

# **Risk and Capital Management**

**Disclosure according to Pillar 3 2023**



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## THE CHIEF RISK OFFICER'S INTRODUCTION AND SUMMARY OF THE YEAR

2023 was another exiting year, with rising uncertainty due to war and international conflicts, rising inflation and still higher interest rates.

Our loan book performed well also during 2023, reflecting stable development in defaults, late payments and overall low losses. Despite higher inflation and interest cost most of our customers were able to service its debt according to plan. We expect higher risk in our loan book going forward and has strengthened our credit and watchlist procedures in both the corporate and retail segment. Going into 2023 we observed higher risk in residential and commercial real estate, construction and retail. Particular in construction we have witnessed increase in watch list and losses. Some industries however, particularly shipping, fishery and energy are performing well due to favourable rates and pricing.

ESG and climate risk continued to be high on the agenda in 2023 as the bank for the first time included ESG KPIs in the bank's incentive structures. The bank has set an ambitious target of net zero emissions, including the lending portfolio, by 2040. In 2023 the bank created a transition plan with decarbonisation pathways aligned with the Science-based Targets Initiative (SBTi) near-term targets, which were based on the bank's climate accounts. During 2023 Sparebanken Vest continued the work to align with the EU Taxonomy and updated the green bond framework to reflect this. Further, the bank has conducted climate risk analyses and scenario analyses, and the bank has estimated financed GHG-emissions (scope 3) for the lending portfolio aligned with the Partnership for Carbon Accounting Financials (PCAF) methodology. As certain industries are associated with a higher exposure to climate-related risks, higher emissions levels or with having negative impacts on the climate, Sparebanken Vest has implemented more stringent assessment criteria in the credit processes for the relevant industries to alleviate these risks.

It is important for Sparebanken Vest to continuously develop internal control, and operational risk management is an inherent and natural part of our business activities and is a responsibility of all employees. Facilitating

good risk assessments and conducting training in this area is an important responsibility of the Risk Management function, and is an integral part of the bank's corporate strategy and sustainability strategy. This will be especially important in 2024, as the bank works to further improve internal control for ESG as the bank strengthens the alignment of financial reporting and ESG reporting to prepare for the new corporate sustainability reporting directive (CSRD).

Compliance risk is monitored, among other things, through annual and frequent risk assessments, control activities and training. Annual plans are drawn up based on a risk assessment, in which resources and measures are allocated to identify and manage compliance risk. Compliance risks and incidents are reported to the CEO and the Board on a quarterly basis. We are satisfied that during 2023 the bank has made substantial progress in how it manages compliance risk, including improved procedures and further clarified roles and responsibilities, thus strengthening the risk culture in the whole of the organisation.

Sparebanken Vest was well capitalised at the end of 2023. Stress tests confirms that Sparebanken Vest has good capital adequacy and the ability to resist much greater losses than our forecasts.

Sparebanken Vest's report on Risk and Capital Management (Pillar III) has been prepared to provide information about risk management, risk measurement and capital adequacy in accordance with the disclosure requirements under Part Eight of Regulation 575-2013 (EBA-GL-2016-11).

This report is updated at least annually.

The methods used to calculate capital requirements as well as information about the bank's internal risk measurement and management are explained in the report. See the tables in the Pillar III Appendix for additional quantitative information.

## Sparebanken Vest 2023 – Risk and Capital Management

The Risk and Capital Management report provides a good and accurate description of the risk situation in Sparebanken Vest. It outlines how risk is measured, managed and reported in the bank.

A handwritten signature in black ink, appearing to read "Jan-Ståle Hatlebakk".

Jan-Ståle Hatlebakk,  
Chief Risk Officer, Risk Management



## RISK STATEMENT FROM THE BOARD OF DIRECTORS

The Board stays informed of the Group's risk development through regular reports and established notification procedures. Risk appetite and other risk frameworks are reviewed and approved by the Board at least once a year. The Board consider that the Group's risk management is sufficient and well adapted to the Group's risk appetite and business strategy. The board has approved this risk statement.

### Credit risk

The credit risk strategy is annually reviewed by the Board. It defines high level guidelines and principles for how the bank should manage the credit risk. Further, the risk strategy defines risk appetite by defining a set up targets and limits for the following dimensions:

- Quality targets, based on IRB parameters.
- Upper limits and targets for growth
- Limits for concentration risk
- Target for return on risk adjusted capital (RORAC)

The credit *policies* are specifications of the above strategic credit guidelines and are approved by the CEO. The bank has policies for Retail, Corporate and different segments within Corporate. The policies set up specific requirements for granting individual credits within these customer segments, as opposed to *portfolio* requirements in the credit risk strategy.

Volume of default and potential bad debt in both retail and corporate market shows a stable development during 2023, supporting low risk in the portfolio. Further, 2023 was another year with low losses and write-downs on loans and guarantees, confirming the conservative risk profile of the portfolio. The level of provisions is considered robust.

### Market risk

The bank has a low risk tolerance for Market Risk. By approving the market risk strategy, the board defines the limits (and hence risk appetite) for all market risk exposures, such as interest rate risk, equity risk, credit spread risk, currency risk, and property risk. The bank's market risk is largely the result of ordinary banking. Compliance with the framework is continuously

monitored by Risk Management, and status is reported periodically to the bank's Board and management.

### Liquidity risk

The Board annually reviews and approves the bank's liquidity analyses (ILAAP), which are used to define liquidity and financing risk tolerance. The bank's liquidity risk shall be moderate, with diversification in terms of markets, sources, and maturity. The bank shall have sufficient liquidity reserves to survive periods when markets close and/or customers withdraw large amounts from their deposits. The Board has set internal limits for Liquidity Coverage Ratio (LCR), Net Stable Funding (NSFR), ratio of liquidity portfolio to material assets, and ratio of stable deposits to net loans.

Sparebanken Vest had good access to funding during 2023 and a satisfactory liquidity position at year end.

### Climate risk

The bank has set ambitious targets for climate mitigation and has committed to the Science-based Targets initiative. In 2023 the bank also included ESG KPIs in the incentive structures. During 2023 the bank updated the green bond framework to further align with the best market practices and the EU taxonomy. The bank aims to promote sustainable solutions and encourages sustainable business by providing flexible lending products, such as sustainability-linked loans. Sparebanken Vest has set ambitious industry-specific goals for reducing climate-related risk the corporate lending portfolio. This is an important tool for understanding and reducing climate risk and for identifying sectors and projects that contribute to restructuring and new earning opportunities. Sparebanken Vest is also measuring carbon-related credit exposure and has published financed emissions in the annual report. The bank has a long-term goal of net zero emissions by 2040, including the lending portfolio. Further, Sparebanken Vest has reported according to the Task Force on Climate-related Financial Disclosures (TCFD) principles in the annual report, which gives a thorough understanding for how the bank handles climate-related risks and opportunities.

### **Operational risk**

Operational risk is managed through a risk strategy document where the Board has set limits in risk appetite, both qualitative and quantitative, for how much operational risk the bank is willing to accept. Operational risk is monitored and managed through management review processes, approval of risk assessment for new products and significant changes (NPAP), continuous assessments and follow-up of customer complaints and incidents (actual or potential). Incidents that have or may affect the bank's profitability or reputation are systematically followed up. No incidents in 2023 were critical to the bank's operations, and the operational losses are low and well within the risk appetite. The status of operational risk is reported quarterly to the Board.

### **Compliance risk**

The bank has strategy and policy documents that regulates how the bank should manage compliance risk. The bank has defined a low tolerance of compliance risk, stating, *inter alia*, that the bank is, and shall be, a

professional and reliable company in relation to customers, employees, investors and society as a whole. The bank's compliance strategy is reviewed and approved by the board on a yearly basis, and it describes the principles and responsibilities regarding compliance with laws, regulations, and internal guidelines.

Compliance risk is monitored, among other things, through annual and frequent risk assessments, control activities and training. Annual plans are drawn up based on a risk assessment, in which resources and measures are allocated to identify and manage compliance risk. Compliance risks and incidents are reported to the CEO and the Board on a quarterly basis.

### **Approval of the Pillar 3 report**

The Board of Directors of Sparebanken Vest has approved the Pillar 3 report. The Pillar 3 report is not subject to external audit.

## RISK MANAGEMENT AND CONTROL

### Risk management framework

Good risk and capital management are key strategic instruments in Sparebanken Vest's value creation process. The bank has developed a strong credit and risk culture characterized by a clear focus on low losses and profitable growth. This is an important foundation for the bank's long-run profitability and access to capital market financing.

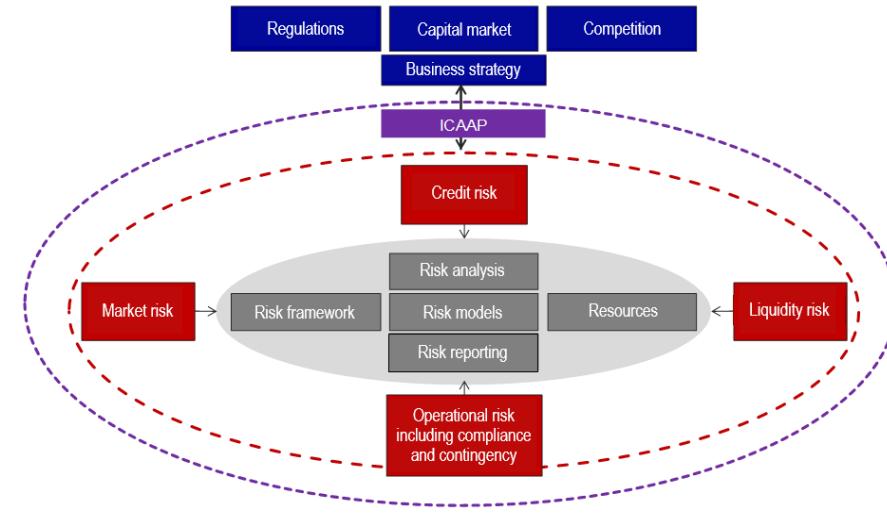
Sparebanken Vest has established its own risk and capital strategies that specify control parameters for the individual risk areas. These strategies are reviewed and approved by the Board at least once a year in connection with the bank's overall planning process. The control parameters are intended to help to ensure the bank's profitability, financial strength, and liquidity through the diversification of risk in the short and long term.

