Pillar III – risk and capital 2012

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 (EBK) is the Eika Alliance's covered bond company and is directly owned by 79 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.

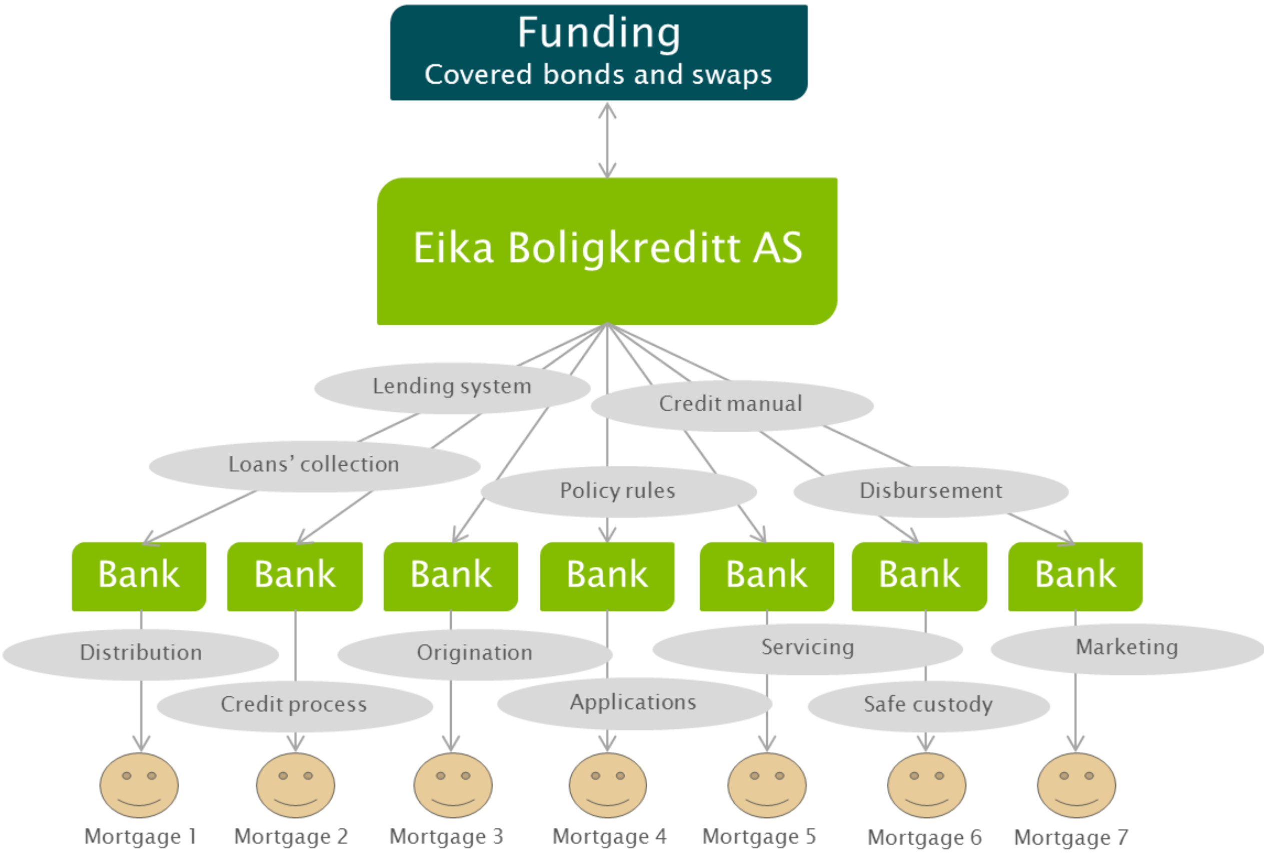
The company changed its name on 21 March 2013 from Terra BoligKreditt AS to Eika Boligkreditt AS. The background for this move was the decision by the Eika Gruppen financial group and bank alliance to change its name from Terra-Gruppen to Eika Gruppen. Since Eika Boligkreditt secures funding exclusively 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.

