Pillar III – risk and capital 2013

Eika Boligkreditt AS

1 INTRODUCTION

The purpose of this document is to provide the market with information about risk management and capital at Eika Boligkreditt AS. It is intended to fulfil the requirements for publication of financial information pursuant to chapter 45 of the capital requirement regulations.

Eika Boligkreditt (hereafter **EBK**) is the Eika Alliance's covered bond company and is directly owned by 77 local banks and the **OBOS** housing association (known collectively as the owner and/or shareholder banks). The company was demerged from Eika Gruppen AS in 2012, and no longer forms part of the Eika Gruppen group. In connection with the change of ownership, a strengthened mechanism was established to provide support for the company from the owner banks. This comprises commitments by the owner banks to provide the company with liquidity and capital in circumstances where such provision is necessary. In addition, the agreements require ownership of the company to be rebalanced on an annual basis. This is intended to ensure at least one annual adjustment so that the holding of each bank and OBOS corresponds to its share of the company's residential mortgage portfolio.

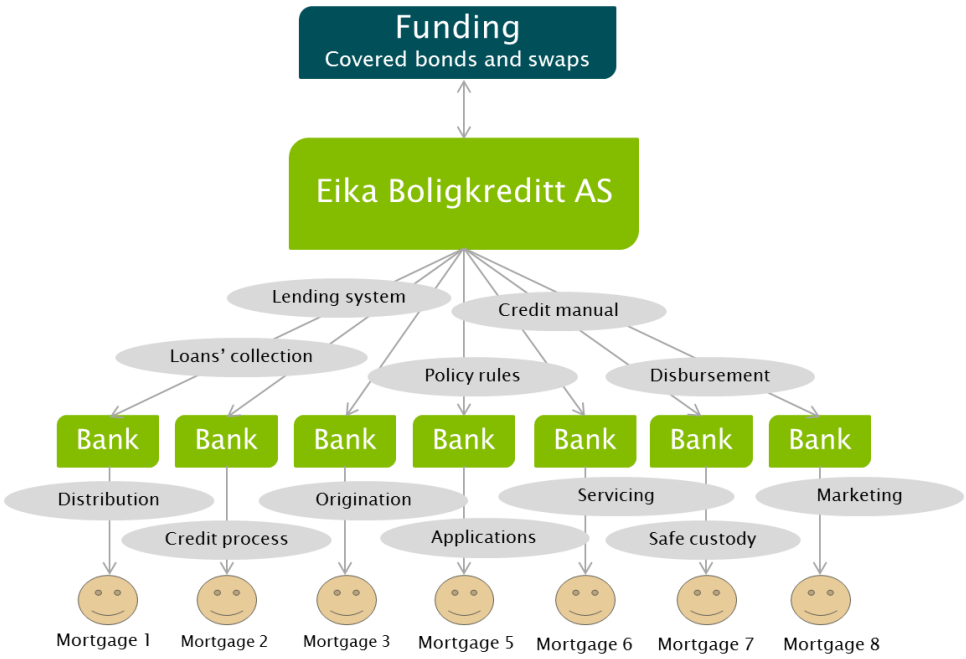
The company changed its name on 21 March 2013 from Terra BoligKreditt AS to Eika Boligkreditt AS. The background for this move was the decision by the Eika Gruppen financial group and bank alliance to change its name from Terra-Gruppen to Eika Gruppen. Since Eika Boligkreditt secures funding exclusively for the owner banks, and is wholly owned by these same local banks and OBOS, it was natural for the company to change to the same brand as the bank alliance.

2 COMPANY STRUCTURE AND OPERATIONS

EBK's main purpose is to secure access for the owner banks in the Eika Alliance to long-term competitive funding by issuing covered bonds in the Norwegian and international financial markets. An important aspect of the company's business concept is to increase the competitiveness of the owner banks and reduce their risk – including refinancing risk.

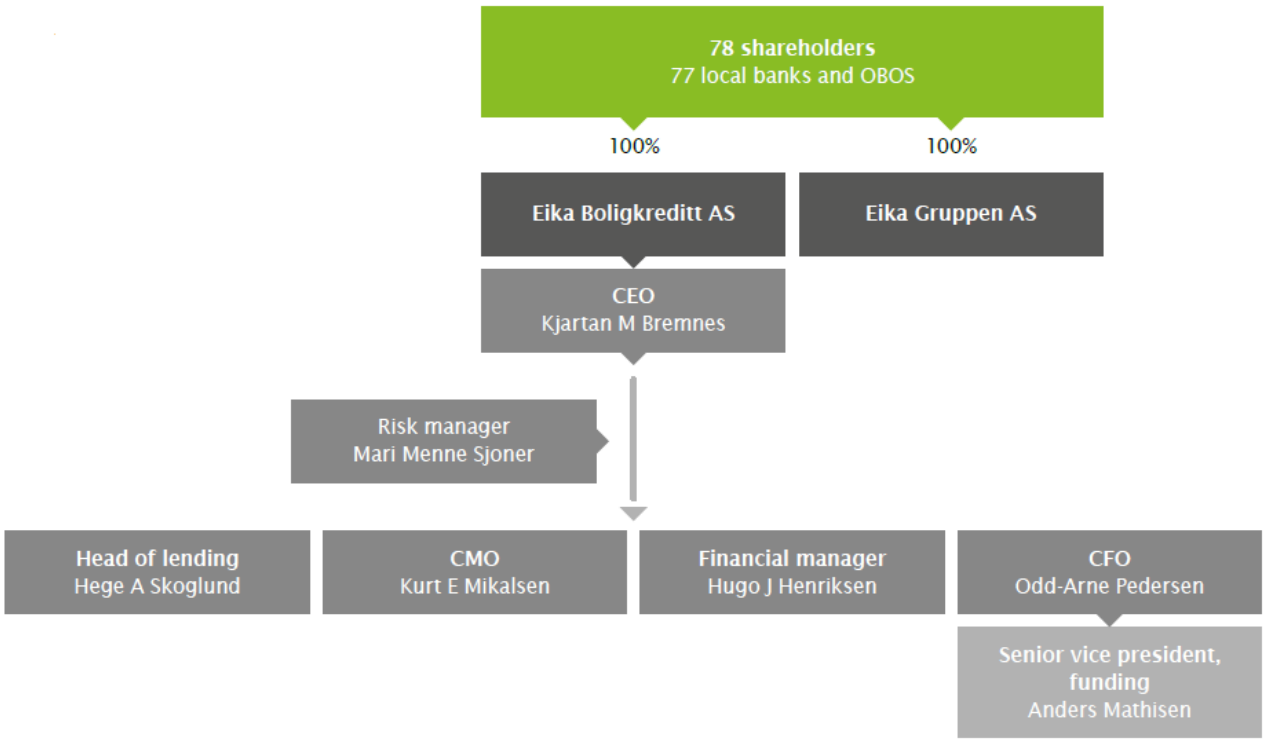
For EBK to be active as an issuer in both Norwegian and international financial markets, its covered bonds must have an international rating. An international rating from Moody's Investors Service (**Moody's**) gives EBK the opportunity to diversify its financing and to obtain funding at the best terms available in the market. The owner banks are prevented from issuing covered bonds directly, but through EBK can nevertheless achieve the advantages of offering residential mortgages financed by covered bonds.