Risk and capital management are among the Board's key focus areas. Based on quarterly reports, the Board evaluates the bank's risk and capital situation in relation to the adopted control targets and parameters. The board confirms, for the purpose of Article 435 CRR, that the bank's guidelines and processes for risk and capital management are adequate regarding the bank's risk profile and strategy.

Through the bank's risk and capital assessments (ICAAP), capital buffers and capital adequacy targets are set in order to safeguard the bank's operations both under normal and stressed market conditions. The bank's liquidity needs and risk profile, including the stipulation of the bank's risk tolerance through targets and limits, are described in a separate ILAAP. As for the ICAAP, the ILAAP is reviewed and approved by the Board on an annual basis.

The recovery plan shall make sure that SPV can be recovered from a stressed situation. The plan is renewed annually together with ICAAP and ILAAP.

The figure below illustrates Sparebanken Vest's risk and capital management:



The bank's risk and capital management mainly relate to the following risk areas.

**Credit risk** The risk of a financial loss as a result of the bank's customers or counterparties failing to meet their commitments relating to loans, credit facilities, guarantees and similar.

**Market risk** Defined as the risk of losses on positions in financial instruments as a result of changes in market variables and/or market conditions within a specified time frame. This includes equity, interest rate, currency and credit spread risk.

**Liquidity risk** Consists of two elements – refinancing risk and price risk. By refinancing risk is meant the risk of not being able to refinance debt and not being able to finance an increase in assets. By price risk is meant the risk of

not being able to refinance commitments without incurring considerable extra costs in the form of unusually expensive financing or a fall in the price of assets that must be realized.

**Operational risk** The risk of losses as a result of inadequate internal processes or systems or of a failure in such processes or systems, human error or external events.

**Compliance risk** The risk of regulatory sanctions, financial loss and loss of reputation as a result of non-compliance with laws and regulations as well as external and internal rules and standards that apply to the business.

**Climate risk:** The risk of loss and financial instability due to physical or transition risks related to climate change

**Regulatory risk:** The risk of future regulation

**Reputational risk:** The risk of loss in income and access to capital because of failing reputation with customers, counterparties, shareholders and government.

**Concentration risk:** The risk of accumulated exposure to a single customer, industry or geographical area.

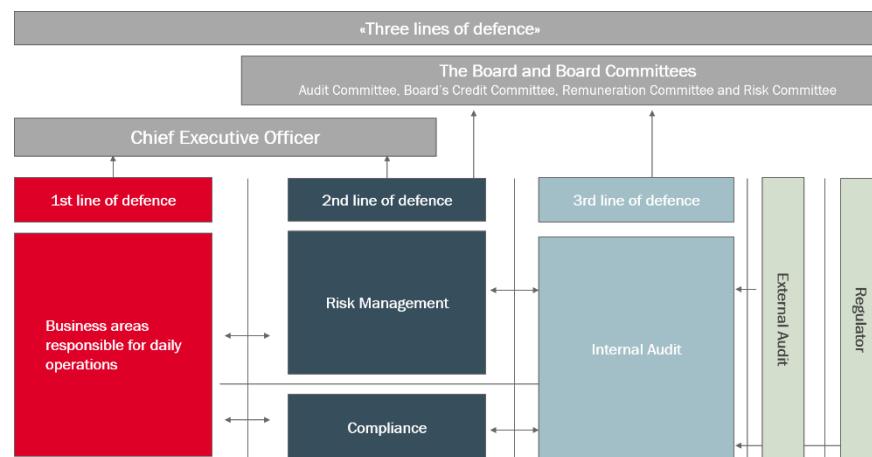
**Strategic risk:** The risk of losses because of failed strategies.

**Ownership risk:** the risk of losses due to negative results in associated companies.

#### Risk tolerance

**The Board of Sparebanken Vest** is responsible for stipulating the bank's overall risk tolerance. The Board also defines the bank's targets and limits in all risk areas, including adopting guidelines for the bank's risk and capital management. Reporting to the Board in relation to targets and limits is done on a quarterly basis.

#### Three lines of defence



**The first line of defense** Owns and manages the bank's risks through its operations. The first line of defense is responsible for satisfactory internal control and identifying, managing and reporting on risks in accordance with internal guidelines. Risks are managed within defined risk appetite, established risk governance and risk culture.

**The second line of defense** Responsible for monitoring, identifying, controlling and reporting on relevant risks, and assist and support first line of defence on identifying, assess and manage risks. The second line of defence is independent of the business units and reports directly to the CEO as well as the Board.

**The third line of defense** An independent internal audit function. The role of the internal audit function is to monitor the bank's overall risk and capital management and internal control on behalf of the Board. The internal audit function is responsible for testing compliance with procedures and guidelines and assessing whether the bank's models for risk and capital management provide a valid picture of the bank's overall risk and capital situation. The internal audit function prepares an annual internal control report that also contains assessments of the bank's IRB system and the bank's capital and risk assessments (ICAAP and ILAAP).

## Roles and responsibilities

**The Board of Directors** Responsible for ensuring that the bank has sufficient own funds in relation to its operations, that it is sufficiently capitalized in relation to regulatory requirements and that it has appropriate internal control (independent Risk management, compliance and internal audit with adequate resources, competence, and responsibilities). The Board shall ensure that the internal control identifies, measures, assess, monitor, manage, mitigate, and report all relevant risks. Once a year the Board of Directors reviews the CEO's report on the status of internal control.

**The CEO** Responsible for the bank's overall risk and capital management, including the development of models and frameworks for management and control. Normally, unless the matter is submitted for the bank's Board, all decisions relating to risk and capital management are made by the CEO in consultation with other members of the bank's management. The bank's risk management and control structure, roles, and responsibilities, is based on the principle of three lines of defence, as illustrated above.

**Risk Management** The bank's second line of defence is organized under Risk Management. The department attends to important functions relating to management, control, reporting and analysis of risk. Risk Management is also responsible for the bank's models and frameworks for risk and capital management, including contingency / security and anti-money laundering procedures.

**Head of Risk Management (CRO)** Reports directly to the CEO. The Head of Risk Management report directly to the Board in cases where the Board does not receive necessary information about material risks via ordinary reporting and notifies the Board if there is identified risks that affect or could affect the bank. The CRO is also responsible for the annual validation of the IRB-models. The Head of Risk Management cannot be replaced without the prior consent of the Board.

**The Compliance Function** An independent second line of defence control function, organized within Risk Management.

The Compliance function is responsible for identifying, assessing, monitoring and reporting on Sparebanken Vest's compliance risk.

Furthermore, assisting the Board, CEO and other first-line managers in the work of ensuring that Sparebanken Vest conducts activities in accordance with applicable legislation and rules, and manage compliance risk in a sound manner.

The Compliance function shall have a risk-based approach, mainly based on the rules and legislation that set requirements for the Sparebanken Vest's operations. This applies amongst to rules for financial services and instruments, consumer protection, anti-money laundering and terrorist financing, sanctions violations and data protection.

As part of the tasks carried out by the Compliance function, is conducting a risk assessment to ensure that risks are monitored and establish a monitoring program. Monitoring and controls include assessment of whether Sparebanken Vest has implemented appropriate and effective procedures, organization and control measures to manage compliance risk.

The compliance function is headed by the Chief Compliance Officer (CCO). The CCO reports directly to the CEO. The CCO cannot be replaced without the prior consent of the Board.

**Managers** All managers in Sparebanken Vest are responsible for managing risk and ensuring good internal control in their areas of responsibility in accordance with the bank's adopted risk profile. In order to ensure good financial and administrative management, all managers must have the requisite knowledge about material risk factors within their own areas. Managers must also ensure that each employee.

**The Board's Audit Committee** Oversee and ensure that Sparebanken Vest has an independent and effective external and internal audit function, and financial and risk reporting that is in accordance with laws and regulations.

**The Board's Credit Committee** Deals with credit matters within the bounds of the authorizations granted by the Board.

**The Board's Remuneration Committee** Ensuring that the bank has a pay policy that complies with applicable regulations for financial undertakings

and is seen as motivating by the bank's management in relation to implementing the adopted strategy and achieving the goals set.

**The Board's Risk Committee** A preparatory and advisory committee for the Board in risk and capital related matters. 6 meetings were held during 2022. In addition to the three lines of defence and the board committees, the following committees have been established to assist with follow-up and control in different areas:

**The IRB Validation Committee** Validation is intended to ensure that the IRB system is well integrated in credit procedures and adapted to relevant credit portfolios. The Committee considers the suitability of models (quantitative validation), the suitability of the system (qualitative validation), and application and compliance (credit control). Annual validation reports are prepared and approved by the Board.

**The Credit Committee** Deals with large exposures and matters of an unusual nature. For large credit exposure, Risk Management represented by the Credit Department shall decide whether or not to endorse the credit approval. The credit approval will not be valid without such endorsement. Watch-list exposure are reviewed quarterly by the Credit Committee.

### Number of directorships held by management body

According to Article 435 (2)(a) CRR, the number of directorships held by members of the management body are listed below in the table:

Navn	Number of directorships in group companies
Arild Bødal	2. with the addition of directorships in group companies
Magne Mørken	1.
Christine Sagen Helgø	2.
Marianne Dorthea Jacobsen	2. with the addition of directorships in group companies
Gunnar Skeie	1. with the addition of directorships in group companies
Kirsti L. Slotsvik	2. with the addition of directorships in group companies
Agnetha Brekke	1. with the addition of directorships in group companies
Henrik Gundersen	None
Kristin Axelsen	None
Stig Standal Taule	None

### Recruitment policy for management body

The members of the Board of Directors are elected by the General Meeting, based on a proposal by the Election Committee. According to applicable law, the Board of Directors shall have a versatile composition, and both genders shall be represented. These requirements are therefore an integral part of the Election Committee's work when preparing its nomination proposal to the General Meeting. In detail, the Election Committee takes into consideration an individual's qualifications, gender, capacity and independence when preparing the nominations.

The Board of Directors of the bank comprises 7 external members, and 3 employee-elected members. Among the external members, 4 are women and 3 are men. Among the employee-elected members, one is a woman and 2 are men. This is in line with the applicable gender requirements. The bank is also of the opinion the versatility requirements are met.