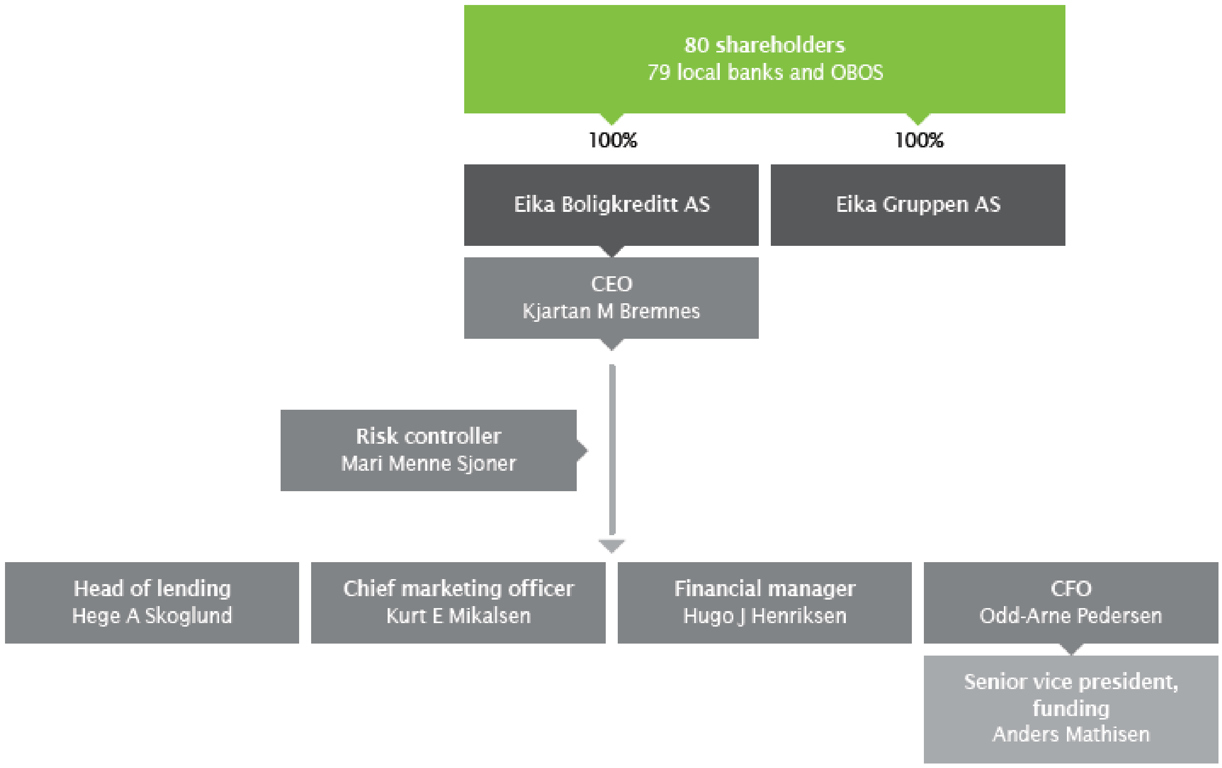
For EBK to be active as an issuer in both Norwegian and international financial markets, its covered bonds must have an international rating. An international rating from Moody's Investors Service (Moody's) gives EBK the opportunity to diversify its financing and to obtain funding at the best terms available 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 Operational structure



The owner banks 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.

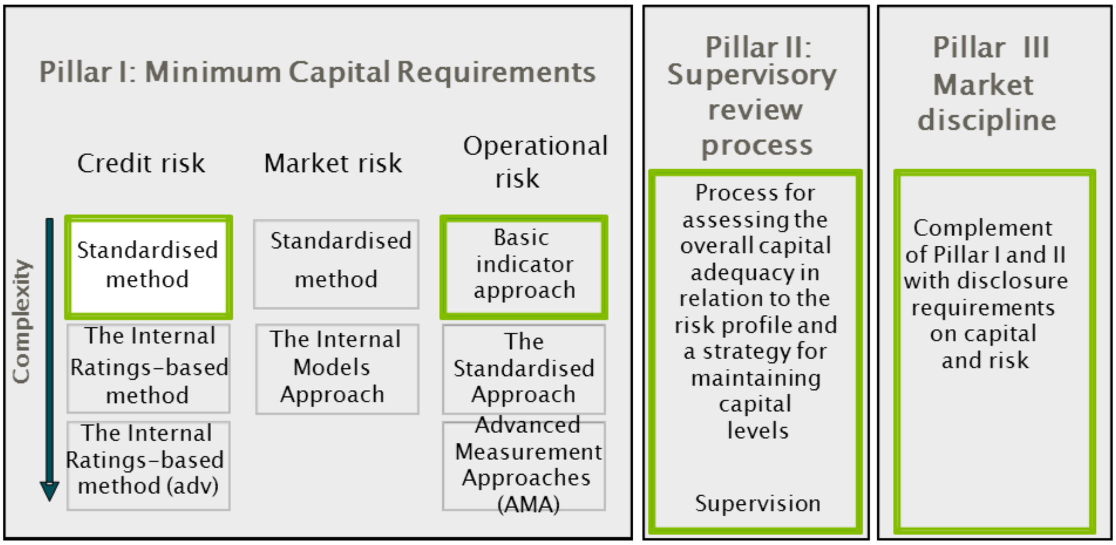
The company's staffing at 31 December 2012 was the equivalent of 15.8 work-years. In addition, services are provided by Eika Gruppen in such areas as human resources, accounting and marketing. EBK's IT platform is also supplied by Eika Gruppen.

