 mths	No installment	02.11.2027
NO0010825094	SOR51 PRO	250	250	248	NIBOR 3 mths	No installment	14.06.2028
NO0010832157	SOR53 PRO	250	250	247	NIBOR 3 mths	No installment	14.09.2028
NO0010837313	SOR54 PRO	100	100	100	NIBOR 3 mths	No installment	23.11.2028
Subordinated loan capital		**1 600**	**1 604**	**1 601**			

Liquidity indicators

The enterprise must at all times have a liquidity reserve (LCR). As of 31 December 2017 the requirement has been 100% .

This means the holding of liquid assets must at least be equivalent to net cash outflow in a given stress period of 30 calendar days. The Liquidity Coverage Ratio is calculated according to the following formula and is expressed as a percentage:

$$\text{Liquidity Coverage Ratio (LCR)} = \frac{\text{Liquid assets}}{\text{Net cash outflow 30 days ahead given a stress situation}}$$

At year-end 2018, LCR was 159% for the Group and 180% for the Parent Bank. Corresponding figures for 2017 were 139% for the Group and 134% for the Parent Bank.

NOTE 15 – INTEREST INCOME AND INTEREST EXPENSES

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Interest income from financial instruments at amortised cost		
42	75	Interest on receivables from credit institutions	10	9
1 835	1 217	Interest on loans given to customers	2 768	2 606
1 878	**1 291**	**Total interest from financial instruments at amortised cost**	**2 778**	**2 615**
		Interest income from financial instruments at fair value		
172	150	Interest on loans given to customers (fixed rate loans)	150	172
156	198	Interest on certificates and bonds	217	168
328	**348**	**Total interest from financial instruments at fair value via profit or loss**	**367**	**340**
		Interest income from financial instruments at fair value via OCI		
	664	Interest on loans given to customers (mortgages)		
	664	**Total interest from financial instruments at fair value via OCI**		
2 205	**2 303**	**Total interest income**	**3 144**	**2 954**

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Interest expenses from financial instruments at amortised cost		
6	19	Interest on liabilities to credit institutions	19	5
521	547	Interest on customer deposits	543	517
281	305	Interest on issued securities	774	675
32	41	Interest on subordinated loans	41	32
45	39	Fees to the Norwegian Banks Guarantee Fund and other interest expenses	39	45
884	**951**	**Interest expenses from financial instruments at amortised cost**	**1 416**	**1 274**
884	**951**	**Total interest expenses**	**1 416**	**1 274**

NOTE 16 – COMMISSION INCOME

PARENT BANK			GROUP	
2017	2018	NOK MILLION	2018	2017
27	26	Guarantee commission	21	22
19	25	Security trading and management	25	19
172	179	Payment transmission	179	172
29	30	Insurance services	30	29
		Real estate turnover and management	105	109
74	86	Fees from other activities	20	19
321	**346**	**Total commission income**	**380**	**370**

NOTE 17 – INCOME FROM FINANCIAL INSTRUMENTS

PARENT BANK			GROUP	
2017	2018	NOK MILLION	2018	2017
-49	-70	Changes in value - fixed rate loans - designated at fair value through profit	-70	-49
54	69	Changes in value - derivatives fixed rate loans - liable to fair value through profit	69	54
5	**-1**	**Net fixed rate loans**	**-1**	**5**
26	-27	Gains(losses) and change in value - certificates and bonds	-33	26
23	16	Share dividend	7	15
61	29	Gains(losses) and change in value - shares	29	61
110	**17**	**Certificates, bonds and shares - designated at fair value through profit**	**2**	**101**
69	100	Change in value - bonds at fixed interest rate - hedge accounting	-217	-504
-70	-100	Change in value - derivatives fixed rate bonds - liable to fair value through profit	214	478
0	**0**	**Net issued securities at fixed rate - hedge accounting**	**-2**	**-25**
IA	IA	Effect of earnings on basisswap	2	-31
	-80	Change in value liabilities Euro - amortised cost	-80	
	72	Change in value financial derivatives - fair value	72	
	-8	**Netto resultateffekt gjeld i Euro**	**-8**	
-1	0	Gains (losses) from buy-back of own bonds - amortised cost	-15	-22
23	25	Currency gains (losses)	25	23
6	2	Other financial derivatives - liable to fair value through profit	2	6
29	**26**	**Net other financial instruments and derivatives**	**12**	**7**
144	**35**	**Net income from financial instruments**	**2**	**88**

Changes in the value of fixed-interest loans include those associated with changes in interest rates and margins. See Note 21 for further details.

NOTE 18 – PAYROLL EXPENSES AND PENSIONS

PARENT BANK			GROUP	
2017	2018	NOK MILLION	2018	2017
283	294	Wages to employees and fee to elected representatives (1)	359	343
44	46	Payroll tax	56	53
16	17	Financial tax	17	16
14	43	Pension costs	45	16
17	16	Other personnel costs	23	25
374	**415**	**Total personnel costs**	**499**	**453**
432	434	Number of FTE at 31.12	507	503
435	433	Average number of FTE per year	505	501

1 – The Bank primarily pays its employees a fixed salary, but also has a bonus scheme. The scheme covers all employees, with the exception of the head of internal auditing. Depending on the achievement of performance goals, the bonus scheme can result in a maximum payment of 1 month salary per employee. Board members are not included in the bonus scheme.

All employees can borrow up to 5 times their gross annual salary at a rate of interest 1.5% lower than the Bank's prevailing mortgage interest rate, provided that the loan does not exceed 85% of the collateral asset's market value.

Pensions

On 1 November 2016, the Bank's defined-benefit group pension scheme through Nordea Liv and Storebrand Livsforsikring was terminated and replaced by a defined-contribution group pension scheme in Storebrand Livsforsikring. Remaining liabilities in the defined-benefit schemes are linked to incapacity/partial incapacity. (Employees who have an estimated pension loss resulting from this change will be compensated.)

The funded defined-benefit group scheme now covers 21 people who are incapacitated/partially incapacitated.

The Bank also has pension liabilities covering 39 people who are not covered by the insurance scheme in connection with early retirement and supplementary pensions. These pension schemes are considered to be defined-benefit schemes. Estimate changes and deviations are recognised directly in the statement of comprehensive income. The new pension scheme, which was introduced in 2010, is treated as a defined-contribution scheme as at 31 December 2018.

The pension scheme fulfils the requirements set out in in the Mandatory Occupational Pensions Act.

The Bank uses the OMF rate as its reference rate. The market for these bonds is considered to be sufficiently liquid at the reporting date.

The pension-related computations performed by an external actuary are based on the following assumptions:

	2018	2017
Discounting interest rate	2.60 %	2.3 - 2.4%
Expected wage adjustment	2.50 %	2.25 - 2.5%
Expected pension adjustment	0.80 %	0 - 2.25 %
Expected 'G' -adjustment	2.25 %	2 -2.25%
Expected investment return on pension resources	2.60 %	2.40 %
Voluntary retirement	0.00 %	0.00 %

The assumptions as at 31 December 2018 have been used as a basis for calculating the pension expense for 2018.
The economic assumptions have been assessed in a long-term perspective. The assumptions are identical to the Norwegian Accounting Standards Board's recommendations. The calculation as at 31 December 2018 is based on mortality table FNH2013 the same table as was used as at 31.12.2017.

Breakdown of pension expense

	31.12.2018		31.12.2017	
NOK MILLION	Funded	Unfunded	Funded	Unfunded
Pension earnings for the year		3		3
Net scheme-change				
Interest costs on the pension commitments		1		2
Recognized return on pension funds				
Total pension costs - defined benefit schemes	**-**	**4**	**-**	**5**
New AFP and permium deposit pension		51		11
Total pension costs recognised in the income statement	**-**	**55**	**-**	**16**
Estimate deviations recognised in the total result		-		13
Total pension costs	**-**	**55**	**-**	**29**
Movements - pension commitments				
Commitments at the beginning of the period	23	84	23	73
Pension earnings for the year		3		3
Interest costs on the pension commitments		1		2
New commitment				
Actuariel losses/gains		-		13
Pension payments		-30		-7
Pension commitments at end of period	**23**	**58**	**23**	**84**
Movements - pension funds				
Pension funds at the beginning of the period	19		19	
Return on pension funds				
Actuariel losses/gains				
New commitment				
Payment into pension funds	1		1	
Pension payments				
Pension funds at end of period	**20**	**-**	**20**	**-**
Net pension commitments	**3**	**58**	**3**	**84**

Active members in the different schemes

	31.12.2018	31.12.2017
Active members of the benefit pension scheme	0	0
Pensioners and disabled in the scheme	21	21
Total number of persons who are included in the benefit scheme	**21**	**21**
Active members of non-insured schemes	12	12
Pensioners and disabled people in non-secured schemes	27	26
Total number of people in non-secured schemes	**39**	**38**
Active members of contribution scheme	462	466
Total number of people in the contribution scheme	**462**	**466**

Sensitivity analysis pension calculation

The Bank switched its group occupational pension arrangements from a defined-benefit to a defined-contribution scheme on 1 November 2016. As a result, pension liabilities were significantly reduced. A sensitivity analysis is therefore not considered to be significant and has consequently not been performed for 2018 and 2017.

NOTE 19 – OTHER OPERATING EXPENSES

PARENT BANK			GROUP	
2017	2018	NOK MILLION	2018	2017
36	39	Marketing	44	40
138	143	IT costs	146	141
30	40	Operating costs - real estate	44	34
16	14	External fees	15	18
10	10	Office supplies	10	10
11	14	Wealth tax	14	11
68	78	Other operating expenses	82	74
309	**338**	**Total other operating expenses**	**355**	**328**

Remuneration paid to auditors is included in other operating expenses.

PARENT BANK			GROUP	
2017	2018	NOK THOUSAND	2018	2017
941	1 157	Ordinary audit fees	1 694	1 279
52	175	Tax advice	175	52
497	530	Other attestation services	788	860
487	1 845	Fees from other services 1	1 845	491
1 977	**3 707**	**Total remuneration of elected auditor (incl. VAT)**	**4 502**	**2 682**

NOTE 20 – TAX

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Deferred tax and deferred tax asset		
58	56	Fixed assets	54	55
13	-5	Securities	-6	13
39	21	Loans	20	39
-22	-15	Pension commitments	-15	-22
-29	-4	Bonds loans	-193	-151
-18	-1	Derivatives	162	89
2	-1	Other accounting provisions	-1	2
43	**51**	**Total deferred tax and deferred tax assets**	**21**	**25**
		Composition of tax cost for the year		
7	**8**	**Change in deferred tax**	**-4**	**1**
3	-2	Deferred tax recognised in the total result comprehensive income	4	3
		Other change in deferred tax	0	
10	**6**	**Deferred tax recognised in the profit for the year**	**0**	**4**
215	206	Tax payable on net income	285	286
10	6	Recognised deferred tax	0	4
-8	0	Excess provision previous years	0	-8
217	**212**	**Tax cost for the year**	**285**	**282**
		Tax payable on net income		
253	236	25% of profit before tax	307	318
-28	-24	25% of permanent differences	-22	-28
-10	-6	Recognised deferred tax	0	-4
215	**206**	**Tax payable on net income**	**285**	**286**
		Payable tax in the balance sheet		
215	206	Tax payable on net income	285	286
13	14	Wealth tax	14	13
	3	Correction of tax previous year	10	
228	**223**	**Payable tax in the balance sheet**	**309**	**299**

Wealth tax is included in tax payable in the balance sheet, but is recognised under other operating expenses in the income statement.

NOTE 21 – FINANCIAL INSTRUMENTS BY CATEGORY

IFRS 9 Financial Instruments replaced IAS 39 Financial Instruments – Recognition and Measurement on 1 January 2018.

The Group has changed its accounting policies from this date. The Group has chosen not to make use of early adoption of IFRS 9, which means that all comparative figures from earlier periods have been prepared according to IAS 39.

Classification with effect from 1 January 2018.

Amortised cost

Debt instruments whose sole purpose is to hold the instrument in order to collect contractual cash flows are recognised at amortised cost.

Fair value through profit or loss

All derivatives must be measured at fair value with the changes in value recognised through profit or loss.

Sparebanken Sør has also chosen to recognise holdings of interest-bearing bonds, certificates and shares at fair value through profit and loss. These are assets and liabilities that are managed, measured and reported to management at fair value.

Fixed-interest loans can be redeemed before maturity against payment for premiums or discounts arising as a result of movements in the interbank interest rate. Sparebanken Sør hedges the interest risk for this balance sheet item by entering derivatives recognised at fair value. As changes in the value of the derivatives are recognised in the income statement, recognition of fixed-interest loans at amortised cost will lead to significant fluctuations in profit. Recognition at fair value through profit or loss will therefore lead to a more harmonised comparison of the profit or loss on the derivative and changes in value of fixed-interest loans.

Fair value through other comprehensive income (OCI)

Loans to retail customers secured by residential will be classified in the Parent Bank at fair value through other comprehensive income under IFRS 9. This is a consequence of the fact that the loans can be sold at a later date to the Bank's wholly owned mortgage companies. The purpose is therefore not solely to receive contractual cash flows but also resale.

Hedge accounting

Sparebanken Sør uses hedge accounting with regard to the Bank's fixed-interest bond debt in Norwegian kroner and foreign currencies. The hedging covers the interest rate risk and foreign exchange risk associated with the bonds.

The change in classification at 1 January 2018 resulted in the following changes.

	IAS 39		IFRS 9		GROUP
NOK MILLION	Measurement	Book value	Measurement	Book value	Change
Financial assets					
Cash and receivables from central banks	Amortized cost	1 143	Amortized cost	1 143	0
Loans to and receivables from credit institutions	Amortized cost	236	Amortized cost	236	0
Net loans to customers		97 518		97 520	2
- Fixed rate loans to costumers	Fair value option	6 316	Fair value option	6 316	0
- Others	Amortized cost	91 202	Amortized cost	91 204	2
Bonds and certificates	Fair value option	13 468	Fair value option	13 468	0
Shares	Fair value option	572	Fair value option	572	0
Financial derivatives	Fair value	754	Fair value	754	0
Ownership in associated companies	Amortized cost	39	Amortized cost	39	0
Financial liabilities					
Debts to credit institution	Amortized cost	902	Amortized cost	902	0
Deposits from customers	Amortized cost	55 580	Amortized cost	55 580	0
Debt incurred due to issue of securities	Amortized cost	44 353	Amortized cost	44 353	0
Financial derivatives	Fair value	306	Fair value	306	0
Subordinated loan capital	Amortized cost	1 404	Amortized cost	1 404	0

	IAS 39		IFRS 9		PARENT BANK
NOK MILLION	Measurement	Book value	Measurement	Book value	Change
Financial assets					
Cash and receivables from central banks	Amortized cost	1 143	Amortized cost	1 143	0
Loans to and receivables from credit institutions	Amortized cost	3 516	Amortized cost	3 516	0
Net loans to customers		66 595		66 602	7
- Residential mortgages (1)	Amortized cost	24 991	Fair value over OCI	25 002	11
- Fixed rate	Fair value option	6 316	Fair value option	6 316	0
- Others	Amortized cost	35 288	Amortisert kost	35 284	-4
Bonds and certificates	Fair value option	12 660	Fair value option	12 660	0
Shares	Fair value option	572	Fair value option	572	0
Financial derivatived	Fair value	385		385	0
Shareholdings in associated companies	Amortized cost	39	Amortized cost	39	0
Financial liabilities					
Debts to credit institution	Amortized cost	974	Amortized cost	974	0
Deposits from customers	Amortized cost	55 593	Amortized cost	55 593	0
Debt incurred due to issue of securities	Amortized cost	17 848	Amortized cost	17 848	0
Financial derivatives	Fair value	283	Fair value	283	0
Subordinated loan capital	Amortized cost	1 404	Amortized cost	1 404	0

All the changes were due to a new measurement model. Mortgages in the Parent Bank are additionally reclassified from amortised cost to fair value through other comprehensive income (OCI).