### Monitoring and reporting

Sparebanken Vest has a strong focus on monitoring, managing and reporting risk and capital matters. This is to ensure that the bank at all times comply with adopted targets and limits and that the bank's overall risk positions are adequately monitored. A management and reporting cycle help to ensure that the Board and management are kept continuously up to date about status and developments.

## Sparebanken Vest 2023 – Risk and Capital Management

The risk report, key figures report and finance / accounting report are submitted as a combined report (LIS – management report) to the bank's management once a month and to the Board quarterly.

The purpose of internal control is to make sure that Sparebanken Vest meets its objectives and at the same time protects customer's values, produce reliable reports and is compliant with laws and regulations. An important part of the internal control is the annual internal control assessment where each division produce a summarising assessment of the internal control in their area. The CEO prepares an overall risk assessment which is processed by the Board.

According to requirements set by the Board, the Compliance function reports to the CEO and the Board quarterly.

Each employee in Sparebanken Vest is obligated to report and deal with operational losses. Operational losses and Compliance deviations shall be reported in the bank's loss and event database, and status on all major

events and Compliance deviations is reported to the management and the board.

The table shows the regular independent reporting to the management and the board. The reporting cycle is regulatory supplemented by information about current market and portfolio developments. The board is also informed if there have been any breaches of recovery indicators, risk appetite limits or other major changes in the risk situation.

Report	Recipient		Frequency			Comment
	The Board	CEO	Annual	Quarterly	Monthly	
Risk Strategies	x		x			Assessment and change of the banks risk tolerance within credit-, market-, liquidity-, and operational risk.
Risk Policy		x	x			Assessment and change of detailed targets and limits for credit-, market- and operational risk.
ICAAP & ILAAP	x		x			Assessment of the banks capital requirements, solvency level and liquidity needs, including stress scenarios.
LIS (Risk reporting)	x	x		x	x	Status and development in relation to targets and limits, in addition to analysis of developments, as well as actual capital adequacy versus the banks targets.
Validation Reports	x		x			Overview of quantitative and qualitative validation completed last year.
Accounting Reports	x		x	x	x	
Impairment assessment		x		x		Review of large and risky exposures and portfolios – individual and groups.

## CAPITAL ADEQUACY AND ADAPTATION TO THE CAPITAL ADEQUACY REGULATIONS

### Regulatory matters

#### Capital adequacy

The bank measures capital adequacy in accordance with CRR II/CRD IV, which entered into force in Norway on 1 June 2022. These regulations contain several important aspects for the bank, such as an extension of the SME Supporting Factor, introduction of a minimum NSFR requirement, a new method to calculate Counterparty Credit Risk in derivatives as well as regulations limiting the bank's need to issue Senior Non-Preferred debt to meet its MREL requirement.

#### Regulatory capital requirements

Sparebanken Vest must meet minimum requirements and combined buffer requirements under Pillar 1 and requirements under Pillar 2.

#### Pillar 1

The minimum requirement for capital under Pillar 1 is 8 % own funds. The requirement must be fulfilled by at least 4,5 % common Equity Tier 1 (CET1), and at least 6 % Tier 1 capital including Additional Tier 1 Capital (AT1). The rest can be fulfilled by Tier 2 capital.

The different methods for calculating the minimum requirement of own funds under Pillar 1 is shown in the table below. Please see chapter IRB for more information about the internal models.

Risk	Category	Approach
Credit risk	State	Standardised approach
	Institution	Standardised approach
	Corporation	IRB Advanced
	Retail	IRB Retail
Market risk	Equity positions	Standardised approach
Operational risk	All	Standardised approach

#### Methods for calculating minimum requirement of own funds

#### Pillar 2

Pillar 2 is an institution-specific requirement and shall cover risks that are not covered by the regulatory minimum requirements (Pillar 1). The Financial Supervisory Authority (Finanstilsynet) determines Sparebanken Vest's Pillar 2 requirement every second year through the Supervisory Review and Evaluation Process (SREP). In December 2023 the bank received its Pillar 2 requirement of 1,5 %, applicable from 31. December 2023.

#### Buffer requirements

The combined buffer requirement consists of capital conservation buffer (2,5 %), the systemic risk buffer (4,5 %), the countercyclical buffer (2 %), and the buffer for systematically important institutions (2 %). The buffer requirements must be met by CET1 capital.

The countercyclical buffer requirement was 2,5 % by the end of 2023. Sparebanken Vest is not defined as a systematically important financial institution and thus, the buffer for systematically important institutions does not apply.

The capital adequacy target is derived as the sum of the regulatory capital requirements that the bank is subject to at any time, and the applicable margin.

#### Leverage ratio

The applicable minimum requirement for leverage ratio is 3 % and it's calculated in accordance with Articles 429 to 429g of the CRR. The leverage ratio exposure includes derivatives, securities financing transactions, off-balance sheet exposure and other on-balance sheet exposure.

The bank's Risk Management is mandated to oversee, control, and monitor the risk profile and capital capacity and to avoid excessive leverage of the bank.

### **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**

The Bank Recovery and Resolution Directive (BRRD), also known as the European crisis management directive, entered into force in Norway on 1 January 2019. BRRD contains requirements for recovery and crisis management measures, rules on write-down or conversion of own funds and eligible liabilities into equity (MREL), and the establishment of a national crisis management fund.

Part of the MREL-requirement must be met with Senior non preferred bonds, a debt class subordinated to senior preferred debt. These bonds can be converted to own funds if necessary. The MREL-requirement must be met in full by 1 January 2024, but the bank can fulfil part of the requirement with ordinary senior debt with a minimum one year left to maturity during the phase-in period. BRRD2 entered into force in Q2 2022 and introduced a cap of the subordination requirement.

The cap is calculated as Pillar 1 x2 + Pillar 2 x2 + Combined Buffer requirement. CET1 used to fulfil the combined buffer requirement can be used to fulfil the subordination requirement calculated by the forementioned formula. The difference between the effective MREL requirement and the cap on subordination can be fulfilled with issued restricted senior unsecured debt with a residual maturity of more than 12 months, applicable at all times.

The resolution authority has set the subordination requirement and the effective MREL requirement at 28,5 % and 35,5 % respectively, of risk exposure amount. The MREL requirement will vary over time based on changes in risk exposure amount and capital requirements.

The subordination requirement shall, as a minimum, be phased in linearly during the rest of the transitional period and shall be fulfilled entirely from 1 January 2024. Sparebanken Vest fulfils the subordination requirement and the effective MREL requirement by a good margin.

## IRB APPROACH

In February 2017, Sparebanken Vest was granted permission to use Advanced IRB (A-IRB) to calculate regulatory capital requirements for credit risk. This means that the bank has permission to use A-IRB for both the mass market and the corporate market. Sparebanken Vest uses a template-based method for operational risk. As the bank does not have any trading portfolios, the bank does not hold capital under Pillar I for market risk specifically. The bank has a limited exposure to equities. Equity positions are risk weighted according to the standard method.

The Board of Sparebanken Vest requires the bank to be well-capitalised. Risk, capital and liquidity assessments (ICAAP / ILAAP) are carried out at least once a year, and the bank's capital strategy must be based on the actual risk to which the business is exposed, supplemented by the effect of various stress scenarios. The bank shall always satisfy the regulatory minimum capital requirements.

One condition for the IRB approval is that the IRB system and its application is validated at least once a year. In Sparebanken Vest, the results of the validation are reviewed by the bank's Validation Committee. Annual validation reports are submitted for review by the Boards Risk Committee and subsequently approved by the Board.

The internal audit function regularly audits the IRB system and its application, including compliance with the Capital Adequacy Regulations. The IRB system is audited at least once a year, and reports are submitted to the Board for review and approval.

### Regulatory capital

The IRB approach is based on three main parameters: probability of default (PD), exposure at default (EAD/CF) and loss given default (LGD). As an AIRB bank, the bank estimates these parameters itself, and the supervisory authorities approve the models and calibration.

### The retail market and SME segment

Sparebanken Vest uses its own PD, EAD and LGD values for the retail market. The LGD model takes account of the recovery rate, type of security,

the expected value of the security, variation in the value of the security and expected payment on the unsecured part of the commitment. The LGD rates are adjusted to represent a period of economic downturn, and thus represent a 'downturn LGD'. The probability of customers in default being cured, the 'cure rate', is estimated as expected recovery per product type.

### Corporate market

The bank was authorised to use the advanced IRB approach (AIRB) for the corporate market in February 2017.

Figures reported after this are based on AIRB, where own estimates are used for all parameters in the risk models.

### Other exposure

The capital requirements for the counterparty types 'institutions and states' are calculated using the standard method.

Limits on uncommitted credit lines to credit institutions are proposed by the Treasury department and are subject to review and approval by the Credit department. Recommendations are then sent to the CEO for final approval.

The maximum limit on uncommitted credit lines is based on the credit institution's rating, and the size of the credit institution's balance sheet.

Ratings from the following rating agencies are accepted by the bank: Moody's, Standard & Poor, Fitch and/or Scope. In cases where a credit institution is rated by several rating agencies, the lowest rating will apply.

An uncommitted credit line is granted for one year, however, they are monitored on an ongoing basis. For rated credit institutions, the limits will be reduced (or removed) if a change in the rating means that the bank's credit criteria are no longer met.