Figure 1 The company's area of operation



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

Figure 2 Company structure



EBK is organised in five departments:

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

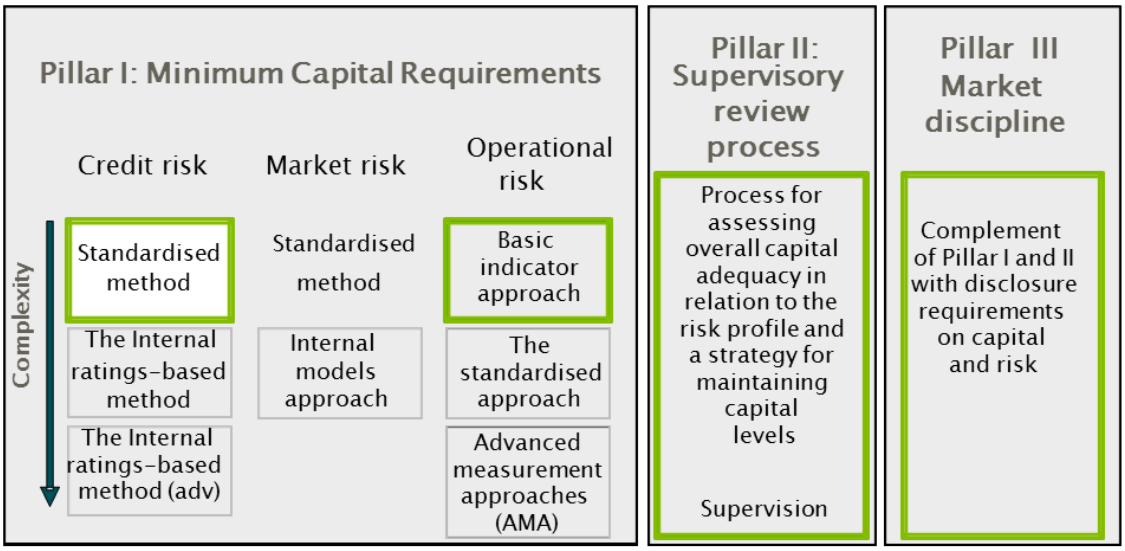
Company staffing at 31 December 2013 was the equivalent of 18.8 work-years. In addition, services are provided by Eika Gruppen in such areas as human resources, payroll, legal affairs, accounting and marketing. EBK's IT platform is also supplied by Eika Gruppen.

3 BASEL II – CAPITAL ADEQUACY STANDARDS

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

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

Figure 3 The Basel II pillars



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

PILLAR I

Pillar I addresses minimum capital adequacy requirements related to credit, market and operational risk.

Amendments to the Act on Financing Activity and Financial Institutions which came into force on 1 July 2013 demand that the company satisfies buffer requirements which exceed its minimum capital requirements. These requirements must be satisfied with core tier 1 capital in Pillar I, and comprise system risk, conservation and counter-cyclical buffers. In addition, an increased requirement has been set for core tier 1 capital in systemically important financial institutions (SIFI).

PILLAR II

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

PILLAR III

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

The capital requirement and targets are assessed on the basis of the international Basel II and Basel III regulations on capital adequacy as specified in the Act on Financing Activity and Financial Institutions and the capital requirement regulations. Pursuant to section 2, sub-section 9(b) of the Act on Financing Activity and

Financial Institutions, a financial institution must at all times have a primary capital (tier 2 capital) which is acceptable in relation to the risk and scope of the institution's business. This must be assessed for both the immediate future and the long term. Capital adequacy must accordingly be higher than the minimum requirement of eight per cent, as specified in detail in the capital requirement regulations. The FSA will evaluate both EBK's capital target and the documentation of the assessments on which the board's conclusions are based.

CONTINGENCY PLAN FOR CAPITAL ADEQUACY

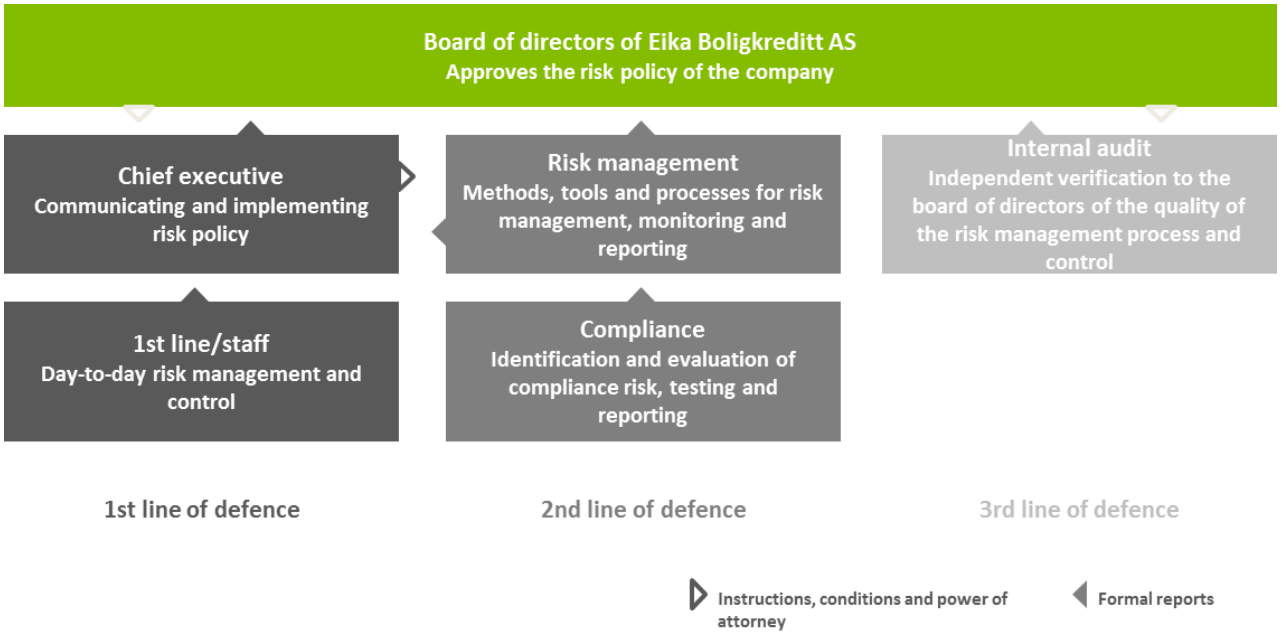
The company has established a contingency plan for capital adequacy which is intended to help ensure that good processes are in place for capital management. EBK is owned by 78 shareholders who are all subject to capital requirements and who all have good solvency. The company's shareholder banks are committed by agreements to participate in issues to strengthen the company's capital in accordance with each shareholder bank's share of EBK's residential mortgage portfolio.

