

**BASEL II Pillar 3 – 2009**  
**Disclosure of Key Risk Information**  
**EKSPORTFINANS**

19.05.2010

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## **Introduction:**

*The purpose of this document is to inform about risk types, risk management and capital adequacy, as described in Pillar 3 of Basel II's capital adequacy rules. Complete information is published annually in the form of this document.*

The information requirements in Pillar 3 include a description of Eksportfinans' capital requirements, calculated according to the methods applied to market risk, credit risk and operational risk (Pillar 1), and information about internal processes to assess the company's total capital requirements (Pillar 2). The company's goal for capital adequacy for 2009 was about 9 %; i.e. one percent more than the previous year.

Eksportfinans uses the standard method for calculating the capital adequacy for market risk and credit risk, and the basic method for operational risk. This is why no risk calculations have been made, based on own analyses and stress tests. We thus have not set aside additional capital, other than the minimum requirement. Eksportfinans has performed deliberations, based on a three year financial decline scenario, and believes that the minimum capital requirements contain enough conservatism to serve as our assessment, including additions for other risk types than the three main types. In the analyses, we have used our internal long-term model, and looked at expected financial figures, in accordance with our current financial plan. The expected net results and capital adequacy figures have then been adjusted, to fit our assessment of a negative development from a) market risk events, b) credit risk events, c) operational risk events, and finally d) negative events in the category of business and strategic risk. We believe that these four risk categories over the timeframe we are examining will provide the guideline. The overall annual negative result effect from these assessments will be added to the basic scenario in the financial plan. An analysis will then be made as to whether our expected result after the negative scenarios for each risk is good enough for the internal capital adequacy goals to be met.

# 1 OVERALL RISK STRATEGY AND GOAL

## 1.1 General Information about the Overall Risk Strategy

The overall risk strategy is setting and controlling the company's risk profile and financial goals, and it will describe the company's total willingness to be exposed to risk.

## 1.2 Overall Risk Strategy for Eksportfinans

Eksportfinans has the following key principles for risk and capital management:

- Management has overall control of the company's total risk and capital management. The board of Eksportfinans regularly monitors the risk and capital profile, and revises the guidelines every year.
- Eksportfinans comprehensively controls the market, credit, operations, business, legal risk and risk of a weakened reputation, as well as capital allocation. This also applies to complex financing, which is usually controlled with a focus on liquidity risk, as maturities can be uncertain.
- The legal department, risk department and finance function have close links to the business areas, but are independent.
- The company must maintain a high credit rating grade from Fitchratings, Moody's Global Investors and Standard & Poor's.

Risk management at Eksportfinans must support the company's strategic development and goal achievement. Eksportfinans must have a low risk profile.

The risk management and capital strategy must help:

- Secure the company competitive terms in the lending markets, so that the company can offer competitive lending terms.
- Secure the company's ability to offer a competitive return for shareholders and other stakeholders.
- Maintain a strong capital base to support development at the company, including exploiting opportunities for growth.

To achieve this, the core capital adequacy goal has been set at about 9 %; i.e. about one percent higher than one year ago.

## **2 RISK MANAGEMENT AND RISK CONTROL AT EKSPORTFINANS**

### **2.1 Purpose**

Eksportfinans' overall goal is to:

- Offer the best lending terms to our clients
- Create value for the owners

Risk and capital management at Eksportfinans must support the company's strategic development and goals, while also securing financial stability.

The overall risk management sets principles for how Eksportfinans will manage, report, monitor and control both its total risk, and the risk of each business area. This overall management will help ensure that the company reaches its overall goals.

### **2.2 Organization, Roles and Responsibilities**

Responsibility for executing risk management and control is shared by the board, audit committee, control committee, management, and the operative units.

#### **Board of Directors**

The board is responsible for external reporting of accounts and risk information, and external reporting according to the Capital Adequacy Regulations.

The board is responsible for the funds which Eksportfinans has control of being managed safely and appropriately. The board must receive periodic and adequate information from the President & CEO and internal audit in order to be able to deal with and follow up:

- Its obligation to be kept up-to-date with the company's financial position, and to ensure that its activities, accounts and asset management are subject to reassuring control.
- That company management provides an appropriate and effective risk management process, in accordance with laws, regulations, articles of association and principles, described in the board's guidelines for overall risk management.
- The company's risk status and risk development with approved limits, risk strategy goals and business strategy.
- That Eksportfinans has sufficient capital, in relation to the company's underlying risk and future growth plans.

#### **Audit committee**

The audit committee is a sub-committee of the board, and supports the board's work with performing the control tasks. The responsibility includes monitoring internal control systems and risk management systems, including internal revision.

#### **Control committee**

The control committee must supervise the company's activities and, among others, see that the activities are conducted in accordance with laws and articles of association. The tasks of the control committee were set out in the instructions with legal authority in

section 3-11 of the Financial Institutions Act. The control tasks are directed towards the work of the board.

**The President & CEO must:**

- Attend to and follow up:
  - The company's risk status and risk development in terms of approved risk strategy goals and business strategy.
  - That proper risk management is established, in accordance with guidelines set by the board.
  - That the risk management is documented, executed and monitored properly.
  - That the reporting obligation to the board complies with laws, regulations, articles of association and principles described in the board's guidelines for overall risk management (this document).
- Annually review significant risk types and risk-adjusted capital adequacy that appears for the overall risk.
- Write an overall assessment of the risk situation that is presented to the board for review. The board can determine that the reporting of significant risks is covered by the ICAAP report, as long as it fits the Internal Control Regulations.
- Follow up that an independent party annually reports the status of the quality of the existing internal control. The independent report must be presented to the board.
- For changes or establishing new products and procedures of significance, ensure that risk assessment, internal control and documentation exist before the activities begin. The board must be informed about significant changes to the company's quality assurance work.
- Meet the executive group regularly, and discuss matters of principle to the company, including decisions that will involve more areas of activity.