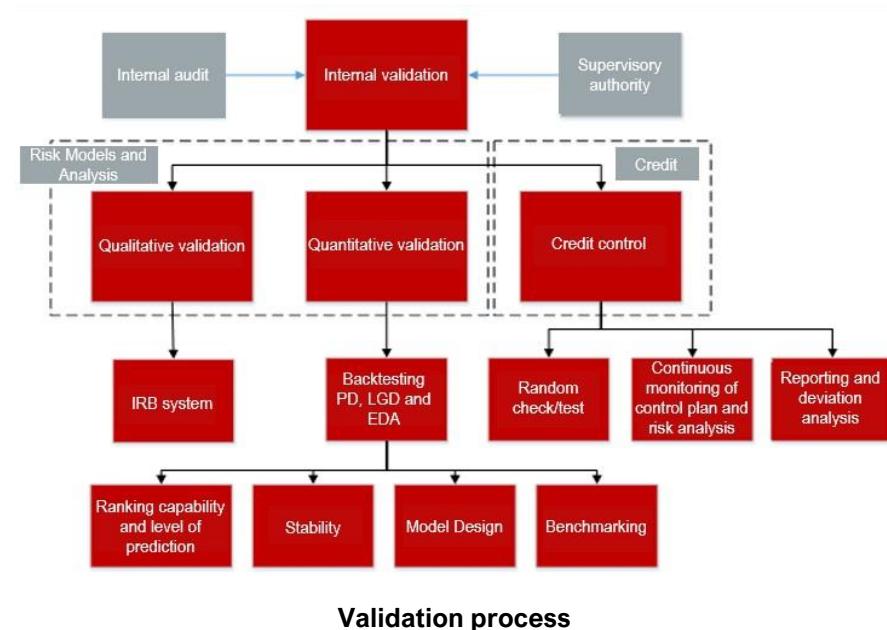
### Validation

The bank's internal validation of the IRB system is ensured through:

- Qualitative validation of the bank's IRB system
- Quantitative validation of the bank's models (PD, CF, LGD, expected loss amount)
- Credit control (compliance)

Qualitative and quantitative validations are carried out annually. The internal audit function assesses both the qualitative and quantitative validations. In addition to the validation reports, the bank's internal audit function shall carry out two additional audit projects on IRB. The Financial Supervisory Authority also follows up the bank's IRB system through thematic supervisory activities and inspections.

Validation of the IRB system falls under Risk Management's area of responsibility.



#### - Qualitative validation

The purpose of qualitative validation is to ensure that the quality of the IRB system is satisfactory. Qualitative validation shall assess the following elements in the IRB system:

- How the IRB system is applied in the bank.
- Overview of IRB activities carried out during the year, and activities planned for the coming year.
- Changes in the IRB system, including changes in IT systems that affect IRB.
- Analyses to ensure data quality and identify the need for changes.
- Review of key processes and functions.
- Presentation of IRB-related audit projects, and follow-up of recommended activities.
- Overview of new regulatory requirements for the IRB system and how they have been addressed.
- Checks to ensure that relevant documentation is up to date.

The bank constantly endeavours to improve the quality of the data used in the IRB models. For this purpose, analyses of data quality are carried out continuously in qualitative validation. The purpose of these analyses is to prevent any deterioration in data quality in connection with changes to the IT system, models etc. The qualitative validation report summarises findings and describes how any gaps identified will be closed.

#### - Quantitative validation

The bank has validation procedures in place that define the framework for quantitative validation. The purpose of quantitative validations is to ensure that the bank's models have satisfactory ranking ability, prediction level and stability. The bank's PD, LGD and EAD estimates for RM and CM are compared with the observed default frequency, loss given default and exposure at default, respectively. The results are assessed in relation to acceptance criteria defined in the validation procedure. Any deviations are

investigated to determine whether they are acceptable or whether changes should be made to the models. In principle, the PD models are 'point-in-time' (PIT) models that vary with cyclical changes. In the annual quantitative validation, the PD value from the model is assessed in relation to the observed default frequency for all years for which the bank has sufficient data. The bank also validates calibrated PD. The bank uses a calibration method that ensures that the regulatory calibrated PD is on a par with the long-run default frequency. This makes the calibrated PD independent of cyclical changes. If the calibrated PD deviates too much from the long-run average, the models must be recalibrated.

When validating the PD models' ranking ability, tests are carried out to assess the models' ability to distinguish between customers in default and customers who remain healthy throughout the year. Among other things, the validation uses ROC (Receiver Operating Characteristic) to assess the ranking ability. The assessment of ROC compared with the bank's defined acceptance criterion shows that the ranking ability of the PD models is very good.

The bank's LGD models are used to predict loss given default. The models include information about security coverage, expected recovery, residual recovery and costs. Since the predicted loss ratio is affected by the sales value of the objects furnished as security, the bank has procedures for updating value estimates. For LGD, the right prediction level is achieved by adjusting the parameters in the model. Every year predicted values are assessed in relation to observed values, both for the model parameters and for the LGD model seen as a whole. The parameters are adjusted as needed. For the residential mortgage portfolio, a distinction is drawn between regulatory LGD and LGD adapted to an economic downturn. Regulatory LGD for mortgages accounts for reference LGD and a LGD floor of 20 %. The validation places most emphasis on the assessment of LGD from the model, in other words LGD adapted to an economic downturn.

The annual quantitative validation assesses the ranking ability of the LGD models, i.e. the models' ability to distinguish between customers with low and high loss ratios. The ranking ability is validated by dividing customers in default into classes based on predicted LGD. The model's ranking ability is satisfactory if the observed LGD increases over the LGD classes.

The bank's EAD models are used to predict exposure at default. The models use conversion factors that are dependent on the product category. The validation results show that EAD is satisfactory for all product categories.

In addition to the annual quantitative validation the bank performs a more frequent supervision in the "Review of estimates"

#### Credit control

The main purpose of credit control is to ensure high credit quality and that the IRB models and the rest of the credit framework are applied as intended, and in line with the bank's business objectives. An assessment of whether the bank's decision support system is used and complied with as intended is an important part of the bank's credit control.

A report of the credit control is prepared on a quarterly basis and reviewed by the validation committee semi-annually.

#### Stress testing

All the bank's IRB approved PD models are subject to stress tests. The purpose of stress testing the bank's PD models is to analyse the effect of an economic downturn on the models' variables and resulting PD. Furthermore, the bank uses the results of the IRB stress tests by performing the bank's annual stress test as part of the ICAAP process.

The bank's LGD and CF models are calibrated for an economic downturn. This means that, in principle, estimated LGD and CF reflect the expected loss ratio and drawdowns on credit given that an economic downturn has occurred.

The purpose of stress tests is to provide insight into circumstances and situations that could lead to substantial changes in the portfolio's credit risk. The main focus for stress testing is a general scenario for an economic downturn that places the bank's portfolio under stress. In addition to the scenario analysis, it is also relevant to look at more bank-specific stress situations, for example a situation that affects industries to which the bank has significant exposure. The stress tests are conducted based on the bank's IRB models and consist of a thorough analysis of how the calculation

basis, default and losses change when the models are applied to the portfolio under different scenarios.

### Scorecard models

The scorecards, which have been developed based on statistical analyses of customer data, comprise historical key figures and customer data that can be collected automatically.

The modelling is primarily based on two data sources: internal data from the bank's data warehouse and external data from Bisnode. Examples of internal data include liquidity and internal payment remarks, while external data sources include tax assessment data, accounting information and external payment remarks. For the PD models, emphasis was placed on identifying a set of specific information variables describing different aspects of the customer, such as behaviour, earnings potential, and downside risk.

To take account of any statistical uncertainty, a safety margin is added to the model estimates. It is then assumed that the number of commitments in default per risk class is a stochastic variable, and the safety margin is set based on statistical uncertainty. The PD value to be used when stipulating the calculation basis (RWA) shall reflect long-run average PD. PD is then adjusted so that the calibrated PD on average concurs with the long-run observed default frequency. This kind of calibration method indicates that the bank uses a through-the-cycle methodology, where PD is recalibrated back to the long-run observed DR if the estimates over time diverge from the long-run observed default frequency.

The LGD data basis consists of the bank's default history and pertaining loss data. The parameter values in the model were quantified based on observed interrelations in the internal data basis, as well as expert assessments.

The LGD model is not calibrated the same way as the PD models. For LGD, the right prediction level is achieved by adjusting the parameters in the model. LGD shall be calibrated for a period of economic downturn, so that all parameters are set regarding this. The parameters are assessed quarterly as well as in connection with the annual quantitative validation.

The retail market scorecard is used for personal customers and small sole proprietorships / general partnerships (EPF/ANS). The retail scorecard consists of one model for mortgages and one for other retail. Both models are applied both to personal customers and to small sole proprietorships / general partnerships. The tax assessment income that is automatically retrieved for a customer can be corrected in the application score. That is the only correction it is possible to make for retail customers and small businesses with personal liability. All corrections must be justified and documented.

The corporate market scorecard is used for all limited liability companies and large sole proprietorships / general partnerships (EPF/ANS). The corporate scorecard is the same for all corporates (SL, SMEs, and other corporates). Recently established enterprises and customers that do not have accounts are dealt with under separate rules. Ordinary customers are assigned a score in the model based on accounting information for the last three years. The customer's behaviour history is also deemed to be strongly predictive. Procedures have been adopted for correcting information that is retrieved automatically. Accounting information can be corrected based on critical assessments and in accordance with the prudence principle. Information showing a history of payment delinquency can be corrected if it is incorrect or has unreasonable consequences. In such cases, an automatic and a corrected score are obtained. All corrections must be justified and documented.

Exposure to equities is not reported under IRB.

The bank has developed cash flow-based score models for revenue-generating property projects, which it uses for decision-making purposes internally in the bank. The cash flow models are forward-looking and assess the uncertainty associated with the projects by enabling simulations of different outcomes.

### Credit Risk Mitigation

On- and off-balance sheet netting is not applied under the IRB approach. Collateral is used to reduce risk, as the collateral can be realized in case of a default. For retail the main type of collateral is residential property. For

corporate the main types are physical assets such as residential property, commercial real estate, ships, motor vehicles, inventory, and operating equipment. In addition, collateral such as guarantees, securities, stocks and receivables are used. Guarantees are used as collateral when calculating LGD but does not apply to PD or EAD estimation. Risk concentrations in the credit risk mitigation follows from concentration of collateral to certain types of assets. There is limited concentration on guaranteed counterparties.

Guarantors are typically personal owner for smaller corporates or corporate mother for larger corporates. Evaluation of guarantor creditworthiness is an integrated part of the credit process, and the guarantors are in most cases substantially more solid than the debtor.

#### **Credit exposure**

Sparebanken Vest uses EAD (exposure at default) as a measure of credit exposure in relation to individual customers and portfolios. EAD is defined

as the proportion of a granted commitment that is expected to have been drawn in the event of a potential future default.