Classification 31.12.2018

GROUP 31.12.2018					
NOK MILLION	Fair value	Financial derivatives used as hedging instruments	Voluntary categorised at fair value (1)	Financial assets and liabilities at amortised cost (2)	Total
Cash and receivables from central banks				1 288	1 288
Loans to and receivables from credit institutions				119	119
Net loans to customers	5 714			91 804	102 942
Bonds and certificates	14 598				14 598
Shares	370				370
Financial derivatives	197		422		619
Ownership in associated companies				584	584
Total financial assets	**20 879**	**0**	**422**	**93 795**	**120 520**
Debts to credit institution				1 918	1 918
Deposits from customers				56 537	56 537
Debt incurred due to issue of securities			24 207	24 116	48 323
Financial derivatives	147		32		179
Subordinated loan capital				1 604	1 604
Total financial liabilities	**147**	**0**	**24 239**	**84 175**	**108 561**

PARENT BANK 31.12.2018					
NOK MILLION	Fair value	Financial derivatives used as hedging instruments	Voluntary categorised at fair value (1)	Financial assets and liabilities at amortised cost (2)	Total
Cash and receivables from central banks				1 287	1 287
Loans to and receivables from credit institutions				3 010	3 010
Net loans to customers	5 714	20 893		37 656	64 263
Bonds and certificates	17 691				17 691
Shares	369				369
Financial derivatives	157		40		197
Ownership in group companies				1 858	1 858
Ownership in associated companies				584	584
Total financial assets	**23 931**	**20 893**	**40**	**44 395**	**89 259**
Debts to credit institution				2 261	2 261
Deposits from customers				56 546	56 546
Debt incurred due to issue of securities			8 314	9 713	18 027
Financial derivatives	146		33		179
Subordinated loan capital				1 604	1 604
Total financial liabilities	**146**	**0**	**8 347**	**70 124**	**78 617**

Classification 31.12.2017

					GROUP 31.12.2017
NOK MILLION	Fair value	Financial derivatives used as hedging instruments	Voluntary categorised at fair value (1)	Financial assets and liabilities at amortised cost (2)	Total
Cash and receivables from central banks				1 143	1 143
Loans to and receivables from credit institutions				236	236
Net loans to customers			6 316	91 202	97 518
Bonds and certificates			13 468		13 468
Shares			572		572
Financial derivatives	216	538			754
Ownership in associated companies				39	39
Total financial assets	**216**	**538**	**20 356**	**92 620**	**113 730**
Debts to credit institution				902	902
Deposits from customers				55 580	55 580
Debt incurred due to issue of securities				44 343	44 343
Financial derivatives	274	32			306
Subordinated loan capital				1 404	1 404
Total financial liabilities	**274**	**32**	**0**	**102 229**	**102 535**

1. Maximum credit risk linked to financial instruments voluntarily classified at fair value, excl. shares totals NOK 19,786 million.
2. Liabilities included in hedge accounting are recognised as financial assets and liabilities at amortised cost.

					PARENT BANK 31.12.2017
NOK MILLION	Fair value	Financial derivatives used as hedging instruments	Voluntary categorised at fair value (1)	Financial assets and liabilities at amortised cost (2)	Total
Cash and receivables from central banks				1 143	1 143
Loans to and receivables from credit institutions				3 516	3 516
Net loans to customers			6 316	60 279	66 595
Bonds and certificates			12 660		12 660
Shares			572		572
Financial derivatives	258	127			385
Ownership in group companies				1 256	1 256
Ownership in associated companies				39	39
Total financial assets	**258**	**127**	**19 548**	**66 233**	**86 166**
Debts to credit institution				974	974
Deposits from customers				55 593	55 593
Debt incurred due to issue of securities				17 848	17 848
Financial derivatives	265	18			283
Subordinated loan capital				1 404	1 404
Total financial liabilities	**265**	**18**	**0**	**75 819**	**76 102**

1. Maximum credit risk linked to financial instruments voluntarily classified at fair value, excl. shares totals NOK 18,978 million.
2. Liabilities included in hedge accounting are recognised as financial assets and liabilities at amortised cost.

NOTE 22 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Methods to determine fair value

GENERAL

For financial instruments, whose carrying amount is a reasonable approximation of fair value, valuation methods are not used to calculate fair value. This applies principally to assets and liabilities with short maturities (3 months) or where interest is due for payment or adjustment within a short period of time (3 months).

INTEREST RATE SWAPS AND CURRENCY SWAPS

The fair value of interest rate swaps is determined using valuation techniques in which the expected future cash flows are discounted to present value. The calculation of expected cash flows and the discounting of these is based on observed market rates for different currencies and observed exchange rates. Estimated present values are checked against the corresponding estimates from the counterparties in the contracts.

CERTIFICATES AND BONDS

The valuation of certificates and bonds is based on future cash flows and credit risk, assessed on the balance sheet date. The valuation is based on observable market rates. The Bank's assessment of credit risk is based on market information from a reputable provider.

LENDING

Lendings recognised at fair value are valued using valuation methods in which the anticipated future cash flows are discounted to present value. A risk-free interest rate is regarded as the interest rate on loans between particularly creditworthy banks. A premium for credit risk and margins is added on the basis of the original supplement for credit risk and margin, and is adjusted in line with changes in the market's pricing of risk, the borrower's creditworthiness and margin changes in the market.

Fair value is considered to be equal to the carrying value for loans with a variable interest rate.

BORROWINGS

Borrowings recognised at fair value are valued at quoted prices, where available, and the securities will be traded in a liquid market. Other securities are valued using valuation techniques and the discounting of expected future cash flows. A risk-free interest rate is regarded as the interest rate on loans between particularly creditworthy banks. A premium for credit risk is added on the basis of other market players' assessments of the Bank's creditworthiness.

DEPOSITS

For deposits at fair value are valued using valuation techniques in which the expected future cash flows are discounted to present value. A risk-free interest rate is regarded as the interest rate on loans between particularly creditworthy banks. A premium for credit risk is added on the basis of other market players' assessments of the bank's creditworthiness. Margin premiums are added on the basis of the initial margin, but with subsequent adjustment of the margin in line with margin changes in the markets.

For floating-rate deposits, fair value is considered to equal nominal value.

SHARES

Shares are valued at quoted prices where available. Other shares are valued using valuation techniques.

In some cases, shares in local companies will mostly represent support for positive action in the local community. For such shares, fair value is set to the share's cost price or nominal value. Fair value may also be written down to NOK 1 where it is evident that the shares have no commercial value.

Classification of financial instruments

Financial instruments are classified at different levels.

Level 1:

Comprises financial assets and liabilities valued using unadjusted, observable market values. This comprises listed shares, derivatives traded on active markets and other securities with quoted market values.

Level 2:

Instruments valued using valuation techniques in which all assumptions (all input) are based on directly or indirectly observable market data. Values can be obtained from external market players or reconciled with the external market players offering these types of services.

Level 3:

Instruments valued using valuation techniques in which at least one material assumption cannot be supported by means of observable market rates. This category includes investments in unlisted companies and fixed-interest loans where the necessary market information does not exist.

PARENT BANK				31.12.2018	GROUP			
Recognised value	Fair value Level 1	Level 2	Level 3	NOK MILLION	Recognised value	Fair value Level 1	Level 2	Level 3
				Assets recognised at amortised cost				
1 287		1 287		Cash and receivables from central banks	1 288		1 288	
3 010		3 010		Loans to and receivables from credit institutions	119		119	
37 656			37 656	Net loans to customers (floating interest rate)	97 228			97 228
				Assets recognised at fair value				
5 714			5 714	Net loans to customers (fixed interest rate)	5 714			5 714
20 893			20 893	Net loans to customers (mortgages)				
17 691		17 691		Bonds and certificates	14 598		14 598	
369	5		364	Shares	370	5		365
197		197		Financial derivatives	619		619	
86 817	**5**	**22 185**	**64 627**	**Total financial assets**	**119 936**	**5**	**16 624**	**103 307**
				Liabilities recognised at amortised cost				
2 261		2 261		Debt to credit institutions	1 918		1 918	
56 546			56 546	Deposit from customers	56 537			56 537
18 027		18 081		Debt incurred due to issue of securities	48 323		48 443	
1 604		1 601		Subordinated loan capital	1 604		1 601	
				Liabilities recognised at fair value				
179		179		Financial derivatives	179		179	
78 617	**0**	**22 122**	**56 546**	**Total financial liabilities**	**108 561**	**0**	**52 141**	**56 537**

PARENT BANK				31.12.2017	GROUP			
Recognised value	Fair value Level 1	Level 2	Level 3	NOK MILLION	Recognised value	Fair value Level 1	Level 2	Level 3
				Assets recognised at amortised cost				
1 143		1 143		Cash and receivables from central banks	1 143		1 143	
3 516		3 516		Loans to and receivables from credit institutions	236		236	
60 279			60 279	Net loans to customers (floating interest rate)	91 202			91 202
				Assets recognised at fair value				
6 316			6 316	Net loans to customers (fixed interest rate)	6 316			6 316
12 660		12 660		Bonds and certificates	13 468		13 468	
572	5		567	Shares	572	5		567
385		385		Financial derivatives	754		754	
84 871	**5**	**17 704**	**67 162**	**Total financial assets**	**113 691**	**5**	**15 601**	**98 085**
				Liabilities recognised at amortised cost				
974		974		Debt to credit institutions	902		902	
55 593			55 593	Deposit from customers	55 580			55 580
17 848		17 944		Debt incurred due to issue of securities	44 343		44 648	
1 404		1 415		Subordinated loan capital	1 404		1 415	
				Liabilities recognised at fair value				
283		283		Financial derivatives	306		306	
76 102	**0**	**20 616**	**55 593**	**Total financial liabilities**	**102 535**	**0**	**47 271**	**55 580**

There were no movements between levels 1 and 2 in 2018 or 2017.

MOVEMENTS IN VALUES RECOGNISED AT FAIR VALUE CLASSIFIED AT LEVEL 3

			GROUP
NOK MILLION	Net loan to customers	Of which credit risk	Shares
Recognised value 01.01.2017	**7 514**	**-14**	**509**
Acquisition 2017	235		21
Of which, transferred from level 1 or 2	0		
Change in value recognised during the period	-48	12	59
Disposal 2017	-1 385		-22
Recognised value 31.12.2017	**6 316**	**-2**	**567**
Acquisition 2018	1 334		66
Of which, transferred from level 1 or 2	0		
Change in value recognised during the period	-69	1	44
Disposal 2018	-1 867		-13
Reclassified as associated companies			-300
Recognised value 31.12.2018	**5 714**	**-1**	**364**

			PARENT BANK
NOK MILLION	Net loan to customers	Of which credit risk	Shares
Recognised value 01.01.2017	**7 514**	**-14**	**509**
Acquisition 2017	235		21
Of which, transferred from level 1 or 2	0		
Change in value recognised during the period	-48	12	59
Disposal 2017	-1 385		-22
Recognised value 31.12.2017	**6 316**	**-2**	**567**
Reclassification mortgages at fair value	25 002		
Acquisition 2018	1 334		66
Of which, transferred from level 1 or 2	0		
Change in value recognised during the period	5 976	1	-13
Disposal 2018 (1)	-69		45
Reclassified as associated companies			-300
Recognised value 31.12.2018	**26 607**	**-1**	**365**

(1) Disposals 2018 includes the net transfer of loans to the subsidiary Sparebanken Sør Boligkreditt AS.
Changes in value recognised in the year apply mainly to financial instruments recognised in the balance sheet as at 31 December.

Loans to and receivables from customers

Loans to and receivables from customers at fair value, classified at level 3, consist of fixed-interest loans and mortgages in the Parent Bank. In the Group exclusively fixed-interest loans.

When valuing fixed-interest loans, the Bank uses three categories: retail market (RM), large commercial commitments and other business commitments. Regarding the retail market, credit spreads have been recognised according to current market prices for fixed-interest loans. For large commercial commitments (50 largest), the customers and spreads are individually assessed on the basis of what each customer would have received in terms of spread/margin at 31 December. For other commercial loans, the value is calculated with a spread that represents an average of what the smaller fixed-interest loans to corporate customers would be at 31 December. For variable-rate mortgages, fair value is recognised as equal to carrying value.

Shares

Concerns shares and investments in companies where there is little or no turnover and discretion has to be exercised in the valuation. Multiples are used to a large extent and earnings-based methods to a lesser extent in connection with valuation. Valuation is affected by discretionary assessments.

Sensitivity analysis level 3

The sensitivity of fixed-interest loans is estimated by changing the margin requirement by 10 basis points. The valuation of fixed-interest loans to private customers is based on available market rates. For the corporate market, there is a greater degree of discretion in determining the market spread/margin as at 31 December.

	GROUP / PARENT BANK	
NOK MILLION	31.12.2018	31.12.2017
Loan to customers	**18**	**16**
- of which, loans to the corporate market (CM)	4	5
- of which, loans to the retail market (RM)	14	11

Hedge accounting

The Bank uses hedge accounting for debt issued at fixed interest rates and in foreign currencies. Financial derivatives used as hedging instruments are recognised at fair value. Bond loans included as hedged objects are recognised at cost price and are continuously adjusted for changes in fair value for the risks that are hedged. The hedging covers the interest rate risk in issued fixed-rate bonds, as well as the foreign exchange risk for bonds issued in foreign currencies. Hedge accounting requires the Bank to maintain a system for measuring and documenting hedge effectiveness.

All bond loans issued at a fixed interest rate or in a foreign currency are included in hedge accounting. Sparebanken Sør uses fair value hedging. The dollar-offset method is used to measure the effectiveness of hedging.

IFRS 9 has simplified the requirements for hedge accounting by linking hedging effectiveness more closely to risk management activities, and consequently provides greater opportunity for assessment. The requirement for a hedging effectiveness rate of 80-125% has been removed with effect from 1 January 2018 and replaced by more qualitative requirements. Among other things, there must be an economic relationship between the hedging instrument and the hedged element, and the effect of credit risk must not dominate changes in value in the hedging relationship. Under IFRS 9 a prospective (future-oriented) effectiveness test is sufficient, while hedging effectiveness under IAS 39 must be viewed both retrospectively and prospectively. Ineffectiveness in hedging, defined as the difference between changes in the value of hedging instruments and in the value of the hedged object, is recognised in the income statement as it arises. The exception is that portion of the change in value that is due to a change in basis spread linked to the hedging instruments.

For interest and currency swaps created from and including 1 January 2018, changes in value due to changes in the currency basis will be recognised through other comprehensive income. Interest-rate and currency swaps created up to 1 January 2018 are recognised at fair value, with changes in value recognised through profit or loss until these fall due.

Hedge accounting in the balance sheet

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Hedging instruments / financial derivatives		
127	40	Interest rate swaps NOK	119	228
		Interest rate swaps EUR	593	304
127	**40**	**Total financial assets**	**713**	**532**
		Hedged items		
9 141	8 300	Nominal debt NOK	9 150	9 991
		Nominal debt EUR (1)	14 324	9 454
114	14	Adjustment of hedged items NOK - interest risk	93	216
		Adjusment of hedged items EUR - interest- and currency risk	639	320
		Hedging instruments / financial derivatives		
18	33	Interest rate swaps NOK	33	18
		Interest rate swaps EUR	0	13
9 273	**8 346**	**Total financial liabilities**	**24 239**	**20 013**

(1) Converted to NOK at exchange rate in effect at the time of issuance.

The hedging instrument is recognised under financial derivatives. Nominal value and adjustment of hedging objects is recognised under debt incurred on issuance of securities.

Result of hedge accounting

PARENT BANK			GROUP	
2017	2018	NOK MILLION	2018	2017
		Result / inneffectiveness in hedge acconting		
0	0	Income effect hedge interest rate risk (NOK)	0	0
		Income effect hedge interest- and currency risk (EUR)	-2	-25
IA	*IA*	*Effect of earnings from currency basis*	*-2*	*-31*
0	**0**	**Total**	**-2**	**-25**
		Other comprehensive income (OCI)		
IA	*IA*	*Change in results from change in value of currency basis*	*-20*	*IA*

The ineffectiveness of the hedge accounting also appears in note 16.

NOTE 23 – BONDS AND CERTIFICATES

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Short-term investments designed at fair value through profit and loss		
3 399	3 133	Certificates and bonds issued by public sector	3 287	3 550
9 261	8 847	Certificates and bonds issued by others	11 311	9 918
0	5 711	Certificated and bonds issued by subsidiaries	0	0
12 660	**17 691**	**Total short-term investment designed at fair value through profit and loss**	**14 598**	**13 468**
12 660	**17 691**	**Investment in securities**	**14 598**	**13 468**
10 300	11 456	Bonds pledged for drawing-rights in Norges Bank	11 456	10 300

Classification of financial investments

Certificates and bonds are rated by external parties. If the securities have an official rating, this rating will be applied. However, in cases where no official rating exists, a credit assessment by an external broker will be used as the basis for risk classification.