**Credit committee**

The credit committee is a decision-making body that makes decisions on credit cases outside existing regulations (see further details in last year's Pillar 3).

The committee held more meetings in 2009 than during the previous year, regarding questions of frame.

**Managers of the areas of activity**

- Exercise risk management in the business operations, in accordance with adopted guidelines.
- Approve credits within the limits.
- Monitor the engagements.
- Perform controls.
- Report in accordance with the Internal Control Regulations regarding execution of controls, flaws and risk assessments.
- Report loss events.

**Risk Department**

- The Risk Department monitors the risk management at the company through regular monitoring of market and credit risk against the limits set. The department is also responsible for methods and calculation of official fair values which are used in the accounts, and responsibility for the model use and model data for balance and liquidity management.
- The Risk Department periodically writes information to attend to and follow up:
  - That the risk management systems work, are followed up and documented in accordance with current laws, regulations, strategy/guidelines and procedures.
  - That the risk management process is appropriate and effective, in accordance with the guidelines set by the board, and that the guidelines seek to achieve best practices.
  - The company's risk status and development with approved risk strategy goals and business strategy.
  - That risk management regulatory requirements are complied with.

#### **Forum for approval of new products, instruments, structures**

This is an ad hoc forum that meets in connection with the approval of new products, instruments and structures. The procedure for approval of new procedures provides further details for the convening of this group. A new system for price and risk calculations by the structured borrowing portfolio of Eksportfinans was implemented in 2009. It has been decided, among others, that structures that are not dealt with directly in the new system will not be issued.

#### **Personnel**

- Must have sufficient knowledge about the risk management process, procedures, instructions, authorizations, and risk models associated with their area of responsibility.
- Must have adequate competence on their area of responsibility to be able to perform adequate self-assessment, and on own initiative be able to evaluate associated measures for improvement.
- Responsible for communicating significant breaches in the risk management process upwards in the organization.

#### **Internal audits**

- The company's internal auditor is Ernst & Young.
- The internal auditor reports the results of the review of projects related to the adopted audit plan to the board, company management, and the Risk Management Department at least once a year.
- Gives objective advice to the board and management about the company's risk management, design and compliance with controls, and compliance with established procedures and guidelines.
- Must have adequate competence and experience, and the methodology and tools to be able to determine whether all areas of significant risk to the company are covered.

## 2.3 Risk Management

Eksportfinans' extensive borrowing, lending and investment activities in many different markets require that the company identify, aggregate and manage the total risk sensibly. The company manages the risk through different frameworks, organizational structures, delegation, calculation/reporting and monitoring.

The process for risk management at Eksportfinans is based on the following elements:

- Control environment
- Risk identification
- Risk analysis
- Guidelines and procedures
- Risk strategy
- Control measures
- Reporting
- Monitoring and follow-up

There is a set of principles in every element that provides the framework for risk management. The elements are discussed in depth in the chapters below.

### 2.3.1 Control Environment

The control environment includes organization of the company, guidelines for management, management style, and the employees' integrity, and Eksportfinans places emphasis on the following principles:

- Basic values / ethical guidelines:  
The company's ethical guidelines and basic values must support the conservative risk profile, and be communicated throughout the entire organization.
- Personnel policy / competence:  
The company's personnel policy must state the expectations on each employee regarding integrity, ethical behaviour and competence. During the past few years, Eksportfinans has adopted a new HR strategy, and all hiring must be discussed by an employment committee.
- Social responsibility:  
Eksportfinans' social responsibility policy consists of guidelines for ethics, notification, corruption and the environment. The company will also adopt a set of voluntary guidelines associated with environmental and social issues related to project financing (the Equator Principles<sup>1</sup>) in 2010, and introduce guidelines for environmental and social issues related to internationalization loans. Eksportfinans must have an active approach to social responsibility in its operation of the company, and in all business activities.
- Control and management structure:  
Management and control covers all processes and control measures that have been implemented by management to secure efficient business operations and execution of the company's strategies. The company's emphasis is on a control and

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<sup>1</sup> The Equator Principles are the financial industry's established frame of reference for assessing and controlling environmental and social risks associated with financing large global projects. The principles were designed by private sector banks in 2003, and are based on the World Bank's environmental standards and the social guidelines of the International Finance Corporation (IFC).]

management structure that promotes goal-oriented management and independent control. Eksportfinans follows the Sarbanes-Oxley framework for accounts reporting which entails extensive use of routine descriptions and presentation of control evidence which makes internal work visible to the auditor. Internal forums have also been established to assess product ranges, the asset/liability composition, and to assess special credit cases in addition to the external control environments.

### **2.3.2 Risk Identification**

The board and management are familiar with Eksportfinans' risk situation, so that frames can be set for the desired risk exposure and it can choose goal-oriented risk management strategies to manage the level of risk in relation to frames and goals. In connection with the financial crisis, the company reduced a number of credit lines, as a result of downgrading of foreign banks. We also introduced country frames that limited the credit risk per country more than was the case in the past. The interest and currency risk frames that limit the allowed market risk were also reduced.

Risk identification must cover all significant risks that face the company and must be carried out at least once a year, or when other circumstances so warrant. There is a constant attempt to attend to the following processes:

- Identify strategic risks as part of ICAAP and the strategy process and incorporate them into the planning. Contacts: board and management.
- Identify significant risks in the company's processes. Contacts: managers and process owners.
- In the event of changes or establishment of new products and procedures of great importance to borrowing, lending or investments, risk identification must be performed before they are allowed. Contacts: forum for approval of new products, instruments, structures
- An asset/liability committee will meet on a monthly basis to perform total assessments of the balance between borrowing and future lending, and serve as an advisory committee for the management group.