#### **Profitability models**

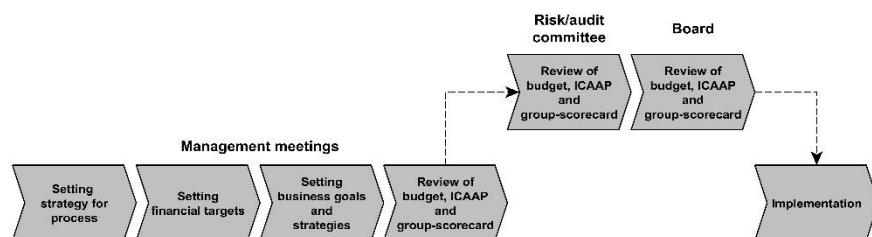
Sparebanken Vest uses RORAC (Return On Risk-Adjusted Capital) as a rate of return measure for the credit portfolio. RORAC is the net result of customer commitments seen in relation to the need for capital based on the bank's risk models, regulatory capital requirements and the bank's actual capitalisation. The risk parameters from the risk classification system are part of the calculations. RORAC is calculated for all commitments, and it is used both as the basis for pricing commitments and when evaluating the portfolio's profitability.

## INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP)

The capital adequacy of Sparebanken Vest is based on Pillar 1, which sets out the statutory minimum capital requirements for financial institutions. In addition to Pillar 1 risks, the other relevant risks and corresponding capital requirements are reviewed as part of the internal capital adequacy assessment process (ICAAP). ICAAP is conducted in line with the Pillar 2 framework, published by the Financial Supervisory Authority of Norway (Finanstilsynet) in circular 3/2022.

### - ICAAP and methodology

The capital assessment is an integral part of the bank's strategy and budget/forecast processes, as illustrated in the flow chart below. The quantitative analyses are also supported by qualitative assessments.



In addition to calculation of the economic capital required to cover the individual risks identified under the Pillar 2 framework, stress tests are conducted to identify the capital effects of stress scenarios.

### - Stress tests

The capital target of Sparebanken Vest is based on a 4-year forecast, and stress tests to assess the capital impact of adverse macroeconomic development. The stress test is based on lower growth rates, reduced net interest income, and increased loan losses, among others. The bank is also performing stress tests related to isolated events of falling housing prices, and concentration risk in the corporate portfolio.

Stress testing is performed as part of the annual ICAAP and ILAAP, and more frequent if the bank finds it necessary based on prevailing market conditions.

The outcomes of the stress tests are used to identify the appropriate margin above the regulatory minimum capital requirement, and to estimate the capital adequacy target.

### - Capital adequacy target and strategy

Based on the ICAAP, the Board approves the risk strategies and adequate capital targets to ensure continued operations and support current and future activities of the bank.

The capital adequacy targets of the bank are derived as the sum of the regulatory capital requirements that the bank is subject to at any time, and the applicable margin. The strategy of the bank is to maintain a margin at the highest of the estimated margin, and the Pillar 2-Guidance decision by the Financial Supervisory Authority. The bank's capital adequacy target is stipulated as a percentage of the regulatory calculation basis.

Sparebanken Vest's main goal is that future capital needs will be covered by the results of ongoing operations (after allocations). The main sources of equity in addition to this, are the issuing/raising of new equity certificate capital, subordinated bonds and subordinated loans (perpetual and/or for a specific period).

Sparebanken Vest's objective is to achieve results that provide a competitive return on the bank's equity capital. The profit for the year after tax will be divided between the equity certificate capital and primary capital in proportion to their relative share of the bank's equity (the owner fraction). Taking into account the bank's capital adequacy, strategy and development, the goal is for close to 50% of the year's profit to be distributed in dividends. The proportion of the profit that is allocated to dividend and donations will be adjusted to the bank's equity situation.

## CLIMATE RISK

Climate risk is risk that arise from impacts from or responses to climate change. Climate-related risks may increase credit risk and result in financial losses for the bank. Climate-related risks are physical risks or transition risks, and both can be associated with lending and financial investments. Physical risk, such as rising sea levels and landslide, can have financial implications for businesses through direct damage to assets or indirect effects through disruption of the supply chain. Transition risk entails a varying degree of financial and reputation risk for businesses in the transition to a low-emission society.

Sparebanken Vest works on Environmental, Social and Governance (ESG) factors at the strategic level, in the day-to-day operations and by making good reporting available. ESG factors are incorporated into the credit strategy and policies, and these factors are used to assess customers.

The bank aims to promote sustainable solutions and encourages sustainable business by providing flexible lending products, such as

sustainability-linked loans. Sparebanken Vest has set ambitious industry-specific goals for reducing climate-related risk the lending portfolio and publicly made available a transition plan. These are important measures for understanding and reducing climate risk and for identifying sectors and projects that contribute to restructuring and new earning opportunities. Sparebanken Vest is also measuring carbon-related credit exposure and has published financed emissions in the annual report. Further, Sparebanken Vest has reported according to the Task Force on Climate-related Financial Disclosures (TCFD) principles in the annual report, which gives a thorough understanding for how the bank handles climate-related risks and opportunities.

## CREDIT RISK

### Definition

Credit risk is the risk of losses if customers fail to meet their commitments to the bank.

Credit risk arises through loans, credit facilities, guarantees, and various derivative transactions with retail and corporate market customers. In internal reporting and risk management, credit risk relating to derivative transactions is quantified using conversion factors that depend on the contract type and term to maturity.

### Development in credit risk

The structure of Sparebanken Vest's lending portfolio is largely the same as at the end of 2022. At year-end, the retail market accounted for approximately 76% (75%) of the portfolio, and approximately 99 % of this portfolio consists of loans secured by residential mortgages. The risk in the retail market portfolio is still deemed to be stable and low.

Defaults and potential bad debt in the retail market amounted to a total of NOK 322 (272) million at the end of 2023.

Defaults and potential bad debt in the corporate market amounted to a total of NOK 1,139 (978) million.

For 2023 as a whole loss costs came to NOK 95 (52) million.

### Credit strategy and credit policy

The credit strategy is annually reviewed by the Board. It defines credit strategy guidelines and principles, as well as overall parameters for the rate of return, quality, growth and concentration in relation to the management of credit risk.

Key guidelines and principles in the credit strategy:

- The principal market area for the bank's credit business is Western Norway. Bulder Bank offers low Loan-to-Value mortgages outside of the primary market (urban areas outside of Western Norway).

- Credit shall only be granted if the requirements with respect to debt-servicing ability are met. Security or a high rate of return or price cannot compensate for a poor ability to service debt.
- Customers must conduct themselves in accordance with generally accepted values and norms.
- Corporate customers' company structure must be transparent. Complex company structures must be fully understood by the bank and are assessed as part of the credit assessment.
- In its lending activity, the bank shall act responsibly and in accordance with the internationally recognised principles for corporate social responsibility and sustainability. Consequences resulting from climate change and risk relating to pollution of the natural environment shall be assessed in connection with credit assessments of individual customers.
- The bank shall actively differentiate prices based on risk and customer profitability.

Overall targets and limits are stipulated in the form of:

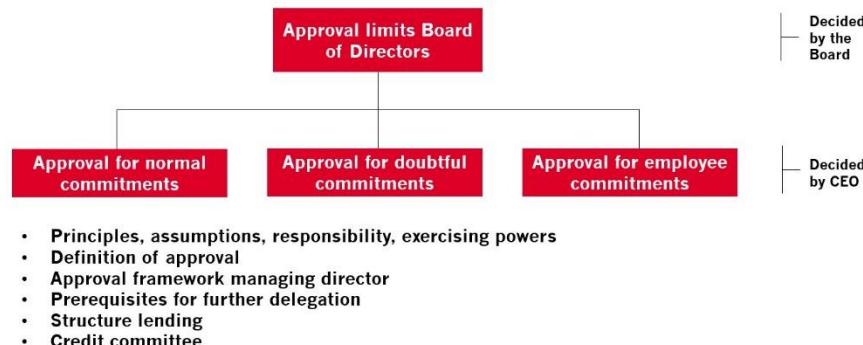
- Return on risk-adjusted capital (RORAC) and Return on Equity (ROE).
- Probability of default (PD) and expected losses as long-term portfolio quality targets.
- Growth parameters for the retail and corporate market.
- Concentration limits for maximum exposure to the specific corporate market segments, as well as individual customer groups.
- Targets for maximum impaired exposure and a number of defaults.

The credit policy specifies the strategic credit guidelines and includes requirements for the composition of and limits on different customer, product and market segments. The bank's corporate market portfolio is divided between 13 industries in addition to the category 'Other'. Separate lending policies have been adopted for sectors Fish Farming, Fisheries and Fish Processing, Real Estate, Building and Construction, Shipping and

Offshore (including Offshore Wind), Real Estate, and Renewable Energy and Small-scale Power Production. The changes in the credit policy and the industry policies are ultimately approved by the CEO.

### Limits on approval

The Approval Regulations stipulate principles for credit decisions and granting of credit authorizations.



### Structure of the Approval Regulations

	Committee	Required endorsement from Credit Department
Board of Directors	Board's Credit Committee	Yes
EVP/Managing Director Corporate Market	Credit Committee	Yes
Regional Approval		No

### Authorization's structure

All approval limits are individual. The approval limits are differentiated by volume, credit risk (probability of default) and position. Credit cases that exceed regional authorizations are approved by the CEO and the Head of Corporate Market acting as a credit committee. For the approval to be valid, the bank's credit department must independently endorse the decision (after approval).

In credit cases that are to be submitted to the Board, a dedicated Credit Committee consisting of selected Board members has been appointed to

approve, on the Board's behalf, credit cases that exceed the CEO's approval limits.

### Risk classification

Scorecards are used for the retail and corporate markets to quantify probability of default (PD) and to classify the debt-servicing ability of individual customers and portfolios. Every month, the bank re-classifies all customers / commitments included in the IRB system. Quantification of the risk parameters EAD (exposure at default) and LGD (loss given default) is done in the same operation, and they are also updated monthly. The scorecard models and quantification of risk parameters have a central place in the management of credit risk and are used in the following contexts, among others:

- The credit approval process, credit authorizations, commitment follow-up and risk pricing of individual customers.
- Risk reporting and follow-up of portfolios, including as the basis for changes to the credit strategy, credit policy, approval regulations and credit processing procedures.
- Calculation of expected losses and economic capital.
- Adaptation of the IRB models used in IFRS 9.

The scorecard models calculate the probability of default for the coming 12-month period. Customers are grouped into 11 risk classes from A to K based on the percentage probability of default (PD). Commitments in classes A–J are considered healthy, while risk class K comprises defaults.