The Bank's risk category	Rating
Lowest risk	AAA, AA+, AA og AA-
Low risk	A+, A og A-
Medium risk	BBB+, BBB og BBB-
High risk	BB+, BB, BB-
Highest risk	B+ and lower

Certificates and bonds

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Certificates and bonds		
12 627	17 559	Lowest risk	14 466	13 436
0	0	Low risk	0	0
0	0	Medium risk	0	0
0	0	High risk	0	0
0	99	Highest risk	99	0
33	33	Accrued interest	33	32
12 660	**17 691**	**Total certificates and bonds**	**14 598**	**13 468**

NOTE 24 – SHARES

All shares and ownership interests are classified at fair value through profit or loss.

GROUP 31.12.2018			
NOK THOUSAND	Equity stake	Book value	Acquisition cost
Shares classified at fair value through profit and loss			
Eksportfinans	1,5	75 000	66 454
Brage Finans	15,5	186 537	160 883
VN Norge AS*	2,27	33 558	-
Norne Eierselskap	17,6	7 687	7 687
Sparebanken Vest		4 764	2 735
Norgesinvestor Proto	17,6	22 955	15 600
Norgesinvestor IV	2,1	13 628	8 058
Other companies (37)		6 225	9 647
Total shares valued at fair value through profit and loss		**350 354**	**271 065**
Participations classified at fair value through profit and loss			
Skagerak Venture Capital 1 KS	12,4	13 860	13 860
Skagerak Seed Capital II AS	10,4	2 002	2 002
Skagerak Maturo Seed AS	5,8	3 150	3 150
Total participations valued at fair value through profit and loss		**19 012**	**19 012**
TOTAL		**369 366**	**290 077**

* The company was restructured in 2018, and the number of shares is stated in billions.

GROUP 31.12.2017				
NOK THOUSAND	Number of shares	Equity stake	Book value	Acquisition cost
Shares classified at fair value through profit and loss				
Frende Holding	675 324	10	260 000	152 148
Eksportfinans	4 026	1,5	81 000	74 082
Brage Finans	11 778 981	15	123 679	97 838
Visa Norge FLI			28 200	-
Norne Eierselskap	31 414 019	17,6	7 687	7 687
Sparebanken Vest	83 398		4 545	2 422
Norgesinvestor Proto	156 000	17,6	23 010	15 600
Norgesinvestor IV	98 750	2,1	13 035	8 058
Other companies (46)			9 884	11 806
Total shares valued at fair value through profit and loss			**551 041**	**369 641**
Participations classified at fair value through profit and loss				
Skagerak Venture Capital 1 KS		12,43	18 454	18 454
Skagerak Seed Capital II AS			1 173	1 173
Skagerak Maturo Seed AS			1 950	1 950
Total participations valued at fair value through profit and loss			**21 577**	**21 577**
TOTAL			**572 618**	**391 218**

Those of Sparebanken Sør's subsidiaries which are included in the consolidated financial statements have no significant investments in shares at 31 December. The overview above is therefore identical for the Parent Bank and the Group.

The Bank's investment in venture companies largely constitutes participation in an investment company. The company values itself based on its underlying portfolio of investments, and the Bank uses this valuation.

The Group has committed to additional payments linked to the investment in Skagerak Venture Capital, Skagerak Seed Capital and Skagerrak Maturo Seed AS. At 31 December 2018, uncalled capital totalled NOK 12,159,000 (NOK 13,548,000 at 21 December 2017).

See also Note 34 – 'Disclosures on related parties' for additional disclosures regarding transactions with associates.

NOTE 25 – OWNERSHIP OF GROUP COMPANIES

					PARENT BANK 31.12.2018
NOK THOUSAND	Type of business	Registered office	Ownership	Share capital	Book value
Sparebanken Sør Boligkreditt AS	Mortgage company	Kristiansand	100 %	1 125 000	1 845 695
Sørmegleren Holding AS	Real estate business	Kristiansand	91 %	5 728	6 983
AS Eiendomsvekst	Property management	Arendal	100 %	3 000	2 935
Arendal Brygge AS	Property management	Arendal	50 %	601	1 000
Prosjektutvikling AS	Property management	Arendal	100 %	100	-
Transitt Eiendom AS	Property management	Kristiansand	100 %	100	1 450
TOTAL					**1 858 063**

					PARENT BANK 31.12.2017
NOK THOUSAND	Type of business	Registered office	Ownership	Share capital	Book value
Sparebanken Sør Boligkreditt AS	Mortgage company	Kristiansand	100 %	525 000	1 245 695
Sørmegleren Holding AS	Real estate business	Kristiansand	91 %	5 728	6 983
AS Eiendomsvekst	Property management	Arendal	100 %	3 000	2 935
Prosjektutvikling AS	Property management	Arendal	100 %	100	-
Transitt Eiendom AS	Property management	Kristiansand	100 %	100	100
TOTAL					**1 255 713**

Shareholdings correspond to the percentage of voting capital.

See also Note 34 – 'Disclosures on related parties' for additional disclosures regarding transactions with subsidiaries.

NOTE 26 – ASSOCIATED COMPANIES

				PARENT BANK 31.12.2018
NOK THOUSAND	Type of business	Registered office	Ownership	Book value
Frende Holding AS	Ensurance	Bergen	20 %	483 108
Balder Betaling AS	Finance	Bergen	22 %	93 100
Åseral Næringshus AS	Property management	Åseral	30 %	450
Torvparkering AS	Garage	Kristiansand	23 %	6 330
Søndeled Bygg AS	Property management	Arendal	29 %	1 125
TOTAL				**584 113**

				PARENT BANK 31.12.2017
NOK THOUSAND	Type of business	Registered office	Ownership	Book value
Åseral Næringshus AS	Property management	Åseral	30 %	450
Torvparkering AS	Garage	Kristiansand	23 %	7 000
Balder Betaling AS	Finance	Bergen	22 %	30 258
Arendal Brygge AS	Property management	Arendal	35 %	500
Søndeled Bygg AS	Property management	Arendal	29 %	1 125
TOTAL				**39 333**

See Note 34 – 'Disclosures on related parties' for additional disclosures regarding transactions with associated companies.

NOTE 27 – FINANCIAL DERIVATIVES

GROUP				
NOK MILLION	31.12.2018	31.12.2018 (1) presented as net	31.12.2017	31.12.2017 (1) presented as net
Assets				
Financial derivatives	619	447	754	507
Liabilities				
Financial derivatives	179	7	306	58

PARENT BANK				
NOK MILLION	31.12.2018	31.12.2018 (1) presented as net	31.12.2017	31.12.2017 (1) presented as net
Assets				
Financial derivatives	197	118	385	180
Liabilities				
Financial derivatives	179	101	283	78

(1) Shows assets and liabilities as if the Bank and the Group had netted their financial derivatives against each individual counterparty.

The Bank and the Group's offsetting rights follow general Norwegian law. By means of ISDA agreements, the Bank and Sparebanken Sør Boligkreditt AS are entitled to offset other balances if certain events occur. The amounts have not been offset in the balance sheet at 31 December 2018 or 31 December 2017 because the transactions are not, as a rule, settled on a net basis. Derivative agreements are entered into with other banks with a solid credit rating.

NOTE 28 – BOND DEBT AND SUBORDINATED LOANS

Debt securities - group

NOK MILLION	31.12.2018	31.12.2017
Bonds, nominal value	47 969	43 990
Value adjustments	170	125
Accrued interest	184	228
Total debt due to issue of securities	**48 323**	**44 343**

Change in debt securities - group

NOK MILLION	31.12.2017	Issued	Matured / Redeemed	Other changes during the period	31.12.2018
Bonds, nominal value	43 990	13 770	-10 052	261	47 969
Value adjustment	125			45	170
Accrued interest	228			-44	184
Total debt due to issue of securities	**44 343**	**13 770**	**-10 052**	**262**	**48 323**

NOK MILLION	31.12.2016	Issued	Matured / Redeemed	Other changes during the period	31.12.2017
Bonds, nominal value	40 922	10 810	-8 069	327	43 990
Value adjustment	42			83	125
Accrued interest	253			-25	228
Total debt due to issue of securities	**41 217**	**10 810**	**-8 069**	**385**	**44 343**

Change in subordinated loan capital - parent bank and group

NOK MILLION	31.12.2017	Issued	Matured / Redeemed	Other changes during the period	31.12.2018
Subordinated loans	1 400	600	-400		1 600
Accrued interest	4				4
Total subordinated loan capital	**1 404**	**600**	**-400**	**0**	**1 604**

NOK MILLION	31.12.2016	Issued	Matured / Redeemed	Other changes during the period	31.12.2017
Subordinated loans	1 200	200			1 400
Accrued interest	3			1	4
Total subordinated loan capital	**1 203**	**200**	**0**	**1**	**1 404**

Debt securities - parent bank

NOK MILLION	31.12.2018	31.12.2017
Bonds, nominal value	17 904	17 580
Value adjustment	13	99
Accrued interest	110	169
Total debt due to issue of securities	**18 027**	**17 848**

Change in debt securities - parent bank

NOK MILLION	31.12.2017	Issued	Matured / Redeemed	Other changes during the period	31.12.2018
Bonds, nominal value	17 580	3 900	-3 656	-80	17 904
Value adjustment	99			-86	13
Accrued interest	169			-59	110
Total debt due to issue of securities	**17 848**	**3 900**	**-3 656**	**-225**	**18 027**

NOK MILLION	31.12.2016	Issued	Matured / Redeemed	Other changes during the period	31.12.2017
Bonds, nominal value	16 204	4 550	-3 174		17 580
Value adjustment	192			-93	99
Accrued interest	188			-19	169
Total debt due to issue of securities	**16 584**	**4 550**	**-3 174**	**-112**	**17 848**

NOTE 29 – LOANS AND DEBT TO CREDIT INSTITUTIONS

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
		Loans to credit institutions		
3 402	2 924	Without agreed maturity	33	122
114	86	With agreed maturity	86	114
3 516	**3 010**	**Total loan to credit institutions**	**119**	**236**
		Debts to credit institutions		
62	327	Without agreed maturity	21	62
912	1 932	With agreed maturity	1 895	840
0	2	Accrued interest	2	0
974	**2 261**	**Total debts to credit institutions**	**1 918**	**902**

GROUP

NOK MILLION	31.12.2017	Issue debt	Net change credits	31.12.2018
Loan to credit institutions	236	0	-117	119
Debt to credit institutions	902	1000	16	1 918
Total net debt to credit institutions	**-666**	**-1 000**	**-133**	**-1 799**

GROUP

NOK MILLION	31.12.2016	Issue debt	Net change credits	31.12.2017
Loan to credit institutions	156	0	80	236
Debt to credit institutions	178	750	-26	902
Total net debt to credit institutions	**-22**	**-750**	**106**	**-666**

PARENT BANK

NOK MILLION	31.12.2017	Issue debt	Net change credits	31.12.2018
Loan to credit institutions	3 516	0	-506	3 010
Debt to credit institutions	974	1 000	-465	2 261
Total net debt to credit institutions	**2 542**	**-1 000**	**-41**	**749**

PARENT BANK

NOK MILLION	31.12.2016	Issue debt	Net change credits	31.12.2017
Loan to credit institutions	2 211	0	1 305	3 516
Debt to credit institutions	232	750	-8	974
Total net debt to credit institutions	**1 979**	**-750**	**1 313**	**2 542**

NOTE 30 – TANGIBLE ASSETS

GROUP	Machinery, inventory and transport equipments		Real estate		Total real estate and inventory	
NOK MILLION	2018	2017	2018	2017	2018	2017
Acquisition cost 01.01.	**215**	**220**	**514**	**570**	**729**	**790**
Additions during the year	9	8	29	13	38	21
Disposals during the year	-19	-13	-24	-69	-43	-82
Acquisition cost 31.12.	**205**	**215**	**519**	**514**	**724**	**729**
Accumulated depreciations and write-downs 31.12.	164	171	147	142	311	313
Book value as at 31.12	**41**	**44**	**372**	**372**	**413**	**416**
Ordinary depreciation	10	11	8	8	18	19
Impairments			1	1	1	1
Gains/losses on sale			-8	2	-8	2

PARENT BANK	Intangible assets	
NOK MILLION	2018	2017
Acquisition cost 01.01.	**175**	**182**
Additions during the year	17	7
Disposals during the year	-11	-14
Acquisition cost 31.12.	**181**	**175**
Accumulated depreciations and write-downs 31.12.	159	160
Book value as at 31.12	**22**	**15**
Ordinary depreciation	10	10
Impairments		
Gains/losses on sale		

PARENT BANK	Machinery, inventory and transport equipments		Real estate		Total real estate and inventory	
NOK MILLION	2018	2017	2018	2017	2018	2017
Acquisition cost 01.01.	**202**	**207**	**485**	**516**	**687**	**723**
Additions during the year	9	8	24	9	33	17
Disposals during the year	-19	-13	-18	-40	-37	-53
Acquisition cost 31.12.	**192**	**202**	**491**	**485**	**683**	**687**
Accumulated depreciations and write-downs 31.12.	152	159	144	141	296	300
Book value as at 31.12	**40**	**43**	**347**	**344**	**387**	**387**
Ordinary depreciation	10	11	8	7	18	18
Impairments			1	1	1	1
Gains/losses on sale			-8	2	-8	2

PARENT BANK	Intangible assets	
NOK MILLION	2018	2017
Acquisition cost 01.01.	**77**	**81**
Additions during the year	17	7
Disposals during the year	-11	-11
Acquisition cost 31.12.	**83**	**77**
Accumulated depreciations and write-downs 31.12.	61	62
Book value as at 31.12	**22**	**15**
Ordinary depreciation	10	10
Impairments		
Gains/losses on sale		

Assumed useful economic life harmonises with the depreciation period for the individual groups of fixed assets. Fixed assets are depreciated on a straight-line basis. The Group's buildings are located in the Bank's own district and are mainly used by the Bank itself.

The rate of depreciation for buildings is in the range 2–5%, and the depreciation rate for machinery, equipment, vehicles and intangible assets is in the range 10–33%.

The Bank leases property and paid NOK 15.1 million in 2018 (NOK 16.1 million in 2017) in annual rent. The normal property leasing period is 5 years, with an option for a further 5 years.

NOTE 31 – DEPOSITS FROM CUSTOMERS

Deposits from customers by sector and industry

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
25 945	26 797	Retail customers	26 798	25 946
9 332	10 072	Public administration	10 073	9 332
485	442	Primary industry	442	485
2 257	1 672	Manufacturing industry	1 672	2 257
797	519	Real estate development	507	782
1 002	978	Building and construction industry	978	1 002
2 778	2 892	Property management	2 892	2 778
552	598	Transport	598	552
1 016	1 005	Retail trade	1 005	1 016
172	147	Hotel and restaurant	147	172
215	207	Housing cooperatives	207	215
5 265	5 176	Financial/commercial services	5 176	5 265
5 761	6 026	Social services	6 026	5 761
17	16	Accrued interests	16	17
55 593	**56 546**	**Total deposits from customers**	**56 537**	**55 580**

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
46 854	47 301	Deposits from customers with no fixed maturity	47 291	46 841
8 722	9 230	Deposits from customers with agreed maturity	9 230	8 722
55 576	**56 531**	**Total deposits from customers**	**56 521**	**55 563**
17	16	Accrued interest	16	17
55 593	**56 546**	**Total deposits from customers incl. accrued interest**	**56 537**	**55 580**

NOTE 32 – OTHER LIABILITIES

PARENT BANK			GROUP	
31.12.2017	31.12.2018	NOK MILLION	31.12.2018	31.12.2017
14	13	Trade creditors	24	24
14	15	Tax withholdings	22	18
34	57	Clearing accounts	57	34
57	78	Other liabilities	80	65
34	35	Accrued holiday pay	51	43
66	90	Other incurred costs	95	72
219	**288**	**Total other liabilities**	**328**	**256**

NOTE 33 – AVERAGE INTEREST RATES

PARENT BANK			GROUP	
31.12.2017	31.12.2018		31.12.2018	31.12.2017
		Debt to credit institutions		
1.26 %	1.81 %	Debt to credit institutions	1.81 %	1.33 %
		Deposits from customers		
0.91 %	1.00 %	Deposits from customers	1.00 %	0.91 %
		Debt incurred due to issue of securities		
1.42 %	1.81 %	Bond debt - floating interest rate	1.71 %	1.26 %
	0.18 %	Bond debt - floating interest rate EUR	0.18 %	
3.11 %	2.66 %	Bond debt - fixed interest rate	2.77 %	3.18 %
		Bond debt - fixed interest rate EUR	0.25 %	0.19 %

The average interest rate is calculated as a weighted average of actual interest rate terms at 31 December, defined as interest in arrears for the full year. No liabilities have special conditions.