### **2.3.3 Risk Assessment**

The running assessments of changes to the portfolio composition, rules, time left on guarantee agreements, etc. provide a basis for how the company will understand and manage the risks identified. This means, among others:

- Quantification of all significant risks, based on recognized methods and procedures for risk measurement, combined with own assessments.
- Execution of sensitivity and stress tests for different scenarios.
- Ensuring that a qualified and structured assessment and documentation of the control and management measures implemented is performed, and that these measures are dealt with properly at the company.
- Writing risk profile goals for central risk types related to risk tolerance, based on the present and expected future exposure.
- At minimum annually calculating the expected and unexpected risk of loss for securities placements (realized and unrealized fluctuations) and credit exposure (expected and extraordinary loss) in connection with ICAAP.
- The managers of each business area responsible for whether defined risk profiles are appropriate, updated and within the company's risk strategy. The risk assessments with an identified risk profile, and proposal for an acceptable risk profile for risk types and risk areas must be presented to and approved by the management group before final approval by the board.

### **2.3.4 Guidelines, Instructions and Procedures**

The board must evaluate the approved risk management guidelines annually.

The board will set guidelines for:

- Overall risk management
- ICAAP at Eksportfinans
- Credit risk
- Liquidity risk
- Market risk, including
  - Interest rate risk
  - Foreign exchange risk
  - Credit spread risk
- Operational risk
- Lending activities at the company
- Borrowing

The following instructions and authorization also apply:

- Regulations relating to instructions for control committees at financing enterprises
- Instructions for the board of Eksportfinans ASA
- Instructions for the President & CEO
- Authorization for the President & CEO
- Instructions for internal audits at Eksportfinans ASA

A number of procedures have been written for each department. These are detailed descriptions that cover taking up loans, identification of market risk, transaction entry into the finance system and approval of new products for handling of the telephone recording system.

For people who commit the company externally, for example through transactions, the job descriptions contain clear authorizations for the products and the frames within which a person can commit the company. An authorization matrix has been written to simplify the overview for managers and personnel.

### **2.3.5 Risk Strategy**

A risk strategy is prioritization and measures that ensure that Eksportfinans manages and follows up risks in accordance with acceptable and approved risk profiles (frames and target figures), so that the total risk exposure complies with the company's overall risk profile.

The following principles will be applied to the choice of a risk management strategy.

The risk management strategies will:

- reflect the company's overall goals and strategies
- be an integrated part of the company's ongoing activities
- match the company's risk tolerance and cost budget

### **2.3.6 Control Measures**

After a risk strategy is chosen, the most important management and control measures in relation to given risks will be chosen and incorporated into the guidelines for managing the risk type in question.

The following principles apply:

- Updated documentation is required of the control and management measures established for all significant parts of the company's areas of activity, with reference to any instructions, authorization and job descriptions.
- In the event of changes or establishment of new significant products and procedures, there must be documentation of the control and management measures that have been established, with reference to any instructions, authorizations and job descriptions before they are implemented.

### **2.3.7 Reporting**

A report will be written every month and sent to the board. This report will provide information about key financial figures, and profit/loss and balance sheet development. An overview will also be given of lending activities, development of the liquidity portfolio, and the borrowing situation.

In the monthly report to the board, the Risk Department will report developments related to credit, market and liquidity risk. Market risk will be reported as credit spread sensitivity, interest rate risk and foreign exchange risk. Credit risk will be reported as counter-party exposure per counter-party, country, region and security type, and be displayed against specific frames. Liquidity risk will be reported in the form of a liquidity scenario and remarks on the extent to which one should consider taking out new loans or possible placement of the surplus liquidity.

The company's risk reporting must ensure that all relevant departments at the organization have an overview of the risk exposure and any flaws in the risk management process. The reporting must provide the foundation for the further follow-up and monitoring of the risk exposure and risk management process at the company.

#### *Risk reporting*

The board must receive reports on positions and trends in accordance with all frames and target figures for risk set by the board.

Risk reports will be written by the Risk Department.

#### *Internal control reporting*

The President & CEO is responsible for attending to the requirements in the Internal Control Regulations regarding documentation and reporting. The following principles apply:

#### Overview of internal control

- A review of control measures within every area of operation of the company will be conducted annually. This overview is based on a systematic analysis of risk elements associated with the ICT Regulations' paragraphs 5, 7 and 11, and inherent risk elements in operations. The analysis is based on a homogenous presentation in every part of the business. The control measures will be assessed and any improvement measures must be described.

#### Review of risks and hedging

- Once a year the members of the company's management group will conduct an overall risk assessment. Each risk element will be analyzed in terms of probability and consequence, and the strength of relevant control measures and the desired level of control. The results of the assessments will be presented collectively, and provide, among others, a foundation for prioritizing internal audit work.

#### Confirmation from managers

- All managers must annually and on behalf of its own area of responsibility provide confirmation of performance of the internal control. Any improvement measures will be remarked on separately.

Report to the board

- A summary of the risk situation will be reported to the board annually. At the same time, the board will approve the proposed annual internal audit plan.

#### **2.3.4 Preparedness Plans**

The ICAAP document defines a preparedness plan for capital adequacy that specifies actions if the capital adequacy is calculated to or would be assessed to fall below set levels. First a 'yellow' level will be reached, triggering certain actions. If the capital adequacy continues to drop, a 'red level' will be reached, triggering more drastic measures.

## 3 BASEL II – CAPITAL ADEQUACY RULES

### 3.1 Introduction to the Capital Adequacy Rules

The regulations for supervision and capital adequacy, Basel II, were introduced in Norway on 1 January 2007. These capital adequacy rules rest on three pillars.

- Pillar 1 is about minimum capital adequacy requirements.
- Pillar 2 is about the authorities' supervisory function, and the financial institutions' own capital assessment.
- Pillar 3 is about requirements for external risk reporting.