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



EBK does not use its own rating-based models to calculate minimum capital requirements, but applies the standardised method for calculating credit and market risk and the basic indicator method for operational risk. In 2013, the company has changed its method for calculating capital requirements for the liquidity portfolio to the standardised method under credit risk. But the standardised method for market risk was still being applied at 31 December 2012.

PILLAR I

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

PILLAR II

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

PILLAR III

Pillar III is intended to supplement the minimum requirements in Pillar I and the regulatory follow-up specified in Pillar II. It will help to enhance market discipline through requirements for the publication of information which makes 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 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

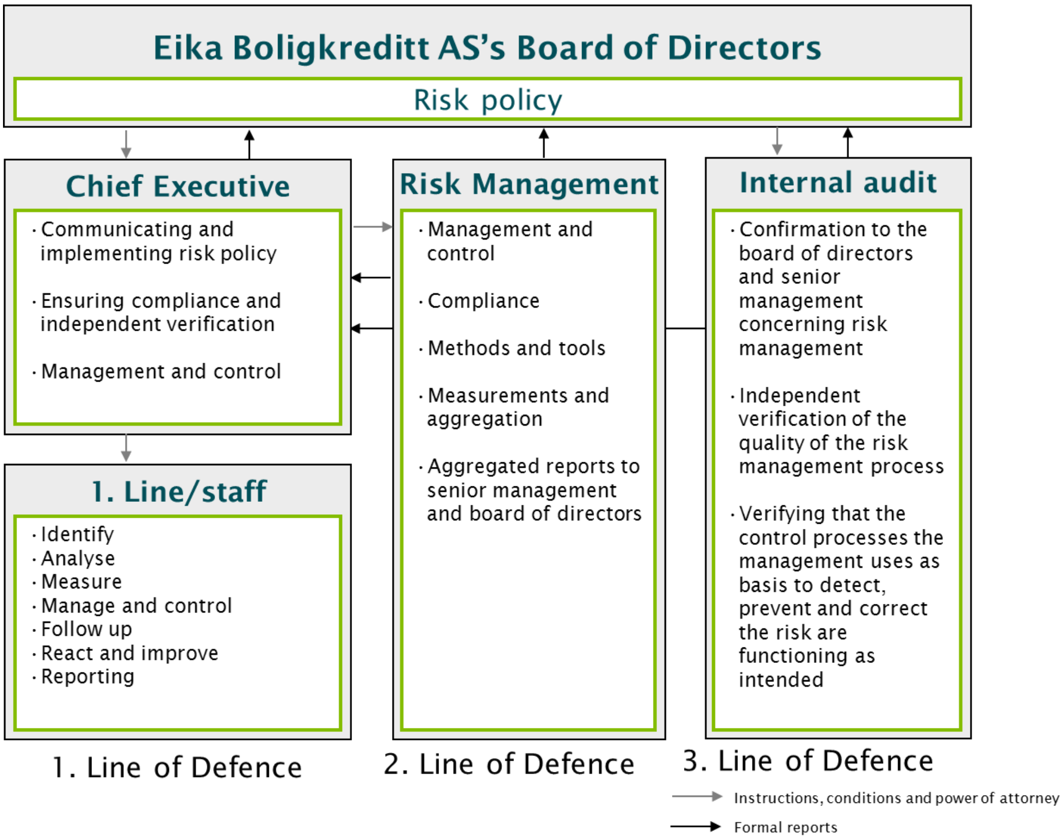
The company has established a contingency plan for capital adequacy which is intended to help ensure that good processes are in place for capital management. EBK is owned by 80 shareholders who are all subject to capital requirements and who all have good solvency. The company's shareholder banks are 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, liquidity, interest rate, 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.

THE ICAAP PROCESS

Representing a significant activity in the company, the ICAAP process is based on strategy, budgets and forecasts prepared annually in November.

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 – 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 of 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 test is 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

Figure 5 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	Moderate
Strategic risk	Low
Reputational risk	Low

NEW CAPITAL REQUIREMENTS

The board of EBK resolved at its meeting of 10 April 2013 to increase the company's capital targets from a tier 1 capital ratio of nine per cent and a primary capital (tier 2 capital) ratio of 10 per cent. These new targets will apply from 1 July 2013 and are as follows:

- core tier 1 capital ratio: nine per cent (unchanged)
- tier 1 capital ratio: 10.5 per cent
- tier 2 capital ratio: 12.5 per cent.