The bulk of the debt to credit institutions is denominated in NOK. Debt established through the issuance of securities is entirely in NOK.

NOTE 34 – DISCLOSURES ON RELATED PARTIES

Sparebanken Sør has entered into transactions with related parties as described in this note and Note 35. Transactions with subsidiaries have been eliminated in the consolidated financial statements. Sparebanken Sør's equity certificate owners are presented in Note 36. Besides loans granted on special terms to employees, all transactions with related parties have been established on market terms. Other than transactions identified in this note and Note 35, and eliminated transactions with the Sparebanken Sør Group, there are no significant transactions or outstanding amounts with related parties.

NOK THOUSAND	Group management	Board of Directors	Chairman of the Board of Trustees
Loans as at 31.12	17 559	4 683	2 340
Interest income	167	129	69
Deposits as at 31.12	9 756	8 431	2
Interest cost	54	103	0

Subsidiaries	Loans	Interest income	Deposits	Interest cost	Interest on bonds	Management fee
Prosjektutvikling AS	16 814	1	769	620		
Eiendomsvekst AS	5 000	19	5 183	0		
Transitt Eiendom AS	5 349	0	0	279		
Sørmegleren Holding AS	3 738	12	10	154		
Sparebanken Sør Boligkreditt AS	2 891 358	872	343 083	70 552	6 536	65 655
Total	**2 922 259**	**904**	**349 045**	**71 605**	**6 536**	**65 655**

Associated companies	Loans	Interest income	Deposits	Interest cost
Arendal Brygge AS	48 860	0	121	1 540
Torvparkering AS	163 133	25	5 534	4 929
Total	**211 993**	**25**	**5 655**	**6 469**

Sparebanken Sør has derecognised loans transferred to Sparebanken Sør Boligkreditt AS. The agreements have been formulated such that the loans qualify for derecognition. The total balance of these loans is stated below.

NOK MILLION	31.12.2018	31.12.2017
Sparebanken Sør Boligkreditt AS	38 729	30 968

Sparebanken Sør Boligkreditt AS purchases the majority of services from the Bank. All transactions between the companies are entered into on market terms. As at 31 December 2018, Sparebanken Sør Boligkreditt AS has an overdraft facility of NOK 4,000 million in Sparebanken Sør. In addition, Sparebanken Sør Boligkreditt AS has, at all times, a revolving credit facility with the Parent Bank, for which an annual commission is paid.

NOTE 35 – REMUNERATION AND SIMILAR BENEFITS

Information in this note applies to the status of the Group's Board of Directors, management and employee representatives.

2018

Key personel NOK THOUSAND	Role	Number of equity certificates	Wages	Performance bonus	Taxable benefits	Pension cost	Total remuneration	Loans
Geir Bergskaug	CEO	40 463	2 809	91	193	2 030	5 123	2 975
Lasse Kvinlaug	Deputy CEO/Director, Corporate market	2 312	1 845	65	227	478	2 615	509
Gunnar Thomassen	Director, Retail market	1 430	1 722	62	227	242	2 253	2 958
Rolf H. Søraker	Director, Group support	868	1 394	54	150	241	1 839	546
Marianne Lofthus	Director, Capital market	0	1 357	52	171	268	1 848	4 447
Bjørn A. Friestad	Director, Risk management	2 393	1 443	55	189	309	1 996	1 343
Gry Moen	Director, Business support	118	1 312	52	190	262	1 816	4 781
Total		**47 584**	**11 882**	**431**	**1 347**	**3 830**	**17 490**	**17 559**

2017

Key personel NOK THOUSAND	Role	Number of equity certificates	Wages	Performance bonus	Taxable benefits	Pension cost	Total remuneration	Loans
Geir Bergskaug	CEO	23 463	2 736	130	172	1 838	4 876	2 981
Lasse Kvinlaug	Deputy CEO/Director, Corporate market	2 312	1 801	92	232	468	2 593	1 076
Gunnar Thomassen	Director, Retail market	1 430	1 647	88	188	249	2 172	3 047
Rolf H. Søraker	Director, Group support	868	1 360	76	137	248	1 821	781
Marianne Lofthus	Director, Capital market	0	1 274	73	173	276	1 796	0
Bjørn A. Friestad	Director, Risk management	2 393	1 408	78	180	309	1 975	1 565
Gry Moen	Director, Business support	118	1 312	73	174	269	1 828	4 876
Total		**30 584**	**11 538**	**610**	**1 256**	**3 657**	**17 061**	**14 325**

The CEO has an agreement for one year's severance pay in the event of enforced resignation before the end of the agreed period of tenure.

There is a bonus system for all the Bank's employees, including Group Management, see Note 18.

							2018
Board of Director's NOK THOUSAND	Role	Number of equity certificates	Remuneration	Pension	Fringe benefits	Total remuneration	Loans and collateral
Stein A. Hannevik	Chairman	10 467	440	301	21	762	10
Inger Johansen	Deputy chairman	0	198		1	199	2 911
Marit Kittelsen	Member	0	144		1	145	1 177
Erling Holm	Member	0	233		1	234	500
Mette Harv	Member	0	132		0	132	0
Tom Erik Jebsen	Member	0	99		0	99	0
Knut R Sæthre	Deputy member	0	90		1	91	0
Jan Erling Tobiassen	Employee representative	0	115		15	130	85
Gunnhild Tveiten Golid	Employee representative	0	115		16	131	0
Sum		**10 467**	**1 566**		**56**	**1 923**	**4 683**

							2017
Board of Director's NOK THOUSAND	Role	Number of equity certificates	Remuneration	Pension	Fringe benefits	Total remuneration	Loans and collateral
Stein A. Hannevik	Chairman	10 467	449	1 807	40	2 296	4 754
Torstein Moland	Deputy chairman	0	185			185	0
Inger Johansen	Member	0	146			146	3 417
Marit Kittelsen	Member	0	111			111	1 285
Erling Holm	Member	0	198			198	500
Tone Vareberg	Member	0	108			108	0
Jan Erling Tobiassen	Employee representative	0	100		16	116	257
Gunnhild Tveiten Golid	Employee representative	0	92		14	106	0
Sum		**10 467**	**1 389**		**70**	**3 266**	**10 213**

				2018
Board of Trustees NOK THOUSAND	Role	Number of equity certificates	1) Remunerations	Loans
Øystein Haga	Chairman, Deposit elected	0	45	2 340
Tormod Nyberg 2)	Deputy Chairman. EC owner	19 372	12	0
Jorunn Aarrestad	Deposit elected	0	16	2 196
Kai Magne Strat	Deposit elected	0	10	637
Ingvild Hovden	Deposit elected	0	7	1 556
Birgitte Midtgaard	Deposit elected	0	5	206
Øyvind Tveit	Deposit elected	0	38	0
Linda Gjertsen	Deposit elected	0	2	1 011
Mette Vestberg Sørensen	Deposit elected	0	16	10
Ole Tom Haddeland	Deposit elected	0	5	646
Ståle Rysstad	Deposit elected	0	27	0
Lisa Jensen	Deposit elected	0	4	0
Wigdis Hansen	Deposit elected	0	13	0
Nils Johannes Nilsen	Public elected	0	2	0
Vidar Stang	Public elected	0	5	0
Harald Fauskanger Andersen	Public elected	0	14	2 349
Einar Holmer Hoven	Public elected - deputy	0	3	0
Alf Albert	EC owner	57 955	16	1 486
Kristian Tørres Brøvig	EC owner	9 747	2	0
Helge Sandåker 3)	EC owner	0	11	0
Kari Anne Norbø 3)	EC owner	0	3	0
Svein Bringsjord 4)	EC owner	7 300	27	1 976
Karen Andersen	Elected by employees	0	19	1 632
Ellen Haugen	Elected by employees	118	5	1 500
Per Bø	Elected by employees	118	5	2 984
Nina Merete Olsen	Elected by employees	70	17	2 485
Bente Sørensen	Elected by employees	198	3	940
Hege Kirkhus	Elected by employees	118	5	2 997
Birger Sløgedal	Elected by employees	0	5	2 498
Sum		**94 996**	**342**	**29 448**

1. Fees paid to the Board of Trustees and the Nomination Committee.
2. Represents Acan AS
3. Represents Sparebankstiftelsen Sparebanken Sør, which owns 7 988 679 equity certificates
4. Represents Sparebankstiftelsen Sparebanken Sør and 7 300 own equity certificates

				2017
Board of Trustees NOK THOUSAND	Role	Number of equity certificates	1) Remunerations	Loans
Øystein Haga	Chairman, Deposit elected	0	34	2 363
Tormod Nyberg 2)	Deputy Chairman. EC owner	30 495	4	0
Jorunn Aarrestad	Deposit elected	0	8	5 068
Kai Magne Strat	Deposit elected	0	10	835
Ingvild Hovden	Deposit elected	0	4	1 713
Oddbjørn Lia	Deposit elected	0	5	4 223
Øyvind Tveit	Deposit elected	0	35	0
Linda Gjertsen	Deposit elected	0	2	1 047
Mette Vestberg Sørensen	Deposit elected	0	16	0
Ole Tom Haddeland	Deposit elected	0	2	800
Ståle Rysstad	Deposit elected	0	26	0
Lisa Jensen	Deposit elected	0	4	0
Wigdis Hansen	Deposit elected	0	7	0
Anders Gaudestad	Deposit elected - deputy	0	4	7 892
Birgitte Midgaard	Deposit elected - deputy	0	2	197
Nils Johannes Nilsen	Public elected	0	4	0
Vidar Stang	Public elected	0	4	0
Harald Fauskanger Andersen	Public elected	0	15	1 926
Alf Albert	EC owner	50 000	2	821
Kristian Tørres Brøvig	EC owner	9 747	2	0
Helge Sandåker 3)	EC owner	0	4	959
Kari Anne Norbø 3)	EC owner	0	2	0
Svein Bringsjord 4)	EC owner	7 300	15	1 963
Karen Andersen	Elected by employees	0	10	1 668
Ellen Haugen	Elected by employees	118	4	1 514
Per Bø	Elected by employees	118	4	3 040
Nina Merete Olsen	Elected by employees	70	10	2 761
Bente Sørensen	Elected by employees	198	4	1 105
Hege Kirkhus	Elected by employees	118	4	3 078
Birger Sløgedal	Elected by employees	618	4	2 565
Sum		**98 782**	**251**	**45 541**

1. Fees paid to the Board of Trustees and the Nomination Committee.
2. Represents Acto AS and Acan AS
3. Represents Sparebankstiftelsen Sparebanken Sør, which owns 7 988 679 equity certificates
4. Represents Sparebankstiftelsen Sparebanken Sør and 7 300 own equity certificates

NOTE 36 – EQUITY CERTIFICATES, EQUITY CAPITAL AND PROPOSED DIVIDEND

The 20 largest equity certificate owners at 31 Dec. 2018

	NAME	NUMBER OF EC	SHARE OF EC-CAP. %
1.	Sparebankstiftelsen Sparebanken Sør	7 988 679	51.00
2.	Arendal Kom. pensjonskasse	450 000	2.87
3.	EIKA utbytte VPF c/o Eika kapitalforv.	434 214	2.77
4.	Pareto AS	417 309	2.66
5.	Bergen Kom. Pensjonskasse	376 231	2.40
6.	Glastad Invest AS	368 765	2.35
7.	Holta Invest AS	310 076	1.98
8.	Otterlei Group AS	236 563	1.51
9.	Wenaasgruppen AS	186 000	1.19
10.	Gumpen Bileiendom AS	174 209	1.11
	Total - 10 largest owners	**10 942 046**	**69.85**

	NAME	NUMBER OF EC	SHARE OF EC-CAP. %
11.	Allumgården AS	151 092	0.96
12.	Merrill Lynch	147 977	0.94
13.	Svenska Handelsbanken AB	100 000	0.64
14.	Ottersland AS	100 000	0.64
15.	Wenaas Kapital AS	94 585	0.60
16.	MP Pensjon PK	85 523	0.55
17.	Artel AS	82 131	0.52
18.	Profond AS	77 115	0.49
19.	Apriori Holding AS	72 575	0.46
20.	Varodd AS	70 520	0.45
	Total - 20 largest owners	**11 923 564**	**76.12**

Sparebanken Sør owned 5,168 own equity certificates at 31 December 2018. Equity capital of NOK 783,197,200, divided between 15,663,944 equity certificates, each with a nominal value NOK 50.

Proposed, not approved dividend

	PARENT BANK	
	2018	2017
Total proposed dividend	NOK 94,0 mill.	NOK 94,0 mill.
Proposed dividend per equity certificate	NOK 6,0 per EC	NOK 6,0 per EC
Number of equity certificates	15 663 944	15 663 944

Dividend for the financial year 2018 is classified as other equity at 31 December 2018.
The dividend approved by the Board of Trustees on 22 March 2018 for the financial year 2017 was paid in 2018.

Equity capital and earnings per equity certificate

NOK MILLION	31.12.2018	31.12.2017
Number of equity certificates	15 663 944	15 663 944
Nominal value	50	50
Equity certificate capital	783	783
Premium fund	451	451
Dividend equalisation fund	369	341
Total equity share capital (A)	**1 603**	**1 575**
Total equity share capital (Parent bank)	10 518	9 970
- hybrid capital	(1 075)	(1 075)
- other equity	(94)	(94)
Equity share capital excl. Hybrid capital and other equity share capital (B)	**9 349**	**8 801**
Ownership ratio after allocation (A/B)	**17.2 %**	**17.9 %**
Ownership ratio, weighted average (1)	**17.9 %**	**18.7 %**

NOK MILLION	2018	2017
Profit for the year, parent bank	731	795
- interest on hybrid capital	(56)	(47)
Dividend basis, parent bank	**675**	**748**
Profit for the year per EC, Parent Bank	7.7	8.9
Profit for the year, Group	938	984
- interest on hybrid capital	(56)	(47)
Dividend basis, the Group	**882**	**937**
Profit for the year per EC, Group	10.1	11.2

Earnings per equity certificate is calculated as the ratio between profit for the year attributable to the owners of equity certificates according to the equity capital certificate ratio in the parent company and the number of equity certificates issued at the end of the year.

Equity certificates owned by the CEO, senior management, members of the Board of Directors, members of the Board of Trustees and their personal related parties as in section § 7–26 of the Norwegian Accounting Act and section § 8-20 of its supplementary regulations are disclosed in Note 35.

NOTE 37 – BUSINESS COMBINATIONS

Business acquisitions:

On 3 October 2018, Sparebanken Sør purchased 10.2% of the shares in Frende Holding AS from Fana Sparebank. The purchase sum was NOK 246.2 million, which was cash funded. The total shareholding after the purchase is 20.2%. From the date of purchase, Frende Holding AS changed from being an investment in shares measured at fair value to being an investment in an associate. The value of the shares at the time of purchase is based on the most recently observed transactions at the time of their takeover.

Frende Holding AS is the parent company of Frende Skadeforsikring AS and Frende Livsforsikring AS, which offer general and life insurance to private individuals and businesses. The company is owned by 15 independent savings banks, and its head office is at Jonsvoll in Bergen. The insurance operation is based on distribution through the owner banks' extensive network of offices in their respective geographical catchment areas, via their own sales centres in the franchise channel and via electronic distribution through the owner banks, partners and frende.no.

The purchase resulted in excess value of NOK 213 million. Management believes that the purchase will have a positive impact on future earnings beyond the value of the company's individual assets. The shareholding in Frende Holding AS corresponds to voting rights.

Based on figures at the close of the third quarter 2018, excess value and the excess value analysis break down as follows:

NOK MILLION	Fair value on the acquisition date
Assets	
Intangible assets	1 002
Fixed assets	314
Financial assets	3 961
Reinsurance share of gross claim payments	140
Receivables	857
Other assets	156
Investments in the unit-linked portfolio	3 472
	9 902
Liabilities	
Technical provisions life insurance	-4 522
Technical provisions general insurance	-2 417
Provisions	-75
Commitment deferred tax	-304
	-7 318
Net identifiable assets at fair value	**2 584**
Other shareholder values at fair value	-2 063
Goodwill	-35
Sparebanken Sør's share of fair value of investment on the acquisition date	**487**
Book value of shares on the acquisition date	487
Book value before acquisition	-241
Purchase price	**246**

NOK MILLION	Sparebankens Sør's calculated excess values recognised on the acquisition date
Assets	
Fixed assets (systems)	63
Costumer portfolio	115
	179
Liabilities	
Share of book value of equity on the acquisition date	274
	274
Net identifiable excess values	**452**
Goodwill	35
Book value of shares in Frende Holding AS on the acquisition date	**487**
Book value of shares on the acquisition date	487
Book value before acquisition	-241
Purchase price	**246**

The acquired company has contributed NOK 1 million in revenue. In addition, NOK 5 million has been recognised in amortisation (expenses) of excess value. This is recognised as income from ownership interests in associates.