This document will cover the requirements regarding disclosure of financial information (Pillar 3) in the capital adequacy rules, but Pillar 1 and 2 are described briefly below.

#### 3.1.1 Pillar 1 – Minimum Capital Requirements

Pillar 1 is about minimum requirements for capital adequacy. The minimum requirement for subordinated capital (core capital + supplementary capital) is 8 % of the basis for the calculations.

Different methods have been developed for each risk type that the financial institution can choose from to calculate the capital requirement – see table 1 below.

*Table 1 – Overview of different approaches*

| CREDIT RISK               | MARKET RISK                | OPERATIONAL RISK         |
|---------------------------|----------------------------|--------------------------|
| Standardized approach     | Standardized approach      | Basic indicator approach |
| Foundation IRB approach*) | Internal models approach*) | Standardized approach    |
| Advanced IRB approach*)   |                            | AMA method*)             |

\*)The method requires approval by the Financial Supervisory Authority of Norway

#### 3.1.2 Pillar 2 – Assessment of the Total Capital Requirements (ICAAP) and Supervisory Follow-up

Pillar 2 is based on two main principles: a) Financial institutions must have a process to assess their total capital in relation to the risk profile and b) Financial institutions must have a strategy for maintaining their capital levels. Under Pillar 2 all risk types to which the company is exposed must be assessed, beyond those covered by Pillar 1.

In addition, the supervisory authorities must review and evaluate the institutions' internal assessment of capital requirements and strategies, and monitor and secure compliance with statutory capital adequacy. The Financial Supervisory Authority of Norway has the authority to initiate measures if it is not satisfied with the result of this process.

#### 3.1.3 Pillar 3 – Disclosure of Information

The purpose of Pillar 3 is to supplement the minimum requirements in Pillar 1 and the supervisory follow-up in Pillar 2. Pillar 3 will contribute to increased market discipline by disclosing information that allows the market, including analysts and investors, to assess the institution's risk profile and capitalization, including management and control.

All institutions must disclose information about their organizational structure, risk management system and reporting channels, and how the risk management is structured and organized. There are also detailed requirements regarding publication of capital levels, capital structure and risk exposure, with the latter depending on the calculation approaches used by the financial institutions in Pillar 1.

Eksportfinans will publish the report on the Internet.

## **3.2 Implementation of the Capital Adequacy Rules at Eksportfinans**

Eksportfinans has chosen the standardized approach for calculating credit risk and market risk. The company has chosen the basic method for operational risk.

Capital assessments (ICAAP) must be conducted at least once a year, and Eksportfinans' capital strategy will be based on an assessment of the risk level at the company, supplemented by the effect of different stress scenarios.

Eksportfinans must meet the regulatory capital requirements at all times.

## **3.3 Accounting Principles and Measurement**

A significant part of the company's balance is made up of financial instruments. The accounting principles applied to these assets and debt items are therefore important in order to understand the accounts. The financial instruments on Eksportfinans' balance sheet can be divided into three categories from an accounting perspective, based on how the values are set:

1. Financial assets and debt measured at fair value with a value change over the result.
2. Loans and receivables measured at the amortized cost.
3. Other financial debt measured at the amortized cost.

### **3.3.1 Financial Assets and Debt Measured at Fair Value with a Value over the Result**

Financial assets and debt that is measured at the fair value, with a value change over the result consists of financial instruments that are either classified for trading purposes or which when measured for the first time are measured at the fair value, with value changes over the result (the fair value option).

Financial instruments for trading purposes include securities classified for trade, as they were primarily acquired for sale in the short-term. The portfolio includes derivatives used for risk management. Loans to finance the portfolio's investments have also been included in the trading portfolio

Financial instruments, which at first calculation are earmarked as at fair value, with value changes over the result, consist of loans and liquidity placements, including securities and bank deposits, loans, and cash deposits as security for swap agreements. The fair value option is used when this yields the most relevant information under the principles for measurements that are available to financial instruments.

### **3.3.2 Lending and Receivables Measured at the Amortized Cost**

Lending and receivables measured at the amortized cost consist of loans and receivables as agreed with the authorities, based on Proposition to the Storting no. 108 (1977–78), referred to as the 108 scheme, and loans to former subsidiary Kommunekreditt Norge AS (now KLP Kreditt AS).

The 108 scheme has been established to offer exporters of capital goods financing at terms that comply with the OECD's consensus agreement for export credits (CIRR financing). The agreement gives Eksportfinans coverage of interest rate and foreign exchange risk associated with lending, borrowing and liquidity in the scheme. The

company will enter into derivative agreements on behalf of the 108 scheme to reduce the market risk.

In connection with the sale of Kommunekreditt, an agreement was entered into for Eksportfinans to provide financing to the former subsidiary during a two-year period. This loan has been recorded to the accounts at the amortized cost.

### 3.3.3 Other financial debt measured at the amortized cost.

Other financial debt measured at the amortized cost consists of borrowing and other debt under the 108 scheme.

### 3.3.4 Fair Value and Amortized Cost

The company measures a significant part of the financial instruments at fair value. Fair value is the amount or the best available estimate of the amount an asset is expected to be able to be sold for, or a liability is settled in cash in a transaction at arm's length between well-informed willing parties.

The fair value of listed securities is based on current selling prices, if possible. If there is no active market for financial assets (or unlisted securities), the company will set the fair value through the use of different valuation methods. This includes the use of transactions that recently took place at arm's length, reference to other instruments that are mainly comparable, discounting of the expected cash flow, and use of recognized valuation models that as far as possible use market data and to the least extent possible unobservable data.