The new targets will satisfy proposed regulatory requirements from their adoption on 1 July 2013, and be adequate in relation to capital requirements based on the company's internal risk assessment. To satisfy new capital requirements, the company will need to increase both its tier 1 and tier 2 capital. EBK will seek to use the financial market to meet the new targets, primarily through issuing new subordinate tier 1 (hybrid) loan and raising a new subordinated tier 2 loan. Based on the Bill from the Ministry of Finance, the company's capital targets will need to be increased again with effect from 1 July 2014. However, it is unclear which requirements will apply to EBK, so that a new assessment of capital targets will be undertaken in next year's ICAAP process. The action taken is considered to be adequate given established support structures with the owner banks, which also commit them to provide capital in the event of a possible increase in capital requirements.

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. Until 31 December 2012, the company also used the standardised method to report market risk on debt instruments. But the guidelines for this have been changed, so that the company is calculating capital requirements for liquidity investments in 2013 on the basis of the standard method for credit risk.

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

- residential mortgages secured by up to 80 per cent of the fair value of the mortgaged property are assigned a 35 per cent risk weighting
- residential mortgage approvals based on security of up to 60 per cent of the mortgaged property are assigned a 35 per cent risk weighting, but a 20 per cent credit conversion factor is applied since these represent an unutilised credit facility with an original tenor of 30 days
- claims on banks and financial institutions are assigned a 20 per cent risk weighting.

As mentioned above, market risk was calculated at 31 December 2012 in line with the rules on trading books in the regulations. The company calculates market risk relating to debt instruments pursuant to Chapter 32 of the capital requirement regulations, including general market risk in accordance with the duration method.

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.

CAPITAL ADEQUACY STATUS PER 31 DECEMBER 2012

Table 1 Capital adequacy per at 31 December 2012

Amounts in NOK 1 000	31 December 2012
Share capital	391,735
Share premium reserve	728,648
Paid-in, non-registered increase of share premium reserve	120,000
Other paid-in equity	477,728
Other equity	1,422
Total equity capital	**1,719,533**
Intangible assets	-4,318
Deferred tax assets	-5,021
Total core tier 1 capital	**1,710,194**
Subordinated loan capital	318,601
Total primary capital (tier 2 capital)	**2,028,795**
Risk-weighted assets and capital adequacy ratio	
Credit risk	16,392,263
Market risk	565,413
Operational risk	192,238
Total risk weighted assets	**17,149,938**
Capital requirement corresponding to 8% of risk-weighted assets	1,371,995
Surplus equity and subordinated capital	656,800
Tier 2 capital adequacy ratio	**11.83 %**
Core tier 1 capital adequacy ratio	**9.97 %**

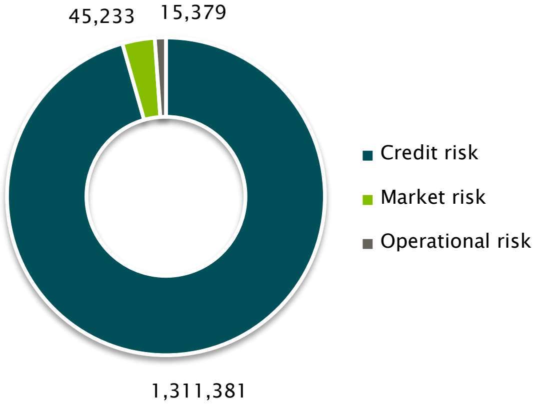
The company had a core tier 1 capital adequacy of 9.97 per cent at 31 December 2012, and a tier 2 capital adequacy of 11.83 per cent. The company's tier 1 capital is core tier 1 capital, since it consists exclusively of equity. NOK 100 million was raised in the first quarter of 2013 through a private placement towards the owner banks, while a subordinated loan of NOK 139 million was redeemed at call on 6 March 2013.

SUMMARY OF MINIMUM CAPITAL REQUIREMENT

Table 2 Capital adequacy allocated to risk type

Amounts in NOK 1 000	31 December 2012
Core tier 1 capital ratio	9.97 %
Tier 1 capital ratio	9.97 %
Capital ratio	11.83 %
Credit risk	1,311,381
Market risk	45,233
Operational risk	15,379
Sum Pillar 1	**1,371,993**

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, and counterparty risk which arises through derivatives and foreign exchange contracts. Credit risk depends 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 96 per cent of its capital requirement under Pillar I at 31 December 2012. 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 at 31 December 2012.