Ahead of the acquisition, Sparebanken Sør received a dividend from Frende Holding of NOK 6.5 million. It also wrote down its original shareholding by NOK 18.9 million in connection with the transaction price at the time of acquisition.

If the acquisition had been carried out as at 1 January 2018, the Group's total operating revenue for the whole period would have been NOK 10.7 million and it would have made an ordinary loss after tax of NOK 9.2 million, after amortisation of excess value.

Included in the valuation of excess value is the portfolio of general and life insurance customers, as well as technical and IT systems. These intangible assets do not fulfil the recognition criterion in IAS 38 and are therefore not recognised separately in the balance sheet. Goodwill is not amortised in accordance with IAS 28, but is tested annually for impairment.

NOTE 38 – IMPACT ON THE FINANCIAL STATEMENTS OF TRANSITION TO IFRS 16

IFRS 16 Leases replaces today's IAS 17 Leases on 1 January 2019. IFRS 16 sets out the principles for recognition, measurement, presentation and disclosure of leases for both parties to a lease, i.e. the customer (lessee) and the provider (lessor). The objective is to ensure that lessees and lessors submit relevant information in a manner which correctly reflects these transactions.

The standard can be implemented with a full retrospective method, in which the transitional effects are posted against the opening balance, in the first comparison year. All comparative figures are revised in line with the rules in IAS 8. Alternatively, modified retrospective application of the standard can be used, which means that the comparative figures are not revised. The effect of implementation is posted against the opening balance for earned equity in the year of implementation. Sparebanken Sør has chosen to make use of a modified retrospective method in connection with transition to the new standard. The reason for this is that the scope of leases in the Group is small and future calculated liabilities are regarded as insignificant in its balance sheet.

Scope and area of use for Sparebanken Sør

The new IFRS 16 standard proposes a method for recognition corresponding to the treatment of finance leases under IAS 17. This means that the lessor must recognise assets and liabilities for most leases in the balance sheet, recognise the depreciation of assets and interest expense on liabilities through profit or loss, and classify repayments of principal with respect to liabilities under financing activities. The interest portion is classified either as operating activities or as financing activities in the cash flow statement.

For the lessor, the current rules for financial and operating leases will generally continue to apply.

Sparebanken Sør has traditionally owned the buildings where the Bank has had its offices. The introduction of the new standard will require only small changes in bookkeeping compared with the original standard. In recent years, there has been a slight increase in the use of leased premises, but on a limited scale. For Sparebanken Sør, the new standard will essentially be applicable to leases where we act as lessee. Transition to the new standard will encompass 23 active leases. A review of all tenancy contracts in the autumn of 2018 has substantiated their previously assumed accounting significance. The implementation of IFRS 16 will have a marginal impact for Sparebanken Sør. See transitional effect as at 1 January 2019.

Measurement and time of recognition

The standard enters into force on 1 January 2019 and is recognised in the company's accounts from this date.

Right of use and leasing liabilities can be measured either from the date of implementation or retrospectively from the contract's start date. If the contract's start date is used, right of use and leasing liabilities on 1 January 2019 will be different, due to previously paid rent and the discount rate. The difference is recognised in equity as a transitional effect.

When measuring at the time of implementation, right of use and leasing liabilities will be identical at transition on 1 January 2109, and no transitional effect will be recognised in equity.

In view of the scope and amounts involved, Sparebanken Sør has chosen to measure right of use and leasing liabilities from the date of implementation. The effects of the two selected methods of measurement have been reviewed for the largest and most long-term contracts ahead of implementation. The differences between the two methods are insignificant. In view of this situation, as at 1 January 2019, no transitional effects will be recognised directly in equity, only the company's assets and liabilities will be covered.

Distinction between service contracts and leases

IFRS 16 distinguishes between service contracts and leases. A distinction is therefore drawn between contracts that give the customer a right to own an asset (lease) and those that represent a purchase of services. IFRS 16 defines a lease as follows: "A contract, or part of a contract, that conveys a right to use the asset (the underlying asset) for a period of time in exchange for consideration. To be considered a lease, a contract must convey the right to control the use of an identified asset.". Service contracts represent mutually unfulfilled contracts, where delivery is considered to take place as and when the service is provided by the supplier and consumed by the customer. Service contracts do not fall under the new IFRS 16 standard.

As well as ordinary tenancy agreements, Sparebanken Sør has a significant contract for the delivery of IT systems. This contract describes "business as a service" and stipulates that it is services that are received. The contract is considered to be a purchase of service, as the right to control the use of an identified asset is not received. The contract is not considered to fall under IFRS 16.

NOK MILLION	IAS 17	IAS 16	
	Book value	Book value	Change
Other intangible assets			
Right of use of rented premises	0	38 181	38 181
	Book value	Book value	Change
Other liabilities			
Obligation of rented premises	**0**	**38 181**	**38 181**

The transitional effect will be identical for the Parent Bank and Group, as there are no leases covered by the new standard in the Group's subsidiaries. A discount rate of 2.6% has been applied in calculating rights of use and liabilities at transition.

NOTE 39 – EVENTS AFTER THE BALANCE SHEET DATE AND CONTINGENCIES

No events of material significance to the financial statements have occurred since the balance sheet date.

NOTE 40 – ACCOUNTING POLICIES USED PRIOR TO 1 JANUARY 2018

A new accounting standard, IFRS 9, was implemented on 1 January 2018. The standard was implemented in the financial statements at the same time. The Group had not chosen to make use of early adoption of IFRS 9, and this means that all comparative figures from earlier periods have been prepared according to IAS 39.

Accounting policies under IAS 39 are reproduced below and taken from the annual report for 2017.

FINANCIAL INSTRUMENTS

Recognition and derecognition

Financial assets and liabilities are initially recognised when the Bank becomes a party to the contractual provisions of the instrument.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire, or the company transfers the financial asset in such a way that the risk and profit potential of the asset concerned is largely transferred. A financial liability is derecognised when the financial liability has been fulfilled, cancelled or has expired.

Offsetting

Financial assets and financial liabilities are offset and presented net in the balance sheet, only when the company has a legally enforceable right to offset, and intends to realise the asset and settle the liability simultaneously.

Classification

Financial instruments are classified into one of the following categories at initial recognition.

- All derivatives measured at fair value with the changes in value through profit or loss
- Financial derivatives designated as hedging instruments
- Financial instruments voluntarily categorised at fair value with changes in value through profit or loss
- Loans and receivables at amortised cost
- Other liabilities at amortised cost

Financial instruments subject to fair value/financial derivatives

Financial derivatives are to be measured at fair value with change in value through profit or loss. Sparebanken Sør has used the following financial derivatives: interest rate swaps, currency futures and currency swaps. Financial derivatives are recognised at fair value and changes in value through profit or loss.

Financial derivatives designated as hedging instruments

This category covers interest swaps and currency swaps used as hedging instruments for actual hedging of the value of bonds issued at fixed interest rates. Hedge accounting is discussed further in item 5.

Financial instruments voluntarily recognised at fair value

The Group chooses at initial recognition to define assets or liabilities at fair value with changes in value through profit or loss if:

- Classification reduces a mismatch in the measurement or recognition that otherwise would have occurred as a result of different rules for measurement of assets and liabilities. This applies to fixed-interest loans that are hedged using derivatives.
- The financial instruments are included in a portfolio that is continuously measured and reported at fair value. This includes certificates and bonds, fixed-interest loans and shares.

Loans and receivables at amortised cost

This category includes loans and receivables that are measured at amortised cost.

Other liabilities at amortised cost

This category includes loans and commitments that are measured at amortised cost.

Measurement on initial recognition

All financial assets and liabilities are recognised in the balance sheet at fair value. For instruments that are not derivatives or measured at fair value through profit or loss, transaction costs which are directly attributable to the acquisition or issue of the financial asset or financial liability.

SUBSEQUENT MEASUREMENT

Measurement at fair value

liability in an orderly transaction between market participants at the time of valuation.

Measurement of financial instruments traded on an active market

Financial instruments traded on an active market are valued at the observed market prices.

Measurement of financial instruments not traded on an active market

The fair value of financial instruments not traded on an active market is determined using a suitable valuation method. Valuation techniques are based on recently signed transactions between independent parties, by referencing instruments with virtually the same content or by discounting cash flows. As far as possible, valuations are based on externally observed parameter values.

Fair value of interest-bearing securities is determined by established market values reported by leading external market players, or at the fair value calculated on the basis of the prevailing market yield and credit spread curves.

In calculating the fair value of swaps entered into, the prevailing market value of the relevant inter-bank interest rate curve is used.

For shares that are not listed or traded actively, the change in value is based primarily on valuations carried out by others. If this is not available, the value of the shares is based on the available accounting information.

Fixed-interest loans are not traded on an active market. The Bank must therefore establish a market spread to estimate the loans' fair value at 31 December. For fixed-interest loans in the private market, the average of the 10 best mortgage deals published at www.finansportalen.no is used as market interest rates.

Measurement of financial guarantees

Financial guarantees are measured at fair value on initial recognition. In subsequent measurements, issued financial guarantees are valued at the highest amount of consideration received for the guarantee, less any recognised amortisation and best estimates in any redemption of the guarantee.

Measurement at amortised cost

Financial instruments not measured at fair value are measured at amortised cost. Revenues are then calculated at the instrument's effective interest rate.

Amortised cost is defined as the carrying amount on initial recognition, less received/paid interest and deductions, plus accrued effective interest, adjusted for net impairment and the net recognised effect of any value hedging.

Effective interest method is a method that calculates amortised cost and accrues interest income/expenses for the relevant period. Interest income is recognised using the effective interest method. The effective interest rate is the interest rate that, by discounting the loan's cash flows over the anticipated term, gives a value equal to the loan's amortised cost on the date of establishment. This means that any difference between the loan's original book value and the accrued value is amortised over the loan's expected maturity.

Impairment of financial assets

Losses on loans are calculated as the difference between carrying amount and net present value of estimated future cash flows, discounted using the effective interest rate. Use of the effective interest method means that interest income on impaired loans is recognised in the income statement. These loans are recognised at the internal interest rate at the date of establishment, adjusted for changes in interest rates until the time of impairment. Interest is recognised through profit or loss based on the impaired value of the loan.

In the balance sheet, loan impairments reduce the carrying amounts of the commitments. In the income statement, losses on loans consist of confirmed losses, changes in impairment losses, revenue on loans and provisions for guarantees, as well as receipts on previously confimed losses. Losses on loans are based on an assessment of the Bank's loan and guarantee portfolio in accordance with IAS 39. The Bank determines the losses on loans and guarantees on a quarterly basis. Non-performing loans are followed up with regular reviews.

Reduction in value of loans and individual impairment losses

An impairment loss is recognised when there is objective evidence that a loan is impaired as a result of credit losses. An impairment loss is reversed when the loss is reduced and the reduction is objectively attributable to an event occurring after the date on which impairment loss was recognised. All loans that are considered material will be assessed to see whether there is objective evidence of weakened creditworthiness, and the objective indication is likely to result in reduced future cash flows for the servicing of the commitment. Objective evidence may be default, bankruptcies, debt restructuring, lack of liquidity or other significant financial problems.

Collective write-downs

Loans for which individual impairment losses have not been recognised are included in collective write-downs. Loans are divided into groups with similar risk characteristics, with regard to ability to pay. Collective write-downs are calculated on sub-groups of loans where there is objective evidence that the future cash flow for the servicing of the

commitments is weakened. Collective write-downs made in order to cover expected credit losses caused by events that have occurred, must take account of losses in the portfolio at the time of measurement, but that are not yet identified at the individual commitment level. Objective events could be a negative trend in risk classification, adverse developments in the value of collateral or negative industry developments.

Confirmed losses

When it is highly probable that a loss is final, it is recognised as a confirmed loss. Some confirmed losses will be covered by previously recognised, individual impairment losses, and will therefore be posted against the previous provision. confirmed losses, not covered by previously recognised, individual impairment losses, as well as any surplus or deficit in relation to previously recognised impairment losses, are posted to profit or loss.

PRESENTATION IN BALANCE SHEET AND INCOME STATEMENT

Loans

Loans are recorded as either loans to and receivables from credit institutions or as net loans to customers. Interest is included in the income statement under interest income. Changes in value due to impairments are included in the income statement under losses on loans and guarantees.

Changes in the value of fixed-interest loans, which have been selected for measurement at fair value, are included in the income statement under net income from financial instruments.

Bonds and certificates

This balance sheet item includes the Group's certificate and bond portfolio. Interest is included in the income statement under interest income. All changes in value are recognised in the income statement under net income from financial instruments.

Shares

The balance sheet includes the Group's shares recognised at fair value. All changes in value are recognised in the income statement under net income from financial instruments.

Financial derivatives (assets and liabilities)

This balance sheet item includes financial derivatives. Changes in value related to the derivatives are recognised in the income statement under net income from financial instruments.

Debt to credit institutions and deposits from customers

This balance sheet item includes liabilities to credit institutions and customers. Interest is recognised in the income statement under interest expenses.

Liabilities from issuance of securities

This balance sheet item includes issued securities debt. Interest is recognised in the income statement under interest expenses. In case of early redemption or repurchase of issued bonds, any gains and losses are recognised under net change in the value of financial instruments.

Subordinated loan capital

This balance sheet item includes issued subordinated loans. Interest is recognised in the income statement under interest expenses.

HEDGE ACCOUNTING

Sparebanken Sør uses hedge accounting in relation to the bank's funding at fixed-interest terms and in foreign currencies. Hedging covers the interest rate risk and foreign exchange risk associated with the bonds.

The Bank's criteria for classifying a derivative as a hedging instrument are:

- The hedge accounting is anticipated to be very effective, in that it counteracts changes in the fair value of the bond issued.
- Hedging must be expected to be effective within the range of 80% to 125%.
- It must be possible to measure the effectiveness of hedging reliably.
- Satisfactory documentation has been established prior to hedging that, among other things, shows that the hedging is effective and is expected to remain effective throughout the period.

Sparebanken Sør uses fair value hedging. Hedging is measured and documented every quarter to ensure that it is effective. The dollar-offset method is used to measure the effectiveness of hedging.

When the hedging is established and effective, interest rate swaps and currency swaps will be recognised in the balance sheet at fair value and in the income statement under net income from financial instruments.

The hedged object is recognised in the balance sheet at amortised cost. Changes in fair value associated with the hedged risk are accounted for as a supplement or deduction in the book value of the bond debt and is added to the income statement under net income from financial instruments.

If circumstances should occur which render hedging ineffective, the Bank/Group will amortise the change in value associated with the hedged object over the remaining period. The associated hedging instrument will continue to be measured at fair value with changes in value through profit or loss.

Calculations

NOK MILLION	31.12.2018	31.12.2017
Return on equity adjusted for hybrid capital		
Profit after tax	939	984
Interest on hybrid capital	-56	-47
Profit after tax, incl. Interest on hybrid capital	**884**	**937**
Opening balance, equity	11 108	10 051
Opening balance, hybrid capital	-1 075	-825
Opening balance, equity excl. hybrid capital	**10 033**	**9 226**
Closing balance, equity	11 845	11 108
Closing balance, hybrid capital	-1 075	-1 075
Closing balance, equity excl. hybrid capital	**10 770**	**10 033**
Average equity	11 477	10 580
Average equity excl. Hybrid capital	**10 402**	**9 630**
Return on equity	8.2 %	9.3 %
Return on equity excl. Hybrid capital	**8.5 %**	**9.7 %**
Net interest income, incl. interest hybrid capital		
Net interest income, incl. interest hybrid capital	1 729	1 679
Interest on hybrid capital	-56	-47
Net interest income, incl. interest hybrid capital	**1 674**	**1 632**
Average total assets	118 600	109 500
As a percentage of total assets	**1.41 %**	**1.49 %**
Operating costs, adjusted for conversion of the pension scheme		
Operating expenses	884	811
Conversion of pension scheme	-	28
Operating expenses, adjusted for conversion of the pension scheme	**884**	**839**
Profit from ordinary operations (Adjusted earnings)		
Net interest income, incl. interest hybrid capital	1 674	1 632
Net commision income	318	312
Share of profit by associated companies (excl. valueadjustment Balder Betaling/Vipps)	-9	-
Other operating income	11	18
Operating expenses, adjusted for conversion of the pension scheme	884	819
Profit from ordrinary operations (adjusted earnings), before tax	**1 110**	**1 143**
Profit excl. Finance, and adjusted for non-recurring items		
Net interest income, incl. interest hybrid capital	1 674	1 632
Net commision income	318	312
Share of profit from associated companies (excl. valueadjustment Balder Betaling/Vipps)	-	-
Other operating income	11	18
Operating expenses, adjusted for conversion of the pension scheme	884	819
Losses on loans, guarantees and undrawn credit	-36	20
Profit excl. Finance, and adjusted for non-recurring items	**1 155**	**1 123**
Tax (25 %)	289	281
Ordrinary operations / adjusted earnings after losses and tax	**866**	**842**
Average equity excl. Hybrid capital	10 402	9 630
Return on equity, profit excl. Finance and adjusted for non-recurring items	**8.3 %**	**8.7 %**

The Board of Directors' report and some accounting presentations refer to adjusted results that are not defined in IFRS (Alternative Performance Measures (APM)).