Lending, borrowing and liquidity under the 108 scheme, and loans to Kommunekreditt are measured at the amortized cost, using the effective interest method. When disbursing loans, the amortized cost will be equal to the value of the nominal amount, adjusted for any premiums or discounts. Using the effective interest method, the internal rate of return will be calculated on the disbursement date. The internal rate of return will be set by discounting the expected cash flow over the expected term to maturity over the amortized cost upon disbursement.

Eksportfinans will assess the risk of credit loss on the part of the loan portfolio that is valued at the amortized cost as insignificant, and consequently has not recorded the fall in value in the portfolio.

Below is a list of realized and unrealized profit (loss) for 2009.

**Table 2**

| (Amount in NOK thousands)  | 2009               |
|--|--------------------|
| Securities 1)  | (58,224)           |
| Foreign currency   | (14,713)           |
| Other financial instruments at fair value 1)                     | 137,298            |
| <b>Net realized profit (loss)</b>                                | <b>64,361</b>      |
| Loans and receivables 1)   | (48,512)           |
| Securities 1)  | 99,438             |
| Commercial paper debt 1)   | 74,694             |
| Bond debt 1)   | (3,917,868)        |
| Subordinated loan capital and capital contribution securities 1) | 1,122              |
| Foreign currency   | (86,759)           |
| Other financial instruments at fair value 1)                     | 8,881              |
| <b>Net unrealized profit (loss)</b>                              | <b>(3,869,004)</b> |
| Financial derivatives related to the 108 agreement 2)            | 11,473             |
| <b>NET REALIZED AND UNREALIZED PROFIT (LOSS)</b>                 | <b>(3,793,170)</b> |

1) Including financial derivatives with the purpose of financial hedging

2) Derivates related to components of the 108 agreement. The 108 agreement is recorded at the amortized cost, which is why these derivatives have not been included in the effects related to the financial instruments at fair value.

### **3.4 Internal Audits**

The company's internal auditor (Ernst & Young) must regularly – at least once a year – review Eksportfinans' process for assessing capital requirements, in relation to risk profile and strategy (the ICAAP process).

## 4 CALCULATION OF CAPITAL ADEQUACY – PILLAR 1

### 4.1 Introduction

The figure below shows the development in the capital adequacy and the core capital adequacy for the past 5 years. The figures have been calculated according to the current capital adequacy rules for the year in question.

**Figure 1** – Capital adequacy and core capital adequacy, 2005–2009

|                  |                       |
|------------------|-----------------------|
| Capital adequacy | Core capital adequacy |
|------------------|-----------------------|

### 4.2 Subordinated Loan Capital

The tables below provide information about the subordinated loan capital, including core capital and additional capital.

All tables are related to regulatory reporting, and are based on figures as at 31 December 2009.

**Table 3** – Specification of minimum requirements for subordinated loan capital (Pillar 1)

| RISK FACTORS  | CAPITAL REQUIREMENTS<br>In NOK millions |
|---|---|
| Credit risk   | 2,454                                   |
| ○ Of which:   |   |
| ○ State   | 0                                       |
| ○ Local and regional authorities                        | 33                                      |
| ○ Publicly-owned enterprises                            | 0                                       |
| ○ Multilateral development banks                        | 0                                       |
| ○ Institutions  | 2,403                                   |
| ○ Enterprises   | 0                                       |
| ○ Security for property                                 | 1                                       |
| ○ Other engagements                                     | 17                                      |
| Market risk   | 473                                     |
| Operational risk  | 215                                     |
| Total minimum requirements on subordinated loan capital | 3,142                                   |

We have no engagements in the engagement categories not mentioned.

**Table 4** – Capital composition

| CAPITAL COMPOSITION               | In NOK millions | Percent of<br>subordinated<br>loan capital |
|-----------------------------------|-----------------|--|
| Share capital                     | 2,771           | 53 %                                       |
| Profit reserve                    | 177             | 3 %  |
| Fund for unrealized capital gains | 403             | 8 %  |
| Other equity                      | 2,057           | 39 %                                       |
| Total equity                      | 5,408           | 103 %                                      |
| Provisions for dividend           | 700             | 13 %                                       |
| Capital contribution securities   | 466             | 9 %  |
| Deductions *)                     | 1,358           | 26 %                                       |
| Additions                         | 4               | 0 %  |
| Total core capital                | 3,819           | 73 %                                       |
| Subordinated loan capital         | 1,372           | 26 %                                       |
| Capital contribution securities   | 0               |  |
| Deductions                        | 0               |  |
| Additions                         | 46              | 1 %  |
| Total additional capital          | 1,418           | 27 %                                       |
| TOTAL SUBORDINATED LOAN CAPITAL   | 5,237           |  |

\*) The deduction to the core capital includes unrealized profit due to reduced value of debt, as a result of the credit spread premium of the Eksportfinans bonds issued having increased. This profit is NOK 1.3 billion after tax.

### **Capital management**

The primary goal of the company's capital management is to maintain a sound capital base, and to secure the company's high credit rating from the international credit rating agencies and to comply with the externally-imposed capital adequacy rules. This goal must provide the basis for the activities, and yield a return to the shareholders and benefits to other stakeholders.

Eksportfinans maintains an actively-managed capital base to cover inherent risk at the enterprise. Eksportfinans' capital adequacy is monitored using, among others, rules and goals set by the Basel Committee for Banking Supervision ("BIS rules/ratios"), and approved by the Financial Supervisory Authority of Norway.

In 2008, the company and its owners implemented a number of measures as a response to the unrest in the financial markets. To strengthen the equity, a share issue was performed on 13 March 2008. The expansion of share capital was NOK 1.2 billion. In March 2008, Eksportfinans' owners signed an agreement with the company (Portfolio Hedge Agreement), where the owners undertook to hedge against further losses in the company's securities portfolio after 29 February 2008. See note 13 for further details. On 26 November 2008, Eksportfinans signed an agreement with the state regarding financing of new export credits that qualify under the state-funded scheme pursuant to the OECD's "Arrangement on Officially Supported Export Credits" on the "Commercial Interest Reference Rate" (CIRR loans). The agreement allows Eksportfinans to borrow from the state for terms to maturity of up to 5 years until 2011. The company did not take advantage of this opportunity.