4 OVERALL RISK AND CAPITAL MANAGEMENT

RISK MANAGEMENT IN EBK

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

Figure 4 Governance and control



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

Quarterly risk and compliance reporting is conducted to provide an overview of exposure in relation to established parameters in the company, allowing the executive management and the board to verify that risk exposure falls within the defined willingness to accept risk. This reporting quantifies and assesses all main

risks relevant to the company, including credit, market, operational, financing and liquidity, interest rate, counterparty, compliance and total balance-sheet risk.

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

ICAAP

The business is required pursuant to section 2, sub-section 9 b of the Act on Financing Activity and Financial Institutions to conduct a capital adequacy assessment process (ICAAP). This process involves assessing capital requirements in relation to the company's goals, policies, current and anticipated risk exposures, and applicable risk frameworks and regulatory provisions. The purpose of the ICAAP is to assess capital requirements in the short and long terms in order to ensure that the company has an adequate buffer in relation to regulatory minimum capital requirements.

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

Stress tests are also carried out by the department with what would be a reasonable but stringent downturn scenario where liquidity dries up for the banks – Pillar II risks. These scenarios are intended to reflect a worst-case scenario for EBK.

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

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

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

5 RISK APPETITE AND CAPITAL POLICY

Table 1 The company's risk appetite

Risk type	Risk appetite
Credit risk	Low
Market risk	Moderate
Operational risk	Low
Liquidity risk	Moderate
Interest rate risk on net interest income	Low
Strategic risk	Low
Reputational risk	Low

NEW CAPITAL AND BUFFER REQUIREMENTS

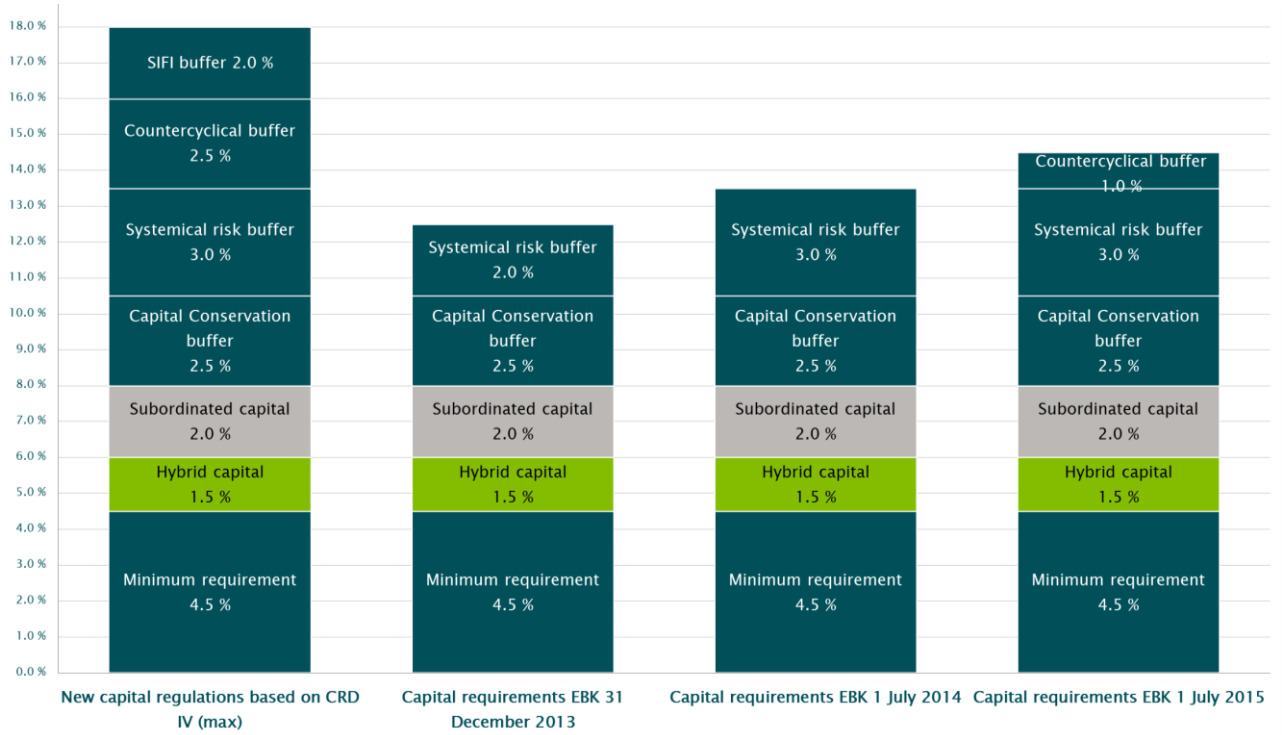
The board of EBK resolved at its meeting of 25 March 2014 to increase the company's internal capital targets from a tier 1 capital ratio of nine per cent and a primary capital (tier 2 capital) ratio of 12.5 per cent. These new targets will apply from 1 July 2014 and are as follows:

- core tier 1 capital ratio: 10 per cent
- tier 1 capital ratio: 11.5 per cent
- tier 2 capital ratio: 13.5 per cent.

The new targets will satisfy revised regulatory requirements from on 1 July 2014, and be adequate in relation to capital requirements based on the company's internal risk assessment. Based on estimated capital requirements, the company judges that capital increases are required. Its target for core tier 1 capital must be fulfilled through equity. The requirement for tier 1 capital can be met through other approved core capital (hybrid capital), which in practice means tier 1 perpetual bonds. Tier 2 capital requirements can be covered by subordinated loans. The company has raised both subordinated loans and tier 1 perpetual bonds in the market, and will also continue to seek to meet its capital requirements in excess of core tier 1 capital by issuing capital instruments in the market.

New buffer requirements which exceed the company's minimum requirements must be met with core tier 1 capital in Pillar I, and comprise system risk, capital conservation and countercyclical buffers. In addition, an increased requirement has been set for core tier 1 capital in systemically important financial institutions (SIFI).

Figure 5 New minimum and buffer requirements for capital in financial institutions



A common denominator for the new buffer requirements is the restrictions imposed on opportunities to make dividend and bonus payments in circumstances where the company fails to satisfy the requirements. In line with the new regulatory minimum and buffer capital requirements, the company increased its capital targets in the spring of 2013. At 31 December 2013, the company required a core tier 1 capital ratio of nine per cent, a tier 1 capital ratio of 10.5 per cent and a tier 2 capital ratio of 12.5 per cent. With effect from 1 July 2014, these targets are being raised by a further percentage point because of the increase in the system risk buffer. Furthermore, the company must also satisfy a possible requirement for a countercyclical buffer,

set at one per cent with effect from 1 July 2015. In its capital planning, company operates with a buffer of 0.5 percentage points on its capital targets. The company implemented a plan for boosting capitalisation in the spring of 2013, when requirements for increased capital were announced with effect from 1 July 2013. However, it is important for the owner banks that EBK continues to save capital, since it is the assets with the best quality and lowest risk which are transferred from the banks to the covered bond institution. Should the need for capital change, the shareholder agreement provides considerable predictability over the provision of capital from the owner banks. Forthcoming increases in capital buffers have been taken into account in the company's calculation of its capital requirements in this year's ICAAP.