The company reports pursuant to the International Financial Reporting Standards (IFRS), and measures mortgage at amortised cost and fair value. Floating-rate mortgages are measured as equal to amortised cost, while 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 3 Credit risk: specification of risk-weighted volume and capital requirement

Credit risk (amounts in NOK 1 000)	Section	Balance sheet	Off-balance sheet items	Adjusted*	CCF	Risk Weight	Calculation basis	Capital requirement
Regional or local government	5-2	12,128	-	-		20 %	2,426	194
Banks and institutions (deposits in other banks)	5-6	1,935,676	-	-		20 %	387,135	30,971
Secured on real estate property	5-9	47,150,908	-5,803,266	-		35 %	14,471,675	1,157,734
Loan commitments to customers (duration 30 days)	5-9 and 6-1 (9)	-	1,371,900	-	0.2	35 %	96,033	7,683
Credit guarantees from the shareholders	5-6	-	5,803,266	-		20 %	1,160,653	92,852
Other assets	5-15	2,211	-	-		100 %	2,211	177
Claims on corporates	5-7	15,024	-	-		100 %	15,024	1,202
OTC derivatives (current exposure method)	5-7 and 21-1	970,974	709,703	-395,032		20 %	257,129	20,570
Total credit risk		**50,086,921**	**2,081,603**	**-395,032**			**16,392,286**	**1,311,383**

*Adjusted for cash collateral from derivative counterparties, see section 18-3 of the capital requirement regulations.

Table 4 Credit risk by commitment category

Claims (amounts in NOK 1 000)	Capital requirement
Claims on regional or local government	194
Claims on institutions	144,393
Claims on corporates	1,202
Claims or contingent claims secured on real property	1,165,417
Other items	177
Total capital requirement credit risk	**1,311,383**

Table 5 and figure 7 Geographic distribution of residential mortgages by Norwegian county

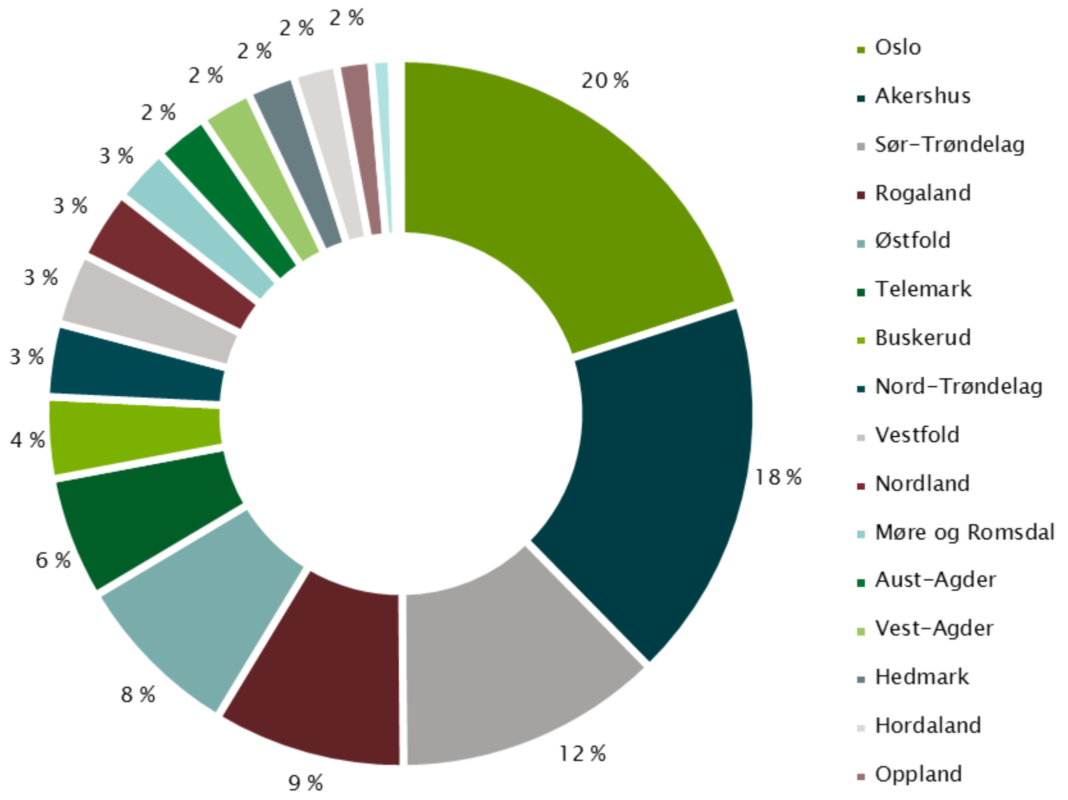


Table 6 Residential mortgages distributed by commitment type and residual time to maturity