Dividends will be set with a view to securing an adequate level of growth and profitability for Eksportfinans, as well as a satisfactory return for shareholders. NOK 700 million in profit has been allocated for the 2009 fiscal year.

### **Subordinated loan capital and capital contribution securities**

*Table 5 – Specification of capital contribution securities*

| <b>CAPITAL CONTRIBUTION SECURITIES</b>   | <b>Principal<br/>In NOK<br/>millions</b> |
|--|--|
| Loan undertaken in February 2003 – GBP 50 million. (3 months LIBOR + margin). The loan is perpetual, but Eksportfinans can recall the loan quarterly from February 2013. | 465,850                                  |
| <b>TOTAL CAPITAL CONTRIBUTION SECURITIES</b>   | <b>465,850</b>                           |

*Table 6 – Specification of subordinate loans*

| <b>SUBORDINATE LOANS</b>  | <b>Principal<br/>In NOK millions</b> |
|---|--------------------------------------|
| JPY 15 billion. Due in 2014 (3 months LIBOR + margin). Non-call.              | 938,520                              |
| USD 60 million. Due in 2016 (3 months LIBOR + margin). Can be called in 2011. | 346,602                              |
| USD 15 million. Due in 2016 (3 months LIBOR + margin). Can be called in 2011. | 86,651                               |
| <b>TOTAL SUBORDINATE LOAN</b>   | <b>1,371,773</b>                     |

## **4.3 Capital Adequacy**

The table below shows the development of capital adequacy during the past three years.

*Table 7 – Capital adequacy 2007–2009*

|  | <b>2009<br/>In NOK<br/>millions</b> | <b>2008<br/>In NOK<br/>millions</b> | <b>2007<br/>In NOK<br/>millions</b> |
|--|-------------------------------------|-------------------------------------|-------------------------------------|
|  |                                     |                                     |                                     |

|   |         |         |         |
|---|---------|---------|---------|
| Core capital  | 3,819   | 3,486   | 2,134   |
| Additional capital  | 1,418   | 1,674   | 1,334   |
| Total capital   | 5,237   | 5,160   | 3,468   |
| Core capital in percent   | 9.7 %   | 7.2 %   | 5.2 %   |
| Total capital in percent  | 13.3 %  | 10.7 %  | 8.4 %   |
| Total risk-weighted assets (incl. "off-balance" elements, operational risk and trading portfolio) | 39,280  | 48,145  | 40,755  |
| Total balance   | 225,254 | 296,514 | 218,380 |

Table 8 provides an overview of the company's assets as at 31 December 2009, and the assets that are secured with guarantees, so that credit loss only occurs if both the borrower and the guarantor breach their obligations.

**Table 8 – Specification of risk-weighted balance sheet as at 31 December 2009**

| ASSET TYPE                                | TOTAL RECORDED VALUE | RISK WEIGHT | RECORDED VALUE | RISK-WEIGHTED VALUE | GUARANTEED | REMARKS   |
|---|----------------------|-------------|----------------|---------------------|------------|---|
| Loan from Eksportfinans                   | 122,353              | 0 %         | 27,342         | 0                   | 23,328     | Guarantee from GIEK<br>Guarantee from other states<br>Guarantee from banks<br>Loan to KLP<br>Kreditt AS |
|   |                      | 20 %        | 58,068         | 11,614              | 4,014      |   |
|   |                      | 20 %        | 30,173         | 6,035               | 44,318     |   |
|   |                      | 35 %        | 48             | 17                  |            |   |
|   |                      | 50 %        | 904            | 452                 |            |   |
|   |                      | 100 %       | 8              | 8                   |            |   |
| Securities                                | 76,090               | 0 %         | 815            | 0                   |            | Bank portfolio  |
|   |                      | 20 %        | 29,144         | 5,829               |            | Bank portfolio  |
|   |                      |             | 46,131         | 5,752               |            | Trading portfolio   |
| Financial derivatives                     | 14,344               |             |                | 2,599               |            |   |
| Other                                     | 12,467               |             |                | 2,497               |            | 8 billion deposits /<br>4 billion with CSA security*  |
| "Off-balance" items                       |                      |             |                | 465                 |            |   |
| Operational risk                          |                      |             |                | 2,689               |            |   |
| Currency risk                             |                      |             |                | 162                 |            |   |
| <b>TOTAL</b>                              | <b>225,254</b>       |             |                | <b>39,280</b>       |            |   |
| Total risk-weighted assets / total assets |                      |             |                | 17.4 %              |            |   |

\*) Cash security given in connection with derivate exposure on regulated ISDA Collateral Support Annex (CSA) agreements.

## **5 ASSESSMENT OF CAPITAL REQUIREMENTS – PILLAR 2**

### **5.1 Summary**

Under Pillar 2, Eksportfinans will calculate financial capital for all significant risk types that the company undertakes through the activities. The financial capital will cover unexpected losses that may arise, and thus ensure that Eksportfinans has the necessary solidity. Eksportfinans will assess the capital requirement based on scenarios for unfavourable future market development.

The scenarios are based on the core capital in the financial plan that will yield a core capital share of about 9 %. A decline in results will then be taken into consideration under the different risk types. The result decline will lead to lower core capital, and there may be a need for supply of capital for the goal of the core capital share to be reached. Finally, it will be ascertained whether the company's planned return can be withheld as means to achieve the goal. This method will be applied to all three years in the financial plan.