6 CAPITAL

The company applies the standardised method for calculating capital requirements for credit and market risk and the basic indicator method for calculating operational risk. The guidelines for calculating capital requirements for market risk have been changed, so that the company calculated capital requirements for liquidity investments in 2013 on the basis of the standardised method for credit risk.

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

- capitalised assets and other credit risk are basically weighted at 100 per cent unless special rules have been specified
- residential mortgages with a loan to value of at least 80 per cent are assigned a 35 per cent risk weight
- residential mortgage approvals based on security of up to 60 per cent of the mortgaged property are assigned a 35 per cent risk weight, but a 20 per cent credit conversion factor is applied since these represent an unutilised credit facility with an original tenor of 30 days
- enterprises with an approved rating are assigned a 50 per cent risk weight
- claims on banks and financial institutions are assigned a 20 per cent risk weight
- covered bonds are assigned a 10 per cent risk weight

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

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

Table 2 Capital adequacy status at 31 December 2013

Amounts in NOK 1 000	31 December 2013
Share capital	592,082
Share premium reserve	1,368,300
Other paid-in equity	477,728
Other equity	997
Total equity capital	**2,439,107**
Intangible assets	-5,177
Deferred tax assets	-35,045
Total common equity tier 1 capital requirement	**2,398,885**
Hybrid capital	248,683
Total core tier 1 capital	**2,647,568**
Subordinated loan capital	429,314
Total primary capital (tier 2 capital)	**3,076,882**
Risk-weighted assets and capital adequacy ratio	
Credit risk	21,194,875
Operational risk	249,813
Total risk weighted assets	**21,444,688**
Capital requirement corresponding to 8% of risk-weighted assets	1,715,575
Surplus equity and subordinated capital	1,361,307
Common equity tier 1 capital adequacy ratio	**11.19 %**
Tier 2 capital adequacy ratio	**12.35 %**
Core tier 1 capital adequacy ratio	**14.35 %**

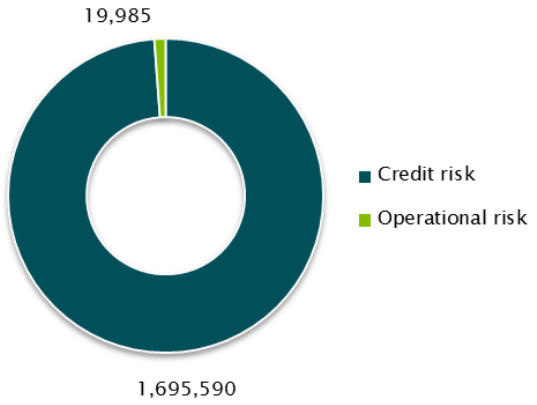
The company's capital adequacy status at 31 December 2013 comprised a core tier 1 capital adequacy of 11.19 per cent, a tier 1 capital ratio of 12.35 per cent and a tier 2 capital ratio of 14.35 per cent. During 2014, the company will probably redeem a subordinated load at regulatory call. If unredeemed, this loan's contribution to tier 2 capital would be reduced by NOK 36 million at 1 October 2014 and a further NOK 18 million at 1 January 2015. EBK issued a NOK 200 million tier 1 perpetual bond during the first quarter of 2014, and its issue plan for 2014 includes a new subordinated loan.

SUMMARY OF MINIMUM CAPITAL REQUIREMENT

Table 3 Capital adequacy allocated to risk type

Amounts in NOK 1 000	31 December 2013
Core tier 1 capital ratio	11.19 %
Tier 1 capital ratio	12.35 %
Capital ratio	14.35 %
Credit risk	1,695,590
Operational risk	19,985
Total Pillar 1	**1,715,576**

Figure 6 Capital requirement on Pillar I (amounts in NOK 1 000)



7 CREDIT RISK

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

RISK APPETITE AND EXPOSURE

Credit risk is the company's most significant risk and accounted for 99 per cent of its capital requirement under Pillar I at 31 December 2013. The company has never experienced defaults exceeding 90 days or losses related to its mortgage business.[1]

The credit risk related to lending must be low. In its credit policy and lending activity, EBK will take account of the applicable regulations which govern credit institutions issuing covered bonds at any given time. See section 2, sub-section 25 and subsequent sub-sections of the Act on Financing Activity and Financial Institutions. Credit risk is strictly limited through the company's business purpose, policies, credit guarantees of the owner banks and the company's credit policy. The company's credit policy for lending is intended to minimise the risk of defaults and to keep credit risk below the level in comparable companies. This will ensure that the company's bonds are a preferred choice for investors.

The company's credit risk consists mainly of residential mortgages secured on the property plus a counterparty risk in bank deposits and derivatives. The counterparty risk is limited by frameworks and requirements concerning the issuers who are the company's counterparties. EBK is also exposed to credit risk in its management of investments in securities other than those issued by the Norwegian government. This credit risk is limited through defined investment frameworks. Capital requirements related to this risk are calculated under market risk.

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

GENERAL CONSIDERATIONS RELATED TO CREDIT RISK IN EBK

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

[1] A mortgage is defined as being in default when payments are delayed by more than 90 days, and the delay is not the result of random circumstances affecting the borrower. Doubtful loans are not necessarily in default, but the customer's financial position and the value of the collateral indicate a risk of loss.

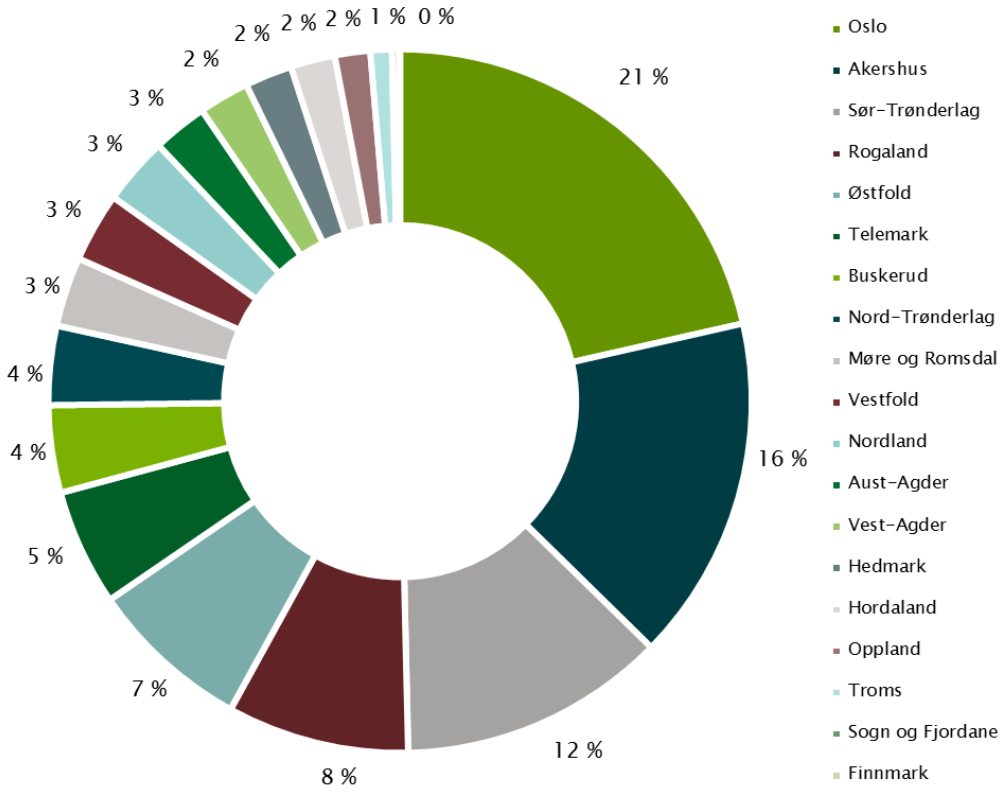
Table 4 Credit risk: specification of risk-weighted volume and capital requirement