Expected maturity of loans	31 December 2012	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	40,349,123	24	397	247	2,913	52,072	223,598	1,714,727	38,355,145
Lending to residential cooperatives	6,688,643	-	-	-	-	22,068	68,023	193,464	6,405,089
Lending to sovereigns	1,672,478	-	36,736	1,635,742	-	-	-	-	-
Lending to local authorities	2,217,543	752,651	1,289,604	-	-	175,288	-	-	-
Lending to banks	3,692,261	1,537,240	81,531	-	-	2,073,489	-	-	-
Lending to corporates	25,057	-	-	-	-	25,057	-	-	-
Total lending	54,645,105	2,289,916	1,408,269	1,635,989	2,913	2,347,974	291,622	1,908,190	44,760,234

The average size of mortgages and other loans is NOK 1 220 000 for private individuals and NOK 11 797 000 for residential cooperatives.

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

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

- *Case guarantee*, covering the entire amount of the mortgage over the period from the owner bank's request for payment until the mortgage's collateral has been perfected (legally registered) and the custody department of the owner bank has checked the documentation.
- *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 owner banks 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 owner banks at any given time. The owner bank's share in the framework guarantee will be calculated on the basis of the owner bank's actual share of the mortgage portfolio transferred by the owner banks at any given time.

The total guarantee liability for the banks 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 2012 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	6,285,006	6,265,320	12,550,326	27 %
40 < x <= 50	6,173,647	157,992	6,331,639	13 %
50 < x <= 60	27,890,469	265,331	28,155,801	60 %
Total	**40,349,123**	**6,688,643**	**47,037,766**	**100 %**
Average LTV	51 %	16 %	46 %	

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	10,027,863	6,360,202	16,388,065	0
40 < x <= 50	10,525,821	241,146	10,766,967	23 %
50 < x <= 60	19,338,215	79,108	19,417,322	41 %
60 < x <= 70	387,986	8,188	396,174	1 %
70 < x <= 75	50,440	-	50,440	0 %
75 < x	18,798	-	18,798	0 %
Total	**40,349,123**	**6,688,643**	**47,037,766**	**100 %**
Average LTV	47 %	13 %	42 %	

The weighted average indexed LTV was 42 per cent, compared with a non-indexed LTV of 46 per cent. Indexing of residential cooperatives shows a weighted average LTV of 13 per cent, compared with a non-indexed weighted average LTV of 16 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. 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 2012, which is the best figure for European issuers of covered bonds rated by the agency. The table presents EBK’s covered bonds as the Terra BoligKreditt Mortgage Covered Bond Programme.

Table 9 Collateral score in Moody's CB performance overview at 30 September 2012

EXHIBIT 12

Deals with lowest (best) Collateral Scores[10]

Name of Programme	Type of Programme	Country	Collateral Score
Terra Boligkreditt Mortgage Covered Bond Programme	Mortgage	Norway	2.0%
HSBC Covered Bond Programme	Mortgage	United Kingdom	2.4%
Landesbank Baden-Wuerttemberg - Public Sector Covered Bonds	Public Sector	Germany	2.4%
OP Mortgage Bank II	Mortgage	Finland	2.5%
OP Mortgage Bank Mortgage Covered Bonds	Mortgage	Finland	2.7%
Deutsche Postbank AG Mortgage Covered Bonds	Mortgage	Germany	2.8%
Norddeutsche Landesbank GZ Public Sector Covered Bonds	Public Sector	Germany	2.8%
Nordea Eiendomskreditt AS Mortgage Covered Bonds	Mortgage	Norway	2.9%
SpareBank 1 Boligkreditt AS Mortgage Covered Bonds	Mortgage	Norway	3.0%
ING-DiBa AG Mortgage Covered Bonds	Mortgage	Germany	3.2%
Deutsche Bank AG - Covered Bond Programme	Mortgage	Germany	3.2%

COUNTERPARTY RISK IN DERIVATIVES

Trading in derivatives is intended to reduce interest rate and currency risks for funding, and to reduce interest rate risk on mortgages with fixed interest rates. When EBK enters into a derivative contract with a counterparty, a counterparty risk arises and capital requirements related to this are calculated using the current exposure method specified in the capital requirement regulations. At 31 December 2012, the company had the following counterparty exposure to derivatives by rating category.

Table 10 Counterparty exposure in derivatives calculated by the current exposure method

Rating	Gross MTM (if positive)	Net MTM*	Total exposure	Capital requirement
AAA	-	-	-	-
AA+	-	-	-	-
AA	-	-	-	-
AA-	29,393	-	246,280	3,940
A+	435,838	178,625	384,482	6,152
A	533,662	531,924	629,517	10,072
A-	153,132	7,000	25,367	406
Total	**1,152,025**	**717,549**	**1,285,645**	**20,570**

*Adjusted for netting agreements and cash collateral from the derivative counterparties.