Eksportfinans' history from its establishment in 1962 until 2007 was characterized by a stable condition in the market and small losses, while the period after 2007 has been more challenging, due to the international financial crisis. We have therefore chosen to illustrate the decline in results in two ways: one calculation that uses result changes that deviate from Eksportfinans' history, but without the level of severity that we and many other financial institutions have experienced during the past couple of years (mentioned in this chapter), and a sensitivity analysis that is a test of how much Eksportfinans' financial plan can tolerate. The sensitivity analysis is stronger than the first calculation and is closer to the financial crisis.

Eksportfinans expects good results during the coming years. Even in the most negative scenario, the financial development appears to be solid, without any dramatic impact on the capital adequacy if the return is withheld.

The negative scenario shows a total decline in result in 2010–2012 which will reduce the capital adequacy, but no more than that the expected result decline can be absorbed by withholding some of an otherwise possible dividend disbursement. The core capital adequacy may thus be kept at 9 %, even with a three-year decline scenario.

There are several elements of uncertainty in the analysis. The analysis does not cover the company's total risks, only the risk types we believe are most important to the company. There is also some uncertainty associated with future volume and margins.

The company has assessed the effect on the result and the capital adequacy of a three-year negative scenario for each of the following five risk types described, and the sum of these effects has been included in the overall assessment of Eksportfinans' capital requirement.

*The next few paragraphs describe the main risk areas, market, credit, liquidity and operational risk, with details on the control and exposure in each area.*

### **5.2 Market Risk**

#### **5.2.1 Management and Control**

It is Eksportfinans' goal to manage and reduce market risk through interest rate and currency swap agreements for all loans, and frames for interest rate and foreign

exchange risk. The company also has frames for credit spread risk in the liquidity reserve portfolio.

The sensitivity of the account results to credit spread changes is calculated per area of activity, and reported to the management group and board on a monthly basis.

In addition to using market information for trading, quantitative goals are also used to control Eksportfinans' exposure to market risk. This includes:

- Risk limits for currency risk per currency and in total. Upper limits have been set for net exposure in foreign currencies that would lead to the company exchanging some currency to Norwegian kroner to reduce the currency risk if they are broken.
- Accordingly, an upper risk limit is set for interest rate risk up to one year per basic point of change in international interest rate levels. If they are broken, adjustments must be assessed, and in principle interest rate exposure must be replaced until one is below the limit.
- A low limit has been set for the sensitivity of credit spread changes for the liquidity reserve portfolio. A stop loss limit has also been set in relation to the portfolio's market value. If the decline in the market value breaks this limit during the last month or in total since the portfolio was established, the securities will be replaced, with securities of higher liquidity and/or lower spread duration until the end of the year and for a minimum of 3 months.
- The limits for interest rate, currency and credit spread sensitivity have all been set in relation to the company's tolerance for market risk.
- The long investment portfolio has been hedged against all market risk (both spreading and currency risk) in the portfolio security agreement with the owner banks, mentioned in Eksportfinans' annual report, among others.

The company's system for management and control of market risk will be regularly evaluated by internal and independent control functions. In Eksportfinans' case, the external control will be performed by the company's internal auditor.

### **5.3 Credit Risk**

Eksportfinans is mainly exposed to credit risk through loans to the export industry, but the company also carries credit risk for the issuer of liquidity papers in which the company has invested, and to counter-parties and swap agreements. The company makes high demands on credit quality for the borrower (direct loans) and to the guarantor to maintain the company's conservative risk profile.

Credit risk is exclusively calculated based on the Basel II standard method in Pillar 1. A cost/benefit analysis was performed in 2008 regarding a possible transition to an advanced approach (IRB). In isolation, such a transition would be based on the expectations entered into the model, also given a certain capital savings. However, the operative and administrative consequences were considered to be so great that a decision was made to not implement a pre-project at the time. Kommunekreditt was an important reason for lower capital requirements, where 20 % weighting under the standardized approach would have yielded significant savings under IRB. With the sale of Kommunekreditt, there was even less use for an IRB transition.

The method used in the assessment of the capital for credit risk in Eksportfinans (Pillar 2) has changed since the previous ICAAP report. The report for 2008 contained its own assessment of the risk weights in the basis for the Pillar 1 calculation.

The company also assumes credit exposure towards counter-parties in derivate agreements. These are identified using ISDA-regulated agreements for swapping security – so-called Credit Support Annex / CSA agreements. Eksportfinans only uses cash as collateral for the CSA agreements.

The lack of internal models and already conservative risk weights in the minimum requirement means that we do not consider increasing the basis for calculations in the year's ICAAP – see 5.3.4. Instead, there will be an assessment of future core capital as a result of a decline in the company's result. The basis for the calculation thus has not been changed.

### 5.3.1 Management and Control

Eksportfinans sets frames based on credit assessments from the three leading rating agencies for all counter-parties, except for Scandinavian financial institutions. For Scandinavian financial institutions without a rating from an agency, an assessment from DnB NOR, Danske Bank and Nordea's own rating systems can be used. Scandinavian financial institutions also take into consideration the bank's assets under management in the framesetting. Eksportfinans also limits the counter-party frames to a given share of the counter-party's loan financing which is not retail deposits (wholesale funding). This limitation has only served as a guide for a very few number of banks.

The company measures and controls its own concentration risk and the counter-party's credit quality, and reports the status and development to the board every month. The appendix "Board guidelines for risk management at the Eksportfinans group" contains quantified frames for exposure on shore, customer segments and rating categories that the company wants to control, so that the concentration risk is kept at an acceptable level. The appendix "Monthly report to the board" shows, among others, credit exposure related to status. Use of credit lines is followed up daily by Risk Management.

### 5.3.2 Model Description and Application

The company uses the standardized approach

### 5.3.3 Portfolio Information

As shown by the table below, the company's portfolio has high credit quality. The average rating for the engagements with an international rating is "double A-".