Alternative performance measures

Sparebanken Sør presents alternative performance measures (APMs) which provide useful information to supplement the financial statements. These performance measures are not defined in IFRS (International Financial Reporting Standards) and by necessity are not directly comparable with the performance measures of other companies. Alternative performance measures are not intended to replace or overshadow accounting figures under IFRS, but are included in our reports to better highlight the underlying operation.

Key figures regulated in IFRS or other legislation are not regarded as alternative performance measures. The same applies to non-financial information. Sparebanken Sør's alternative performance measures are presented in the overviews of key figures, calculations and the Board of Directors' report. All APMs are presented with comparative figures. The APMs mentioned below have been used consistently over time.

Sparebanken Sør's alternative performance measures and definitions.

Measure	Definition
"Return on equity (ROE) (Ordinary profit in % of average equity capital)"	These measures give relevant information on Sparebanken Sør`s profitability by measuring the ability to generate profits from the shareholders' investments. ROE is one of Sparebanken Sør`s most important APM. Return on equity (ROE) is calculated as: Shareholders' share of profits for the period divided by average equity excluding hybrid capital.
Book equity per ecuity certificate (including dividend)	This key figure provides information on the value of book per equity certificate. This enables the reader to assess the reasonableness of the market price of the equity certificate. Book equity per equity certificate is calculated as shareholders' equity excluding hybrid capital at the end of the period, divided by the total number of outstanding certificates.
Profit / dilluted earnings per equity certificate	This key figure provides information on the profit compared to the dilluted earnings per equity certificate at the relevant time, which provides a basis for assessing the reasonableness of the profit on the earnings per equity certificates. Dilluted earings per equity certificate is calculated as majority interest muliplied by equity certificate ratio, divided by number of equity certificates issued.
Growth in loans (gross) as %. last 12 months	"Growth in lending over the last 12 months is a performance measure that provides relevant information on the level of activity of and growth in the bank's lending business. The bank uses Sparebanken Sør Boligkreditt (SSBK) as a source of funding, and this key figure includes loans sold to them since this better reflects the level of activity and growth in lending than if these loans were excluded. Lending growth is calculated as gross loans incl. loans sold to SSBK at period-end minus gross loans incl. loans sold to SSBK at period-start divided by gross loans incl. loans sold to SSBK at the start of the period."
Growth in deposits as %. last 12 months	"Growth in deposits over the last 12 months is a performance measure that provides relevant information on the level of activity of and growth in the bank's liquidity position. Deposit growth is calculated as total deposits from customers at period-end minus total deposits from customers at period-start divided by total deposits from customers at the start of the period."
Deposit as % of net loans	These measures give relevant information on Sparebanken Sør's liquidity position. The APM is calculated as: Customer deposits divided by net loans to customers at the end of the period.
"Cost/income ratio (Total operating costs in % of total incomes)"	This ratio is included to provide information on the correlation between income and expenses and is considered to be one of Sparebanken Sør`s most important performance measures. It is calculated as: Total operating expenses divided by total income.
Price/book value per equity certificate	This measure is used to compare the company's current market price to its book value. It is frequently used to compare banks. Calculated as: Sparebanken Sør's closing share price at the end of the period divided by book value per equity certificate.
Losses on loans as % of net loans (annualised)	"This key figure indicates recognised impairment cost as a function of net loans incl. loans transferred to Sparebanken Sør Boligkreditt. The figure is calculated as loss recognised in the period divided by net loans incl. loans sold to SpareBanken Sør Boligkredit at period-end. Where information is disclosed on loan-loss ratios for periods shorter than one year, the ratios are annualised for recognition purposes."
Gross defaulted loans over 90 days as % of gross loans	"This ratio is presented because it provides relevant information on the bank's credit exposure. It is calculated as total defaulted exposures (over 90 days) divided by total loans incl. loans sold to Sparebanken Sør Boligkreditt at period-end."
Lending margin (CM and RM)	Measures the group's average profit from loans, calculated as average lending rate (return) with deduction of 3 month NIBOR. Avereage lending rate is calculated as interest income as a percentage of average gross loans to customers.
Deposit margin (CM and RM)	Measures the group's average profit from deposits, calculated as 3 month NIBOR with deduction of average deposit rate, Avereage deposit rate is calculated as interest expence as a percentage of average deposits from customers.
Average lending rate	See Lending margin (CM and RM) above
Average deposit rate	See Deposit margin (CM and RM) above

Corporate governance

CORPORATE GOVERNANCE REPORT

Sparebanken Sør is an independent financial services group whose principal activities are in banking, securities and real estate in the Agder counties, Telemark and Rogaland.

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

					PARENT BANK 31.12.2018
NOK Thousand	Type fof business	Office location	Owner shares	Share capital	Nominal value
Sparebanken Sør Boligkreditt AS	Credit institution	Kristiansand	100 %	1 125 000	1 845 695
Sørmegleren Holding AS	Estate agency firm	Kristiansand	91 %	5 728	6 983
AS Eiendomsvekst	Property managment	Arendal	100 %	3 000	2 935
Arendal Brygge AS	Property managment	Arendal	50 %	601	1 000
Prosjektutvikling AS	Property managment	Arendal	100 %	100	-
Transitt Eiendom AS	Property managment	Kristiansand	100 %	100	1 450
Total					**1 858 063**

The headquarter and registered address of the bank are in Kristiansand. The head office of the retail banking division and some of the corporate functions are located in Arendal. The Bank's organisation number is 937 894 538.

This report is based on NUES (Norwegian Code of Practice for Corporate Governance) and the "comply or explain" requirements of the Oslo Stock Exchange.

The company's intention with this document is:

- To clarify the allocation of roles between the Bank's governing bodies and day-to-day management
- Equal and secure access to reliable and timely information on the company's operations
- Equal treatment of equity certificate holders
- To optimise the company's value in a long-term perspective

The corporate governance principles have been specified in various policy documents for Sparebanken Sør's operations. This includes the bank's articles of association, strategies, Board instructions, instructions for the CEO, framework for management and control, ethical guidelines and procedures for own-account trading.

THE CONNECTION WITH THE BANK'S OTHER POLICY DOCUMENTS

The Bank's strategy documents specifies the overall plans for the Group, and to complement the totality of the Group's policy documents there should be a close correlation between the overall strategy document and the complementary and more detailed governance documents.

The structure of the various documents is shown below.

For some policy documents there are, in addition, supplementary documents adopted by the administration. To ensure that the various policy documents correspond to the Group's objectives, the policy documents have to be revised and maintained regularly. An audit is normally carried out within a period of 12 months with a decision by a relevant authority.

For operationalization of the Bank's strategic objectives, detailed annual action plans will be prepared, which also are related to the critical success factors included in the strategy document.

The document owner is responsible for ongoing maintenance, including presenting proposals for changes and ensuring that these are treated in accordance with the Bank's procedures. The document owner is responsible for implementing the governing documents in the organisation.

OPERATIONS

Objectives

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

Main strategies

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 and Telemark. In addition, the Bank aims to strengthen its position in the KNIF segment (Kristen-Norges Innkjøpsfelleskap), 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.

The Board directs the Bank's operations, and the work of the Board follows an established annual plan and Board instructions. The Board adopts the Bank's strategy in a three to five-year perspective. The strategic plan is evaluated on a rolling basis over the strategic period. The Board establishes goals and a risk profile for the business annually.

As a traditional savings bank dating back to 1824, Sparebanken Sør is run in accordance with the statutory rules that apply at any particular time to savings banks. The Bank can perform all normal banking transactions and services and provide investment services in accordance with the applicable regulations at any time. See the articles of association on the Bank's website www.sor.no.

Social responsibility

Social responsibility is integral to Sparebanken Sør's business. Sparebanken Sør's corporate 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. Work on social responsibility helps to strengthen the Bank's competitiveness, reduce risk, and attract good customers, investors and skilled employees.

Sparebanken Sør is committed to taking considerations of the climate, the environment, social conditions and good corporate governance in all its activities, including the development of products and services, advisory and sales activities, investment and credit decisions, and in its production and operations. Sparebanken Sør must contribute to the infringement of human and workers' rights, corruption, serious environmental damage and other acts which may be regarded as unethical.

By being a community building company, Sparebanken Sør contributes toward sustainable industrial and social development through creating values for the region. The Bank also supports projects in culture, sport and other areas that make a positive contribution in the local communities, where the Bank has offices. In addition to traditional sponsorship of teams and clubs, the Bank carries on the strong tradition of making donations for the public good in its capacity as an independent savings bank.

Measures against money laundering and the financing of terrorism

Sparebanken Sør must comply with the authorities' anti-money laundering regulations whose purpose is to combat money laundering and the financing of terrorism. This includes both an automatic notification system for suspicious transactions and responsibility for each individual employee to report individual cases or, if appropriate, to carry out intensified customer checks. The Bank has specific procedures for this and provides continuous training for employees, particularly those, who are in direct contact with customers.

Environmental matters

Sparebanken Sør takes account of climate issues. Environmental protection is becoming increasingly more important to and the bank would like to do its part to contribute. Sparebanken Sør has defined work on internal environmental efficiency as a priority area in the Bank's response to climate change.

Deviations from the recommendation: None.

EQUITY AND DIVIDENDS

Equity

Sparebanken Sør's equity is complex for several reasons. The most important of these are the size of the Group, a stable market for long-term funding and the Bank's objectives in a long-term, strategic perspective. Through annual evaluation of management and control, including the Internal Capital Adequacy Assessment Process (ICAPP), the Group has a strong focus on ensuring that its equity is tailored to its goals, strategies and risk profile. The capital situation is monitored closely through the year with internal calculations and reports.

Dividend

Risk-adjusted return is assumed to be high and competitive in the market. The equity certificate holders' mathematical share of profit is split between a cash dividend and an equalisation fund. The objective is for around half of the equity certificate holders' share of profit for the year after tax to be distributed as a dividend.

Emphasis is placed on the bank's equity development, solvency, liquidity situation and market adjustment when determining the size of the cash dividend and the share of the profit.

Board authorisations

The Bank's articles of association do not contain any provisions on the purchase of own equity certificates. Decisions on this issue must be discussed and adopted by the Board of Trustees, which can authorise the Board of Directors. Such decisions/authorisations to increase equity are otherwise based on the Financial Institutions Act and the principles set out in the Public Limited Companies Act.

Deviations from the recommendation: None.

EQUAL TREATMENT OF SHARE-HOLDERS AND TRANSACTIONS WITH RELATED PARTIES

The bank will place strong emphasis on transparency in relation to those, who provide the bank with equity and funding, and those who have relations with the bank in other ways.

Sparebanken Sør has one equity certificate class, and all equity certificate holders are treated equally. The Bank follows the provisions of the Financial Institutions Act on restrictions in ownership and voting rights insofar as the provisions apply to savings bank with listed equity certificates. Existing equity certificates have preference in the event of increases in capital, unless special circumstances dictate that this rule be waived. The waiver in such a case will be reasoned, and the reasons will be published in a stock exchange report.

In cases where the Bank has transactions in its own equity certificates, these are done on the stock exchange. If significant transactions occur between the Sparebanken Sør Group and equity certificate holders, board members, senior executives or parties related to these, the Board of Directors must ensure that a valuation has been made by an independent third party.

The Bank is obliged by the Stock Exchange's rules on reporting financial and other information to the market.

Deviations from the recommendation: None.

EQUITY CERTIFICATES AND NEGOTIABILITY

Sparebanken Sør's equity certificates are listed on Oslo Stock Exchange and are freely negotiable.

The only restriction is statutory requirements which at present stipulate that acquisition of a qualified share of the equity capital, at 10 percent or more, requires consent from the Ministry of Finance.

Listing on the stock exchange ensures that the Bank abides by the terms and conditions which apply at any time in the equity market.

Deviations from the recommendation: None.

THE BOARD OF TRUSTEES

A savings bank is, in essence, self-owned institution, and the management structure and composition of its governing bodies differs from those of limited liability companies with respect to the governing bodies a savings bank shall have. The Bank's governing structure and the composition of its governing bodies are deemed to comply with the wording of the recommendation"to the extent appropriate to savings banks with listed equity certificates".

The Bank's highest governing body is the Board of Trustees, which must ensure that the Bank acts in line with its purpose and in accordance with laws, articles of association and the Board of Trustees' own resolutions.

The Board of Trustees consists of 28 members, of whom 12 represent customers, 3 represent the general public, 6 represent equity certificate holders and 7 represent the Bank's employees. Mechanisms have been adopted that ensure geographical spread in the representation of the Bank's market areas.

Notice to the Board of Trustees' meetings will be sent with at least 21 days' notice. The Board of Trustees does not make decisions in other cases than those specified in the notice of the meeting.

The Board of Directors and auditor attend meetings of the Board of Trustees.

Deviations from the recommendation: None.

NOMINATING COMMITTEES

Under the Bank's articles of association, 4 nominating committees are elected:

- The Trustees Election Committee shall prepare the elections of Trustees. One nominating committee with 8 members is elected from among the members of the Board of Trustees and shall have representatives from all groups represented in the Board of Trustees.
- The Depositor Nomination Committee shall prepare the election of depositors to the Board of Trustees. One nominating committee with 4 members is elected from among the depositor-elected members of the Board of Trustees.
- Nomination Committee for the equity certificate holders shall prepare the election of representatives of the equity owners to the Board of Trustees. One nominating committee with 4 members is elected from among the equity certificate-elected members of the Board of Trustees.
- The nomination committee for employees shall prepare the election of employee representatives to the Board of Trustees. The Nomination Committee consists of 6 members, of which 4 are appointed by the employees and 2 by the management.

A list of the various nomination committees can be found on the Bank's website www.sor.no.

The work of the nomination committees

The Board of Trustees' nominating committee prepares election of the Chairman and Deputy Chairman of the Board of Trustees, the Chairman, Deputy Chairman and other members and deputy members of the Board of Directors, excluding the employees' representatives. Likewise for elections of the Chairman, members and deputy members of the Nominating Committee.

The reasons for the recommendations of the Board of Trustees, the depositor-elected, equity certificate-elected and employees' nominating committees shall be given.

Deviations from the recommendation: None.

THE BOARD OF DIRECTORS, COMPOSITION AND INDEPENDENCE

The composition of the Board of Directors is stated in Article 4-1 of the articles of association.

The Board of Directors is composed of 7 to 8 members, of which at least 2 are from Vest-Agder, at least 2 from Aust-Agder and at least 1 from Telemark, as well as 2 members elected from among the employees. 2 personal deputy members are also elected from among the employees, and for the other members of the Board of Directors 1 permanently attending deputy member with right to speak is elected.

It has been agreed that representation from the former Sparebanken Sør and Sparebanken Pluss shall be balanced until 31 December 2019.

Members of the Board of Directors are elected for two years.

The composition of the Board is based on expertise, capacity and diversity, and in compliance with the Bank's articles of association with regard to geographical distribution.

The Board of Directors independence

None of the bank's day-to-day management is a member of the Board of Directors.

The Board members' independence

All members of the Board of Directors nominated by the Board of Trustees are independent of executive personnel. The members of the Board of Directors are also independent of significant business connections.

Deviations from the recommendation: None.

THE WORK OF THE BOARD OF DIRECTORS

The Board of Directors is responsible for the funds at the Bank's disposal being managed in a secure and appropriate manner. The Board of Directors must ensure the satisfactory organisation of the Bank's operations, keep itself informed of the Bank's financial position and ensure that its operations, accounting and asset management are subject to satisfactory control.

The Board of Directors shall supervise day-to-day management and the Bank's operations in general.