Credit support annex (CSA) agreements have been signed with all the company's derivatives counterparties. This means that market values are calculated at least weekly and, in the event of a deterioration in the counterparty risk because the counterparty has been downgraded, the counterparty will post collateral in the form of cash for the portion of the market value which exceeds the predefined rating triggers. These agreements reduce the company's credit risk through offsetting under the agreements as well as the possible posting of cash collateral. The effects of the agreements are taken into account when calculating net fair value and the amount of mortgages and advances. 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. 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 and for 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 1 312 million at 31 December 2012. 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 liquidity investments is to safeguard the existing mortgage portfolio and to provide a buffer in the event of a liquidity crisis. We have a target that the portfolio generate a return equal to or higher than the average of three-month Nibor and the Oslo Stock Exchange's index of government bonds with a tenor of 0.25 years (ST1X). Such investments can be roughly divided into three categories.

- Low risk: securities which can be realised/sold at any time should liquidity be required. Government bonds are considered a low-risk investment.
- Moderate risk: investments which comply with the regulations for inclusion in the cover pool are considered to be a moderate risk. Government bonds with a residual time to maturity of more than one year, covered bonds, and county and municipal bonds are considered to be a moderate risk.
- High risk: investments in bonds with a residual time to maturity of more than 100 days and a credit rating below A3.

The company will place its excess liquidity and/or liquidity reserves in investments with low to medium risk. Risk will normally relate to interest rates and credit spreads. Possible exchange rate risk will be hedged. The company had no exchange rate risk at 31 December 2012.

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

Rating	Market value
AAA	5,994,286
AA+	-
AA	-
AA-	75,813
Sum	**6,070,099**

EBK's liquidity portfolio is carried at about NOK 6 billion and constituted 10 per cent of the company's total assets at 31 December 2012. 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 2012, utilising section 32, sub-section 4 on specific risk of debt instruments, and section 32 sub-section 7 on general risk of debt instruments (the duration method).

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

Market Risk	Amount	Weight	Calculation basis	Capital requirement
Sovereigns	1,672,478	0.0 %	-	-
Residual term 6 months or less	2,123,787	3.1 %	66,368	5,309
Residual term 6 months to 24 months	949,440	12.5 %	118,680	9,494
Residual term exceeding 24 months	1,324,394	20.0 %	264,879	21,190
Total spesific risk (issuer risk)			449,927	35,994
Total general market risk (interest rate risk)			115,490	9,239
Total			**565,417**	**45,233**

All investments are made in floating rate notes or fixed rate instruments shorter than 1 year. This means that the asset and liability side of the balance sheet is matched regarding interest risk. More details about interest rate risk in the balance sheet are provided in chapter 11 below.

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 department 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 change in the interest rate curve and a zero-to-one percentage point shift in credit spreads for notes with a credit spread risk (contingent on the issuers credit risk). The interest rate risk framework also includes other interest rate risks in the balance sheet. Market risk in the liquidity portfolio is managed on an daily basis by the funding department.

MINIMUM PRIMARY CAPITAL REQUIREMENTS

EBK applies the standardised method for calculating market risk. The capital requirement was calculated to be NOK 45.2 million at 31 December 2012.

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 risk.

RISK APPETITE AND EXPOSURE

EBK uses the basic indicator method for calculating the capital requirement for operational risk. 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	2010	2011	2012
Net income	80,263	71,938	155,383
Average income			102,528
Basis of calculation			192,240
Capital requirement			**15,379**

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. Appropriate insurance policies have also been put in place and relevant contingency plans 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 NOK 15.4 million at 31 December 2012.

10 LIQUIDITY RISK

Liquidity risk is the risk that the company will be unable to meet its current liabilities and/or to fund changes in the allocation of assets without incurring significant extra costs, in the form either of a decline in the price of assets which need to be realised or of an excessive funding cost.