Credit risk (amounts in NOK 1 000)	Section	CCF	Balance sheet	Off-balance sheet items	Risk Weight	Calculation basis	Capital requirement
Sovereigns	§ 5-1		298,095		0 %	-	-
Regional or local government	§ 5-2		1,655,876		20 %	331,175	26,494
Banks and institutions (deposits in other banks)	§ 5-6		3,453,018		20 %	690,604	55,248
Credit guarantees from the shareholders	§ 5-6			6,672,562	20 %	1,334,512	106,761
OTC derivatives (standardised method)	§ 5-7 og § 23			2,154,782	20 %	430,956	34,477
Claims on corporates (rated)	§ 5-7		25,101		50 %	12,551	1,004
Claims on corporates (unrated)	§ 5-7		15,000		100 %	15,000	1,200
Secured on real estate property	§ 5-9		57,772,985	-6,672,562	35 %	17,885,148	1,430,812
Loan commitments to customers (duration 30 days)	§ 5-9 og § 6-1 (9)	0.2		689,444	7 %	48,261	3,861
Partially disbursed loans	§ 5-9 og § 6-1 (8)	0.5		626,818	18 %	109,693	8,775
Covered bonds	§ 5-13		3,350,349		10 %	335,035	26,803
Other assets	§ 5-15		1,941		100 %	1,941	155
Total credit risk			**66,572,365**	**3,471,044**		**21,194,876**	**1,695,590**

Table 5 Credit risk by commitment category

Claims (amounts in NOK 1 000)	Capital requirement
Claims on regional or local government	26,494
Claims on institutions	196,486
Claims on corporates	2,204
Claims or contingent claims secured on real property	1,443,448
Covered bonds	26,803
Other items	155
Total capital requirement credit risk	**1,695,590**

Figure 7 Residential mortgages by Norwegian county as % of total mortgage volume at 31 Dec 13



The geographic concentration of residential mortgages by Norwegian county as a percentage of total mortgage volume is presented in figure 7. Having the local shareholder bank as the distributor channel,

means that customers have a good geographic spread. The company's customers are primarily private individuals, each of whom accounts for a relatively small proportion of the company's total portfolio.

Table 6 Residential mortgages by commitment type and residual time to maturity (amounts in NOK 1 000)

Expected maturity of loans	31 Dec 2013	0-1 mo	1-3 mo	3-6 mo	6-12 mo	1-3 years	3-5 years	5-10 years	>10 years
Lending to residential housing	48,558,388	3	202	504	4,341	64,669	297,841	2,072,234	46,118,594
Lending to residential cooperatives	9,103,576	-	-	-	1,838	48,004	36,585	247,604	8,769,545
Liquidity sovereigns	298,095	-	-	298,095	-	-	-	-	-
Liquidity regional or local government	1,702,875	49,999	1,327,441	250,207	-	75,228	-	-	-
Liqudity covered bonds	3,340,580	-	187,057	-	200,587	2,490,940	461,995	-	-
Lending to banks	3,401,306	3,401,306	-	-	-	-	-	-	-
Lending to corporates	25,077	-	-	-	25,077	-	-	-	-
Total lending	66,429,898	3,451,308	1,514,701	548,806	231,844	2,678,842	796,422	2,319,838	54,888,139

Table 6 shows that EBK has a good spread of maturities on its mortgages and other lending, which helps to reduce the company's credit risk.

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

CREDIT RISK – THE STANDARDISED METHOD

As an issuer of covered bonds, EBK must ensure that all loans and advances in its cover pool comply with credit quality step 1 or 2. When assessing ratings, only those from Standard & Poor's, Moody's and Fitch are utilised. Where a counterparty has been rated by all three agencies, the median is used to assess the credit quality step. The mean value is applied when it has been rated by two accredited agencies, and a rating from just one is used directly.

- States and central banks: long-term ratings by an accredited agency are used to assign the credit quality step.
- Local and regional government: the national long-term rating is applied.
- Institutions: the relevant long-term government rating is applied to determine the credit quality step for banks and for credit and financial institutions, which thereby acquire a credit quality step higher (poorer) than the government.
- Enterprises: long-term ratings from an accredited agency are used to assign the credit quality step, with a 100 per cent weighting applied to relevant claims if no approved rating exists.

GUARANTEES

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

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

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

- *Loss guarantee,* covering the portion of the principal upon payment which exceeds 50 per cent of the reasonable value of the mortgaged property or properties (determined upon payment). The minimum loss guarantee liability of the distributor will be NOK 25 000 per mortgage, irrespective of the mortgaged amount and the value of the collateral. The guarantee will remain in force for a period of six years from the date on which the collateral has been perfected (legally registered) or on which payment is requested, if later. The loss guarantee comes into effect when the case guarantee expires.
- *Proportion of a framework guarantee*, covering a total of one per cent of the mortgage portfolio transferred by the distributors at any given time. The distributor share in the framework guarantee will be calculated on the basis of the distributor actual share of the mortgage portfolio transferred by the distributors at any given time. The framework guarantee can be used if losses incurred in excess of the above-mentioned guarantees, or if the shareholder banks default on their guarantee commitments.

The total guarantee liability for the distributors is the total of all three guarantees mentioned above. This part of the residential mortgage portfolio is assigned a 20 per cent risk weighting.

In addition to the above-mentioned guarantees, EBK has the right to offset commission payments to the shareholder banks for up to 12 quarters. This offsetting can be used to cover losses which exceed the above-mentioned guarantees, and will apply to commission payments to the bank transferring the mortgage which may have gone into default.

An overview was established at 31 December 2013 of the outstanding residential mortgage portfolio compared with the valuation of the mortgage collateral at origination. This shows that the company has mortgages within the following collateral bands.