The Board of Directors shall ensure that the Bank has good management and control systems in order to meet the statutory provisions applicable to the business.

The Board of Directors conducts an annual self-assessment.

The Audit Committee

The Audit Committee have separate instructions adopted by the Board of Directors. The committee is a preparatory and advisory committee for the Board of Directors, whose purpose is to strengthen work on financial reporting and internal control. At least one of the committee's members must be independent of the business and have qualifications (formal or experience-based competence) in accounting and auditing.

The Audit Committee prepares the Board of Directors' follow-up of the financial reporting process, monitors internal control and risk management systems, has ongoing contact with the Bank's chosen auditor, and assesses and monitors the auditor's independence.

The Board of Directors elects 4 members to the committee from among its members. The Board's chair is elected to chair the Audit Committee.

In accordance with the NUES recommendation, the majority of the members in the Audit Committee, are independent of the business.

The Risk Committee

The Risk Committee has separate instructions adopted by the Board of Directors. The Risk Committee is a preparatory and advisory committee to the Board of Directors and shall ensure that risk and capital management in the Group supports the Group's strategic development and achievement of objectives while ensuring financial stability and prudent asset management. The Risk Committee shall monitor the overall risk and assess whether the group's management and control systems have been adjusted to the risk level and the scope of the business.

The Board of Directors elects 4 members to the committee from among its members. The Chairman of the Board is elected as Chairman of the Risk Committee.

The majority of the committee is, in accordance with NUES' recommendation, independent of the business.

The Remuneration Committee

The Remuneration Committee has separate instructions adopted by the Board of Directors. The Remuneration Committee will help to ensure that there is consistency between the bank's remuneration arrangements, the overall objectives, risk tolerance and long-term interests.

The committee prepares all matters relating to remuneration schemes for the Board of Directors. The committee must support the work of the Board of Directors to determine and ensure that the Bank at all times has and practises guidelines and frameworks for remuneration arrangements.

The Bank has established a Remuneration Committee consisting of 5 members of the Board of Directors, of whom 1 member is an employee representative. The Chairman of the Board is elected as Chairman of the Remuneration Committee.

The majority of the committee is, in accordance with NUES' recommendation, independent of the business.

RISK MANAGEMENT AND INTERNAL CONTROL

The Bank has established a separate risk management and control division. There is a clear division of responsibility between the various governing bodies in the Bank in accordance with laws and regulations, as well as internally adopted management, control and reporting procedures. Key bodies are the Board of Trustees, the Board of Directors, external auditing, internal auditing and Group management.

Internal audit

The Bank's internal auditor reports to the Board of Directors and submits an annual report to the Board of Directors on completed audit projects. On behalf of the Board of Directors, the internal auditor must ensure that adequate and efficient internal control and risk management procedures have been established and implemented. Separate instruction has been prepared for the internal auditor. Each year, the Board of Directors approves the annual internal auditing plan and resource requirements. The internal auditor may participate as an observer at the Board of Directors' meetings.

Internal control

The Bank has established guidelines and procedures for the implementation of internal controls based on the COSO model. This model has an international standard for comprehensive risk management, and is widely used within the financial sector. Responsibility for practical implementation of the Group's internal control processes is allocated to the Risk Management Division, organised independently of the business units.

Compliance

The Bank focuses on having good processes to ensure compliance with applicable laws and regulations, and has established a separate compliance function as part of the Risk Management Division, organised independently of the business units.

Risk management and capital adequacy

Good risk and capital management is a key part of Sparebanken Sør's long-term value creation. The bank's overall objectives are given by the strategic business concept. The targeted return is decisive for the bank's activities and specification of targets. Focus is to ensure the bank's short and long-term competitive power. Sparebanken Sør's market and business objectives are balanced against the bank's risk capacity and willingness. Risk and capital assessments are an integral part of the bank's strategic and business processes.

The Board of Directors has adopted guidelines for the Bank's capital assessment. A process related to the Bank's risk and capital adequacy assessment (ICAAP) is carried out annually. The Board of Directors ensures that the bank has sufficient capital relatively to the desired risk and the bank's operations and ensures that the bank is adequately capitalised in respect of regulatory requirements. The ICAAP - process is based on requirements set out by the authorities in addition to the banks own assessments.

The bank must adhere to the Financial Supervisory Authority of Norway's provisions given by "Minimum total capital ratio requirement and provisions on major commitments with individual customers as regards the capital base".

Consideration of external factors in value creation

As a basis for its operations, the Bank must set strict requirements for honesty and good business ethics. The Bank therefore expects employees and elected representatives to have a high level of integrity, and attitudes in accordance with the Bank's code of conduct. These provide guidance on customer care, donations, confidentiality, participation in other commercial activity and transactions with related parties. The code's guidelines also requires employees to report any breaches of internal guidelines, laws and regulations. The procedure for how such disclosures are to be made is described in more detail in the Bank's whistleblowing routines.

Deviations from the recommendation: None.

REMUNERATION OF THE BOARD OF DIRECTORS

Directors' fees are determined by the Board of Trustees following a recommendation from the Nominating Committee. The size of the fees reflects the Board of Directors' responsibilities, expertise, time and the complexity of the business. The members of the board's sub-committee receive special compensation.

Deviations from the recommendation: None.

REMUNERATION OF EXECUTIVE PERSONNEL

The remuneration to the CEO and the head of internal auditing is determined by the Board of Directors, following a proposal from the Remuneration Committee. Remuneration paid to members of Group management is determined by the CEO in consultation with the Remuneration Committee. No members of Group management receive performance-based remunerations other than participating in the Bank's ordinary bonus scheme, which encompasses all Bank employees. The head of internal auditing does not receive performance-based remuneration, and does not participate in the Bank's ordinary bonus scheme.

The Board of Directors' declaration on pay to executive personnel is submitted to the Board of Trustees annually.

Deviations from the recommendation: None.

INFORMATION AND COMMUNICATION

The Bank must have an open and active dialogue with all stakeholders. It is the intention of the Bank that customers, equity certificate holders, lenders (financial market players) and public authorities should have simultaneous access to correct, clear, relevant and complete information on the Bank's strategies and financial objectives, development and financial situation.

Information to the market is communicated through quarterly stock exchange and press releases, a separate Investor Relations area on the Bank's website and financial reports.

Deviations from the recommendation: None.

COMPANY ACQUISITION

Sparebanken Sør is a self-owned institution that cannot be taken over by others through acquisition. The ownership structure is regulated by law, and no party may own more than 10 percent of the Bank's equity. Acquisition exceeding this limit must be approved by the Financial Supervisory Authority of Norway.

The savings bank foundation Sparebankstiftelsen Sparebanken Sør owns 51 percent of the equity certificates in the merged bank.

Statutory limits on ownership are assumed to be within the wording of the recommendation "to the extent appropriate to savings banks with listed equity certificates".

Deviations from the recommendation: None.

EXTERNAL AUDITOR

An external auditor is selected by the Board of Trustees and submits an annual auditor's report concerning the annual financial statements. The external auditor attends the meeting of the Board of Directors at which the annual financial statements are discussed. The external auditor also attends meetings of the Audit Committee and has an annual meeting with the Board of Directors without members of administration being present. The external auditor's fees are considered by the Board of Trustees when the annual financial statements are discussed. The relationship with the external auditor is also governed by a separate letter of engagement which, among other things, is concerned with the parties' responsibilities.

The Audit Committee monitors the auditor's independency, including what other services are provided by the auditor.

Deviations from the recommendation: None.

Corporate social responsibility report

CORPORATE CITIZENSHIP

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

As a savings bank with both direct private ownership and community ownership, the ownership structure gives two clear but different purposes. Through solid operations, Sparebanken Sør shall deliver competitive returns to the bank's equity owners and, in addition, contribute to a good living environment and positive business development in the communities where the bank is represented.

With local knowledge and proximity to its customers, the Bank makes daily assessments concerning finance and risk, where taking a long-term view is crucial in all decisions. For the Bank, corporate social responsibility means taking shared responsibility for the sustainable economic, social and environmental development of the areas where the Bank operates. Sparebanken Sør is committed to taking account of the climate, the environment, social conditions and good corporate governance in all its activities, including the development of products and services, its advisory and sales activities, its investment and credit decisions, and its production and operations. The Bank shall not contribute to the violation of human and labor rights, corruption, serious environmental damage or other acts which may be perceived as unethical.

All activity in Sparebanken Sør is, without exception, exercised in accordance with applicable laws and regulations in Norway. Although the Bank, as the region's largest and foremost financial group, focuses primarily on the local community, it is also committed to ensuring that everything it does is also sustainable in a global context. Sparebanken Sør fully supports the UN's sustainable development goals and therefore has no interest in trying to exert influence in a direction that conflicts with attainment of these goals. The Bank has acceded to the UN Global Compact.

Corporate social responsibility activities are integrated into the Bank's strategy and procedures, ensuring that ethics, the environment and important social issues are always on the agenda. Ensuring that day-to-day operations, in all business areas, are closely focused on financial value creation is a very important aspect of the Bank's corporate social responsibility.

For the Bank, responsible business practice means integrating corporate social responsibility into all business processes and all parts of the value chain. Clear requirements are also set for the Bank's customers in relation to responsible business practice.

A criterion for any customer relationship is that customers must comply with legislation and agreements applicable in Norway and in the countries where the customers are represented. This includes striving for equality and zero tolerance of racism and other discrimination at the workplace. The Bank also expects its customers to respect regulations on the use of natural resources, activity in areas that are currently used in other ways by the local population or indigenous peoples, or in areas with a vulnerable environment, endangered species or water shortages.

The Bank shall not provide funding for customers/enterprises that:

- Engage in activities that are contrary to the Bank's ethical guidelines or otherwise operate in ways that do not accord with the public's perception of ethical conduct.
- Have acted dishonestly towards the Bank or other actors, and/or have been involved in criminal activity.
- Operate in contravention of public laws, regulations and mandatory environmental requirements, and/or do not have necessary approvals from public authorities.

Sparebanken Sør wishes the companies the Bank finances to demonstrate that they have procedures in place to fulfil statutory requirements, and through management and what they say and do act in a manner that is in line with the public perception of ethical conduct.

DEVELOPING SOCIETY THROUGH VALUE CREATION

To contribute to further growth and skills-based jobs, Sparebanken Sør has provided capital to regional development funds such as Aust-Agder Næringsselskap and Teknova. Through its ownership in the former Coventure, the Bank is also a shareholder of the national research company Norce. A company which has close links to the University of Agder. Together with other regional players, Sparebanken Sør contributed to raising private capital for the establishment of the national fund focusing in the seed stage, attached to Skagerak Maturo in Kristiansand. The purpose of this seed stage fund is to create a greater diversity of businesses and jobs in several industries.

CUSTOMER SATISFACTION THROUGH SOUND SOLUTIONS

The Bank shall offer good financial solutions and professional advices to its customers. By knowing the customer and seeing the totality of their financial needs, a foundation is established for good customer experiences and an enduringly high level of customer satisfaction. Good customer relations are important for stable and profitable banking, and essential if the Bank is to fulfil its societal mission. Sparebanken Sør is included in the EPSI Norway annual bank survey. In the 2018 survey, the Bank received a satisfaction score of 75.8 in the retail market. Sparebanken Sør was the fourth best bank, scoring 4.2 points above the sector average. In the corporate market, Sparebanken Sør was the best bank in the survey, with a score of 73.2 (3.9 points above the sector average).

Sparebanken Sør is dependent on customers having confidence in the Bank and its solutions. Customers are increasingly concerned that the pursuit of returns should not be on the expense of environmental and social conditions. In the Bank's experience, it matters to customers that corporate social responsibility is integral to the Bank's operations.

EMPLOYEES AND ORGANISATION

Sparebanken Sør aims to be an attractive and inclusive workplace for employees of all age groups and in all phases of life. The Group endeavours to ensure that all employees experience a good balance between work, home and leisure time. Constant efforts are made to encourage employees to maintain good health, both by developing a good working environment and by encouraging physical activity. Employees whose needs are met perform better, which benefits both themselves and the business. To promote better health and improve motivation and job satisfaction, the Group reimbursed significant amounts in 2018 to cover some of the expenditure employees have incurred for regular exercise.

Sparebanken Sør has developed a code of conduct to ensure that all parts of the organisation understand and respect its ethical standards. The code of conduct applies to all employees, and describes, for example, how employees should respond to challenges related to impartiality and conflicts of interest, participation in other commercial activity, and their own and customers' trading in financial instruments. The code's guidelines are intended to ensure that employees do not become embroiled in conflicts of interest, and clear procedures are established should this occur. All employees review the code's ethical guidelines on an annual basis. The Bank's financial advisers receive an annual update on the guidelines as part of the various authorisation schemes.

The Group has established a good framework for the organisation and its employees, which includes a staff handbook, an HSE handbook, an inclusive workplace agreement (IA) and several internal committees established under collective bargaining agreements. There is good cooperation between the management and employee representatives in these areas.

EQUALITY

For Sparebanken Sør, equality and diversity are important. In 2018 there was set up an equality and diversity committee. The Bank has a long-term objective to achieve a relatively even gender distribution at all levels of the organisation, and aims to increase the proportion of women in senior positions. When recruiting, the best female applicant will always be assessed against the best male applicant. In departments where one gender is under-represented, special emphasis shall be taken into consideration. The Bank makes determined efforts to promote diversity and prevent unequal treatment and discrimination. When recruiting, the best-qualified applicant with an ethnic background other than Norwegian shall be interviewed.

The Bank was involved in the "Likestilt arbeidsliv" (Equality at Work) project along with 15 other regional companies over the period 2017/2018. The aim of the project was to establish a certification scheme for enterprises that respect equality. "Likestilt arbeidsliv" was a joint project between Vest-Agder County Council, Aust-Agder County Council, the Department of Children, Youth and Family Affairs and the Chamber of Commerce in the Kristiansand region. The project measured the Bank's performance with respect to equality, recruitment, equal pay, inclusive working environment, workplace adaptation, the percentage of full-time jobs offered and life-phase flexibility. The Bank became the first bank in Norway to be certified in relation to equality and diversity in June 2018.

For several years, the Group's management and trade unions have collaborated in the area of equal pay. Although the goal has not yet been attained, the figures point to a positive trend.

Equality report 2018

	2018	2017
Number of full-time equivalents, total	455	487
Women	50%	54%
Men	50%	46%
Part-time women	10.1	10.9
Part-time men	0.9	1.0
Percentage of women by level		
Management level 1	0.0%	0.0%
Management level 2 (Group management)	28.5%	28.5%
Management level 3 (Management teams divisions)	30.0%	27.0%
Management level 4 (ass. bank manager - bank managers RM)	44.0%	44.0%
Percentage of women on the Board	50.0%	50.0%
Average salary		
Women	558.453	529.080
Men	683.208	658.343
Women's pay in relation to men's	81.7%	80.4%
Women's pay in relation to men's		
Female managers' average in relation to male managers	89.6%	89.4%
Management level 1	-	-
Management level 2	82%	82%
Management level 3	88%	88%
Management level 4	100%	98%

ENVIRONMENT AND CLIMATE

Sparebanken Sør has given a commitment through the UN Global Compact to support a precautionary principle in relation to environmental challenges, take initiatives to promote increased responsibility for the environment and encourage the development/diffusion of environmentally friendly technologies. Sparebanken Sør views efforts to cut greenhouse gas emissions as an element of the Bank's corporate social responsibility. This applies both globally, through our responsibility to contribute to the UN's sustainable development goals, and locally, through the Bank's engagement of making the region, in which it operates in, to a better place.

As part of these efforts, a decision has been made that the Bank's operations should be climate -neutral. At the end of 2018, these obligations are being met through compliance with the UN's requirements for climate-neutral businesses according to the following criteria:

1. BThe Bank annually publishes an approved climate balance sheet for the business. The approval is given by CEMAsys.com AS.
2. The Bank has evaluated its energy consumption, and has set targets to reduce its own greenhouse gas emissions.
3. The Bank offsets its residual emissions by purchasing emission permits.

An environmentally awareness is aimed for with regard to paper use, waste management, recycling, transport and travel. To reduce emissions and costs in connection to travel regarding meetings, investments have been made in videoconferencing technology in many departments. In addition, all offices have technology that enables PC-assisted conference calls. The Bank purchases electricity with a certificate of origin and emission permits for voluntary offsetting of its own greenhouse gas emissions.