The bank's scorecards for the retail market are broken down by product, so that customers are assigned one PD for home mortgages and another PD for other products. The scorecards for the corporate market estimate PD at customer level. The PD models are used internally in connection with the granting of loans and pricing.

For management and reporting purposes, the portfolios are divided into risk classes based on PD. The risk classes are sub-divided into decision zones that are used in connection with operational decision support and the

management of authorizations. The division into risk classes is the same for all portfolios. It is shown in the table below<sup>1</sup>. The table also shows the relationship between the classification used by the biggest external rating agencies and the bank's own classification. The division into decision zones is specific to the individual portfolios.

Class	Lower limit PD	Upper limit PD	Rating scale Moody's	Rating scale Standard & Poor's
<b>A</b>	0.00%	0.10%	AAA – A-	Aaa – A3
<b>B</b>	0.10%	0.25%	BBB+ – BBB	Baa1 – Baa2
<b>C</b>	0.25%	0.50%	BBB-	Baa3
<b>D</b>	0.50%	0.90%	BB+	Ba1
<b>E</b>	0.90%	1.50%	BB	Ba2
<b>F</b>	1.50%	2.75%	BB-	Ba3
<b>G</b>	2.75%	5.00%	B+	B1
<b>H</b>	5.00%	10.00%	B	B2
<b>I</b>	10.00%	25.00%*	B – CCC/C	B3 – Caa3/C
<b>J</b>	25.00%	99.99%		
<b>K</b>	100.00%	100.00%		

### Risk classes based on probability of default

Class K represents customers in default (PD = 100 %). Class K is sub-divided into two sub-classes, K1 and K2, where individual write-downs have been carried out for K2 customers. In this context, the bank uses the Capital Adequacy Regulations' definition of default as being overdrawn for 90 days or more. The bank uses a lower limit of NOK 1,000 or 1% of outstanding debt as 'not insignificant' for past due-exposures for retail customers. The corresponding lower limit for corporate customers is NOK 2,000 or 1% of outstanding debt.

In addition to default of payment, the following default criteria are included:

- Individual loss write-downs
- Confirmed losses
- Bankruptcy

- Debt settlement
- Voluntary debt settlement arrangement
- Compulsory winding-up proceedings instituted
- Insolvent – applies to corporate customers
- Materially reduced debt service capacity
- Material breach of covenants – applies to corporate customers
- Fire sale of collateral
- Default of the related party for the consolidated exposure

The state, county authorities, municipalities and the bank's subsidiaries are assigned to the best risk class for internal applications of PD. State and institutions are reported under the standardized approach.

The bank does not currently use external ratings in the IRB system. For capital adequacy purposes, the bank uses its own values for PD (probability of default), CCF (credit conversion factor) and LGD (loss given default) for retail market customers and corporate customers.

See the appendix for further information about credit portfolios broken down by risk class.

### The credit assessment process

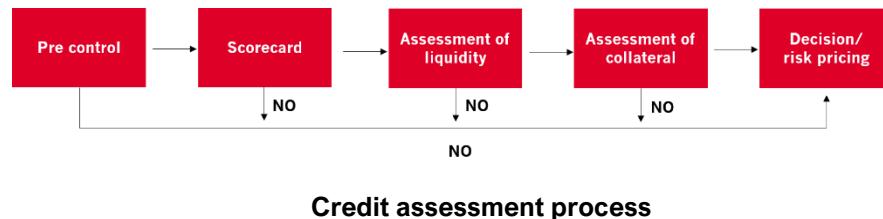
In the credit assessment process, the bank uses decision-support systems for the retail and corporate markets. For the retail market, there is one standardized procedure for all retail market customers. For the corporate market, the procedures are adapted to suit small enterprises, newly established enterprises and 'ordinary' enterprises, as well as special analysis models for key industries. The decision-support system is also used in the annual review of the corporate customer commitments.

Extensive information is collected in connection with all loan applications. This information forms part of the decision basis. It includes:

<sup>1</sup> To correspond with the rating scale, the PD in risk class I ranges from 25 % to 40 %

- General information about the customer, business strategy and sustainability, corporate structure and governance, industry information, competition and market analysis.
- The bank's exposure (including consolidated exposure to the customer group) and evaluation of collateral.
- Historical financial information and forecasts.
- Payment delinquency history and auditor comments.

The steps in the decision-support systems are illustrated in the figure below.



The purpose of initial checks is to uncover whether the customer / loan application is within the bounds of the bank's strategy and policy and to uncover at an early stage any obvious risk factors that may have a bearing on the subsequent processing of an application.

The scoring / classification process results in a decision recommendation, which is important in the subsequent processing, including in relation to pricing and authorization level.

## Procedures and guidelines for the valuation of security

The bank has procedures and guidelines for the valuation of assets pledged as security. When assessing security coverage, a model and regulations are used to calculate the expected value in a realization situation of various assets pledged as security. For houses and holiday homes, the basis is a valuation, sales price or estimated value from the company Eiendomsverdi, or, in exceptional cases, a value estimated by the case administrator. For

such exception cases, the cases must be submitted to the regional bank manager for decision. Based on the property's location and standard, the value basis is reduced at fixed rates to arrive at its realization value. When pricing risk, a risk-adjusted rate of return on economic capital as well as return of equity is calculated for each individual commitment.

## Commitment follow-up

Corporate market customers whose commitments exceed a defined minimum level are followed up annually or quarterly, depending on their size, risk class and assessed risk. The decision-support system is used, and corresponding assessments are carried out as for credit approval. Defaults and potential bad debt follow separate quarterly follow-up processes that form the basis for decisions on provision for losses. In the event of a failure to arrive at solutions for retail customers, the commitments are transferred to central credit support departments and/or an external debt collection agency.

## Loss assessment

All commitments that are subject to individual assessment shall be assessed in order to determine whether there is objective evidence showing that a loss event has occurred and whether the loss event has reduced the estimated future cash flows from the loan.

If there is objective evidence of impairment, the loan loss provision is calculated as the difference between the balance sheet value (balance + accrued interest on the valuation date) and the present value of future cash flows. The estimation of future cash flows also includes the sale of assets pledged as security, including related costs where this is relevant.

The claim against the customer remains in place, unless it has been agreed with the customer that the loan is to be written off.

The IFRS9-model is described in the annual report in note 11.

## COUNTERPARTY RISK FOR DERIVATIVES

The bank is exposed to counterparty risk, both through derivative transactions with the bank's customers and in connection with hedging positions and trading through the interbank market. The parent bank conducts internal derivative transactions with the subsidiary Sparebanken Vest Boligkredit in connection with fixed interest loans and funding in the European market.

Counterparty risk is defined as the risk that a counterparty defaults before the bank has received settlement, with the resultant risk of any unrealised gains being lost.

When credit assessing derivative agreements, the bank uses conversion factors to convert a derivative agreement into a credit equivalent. The conversion factors take account of the contract type and the term to maturity of the contract. The bank uses the market value method in its capital adequacy reporting. In the market value method, the EAD of a derivative agreement is the reinvestment cost on the reporting date plus a rate for potential future credit exposure. Through the implementation of CRR II in Norway, the bank has, due to the size of its derivative activities in connection with hedging non-NOK funding, changed its methodology for the calculation of capital requirements for counterparty credit risk in derivatives. The bank has implemented the standardized approach to counterparty credit risk (SA-CCR) and started reporting based on this methodology at the end of Q2-2022.

The risk weight of the exposure is then calculated using a method that depends on the counterparty type. Exposure in the interbank market is calculated using the standard method, IRB Advanced is used for corporate market customers, and IRB Retail is used for the mass market.

The bank has entered into ISDA agreements with CSA supplements with all derivative counterparties in the interbank market and has procedures for monitoring collateral in connection with derivative transactions. In the interbank market, it is normally the counterparty that estimates the market value of the derivative agreements and the amount of collateral to be exchanged, while the bank's back- and mid-office function controls these

calculations. The provision of collateral takes place through margining, mainly in cash. The bank's back- and mid-office function performs all payments, including margins payments and settlements. For the parent bank, none of the external agreements have rating triggers requiring the parent bank to transfer more collateral in the event that the parent bank would experience a rating downgrade. For the internal derivative transactions between the parent bank and Sparebanken Vest Boligkredit there is a rating trigger connected to the parent bank's rating. In the event that the parent bank is downgraded to a certain threshold, the parent bank would be replaced with an external counterparty. This arrangement is one-side, meaning that Sparebanken Vest Boligkredit would not have to provide further collateral in the event of a downgrade. Sparebanken Vest Boligkredit's agreements with counterparties imply that the counterparties would have to provide more collateral if they were to be downgraded, but as for internal transaction, this is a one-sided commitment.

On certain derivative contracts, the bank also conducts clearing through London Clearing House in order to reduce counterparty risk. Effectively, the counterparty with whom the bank conducted the trade is replaced by the clearing house and all the counterparties to clearing house posts Initial Margin to reduce probability of loss for the clearing house. Clearing also has consequence for the capital the bank's needs to hold for counterparty risk in derivatives. As the risk is reduced, the capital the bank needs to hold is also reduced. Since the bank is not a member of the clearing house, the bank conducts the clearing through clearing brokers with which the bank has established agreements. The share of cleared contracts has been increasing recently, and the bank expects this development to continue.

Regarding wrong-way risk this is defined by ISDA as the additional risk present «when exposure to a counterparty is adversely correlated with the credit quality of that counterparty». At a consolidated level, the cross-currency interest rate swaps are important derivatives to the Group, both due to the size of the nominal values as well as the duration of the derivative typically being long, as it is matching long term funding. Exposure in cross currency interest rate swaps will increase if the Norwegian Krone weakens

compared to foreign currency. The Norwegian Krone may weaken both due to global market turbulence, where investors are seeking safe havens, or due to more domestic conditions. For Norwegian counterparties, depending on the magnitude of the market turbulence, this may lead to downgrades of the counterparties. Due to rating triggers, as mentioned above, it may then be necessary to identify replacement counterparties. For this reason, the

bank's policy is to maintain and utilize an adequate number of uncommitted lines to a broad and diversified set of foreign counterparties, including both larger Scandinavian and European banks. On the back of this, the bank considers the wrong-way risk to be at an acceptable, low level.