Table 7 Distribution of unindexed LTV

Loan to value (LTV)	Unindexed values			
	Residential	Residential cooperatives	Total	Share of total
0 <= 40	7,516,120	8,332,519	15,848,639	27 %
40 < x <= 50	7,431,129	429,682	7,860,811	14 %
50 < x <= 60	33,611,140	341,375	33,952,515	59 %
Total	**48,558,388**	**9,103,576**	**57,661,964**	**100 %**
Average LTV	51.3 %	18.5 %	46.1 %	

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

CONTINUOUS VALUATION OF COLLATERAL

The portfolio is indexed on a quarterly basis against market values estimated by Eiendomsverdi. The valuations undertaken by Eiendomsverdi are based on indexing against Norway's public property register (formerly the GAB register). Eiendomsverdi indexes against objects sold over time in the immediate vicinity and makes adjustments for price developments and the valuations registered by EBK on the mortgaged property at origination. However, Eiendomsverdi utilises reduction factors in the event of low turnover of properties, etc. The model therefore functions best in areas with a high turnover. Were house prices to fall, the company would have a good margin before possible repossessions might lead to loss. The table below presents indexed market values which show that the company has mortgages within the following collateral bands.

Table 8 Distribution of indexed LTV

Loan to value (LTV)	Indexed values			
	Residential	Residential cooperatives	Total	Share of total
0 <= 40	10,636,792	8,474,958	19,111,750	0
40 < x <= 50	10,799,256	399,474	11,198,731	19 %
50 < x <= 60	20,554,818	184,135	20,738,954	36 %
60 < x <= 70	6,481,107	45,009	6,526,115	11 %
70 < x <= 75	86,414	-	86,414	0 %
75 < x	-	-		
Total	**48,558,388**	**9,103,576**	**57,661,964**	**100 %**
Average LTV	48.6 %	16.2 %	43.5 %	

The weighted average indexed LTV at 31 December 2013 was 43.5 per cent, compared with a non-indexed LTV of 46.1 per cent. Indexing of residential cooperatives shows a weighted average LTV of 16.2 per cent, compared with a non-indexed weighted average LTV of 18.5 per cent. This indicates that house prices have risen across the board since the mortgages were granted.

Some mortgages are indexed with a higher LTV than at origination. The table above shows that no loans exceed the limit of 75 per cent of the property's value, which is the maximum permitted LTV pursuant to section 2, sub-section 28 of the Act on Financing Activity and Financial Institutions. Indexing is performed quarterly and, where mortgages and advances exceed the limit of 75 per cent of LTV, valuation documentation is obtained to establish that EBK has satisfactory collateral. If satisfactory valuation documentation cannot be obtained for the mortgaged collateral, the bank will have to reduce the mortgage or possibly transfer the mortgage back to its own balance sheet.

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

Based on the most recently available analysis of EBK's cover pool, Moody's specified a collateral score of two per cent at 30 September 2013, which is the best figure for European issuers of covered bonds rated by the agency. The table presents EBK's covered bonds as the Eika BoligKreditt Mortgage Covered Bond Programme.

Table 9 Collateral score in Moody's global CB performance overview at 30 September 2013

EXHIBIT 17

Deals with Lowest (Best) Collateral Scores[10]

Name of Programme	Type of Programme	Country	Collateral Score
Eika Boligkreditt AS Mortgage Covered Bond Programme	Mortgage	Norway	2.0%
OP Mortgage Bank II	Mortgage	Finland	2.3%
HSBC Covered Bond Programme	Mortgage	United Kingdom	2.4%
OP Mortgage Bank Mortgage Covered Bonds	Mortgage	Finland	2.6%
SpareBank 1 Boligkreditt AS Mortgage Covered Bonds	Mortgage	Norway	2.7%
Deutsche Postbank AG Mortgage Covered Bonds	Mortgage	Germany	2.8%
Landesbank Baden-Wuerttemberg - Public Sector Covered Bonds	Public Sector	Germany	2.9%
Storebrand Boligkreditt Mortgage Covered Bonds	Mortgage	Norway	3.0%
ING-DiBa - Mortgage Pfandbriefe - Covered Bond Programme	Mortgage	Germany	3.0%
Aktia Real Estate Mortgage Bank PLC - Euro Medium Term Covered Note Programme	Mortgage	Finland	3.1%

COUNTERPARTY RISK IN DERIVATIVES

The company enters into derivative contracts to hedge interest rate and currency risks for funding, and to reduce interest rate risk on mortgages with fixed interest rates. At 1 September 2013, EBK changed its method for calculating exposure to derivatives from the current exposure method to the standardised method. The latter takes greater account of the established contracts held by the company with derivative counterparties, and has led to more robust operating parameters for stability in the exposure calculations. At 31 December 2013, the company had the following counterparty exposure to derivatives by rating category.

Table 10 Counterparty exposure in derivatives calculated by the standardised method (amounts in NOK 1 000)

31 December 2013			Standardised method			
Rating	Potential future exposure	Net MTM	Collateral	Net MTN minus collateral	Exposure at default	Capital requirement
AA	598,822	1,680,555	943,707	736,848	1,151,000	18,416
A	636,719	1,874,218	1,275,760	598,457	1,003,782	16,061
Total	**1,235,541**	**3,554,773**	**2,219,467**	**1,335,305**	**2,154,782**	**34,477**

Credit support annex (CSA) agreements have been signed with all the company's derivatives counterparties. The company's contracts with derivative counterparties specify that the company has the unilateral right to collateral for the market values of derivatives which exceed the predetermined rating limits. Under existing contracts, market values are normally calculated weekly. During the fourth quarter of 2013, EBK established daily valuation and cash posting with some counterparties, which helps to reduce the company's credit risk even further. Since the CSA agreements are unilateral, EBK will avoid finding itself in a position where it needs to post collateral in the event of a possible downgraded rating.

MANAGEMENT AND CONTROL

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

The company has established policies for credit risk on mortgages, counterparty risk and capital management, which form the basis for management and control of credit and counterparty risk. The status of

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

CAPITAL REQUIREMENTS

EBK applies the standardised method to calculate the capital requirement for credit risk. This was calculated to be NOK 1 696 million at 31 December 2013. The company's capital targets are considered to be adequate for possible credit risk not taken into account in the Pillar I calculation of capital requirements.

8 MARKET RISK

Market risk is the risk of loss on the market value of portfolios of financial instruments as a consequence of fluctuations in interest rates, credit spreads and exchange rates.

RISK APPETITE AND EXPOSURE

The company's business purpose is to obtain favourable funding by issuing covered bonds. This means that its excess liquidity must satisfy legal and regulatory requirements concerning what may be included in the cover pool. The objective of the company's investment of surplus liquidity is to have liquidity available at all times to secure the financing of growth and maturation, and to secure the highest possible return within specified risk parameters. Surplus liquidity is held in bank deposits or fixed-income securities in NOK. The company's surplus liquidity will be invested at low to moderate risk. Risk will normally comprise interest rate and credit spread risk.

The company has established parameters for the liquidity portfolio.

- Interest rate risk: the average duration of all surplus liquidity investments will be less than six months. The duration of the individual security must be less than one year when derivatives are taken into account. For repurchase agreements, the duration of the underlying security must be less than three years.