The Bank's branch in Arendal has eco-lighthouse certification, and a plan has been made to certify all the Bank's branch offices. Eco-lighthouse certification is an external verification of Sparebanken Sør confirming that the Bank fulfils a set of criteria and implements measures for more environmentally friendly operation and a good working environment. Sparebanken Sør was involved in the establishment of, and a continued member of, the climate network Klimapartnere Agder (Climate Partners Agder).

The Bank prepares an annual climate report to enable it to identify emissions, quantify pollution and enable it to implement specifically targeted measures. This report, which is published on the Group's website, is based on the international standard "A Corporate Accounting and Reporting Standard". The report covers consumption related to transport, energy, waste and air travel. The Bank is not aware of any environmental impact, other than consumption, that can be converted to carbon equivalents, and therefore does not publish emission figures.

In 2018, Sparebanken Sør purchased emission permits for voluntary offsetting of its own greenhouse gas emissions equivalent to 219 tonnes of CO2. The emission permits, which are linked to the project GS 1385; Energy-efficient and clean-burning kitchen stoves in Ghana, approved by the Gold Standard Foundation in accordance with the guidelines and methodology of the UN Framework Convention on Climate Change. In addition to the climate benefit, the project has positive health and economic consequences.

In 2018, Finance Norway presented a “Roadmap for green competitiveness in the financial sector“. One of the clearest recommendations is for the financial sector to improve its expertise in climate-related risk and opportunities, and thereby better decisions can be made about who receives funding and at what cost. Assessments of the financial consequences of climate-related changes, both physical and in the conditions under which the businesses operate (transition risk), form a natural part of the financial sector’s administrative responsibility.

Sparebanken Sør aspires to improve its expertise in climate-related risk, and as part of this endeavour in 2018 the Bank took part in a regional pilot project organised by the Confederation of Norwegian Enterprise, which put sustainability as a competitive force firmly on the agenda.

MONEY LAUNDERING AND FINANCING OF TERRORISM

Financial crime, including the laundering of profit, undermines the legal economy in any society. Sparebanken Sør supports actions aimed at fighting financial crime and financing of terrorism. A new Money Laundering Act, implemented in 2018, strengthens the requirements banks must meet with regard to money laundering. In 2018, Sparebanken Sør prepared a policy on money laundering and revised its anti-money laundering procedures to bring internal rules in line with the new law and regulations.

Under the Money Laundering Act, the Bank has a responsibility to know its customers, and therefore has a strict policy when taking on new customers. The Bank shall not be used to facilitate criminal acts such as money laundering and corruption. Identity checks must be carried out on new customers, and the customer’s aims and the intended type of customer relationship must be clarified.

Sparebanken Sør has held an anti-money laundering training programe for its employees.

INVESTMENTS AND ETHICAL MANAGEMENT

Sparebanken Sør’s investment activity complies with Norwegian laws and regulations whose object is to ensure that the Bank is not complicit in infringement of human or workers’ rights, corruption, serious environmental damage or other actions generally deemed to be unethical. Sparebanken Sør does not invest in companies that themselves, or through entities they control, produce tobacco or pornography. The same applies to companies involved in anti-personnel mines and cluster munitions, or companies that develop and produce key components for weapons of mass destruction.

Sparebanken Sør recommends its customers invest in funds from 5 suppliers, which all take a good and deliberate approach to corporate social responsibility in their investments. All the suppliers have signed or adhere to the UN’s Principles for Responsible Investment, and have clear guidelines for the exclusion of companies.

As a distributor of mutual funds to the Bank’s customers, Sparebanken Sør is able to influence which companies receive funding and how ownership is exercised. The Bank sets clear requirements for suppliers in its role as a distributor of mutual funds. Sparebanken Sør takes responsibility for selecting funds and fund managers that have good principles and procedures in place to ensure socially responsible investments.

Sparebanken Sør has at all times a significant portfolio of liquid investments to fulfil the requirements made of the Bank. The portfolio is designated as certificates and bonds in the quarterly and annual financial statements. These investments are exclusively in debt instruments issued by governments, financial institutions, Norwegian companies, Norwegian and Swedish municipalities, Norwegian county councils and companies with a government/municipal/county council guarantee.

LENDING ACTIVITIES

The Group’s credit strategy emphasises that the Bank’s corporate customers shall adopt a long-term perspective, and the companies must operate in accordance with applicable laws and regulations, including human rights and environmental protection. The Bank’s corporate customers cover the full range, from sole proprietorships to listed companies. The majority of customers are typical SMEs in the region, and the Bank has customers in most business sectors. The largest sector in terms of capital is property. A varied customer portfolio enables the Bank to reduce risk related to individual sectors and to ensure stability. A list showing exposure to individual sectors are published every quarter.

The Bank has established self-imposed limits for individual sectors. Even if the companies operate under Norwegian law, it is not desirable for sustainability reasons to establish customer relations with or grant credit to customers in the following sectors:

- Gaming companies
- Companies that produce or contribute to the distribution of pornographic material
- Producers of controversial weapons and weapons and ammunition manufacturers/suppliers without government approval.
- Tobacco industry

SUPPORTING THE PUBLIC GOOD

As a savings bank with both direct private ownership and community ownership, the ownership structure gives two clear but different purposes. Through solid operations, Sparebanken Sør shall deliver competitive returns to the bank's equity owners. In relation to society at large, the Bank shall help support the public good through distributions from this year's profit.

In 2018, the Bank donated NOK 40 million to various organisations, clubs and associations. The Bank's donations focus on:

- Culture
- Competence/education
- Sport and physical activity
- Clubs/associations/organisations

CORPORATE SOCIAL RESPONSIBIILTY REPORT

	2018	2017	2016
Strategic			
Group strategy	Updated	Updated	Updated
CSR (Corporate Social Responsibility) strategy	Updated	Established	
Policy for sustainable credit processes	Established		
Value creation (NOK million)			
Tax expense for the Group	285	282	284
Wealth tax	17	11	14
Payroll tax	44	44	46
Financial tax	18	16	0
Tax paid by employees	105	93	96
Total taxes/charges	**469**	**446**	**440**
Net wages/pensions and other benefits	499	453	425
Cash dividend to shareholders	94	94	94
Growth capital, retained profits	748	802	824
Society/social conditions			
Number of FTEs including temporary staff	434	432	439
Non absence degree	96.2%	96.8%	96.3%
Proportion of women in senior positions	34.4%	34.0%	33.0%
Mean age	50.6	51.8	50.9
IA Agreement	Continued	Continued	Continued
Strategy for life-phase policy	Continued	Continued	Continued
Ethical guidelines	Updated	Continued	Continued
Donations and sponsorships			
Sponsorship (NOK million)	14.8	14.8	15.4
Number of donations	494	444	445
Total donations (NOK million)	40	26.8	33.5
Environment			
Residual waste (tonnes)	28.5	21.2	23.3
Sorted waste (tonnes)	13.7	12.2	17.5
Power consumption (kWh)	5 566 067	5 652 062	5 788 966
Number of flights within Nordic countries (one way)	550	610	710
Number of flights outside Nordic countries	50	110	84
Driving remuneration (km)	535 635	533 715	568 219
Number of electric cars as part of car pool	3	5	5
Number of videoconference rooms	18	18	16

Declaration from the Board of Director's and CEO

Declaration in accordance with section 5-5 of the Securities Trading Act

The Board of Directors and Sparebanken Sør`s Chief Executive Officer hereby confirm that the Bank and the Group`s 2018 financial statements have been prepared in accordance with currently valid accounting standards and that the information provided in the financial statements presents a true and fair view of the Bank's assets, liabilities, financial position and overall results.

In addition, we confirm that the Board og Directors report give a true and fair view of the development, results and financial position of the Bank and the Group, together with a description of the most central risk factors and uncertainties facing the Bank and the Group.

Kristiansand, 31 December 2018 / 5 March 2019

Stein A. Hannevik Chairman	Inger Johansen Deputy Chairman	Tom Erik Jebsen	Erling Holm	Marit Kittilsen
Mette Ramfjord Harv	Jan Erling Tobiassen	Gunnhild Tveiten Golid	Geir Bergskaug CEO	

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To the Board of Trustees of Sparebanken Sør

Independent Auditor's Report

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Sparebanken Sør, which comprise:

- The financial statements of the parent company Sparebanken Sør (the Company), which comprise the balance sheet as at 31 December 2018, the income statement, other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and

- The consolidated financial statements of Sparebanken Sør and its subsidiaries (the Group), which comprise the balance sheet as at 31 December 2018, the income statement, other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion:

- The financial statements are prepared in accordance with the law and regulations.

- The accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

- The accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for Opinion

We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company and the Group as required by laws and regulations, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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State authorised public accountants, members of The Norwegian Institute of Public Accountants, and authorised accounting firm

Independent Auditor's Report - Sparebanken Sør

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for 2018. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The business activities of the Group and the Company are laregly unchanged compared to the previous year. We have not identified regulatory changes, transactions or other events that classify as new Key Audit Matters. The implementation of IFRS 9 has led to changes in our audit of valuation of loans to customers but our focus areas have remained the same in 2018 as in the previous year.

Key Audit Matter	How our audit addressed the Key Audit Matter
Valuation of loans to customers We focused on this area because loans to customers represent a significant portion of totals assets in the balance sheet and because valuation of loans to customers involves considerable judgement and large quantities of data which makes calculation of impairment of loans to customers complex. Impairment of loans to customers is performed in accordance with IFRS 9. For loans to customers where objective indicators of impairment exist, impairment is determined individually for for each loan. For other loans to customers, impairment is calculated collectively based on a model. Both methods involve judgement that may affect financial results for the period and compliance with solvency regulations due to the risk classification of loans. IFRS 9 was implemented with effect from 1 January 2018. The main change related to the implementation is that impairment of loans to customers is to be estimated based on expected credit loss as opposed to before based on incurred credit loss. For loans to customers where objective indicators of impairment exist, we have focused specifically on management's process for identification of loans to customers where objective indicators of impairment exist, management's follow-up	As part of our audit of expected impairment provisions, we assessed design and tested operating effectiveness of controls over quality assurance of assumptions and calculation methods. We determined that we could rely on these controls for the purposes of our audit. In addition, we performed detailed testing related to both loans to customers where impairment is calculated collectively based on a model and where impairment is estimated individually based on objective indicators of impairment. For loans to customers where objective indicators of impairment existed and the impairment was estimated individually, we testet a sample of such loans. We assessed the recoverable amount and cash flows that management had prepared to support the amount of impairment loss. We challenged management's assessment by interviewing client account managers and management. We compared the recoverable amount to external evidence where available. The outcome of our testing showed that the assumptions used by management when calculating individual impairment losses were reasonable. Where impairment is calculated collectively based on a model, we gained a detailed understanding of the process and performed testing to assess the following: - Calculations and methods used. - That the model used was was in accordance with the applicable framework and operated as intended. - Reliability and accuracy of central parametres and data used by the model. - Accurate and complete transfer of information from

of such loans and the assumptions used by management to calculate the impairment loss.

For other loans to customers where impairment loss has been calculated collectively based on a model we have focused specifically on:

- Risk classification of loans to customers.
- Calculation of expected credit loss.
- Calculation of probability of default.
- Identification of significant change in credit risk.
- How loans to customers have been allocated to stages.
- Determination of signifcant input variables to the model.

We refer to notes 6 through 11 to the financial statements for a description of the group's impairment model, credit risk and impairment of loans to customers.

the model to the accounting system.

Our testing gave no indications of material misstatement.

We have looked at the information disclosed in the notes related to valuation of loans to customers and found it to be sufficient and adequate.

IT systems supporting financial reporting

We focused on this area because the bank's financial reporting system and business as a whole are dependent on complex IT and payment systems. Potential weaknesses in automated processes and related IT dependent manual controls may disrupt the continuous operation of the IT and payment systems and cause risk of misstatements.

The bank used external service organisations to operate certain key IT and payment systems. The auditors of the respective service organisations evaluated design and tested operating effectiveness of the controls addressing integrity of the IT and payment systems that are relevant to financial reporting. We satisfied ourselves regarding the auditor's competence, capacity and objectivity and examined the reports received and assessed potential weaknesses and remediation initiatives. We also performed testing of access controls related to the bank's IT systems and segregation of duties where this was considered necessary to our audit.

Our assessments and tests showed that we could rely on the IT and payment systems relevant for our audit.

Other information

Management is responsible for the other information. The other information comprises information in the annual report, except the financial statements and our auditor's report thereon.

(3)

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Board of Directors and the Managing Director for the Financial Statements

The Board of Directors and the Managing Director (Management) are responsible for the preparation in accordance with law and regulations, including fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company’s and the Group’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error. We design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's or the Group's internal control.

Independent Auditor's Report - Sparebanken Sør

- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company and the Group to cease to continue as a going concern.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Opinion on the Board of Directors' report

Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Board of Directors' report and in the statements on Corporate Governance and Corporate Social Responsibility concerning the financial statements, the going concern assumption and the proposed allocation of the result is consistent with the financial statements and complies with the law and regulations.

Opinion on Registration and Documentation

Independent Auditor's Report - Sparebanken Sør

Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements *(ISAE) 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, it is our opinion that management has fulfilled its duty to produce a proper and clearly set out registration and documentation of the Company’s accounting information in accordance with the law and bookkeeping standards and practices generally accepted in Norway.

Kristiansand, 5 March 2019
PricewaterhouseCoopers AS

Reidar Henriksen
State Authorised Public Accountant

Note: This translation from Norwegian has been prepared for information purposes only.

(6)

Organisation

Board of Trustees

The Board of Directors

CEO
Geir Bergskaug

Deputy CEO / Director Corporate market	**Director Retail banking**	**Director Capital market**	**Director Group support**	**Director Risk management**	**Director Business support**
Lasse Kvinlaug	Gunnar Thomassen	Marianne Lofthus	Rolf H. Søraker	Bjørn Friestad	Gry Moen

THE BANK'S BRANCHES

The Group management

Geir Bergskaug (1960)

CEO from 1 January 2014. Former CEO of the "old" Sparebanken Sør from 1 November 2010. Worked in Gjensidige as Director and Executive Vice President (1999–2010), chairman of the board of Gjensidige Bank (2008–2010), General Manager / Director of DnB NOR (1988–1999). Master of Business and Economics from the Norwegian School of Economics and Business Administration. Additional education from Harvard Business School in Boston – GMP, INSEAD, Fontainebleau in France – MBA.

Lasse Kvinlaug (1961)

Deputy Chief Executive from 1 January 2014 and Corporate Market Director. Master of Business and Economics. Formerly worked in Sparebanken Pluss as Deputy Chief Executive, Director and General Manager (1997–2013). Also experience from Sparebanken NOR / Sparebanken ABC (1987–1997), as Assistant General Manager with responsibility for the corporate market in Kristiansand. Financial Consultant in Statoil (1984–87)

Marianne Lofthus (1961)

Capital Market Director from 1 January 2014 and General Manager of Sparebanken Sør Boligkreditt. Was CFO in Sparebanken Pluss (2003–2013) and has many years of experience from the financial operations in Sparebanken Pluss, Norsk Hydro and Sparebanken NOR. Master of Business and Economics from the Norwegian School of Economics and Business Administration.

Gunnar P. Thomassen (1965)

Retail Banking Market Director from 1 January 2014. Previously worked in Sparebanken Sør as director, regional director and bank manager (1999–2013) Also has experience from Ernst & Young Management Consulting and the Industrial Fund/SND Graduate engineer in Industrial Economics from the Norwegian University of Science and Technology.

The Group management

Rolf H. Søraker (1960)

Group Support Director from 1 January 2014. Was also Group Support Director in the “old” Sparebanken Sør from (2009–2013) and has a wide range of experience from various roles in Sparebanken Sør from 1986. Was Managing Director of Sør Boligkreditt (2008–2013). Also has experience from the educational system and the Norwegian Armed Forces. Education from the Norwegian Armed Forces, Telemark University College and BI, Master of Management.

Bjørn A. Friestad (1959)

Risk Management Director from 1 January 2014. Was responsible for credit and business development in Sparebanken Plus (2001–2013). Has a wide range of experience from various business areas in Sparebanken Agder / Sparebanken Pluss since 1986. Master in Business and Economics and aut. financial analyst (AFA) from the Norwegian School of Economics and Business Administration.

Gry Moen (1963)

Business Development Director from 1 January 2014. Has also worked in “old” Sparebanken Sør as Business Development Director from 2011. Was General Manager of ABCenter Holding (2009–2010) and Marketing Director in Sparebanken Sør (2006–2009). Has previous experience from Statoil, Telenor and LOS / Agder Energi. Education from Trondheim Business College / Ecôle Superiéure de Commerce Grenobles/Nantes.


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