RISK APPETITE AND EXPOSURE

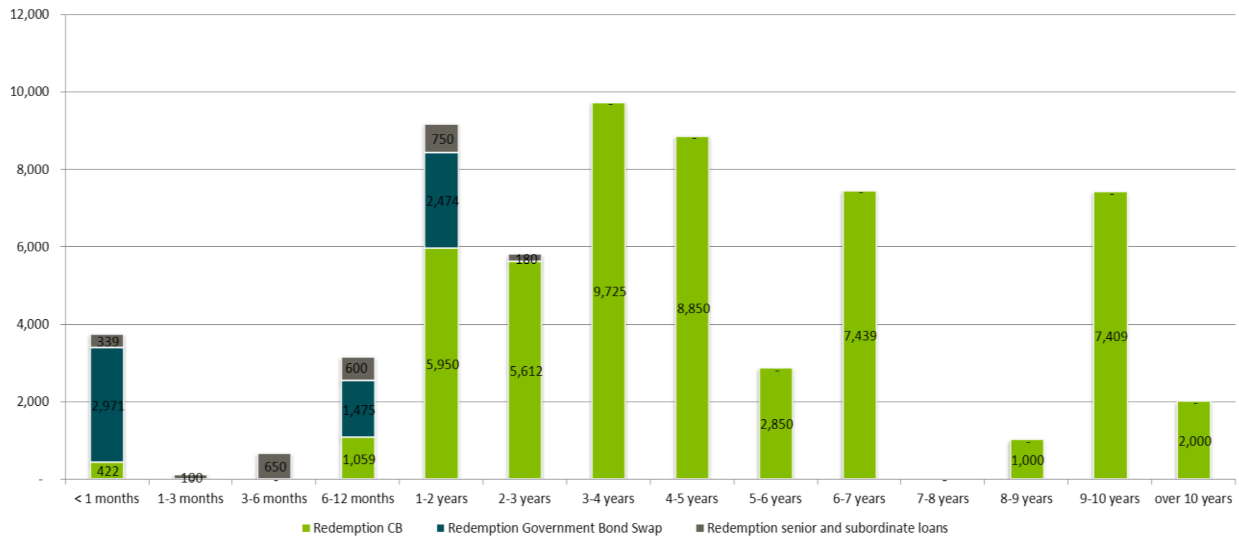
EBK finances lending primarily through the issue of covered bonds. Through its opportunity to make such issues, the company achieves lower borrowing costs than its owner banks. Since EBK's main purpose is to meet a significant share of the funding requirements of its owner banks, it is intrinsically exposed to moderate to high liquidity risk. The company will also raise ordinary senior unsecured bonds and certificate loans, primarily involving the issue of loans with a short tenor 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 accepts an exposure to moderate liquidity risk, and relevant frameworks have been approved to satisfy this.

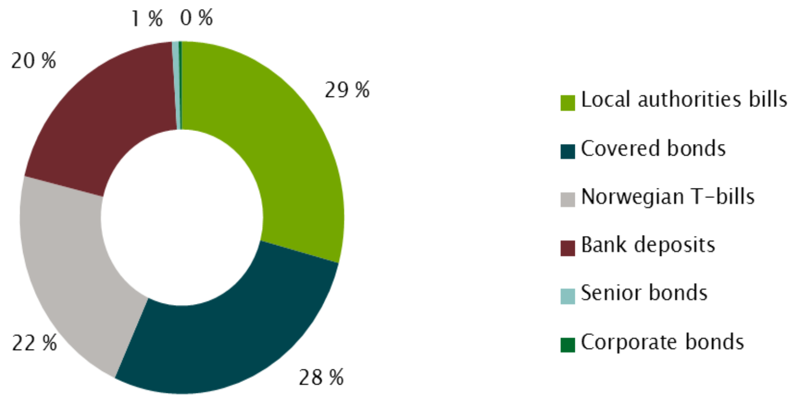
EBK has loans which matures in 2013 totalling NOK 7.6 billion, corresponding to 13 per cent of its total assets. The company had a liquidity buffer of NOK 7.6 billion at 31 December 2012.

Figure 8 Redemption profile per first quarter 2013 (amounts in NOK million)



The maturity profile of the company's loans is presented above, updated at 31 March 2013. EBK has increased the average time to maturity for its funding in recent years by issuing bonds with long tenors, which reduces its refinancing risk.

Figure 9 The composition of the liquidity portfolio



MANAGEMENT AND CONTROL

EBK has established a separate policy for 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.

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 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

Risk associated with net interest income arises from differences between interest terms for borrowing and 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 borrowing 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 will reintroduce fixed interest mortgages as approved additions to the cover pool. 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

Interest rate sensitivity	Duration	Amounts	Effect
Funding*	0.15	52,695,171	77,044
Lending with floating rate	-0.12	45,384,478	-54,461
Lending with fixed rate*	-0.25	1,653,288	-4,095
Liquidity portfolio	-0.22	6,070,099	-13,226
Bank deposits	-0.01	1,537,240	-119
Total ex. Liquidity portfolio			**18,488**
Total			**5,143**

*adjusted for det effect of OTC derivatives

The stress scenario shows that circumstances in which EBK's funding cost increases 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 and back office departments.

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 BUSINESS AND STRATEGIC 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 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 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.