- Credit/spread risk: the average tenor for all surplus liquidity investment must be less than two years. The tenor of an individual security must be less than 3.5 years. The tenor for repurchase agreements must be less than 100 days.

The company's total risk parameter for credit spread and interest rate risk will be five per cent of its total tier 2 capital, with an expected composition of three per cent interest rate risk and two per cent credit spread risk. The maximum permitted value change is calculated as the consequence of a one percentage point parallel change in interest rates and an increase of 0.5 percentage points in credit spreads with the issuer. The company calculates capital requirements related to market risk pursuant to part II of the capital requirement regulations, standardised method for credit risk. The company had no exchange rate risk at 31 December 2013.

Table 11 Liquidity portfolio by rating (amounts in NOK 1 000)

Rating	Market value
AAA	5,304,320
AA+	-
AA	-
AA-	75,467
Total	**5,379,787**

EBK's liquidity portfolio is carried at about NOK 5.4 billion and constituted 7.7 per cent of the company's total assets at 31 December 2013. It consists exclusively of fixed-income securities in NOK. The portfolio is invested primarily in covered bonds and municipal bills, and also in some senior notes with a short residual time to maturity and a good credit rating. The portfolio varies in size in line with the company's liquidity requirements over the coming year. The company calculated the position risk for debt instruments at 31 December 2013, based on the standardised method for credit risk (Pillar I).

Table 12 Calculation basis and capital requirement for market risk (amounts in NOK 1 000)

Market Risk	Amount	Weight	Calculation basis	Capital requirement
Sovereigns	298,095	0 %	-	-
Covered bonds	3,350,349	10 %	335,035	26,803
Regional or local government	1,655,876	20 %	331,175	26,494
Senior unsecured	50,366	20 %	10,073	806
Claims on corporates	25,101	50 %	12,550	1,004
Total	5,379,787		688,834	**55,107**

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

MANAGEMENT AND CONTROL

The company has established policies for asset liability and investment management, which form the basis for management and control of market risk. The company's risk management and compliance function continuously assesses exposure in relation to approved risk acceptance and frameworks. It prepares quarterly risk and compliance reports for the board, which quantify and assess market risk exposure in relation to risk appetite. The board-approved framework as a percentage of tier 2 capital is meant to cover the interest rate risk of a one percentage point parallel change in the interest rate curve and a 0.5 percentage point increase in credit spread with the issuer. Market risk in the liquidity portfolio is managed on a daily basis by the funding department.

CAPITAL REQUIREMENTS

EBK applies the standardised method for credit risk to calculate market risk. The capital requirement was calculated to be about NOK 55 million at 31 December 2013, and is included in the total capital requirement for credit risk.

9 OPERATIONAL RISK

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

RISK APPETITE AND EXPOSURE

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

Table 13 Calculation basis and capital requirement for operational risk (amounts in NOK 1 000)

Operational risk	2011	2012	2013
Net income	69,544	138,147	192,018
Average income			133,236
Basis of calculation			249,813
Capital requirement			**19,985**

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

MANAGEMENT AND CONTROL

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

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

Overall risk management and control are described in chapter 4 above.

CAPITAL REQUIREMENTS

EBK applies the basic indicator method to calculate the capital requirement for operational risk. The capital requirement was calculated to be about NOK 20 million at 31 December 2013.

10 FINANCING AND LIQUIDITY RISK

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

RISK APPETITE AND EXPOSURE

EBK finances lending primarily through the issue of covered bonds. Through its opportunity to make such issues, the company achieves lower borrowing costs than its owner banks. The company will also raise ordinary senior unsecured bonds and certificate loans, primarily involving the issue of certificate loans to cover overcollateralisation related to the Euro Medium Term Covered Note (EMTCN) programme.

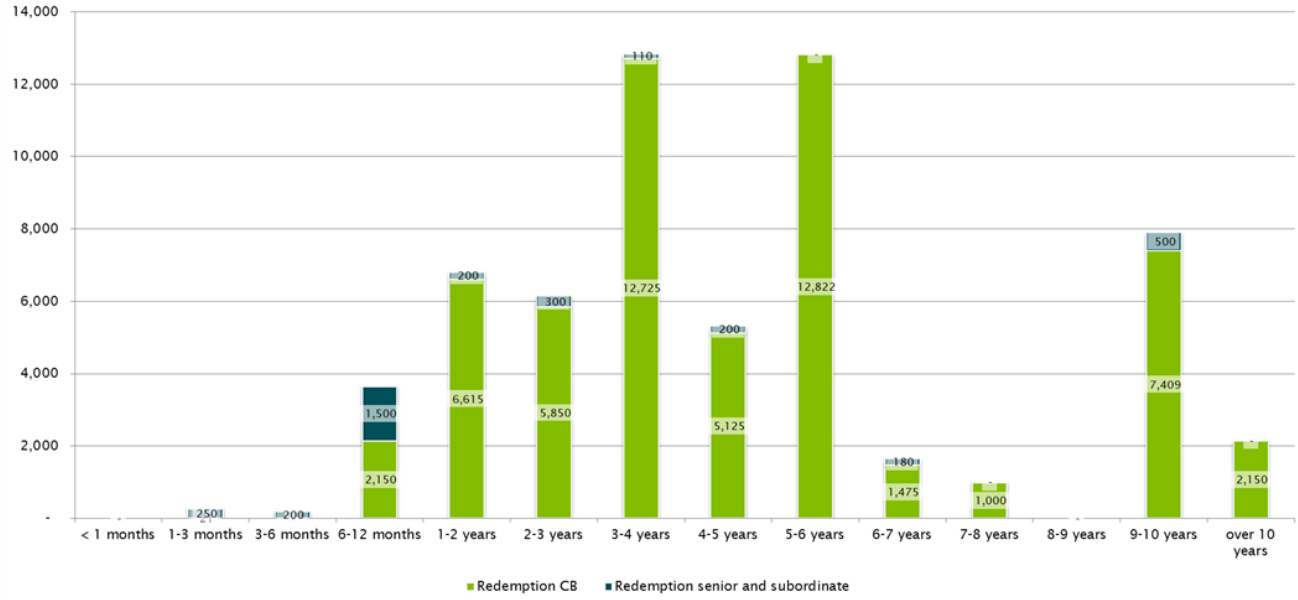
EBK has entered into an international borrowing programme for its bonds. This EMTCN programme was signed and listed on the London Stock Exchange on 10 August 2007, and is revised annually.

The company has established parameters for financing and liquidity risk to keep financing and liquidity risk satisfactorily low, and to comply with section 2, sub-section 32 of the Act on Financing Activity and Financial

Institutions, the regulations for credit institutions issuing covered bonds and the regulations on sound liquidity management.