## MARKET RISK

### Definition

Sparebanken Vest defines market risk as the risk of a loss on a financial instrument as a result of changes in market variables and/or market conditions within a specified time frame. Market risk arises as a result of the bank holding open positions in various financial instruments and can be subdivided into the following main groups; Interest rate risk; Currency risk; Equity risk; and Credit spread risk.

### Market risk strategy

The bank's market risk is managed through defined position targets and limits for each risk area. The market risk strategy, which is approved by the Board, sets out overall guidelines for the bank's activities in the capital markets, including limits on the bank's total exposure in relation to currency risk, equity risk, credit spread risk, and interest rate risk. The bank's investments shall be justified on the basis of the needs of the banking operations or the goal of increasing the bank's earnings. However, the targets and limits are set so that negative effects should not materially affect the bank's financial strength. Market risk is measured for both balance sheet and off-balance sheet items.

### Management and reporting

The management of market risk is embedded in the bank's market risk strategy and specifies and delegates limits and authorizations.

The interest rate, currency and credit spread risk is managed by the first line of defence represented by the Treasury function, which is organized under the Economy and Finance division, and by Sparebanken Vest Boligkredit AS. Regarding the equity risk, the bank has a small Venture Portfolio that has been in run-off for the past years, in addition to a Strategic Portfolio containing positions of strategic relevance to the bank. The bank's Head of Finance has been given authorization to manage the Venture Portfolio, whereas decisions regarding the Strategic Portfolio must be made by the Board or Management.

The reporting structure and roles relating to monitoring of the bank's market risk are formalized and set out in the bank's market risk strategy. Market risk exposure is reported monthly to the bank's management and quarterly to the Board. Risk Management is responsible for reporting on these risk factors to the management and Board, thereby ensuring that follow-up and reporting are independent.

### Control parameters/limits and models

Sparebanken Vest continuously measures and monitors the market risk to which the bank is exposed. The bank's method for measuring and monitoring equity risk, interest rate risk, credit spread risk, and currency risk is based on the methodology presented by the Financial Supervisory Authority on assessment of risk and capital needs. The detailed descriptions of the methods are presented in "Finanstilsynet's practices for assessing risk and capital needs" (Circular 3/2022), including Appendix 3.

### Interest rate risk

Interest rate risk is the risk of losses as a result of changes in the interest rate. Sparebanken Vest takes on interest rate risk through ordinary banking operations of lending and borrowing, where some assets and funding are at fixed interest rates. Sparebanken Vest also take active market positions, and has holdings of bonds and certificates, mainly in order to meet the bank's liquidity requirements. When measuring its interest rate exposure, the bank uses the six shock scenarios described in EBA Guideline 2018/02, referred to in Circular 3/2022. The shocks are parallel shifts of the yield curve up and down, steeper and flatter yield curve, and shocks up and down to the short interest rates.

As part of the market risk strategy, the Board approves limits on the interest rate risk that supports the banking operations and limits the effect on the bank of large interest rate shifts. The Treasury department manages and monitors the interest rate risk, and use derivative agreements, including interest swap agreements, to mitigate the risk.

### **Currency risk**

Currency risk is the risk of loss as a result of changes in foreign exchange rates. Sparebanken Vest is subject to currency risk through ordinary banking operations, mainly through marked funding, and through market transactions.

As part of the market risk strategy, the Board approves limits on open currency position (translated into NOK), both for the total open currency position, and for open positions on single currencies. The Treasury department manage the currency risk, and mitigate risk through derivative agreements, including basis swaps.

### **Equity risk**

Equity risk is the risk of loss as a result of changes in the share prices. Sparebanken Vest is exposed to equity risk through the equity investments under the two defined investment mandates: the Venture portfolio and the Strategic portfolio. Equity risk is measured and managed through exposure in NOK.

As part of the market risk strategy, the Board approves limits on the equity investments. The portfolio is managed by Economy and Finance represented by the Director of Finance and Investor Relations. Decisions regarding the Strategic Portfolio are made by the Management or the Board of the bank. The equity risk is limited as the portfolios is of limited size and following the run-off strategy of the Venture Portfolio.

Shareholdings in subsidiaries and associated companies are treated separately and is part of the chapter on information about consolidation.

### **Credit spread risk**

Credit spread risk is the risk of loss as a result of changes in credit spreads. The bank is exposed to credit spread risk on the interest-bearing securities in the bank's balance sheet. According to the methodology (circular 3/2022), credit spread risk is estimated based on rating, duration, and assumed credit spread change of the interest rate securities.

As part of the market risk strategy, the Board approves the limit of credit spread risk related to the bank's assets, which is in line with the investment strategy of the liquidity portfolio. The Treasury department manage the credit spread risk and mitigate the risk through diversified investments.

### **Regulatory capital**

The bank does not have any trading portfolios, and as such the bank does not calculate regulatory capital relating to market risk. The equity positions described above (Venture and Strategic Portfolio) are exempt from the IRB approach, and regulatory capital is calculated using the standard method.

## LIQUIDITY RISK

### Definition

Liquidity risk consists of two elements – refinancing risk and price risk.

By refinancing risk, it is meant the risk of not being able to refinance debt and not being able to finance an increase in assets. By price risk it is meant the risk of not being able to refinance commitments without incurring considerable extra costs.

### Liquidity risk management

#### Strategies and processes in management of liquidity risk

The Board of Sparebanken Vest has the overall responsibility to determine the level of liquidity risk tolerance and establish a liquidity risk strategy applicable for the bank.

Sparebanken Vest focuses on maintaining a low liquidity risk, while at the same time ensuring that the cost of funding does not exceed the level where it weakens the bank's competitiveness. The risk tolerance is managed through various control parameters and liquidity limits, and through the use of scenarios and stress tests. The bank's liquidity strategy comprises two basic pillars:

- The bank's liquidity management shall ensure that the bank can meet its commitments as they fall due, and that the bank is able to realize its growth ambitions on acceptable terms.
- The bank's liquidity management shall ensure that the bank has sufficient liquidity reserves to survive periods when markets close and/or periods when customers withdraw large amounts of their deposits.

To reduce the risk associated with increased dependence on funding from the financial market, the liquidity strategy requires the bank to diversify its funding. Sparebanken Vest is therefore obliged to diversify with respect to funding sources and markets, and to spread its maturity structure.

The bank has liquidity reserves to secure financial flexibility under normal operations, and to survive periods of difficult market conditions. The size of the bank's liquidity reserve is determined by three factors:

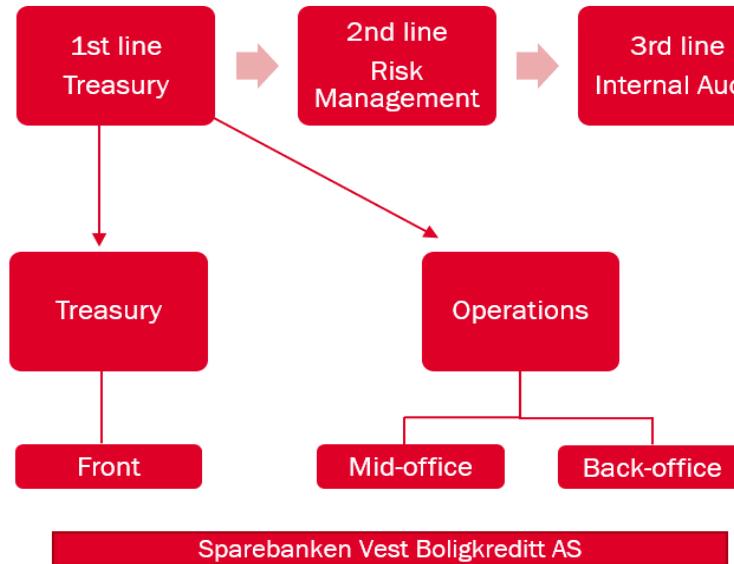
- Regulatory requirements. At all times, the portfolio shall constitute 100 % of liquidity outflow defined in the LCR Regulations.
- Flexibility. Ensures that the bank itself decides when and how it raises financing.
- Contingency – in the event of the bank's external sources of financing not functioning, the bank's liquidity portfolio will be used to cover the bank's external commitments.

The size and composition will be balanced against the costs involved with maintaining the portfolio.

#### Structure and organisation of the liquidity risk management function

Sparebanken Vest's liquidity function is managed by Economy and Finance, represented by the Treasury function. The department manages day-to-day cash flows and is responsible for covering the bank's funding needs.

Liquidity management and control is attended to by Economy and Finance and Risk Management. In this context, a distinction is drawn between the overarching level and day-to-day operational liquidity management and control. Day-to-day operational management / control is attended to by the mid and back-office functions (Economy and Finance), while responsibility for risk management and control of liquidity at the overarching level rests with Risk Management.



relationship between available stable funding (liabilities) and necessary stable funding (assets). Both the LCR and the NSFR has a minimum regulatory requirement of 100%.

In addition, the bank also has limits to the net funding needs the next three months, targets on stable deposits/loans ratio and a minimum target on credit rating. The control parameters all have in common the objectives to reduce liquidity risk and secure financial flexibility.

The liquidity control indicators are reported monthly to the CEO and quarterly to the Board. The quarterly report is a more comprehensive report including, among others, stress tests on the liquidity buffer. Once a year, the ILAAP (Internal liquidity adequacy assessment process) is presented and approved by the Board based on the risk tolerance of the Board. Besides internal reporting, the bank monthly reports to the supervisors and other stakeholders, such as Norges Bank (The Norwegian central bank).

#### Policies for hedging and mitigating liquidity risk

Through the yearly ILAAP, the board determines the liquidity managing targets and limits, which is set out in the bank's liquidity risk strategy. The objective is to manage the liquidity risk at a moderate profile, where the risk control indicators ensure the risk stays within risk tolerance.

The risk appetite is naturally limited by the regulator's requirements to LCR and NSFR but is as well managed by several stress tests carried out regularly throughout the year. To test whether the liquidity buffer is large enough, the bank tests how long it can operate without the access to external funding. The liquidity is tested both in the scenario where it operates as normal, including growth ambitions, and without growth. The test gives a greater understanding of the size of the liquidity buffer in addition to the requirements set by the regulators.

#### Business contingency - and recovery plans

The bank has in place a crisis management framework covering both liquidity and solidity crisis. The framework describes who's in charge in a crisis, actions to implement, potential outcomes and process for escalation.