**Table 9 – The company's aggregated exposure per rating category as at 31 December 2009**

| (NOK millions)          | Loans  |            |            | Liquidity portfolio |               |                     | Loan to Kommunekreditt        | Total   |
|-------------------------|--------|------------|------------|---------------------|---------------|---------------------|-------------------------------|---------|
| Rating group            | Direct | Guarantees | Tot. loans | Liq. res. portfolio | PHA portfolio | Tot. liq. portfolio | (security in municipal loans) |         |
| AAA                     | 1,971  | 27,502     | 29,473     | 10,517              | 19,497        | 30,013              | 30,058                        | 89,544  |
| AA+/AA/AA-              | 7,489  | 7,489      | 3,629      | 9,306               | 12,935        |                     |                               | 20,424  |
| A+/A/A-                 | 3,893  | 39,118     | 43,011     | 9,777               | 15,542        | 25,318              |                               | 68,330  |
| BBB+/BBB/BBB-           | 1,233  | 577        | 1,810      | 208                 | 3,996         | 4,204               |                               | 6,014   |
| BB+/BB/BB-              |        | 3          | 3          |                     | 153           | 153                 |                               | 155     |
| B+/B/B-                 |        | 3          | 3          |                     |               |                     |                               | 3       |
| CC+/C                   | 86     | 402        | 488        |                     |               |                     |                               | 488     |
| No international rating | 8,992  | 843        | 9,835      | (2)                 | 3,428         | 3,426               |                               | 13,261  |
| Grand Total             | 16,176 | 75,936     | 92,111     | 24,128              | 51,921        | 76,049              | 30,058                        | 198,219 |

Most of Eksportfinans' loan portfolio is guaranteed by either GIEK or banks (see table 9). Annual disbursements from guarantors indicate defaults in the export lending portfolio. Annual disbursements from the bank guarantors and GIEK have been well under 0.1 % of the guaranteed loan portfolio since 2004.

### 5.3.4 Capital Requirement for the Credit Risk at Eksportfinans

The basis for calculating credit risk in Pillar 1 is part of the calculation of the company's capital requirement. Eksportfinans believes that the regulatory risk weights will be conservative enough for the company also in a Pillar 2 calculation. The reason for this is that Eksportfinans takes little credit risk. This reflects that all of 88 % of the portfolio has double security lines or is a loan to municipalities. The remaining 12 % are mainly direct loans to Norwegian savings banks. In addition, it is the company's assessment that management and control of credit risk is acceptable, but it will continue to work to develop more quantitative methods to calculate the company's appetite for risk.

## **5.4 Liquidity Risk**

### **5.4.1 Management and Control**

Some of the loans to Eksportfinans have an uncertain term to maturity due to call and trigger opportunities. The loans and investments can generally be terminated early.

Eksportfinans has the following available liquidity buffers for the liquidity risk from the uncertainty in the maturity profile on the balance sheet:

- Short liquidity reserve portfolio where the terms are adapted to maturity on the debt side, when buying the liquidity papers.
- A borrowing program of USD 6 billion, in both USCP and ECP.
- Committed credit lines with three of the owner banks, in addition to an American bank.

In addition, since the autumn of 2008, Eksportfinans has been able to take up loans with a duration of up to 5 years from the public treasury. So far this right has not been used, and will expire on 31.12.2010.

### **Capital requirement for liquidity risk**

No capital requirement is calculated for liquidity risk. The company's goal is core capital adequacy of about 9 %. This level must, among others, contribute to a sufficiently good rating for the preferred funding sources to be available. This goal thus contributes to the liquidity risk being kept at an adequate level. The liquidity is mainly controlled by setting frames and defined access to liquidity reserves.

## **5.5 Operational Risk**

### **5.5.1 Management and Control**

The company conducts many large and to some extent complex transactions. Good management of the operational risk is key to maintain a low total risk level. Losses that are due to operational risk have historically been low at Eksportfinans.

During the past 10 years, there has only been one case (in 2002) of a significant operational error regarding transfers that led Eksportfinans to have had to assume losses. The loss is due to an error in notifying the counter-party when cancelling a swap. However, procedures were changed later, to prevent that the same or similar situations from arising again. The ensuing losses were some NOK 30 million (EUR 3.6 million).

In 2008, a provision was made for bad debts for one of the company's agent banks. This event is special and is in the borderland between operational risk and credit risk. The provision for bad debts has been adjusted by the level of reuse, estimated by independent parties. If the bank's bankruptcy estate does not agree with Eksportfinans'

assertion that the claim towards the bank is a prioritized claim, pursuant to Icelandic law, the case will be referred to the Icelandic courts.

The company follows the American Sarbanes-Oxley Act, which specifies a number of requirements regarding reporting format, procedure descriptions, password protection, version management, training, assessment of reasonability, etc. to reduce user and model risk associated with the value calculations in the accounts.

To reduce the documentation risk associated with loan agreements and guarantees, Eksportfinans uses standardized documentation that has been tested over a long period of time and checked against practice in the market. Norwegian law and the dispute forum in Norway apply to the documents. When the borrower is foreign, confirmation will be procured from a legally competent source that the liability and any securities are validly and bindingly established in accordance with local rules.

## **5.6 Business/Strategic Risk**

Business risk and strategic risk are considered as one and the same risk type. The strategy process that was conducted in 2009 has had great focus on the company being able to adapt to changes in the competitive situation and market conditions.

Capital is not calculated for business or strategic risk in the Pillar 1 calculation. An assessment of business and strategic risk will therefore be based on a decline in results.

### **Summary**

An overall assessment of all major risk types that affects our enterprise today, stressed negatively over three years, yields an outcome that still allows 9 % capital adequacy over the next three years, as long as lower dividends are disbursed than planned.

### **Eksportfinans**

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