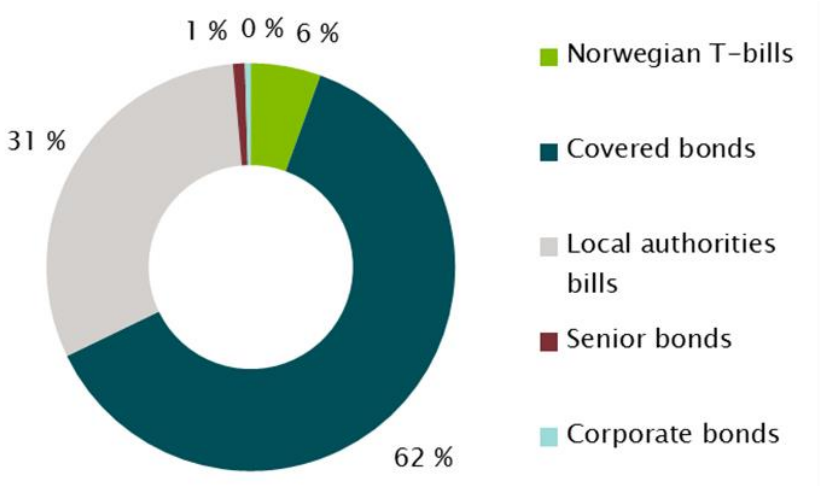
During 2013, EBK issued NOK 21.6 billion in bonds and certificates, and has a very good liquidity position. It had a liquidity buffer of NOK 6.4 billion at 31 December 2013. The company complied with all parameters for risk exposure in 2013, and paid special attention to continued work on increasing the average tenor for its own covered bond issues.

Figure 8 Redemption profile at 31 December 2013 (amounts in NOK million)



Investor interest in subscribing to the company's covered bonds was again very high in 2013, and the company has also achieved good terms for its borrowing. During 2013, EBK used the Norwegian market for financing covered bonds. The average tenor for new financing in 2013 was 7.5 years.

Figure 9 Composition of the liquidity buffer



MANAGEMENT AND CONTROL

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

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

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

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

Overall risk management and control are described in more detail in chapter 4 above.

CAPITAL REQUIREMENTS

Liquidity risk is not included in the capital requirements defined under Pillar I. The assessment of capital requirements for liquidity risk is included in the assessment of the Pillar II buffer, and the company's capital targets are considered adequate to cover risks over and above the minimum regulatory requirements.

11 INTEREST RATE RISK RELATED TO NET INTEREST INCOME

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

RISK APPETITE AND EXPOSURE

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

EBK permitted new origination of fixed rate mortgages to the cover pool until 1 January 2012. Since then, the fixed interest portfolio has been diminishing because no new mortgages of this type have been permitted

originated into the cover pool. During the second quarter of 2013, however, the company reintroduced fixed interest mortgages as approved additions to the cover pool under new agreements with the banks. EBK establishes the interest rate for fixed interest mortgages, while the owner banks specify customer terms and interest rates based on borrowing costs and risk assessment for the advance.

Active use will be made of derivatives to reduce interest rate risk. Such risk related to net interest income must be kept at a moderate level. Interest rate swaps, in which EBK receives a fixed interest rate and pays a floating interest rate, are entered into to convert issues of bonds and certificates from fixed to floating interest rate exposure. Financing at a floating interest rate would reduce the risk for the company, since most lending is done at a floating interest rate. Interest rate swaps where EBK receives a floating interest rate and pays a fixed interest rate are entered into to hedge the interest rate margin of lending at a fixed interest rate. EBK uses hedge accounting pursuant to the IFRS on borrowing at fixed interest rates, and an interest swap must be assessed as very effective when entered into.

The company measures interest rate risk in the balance sheet quarterly, based on the duration of the various claims and commitments. Duration means the number of years until the next interest rate adjustment.

Table 14 Interest rate sensitivity in the balance sheet (amounts in NOK 1 000)

Interest rate sensitivity	Duration	Amounts	Effect
Funding	0.14	61,282,063	83,050
Lending with floating rate	-0.12	56,291,428	(67,550)
Lending with fixed rate*	-2.44	1,370,536	(33,447)
Derivatives lending	2.02	1,487,552	30,106
Liquidity sovereigns	-0.46	298,095	(1,380)
Liquidity covered bonds	-0.16	3,340,580	(5,272)
Liqudity regional or local government	-0.21	1,727,952	(3,556)
Liquidity bank deposits	-0.01	3,401,306	(233)
Total incl liquidity portfolio			**1,719**
Total excl liquidity portfolio			**12,160**

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

MANAGEMENT AND CONTROL

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

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

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

CAPITAL REQUIREMENTS

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

12 STRATEGIC AND BUSINESS RISK

Business risk is the risk that covariation between income and expenses will be absent over time. Strategic risk is defined as the risk of weakened profitability owing to changes in competitive terms, operating parameters, external factors and so forth. Reputational risk is also addressed under business risk, and consists of the risk of loss owing to reputational damage from negative publicity.

RISK APPETITE AND EXPOSURE

EBK has established a good business strategy and comprehensive risk policies for managing strategic risk. Goals have been set in the business strategy, and other policies have overarching frameworks related to risk appetite. The company's strategy is to meet a significant share of the funding requirements of the owner banks and reduce their refinancing risk by issuing covered bonds in the Norwegian and international markets.

The company is exposed to reputational risk related to Eika as a brand. Adverse developments related to the Eika Alliance, Eika Gruppen As and/or companies in the Eika Gruppen group may have detrimental effects on EBK's reputation, particularly in the funding market. The risk of damage to the Eika brand's reputation with customers for residential mortgages is smaller, since the customer's relationship is with their local bank rather than with EBK.

In addition, EBK is exposed to reputational risk related to the reputation of Norwegian issuers of covered bonds. International investors often treat all Norwegian issuers of covered bonds as a single category. Statements by the Norwegian authorities which might indicate, for example, a lack of government support could adversely affect the reputation of other Norwegian issuers. Reputational risk could have significant consequences for the company as a funding instrument – by damaging its credit rating, for example. Such risk is accordingly closely related to EBK's financing and liquidity risk.

Regulatory risk also forms part of business risk. The company has a regulatory risk related to changes in government regulations. Issuing covered bonds is regarded by the government as an important element in bank financing, and substantial official resources have been devoted to ensuring that the regulations are appropriate for this business. EBK has assessed the effects of proposed changes to capital and liquidity requirements, and does not see any significant costs related to their introduction, other than the increase in capital which must be contributed by the owner banks or obtained from the market because the capital targets have been raised. Compliance with the proposed liquidity requirements could also be expensive, particularly because it will be necessary to maintain large holdings of government securities to meet them. Given the current market, investing in government securities is expensive compared with other types of interest-bearing securities. Reducing risk accordingly means a considerably higher negative carry of excess liquidity, particularly in order to comply with the proposed LCR requirement.

MANAGEMENT AND CONTROL

Good strategy processes are important for ensuring management and control of business and strategic risk. EBK has an annual cycle in which revision of business and risk policies plays a fixed role. Changes made to the company's support structure, whereby the shareholders have undertaken to provide liquidity and capital support when required in a crisis, form part of the management and control of business risk.

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

CAPITAL REQUIREMENTS

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