See chapter “Crisis management – contingency and recovery” for more details.

### Stress tests

The bank carries out stress tests in order to assess its liquidity situation given disturbances in the market and/or disturbances in the bank's operations. The Board of Sparebanken Vest determines the assumptions that will apply and discusses the assumptions and results of the calculations. Key assumptions in all the scenarios include customers withdrawing their deposits from the bank, increased drawing on credit facilities, and refinancing in the capital market becoming partly or wholly unavailable. The purpose of the liquidity stress tests is to analyse the bank's ability to finance planned activities (both growth and refinancing). Numerous stress tests are performed in relation to liquidity and financing, including:

- Soft liquidity stress – where only the market, and not the bank, is affected by the stress situation.
- Severe liquidity-stress – where both the bank and the market are under stress, or where only the bank is affected by the stress.
- Price fall in the housing market – affecting the bank's capacity to issue covered bonds.
- Closed financial markets – An indication on how long the bank can operate before it breaks the minimum requirements for LCR without access to external funding.

Severe stress in the first 30 days is set equal to the LCR requirements but continued liquidity output beyond the horizon of 30 days is expected to ensure that the stress situation is more conservative than LCR. A price fall in the housing market builds on assumptions from ICAAP.

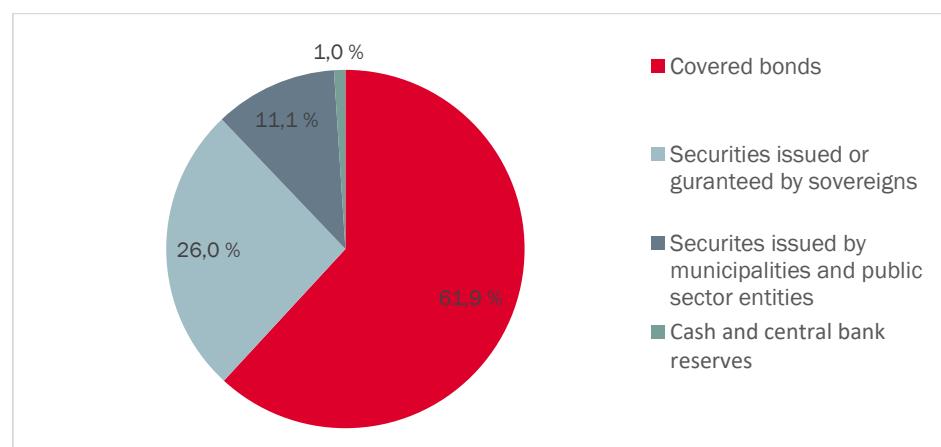
General experiences indicate that stress situations (particularly those only relating to the bank) should be resolved within 30 to 60 days if the bank is to continue operating without any significant changes to its business basis.

The bank's liquidity stress tests are based on targeted development, but the assumptions for the bank's liquidity needs and financing change

significantly as a result of a market and bank crisis. In a severe stress scenario, the bank must implement dramatic measures to survive. There is no basis for growth in this scenario, the bank's balance sheet is reduced, and priority is given to refinancing current financing.

### Development in LCR

The development of LCR is described in the Pilar 3 attachments. Over time, Sparebanken Vests LCR percentage has generally varied between 130 % and 160%, well above the regulatory minimum requirements. Most of the liquidity buffer consists of highly liquid level 1 assets, while a minor part is invested in level 2 assets including covered bonds and securities issued or guaranteed by sovereigns or municipality and public sector entities.



**Composition of High Quality Liquid Assets**

Sparebanken Vest has LCR requirements in EUR and NOK, which is the banks significant currencies. This is identified by having liabilities of 5% or more of the bank's total liabilities. The bank owns liquid assets primarily in NOK, but as well in EUR and SEK.

Derivative exposures are managed daily and is considered in the daily liquidity needs, in addition to liquidity stress tests.

Sparebanken Vest strives to maintain a well-diversified funding structure consisting of subordinated loans and bonds as well as a diversified redemption profile. Due to the banks wholly owned subsidiary Sparebanken Vest Boligkreditt, the majority of the bank's long-term funding is covered bonds, issued by Sparebanken Vest Boligkreditt.

#### **Asset encumbrance**

In accordance with EBA Guideline 2014/03 the bank considers an asset to be encumbered if it «has been pledged or if it is subject to any form of arrangement to secure, collateralize or credit enhance any on-balance-sheet or off-balance-sheet transaction from which it cannot be freely withdrawn (for instance, to be pledged for funding purposes) ». For the bank, the following areas are deemed relevant in consideration to asset encumbrance:

**Secured financing transactions** Assets pledged as collateral for repo agreements, either with financial counterparties or the central bank of Norway, Norges Bank.

**Collateral agreements** Collateral placed for the market value of derivatives transactions. This element is relevant both for derivatives traded over-the-counter (OTC) and derivatives that are placed through clearing systems.

**Central bank facilities** The bank pre-positions assets with the central bank, and consider these unencumbered in the event that the facilities are not used, as the central bank allows withdrawal of assets placed without prior approval.

**Assets in cover pools used for covered bonds issuance** The bank generally considers assets that are underlying covered bonds issuance encumbered.

## OPERATIONAL RISK

### Definition

Operational risk is the risk of unexpected fluctuations in results due to inadequate or deficient internal processes or systems, human error or external events, which means the bank must retain sufficient economic capital to secure itself against large and unexpected operational losses. Operational risk is often associated with specific, isolated events. Several events in the financial industry confirm that losses as a result of operational risk occur regularly, that they must be dealt with as they arise and that they must be continuously monitored.

### Management and reporting

Sparebanken Vest meets the criteria to use the Standardised Approach to calculate the capital requirement for operational risk.

Sparebanken Vest's management of operational risk is described in the operational risk strategy and shall ensure that the bank's operational risk is consistent with the risk level the bank has stipulated for its risk profile and risk strategy. In addition, it shall ensure that requirements in laws and regulations are met. The strategy is approved by the Board and is reviewed annually.

Management and control of operational risk in Sparebanken Vest can be described at three levels:

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

Operational responsibility for management and control of operational risk, and thus also for the quality of the bank's operations, rests with the individual line manager (first line of defence). This responsibility follows from job descriptions and various guidelines and procedures.

On behalf of the CEO, the Risk Management unit attends to matters relating to the overall management of operational risk. The tools used in the

management and control of operational risk include annual risk mapping, registration of events and losses, scenario analyses, risk and control assessments, business continuity management, crisis management risk assessment in connection with the launch of new products and services or new outsourcing agreements, monitoring of key risks, and information security.

In its annual internal control report, the internal audit function, which reports directly and independently to the Board, presents its assessment of the bank's management and control of operational risk. The internal audit function also carries out corresponding assessments for other risk areas.

The bank's management and control of operational risk shall build on the six elements illustrated in the figure below.



The annual risk mapping and associated processes for identifying and assessing risks, and confirmation of control measures aimed at dealing with and reducing risk, have a central place in the bank's overall management and control of operational risk.

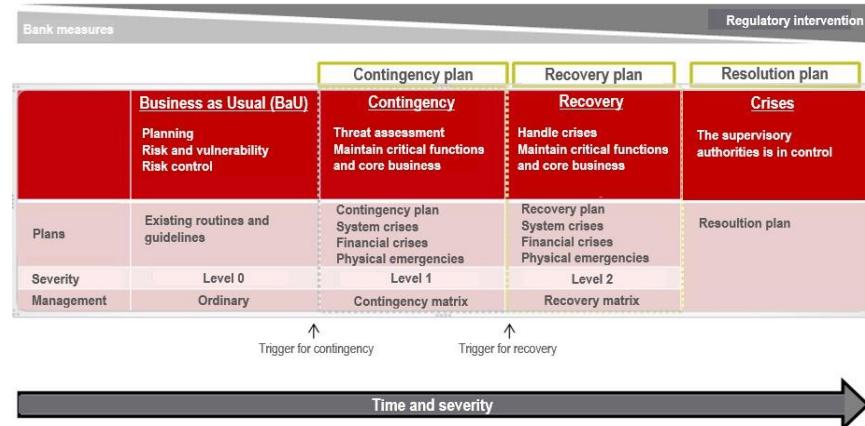
The bank's management participates in risk identification and assessment. All the bank's managers confirm annually that control measures are in place for all material risks and that they are implemented in accordance with instructions, procedures etc. In addition, operational loss events are registered as they arise in the Group's loss database.

The most material risk areas are identified on the basis of risk assessments, confirmation of internal control and registration of events. Necessary measures are implemented and followed up by those with organizational responsibility. There are also action plans that set out measures to be implemented as a result of events reported in the loss database and based on continuous risk assessment. Sparebanken Vest's policy and process for new products and services and changes in existing is an important part of the operational risk framework. The process ensure that all risks is assessed before the product, service, or change is approved.

Material risks in each division are evaluated each quarter and followed up by Risk Management. An analysis of Sparebanken Vest's top risks and how they are assessed and managed is reported to the board on a quarterly basis. Severe incidents and non-conformities addressed in action plans is also included.

## CRISIS MANAGEMENT – CONTINGENCY AND RECOVERY

The bank has prepared a crisis management framework. This framework is based on a severity level categorization, where level 0 is ordinary operations, level 1 is contingency, and level 2 is recovery. The contingency and recovery plans describe trigger points that determine when a situation is redefined from one level to another.



### Overview of the crisis management framework

The framework is thematically organized into system crises, financial crises and physical emergencies. System crises include operational disruption to IT systems and cyberattacks. Financial crises concern capital adequacy and liquidity crises. Physical emergencies are situations where persons or property are at risk. The crisis framework describes different measures to

implement if a crisis should occur, and the expected impact the measure should have in a stressed situation. The trigger points are ongoingly monitored with different frequency depending on the trigger point and are reported to the management body quarterly.

The communication plan covers communication needs for all types of crises and is intended to apply to communication with different stakeholders, including customers, investors and the media. The cash contingency plan describes how the bank will handle an increased need for cash. The plan can be used in the event of system, financial or physical crises. Continuity plans interface with contingency and recovery plans and describe how the different business areas can best carry out their tasks in a crisis.



### The bank's plans for crisis management / capital management