2014

Risk and Capital Management

Länsförsäkringar Bank AB

Länsförsäkringar

Contents

1 Introduction

The document "Risk and capital management Länsförsäkringar Bank AB" has been prepared in accordance with the requirements set out in the Capital Requirements Directive CRD 2013/36/EU and Directive CRR (EU) 575/2013. The purpose of this document is for the institution to provide detailed and transparent information regarding the risks the institution is exposed to, the institutions risk management and its capital situation in relation to the regulatory capital requirements.

In this document, the term "Bank Group" refers to Länsförsäkringar Bank AB, and its subsidiaries Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB. Unless otherwise expressly stated, the term "the Bank" is used to refer to the consolidated situation, which comprises Länsförsäkringar AB, Länsförsäkringar Bank AB, Länsförsäkringar Hypotek AB, Länsförsäkringar Fondförvaltning AB and Wasa Kredit AB.

The comparative period for the consolidated situation is 31 March 2014, unless otherwise stated. If tables or data refer to the former highest level of consolidation, meaning the Bank Group, of which Länsförsäkringar AB is not a part, the comparative period is 31 December 2014.

1.1 Länsförsäkringar Bank AB in brief

1.1.1 Strategy and goals

Länsförsäkringar Bank AB was founded in 1996 and is the fifth largest retail bank in Sweden with a business volume of SEK 354 billion. The banking operations are conducted only in Sweden and business volumes have grown in all areas. The strategy is to offer banking services to the Länsförsäkringar Alliance's customers and leverage Länsförsäkringar's strong brand and local presence through the customer-owned regional insurance companies. The banking operations have a large customer base with the Länsförsäkringar Alliance's 3.5 million customers. The main target groups are the 2.9 million retail customers, of whom 1.8 million are home-insurance customers. Other target groups are agricultural customers and small businesses. The aim is, based on low risk, to maintain healthy growth in volumes and profitability, while at the same time having the most satisfied customers and increase the share of customers who have both banking and insurance with Länsförsäkringar. Länsförsäkringar Bank AB has had Sweden's most satisfied retail customers, according to the 2014 Swedish Quality Index. Länsförsäkringar Bank AB was named "Bank of the Year 2014" by Privata Affärer. With a comprehensive banking and insurance offering from Länsförsäkringar, customers receive a secure, total solution for their private finances.

Customer ownership

The Länsförsäkringar Alliance consists of 23 local, customer-owned regional insurance companies and the jointly owned Länsförsäkringar AB, which is the Länsförsäkringar Bank AB's Parent Company. The insurance customers own the regional insurance companies, which means that the principles of customer ownership also apply to the banking operations. Long-term respect for customers' security is fundamental to Länsförsäkringar since customers are both the principal and owners. The bank has low risk tolerance, which provides a stable performance over time. Lending is characterised by low risk and the in-depth, local customer and market knowledge of the regional insurance companies, combined with the conservative view of risk, generates growth with high credit quality.

Customer meetings and local market knowledge

The regional insurance companies are responsible for the local business operations and customer relationships. Business decisions are made locally and the regional insurance companies' commitment and network provide broad and in-depth knowledge about customers and market.

The branch network of the banking operations are found at the 128 branches of the regional insurance companies throughout Sweden. Trust, security and long-term relationships are high priorities within Länsförsäkringar and are created through personal customer meetings.

Mobile app and Internet bank simplifies

Digital services make it convenient and easy for customers to do their banking. The award-winning mobile app now has more logins than the Internet bank and the number of business transactions performed in both of these channels are increasing. The bank's goal is to be the leader in digital services.

Customer-driven and effective business model

Länsförsäkringar Bank AB supports the regional insurance companies in their advisory services and sales. Product development takes place in close cooperation between the regional insurance companies and Länsförsäkringar Bank AB. This cooperation features continuous efficiency enhancements to implement improvements that lead to improved advisory services, more efficient processes and lower expenses.

A strong brand

The Bank's successful growth and position in the market is based on Länsförsäkringar's strong brand, local presence and customer ownership.

1.2 Significant events during the year

CRR/CRD IV

CRR and CRD IV were introduced to the Bank's operations during 2014.

Consolidated situation

With CRR coming into effect, Länsförsäkringar Bank AB will be subject to a change of rules regarding the reporting of capital adequacy concerning the reporting of the consolidation level. Under CRR, in addition to the Bank Group, the consolidated situation includes the parent mixed financial holding company Länsförsäkringar AB. Since the Bank maintains the opinion that the actual risk and capital situation best are presented in the Bank Group's capital ratios, these are published in parallel with the capital ratios according to the new consolidated situation. As previously stated in the company's reports, the Bank has submitted a new application to the Swedish Financial Supervisory Authority seeking exemption from the provision under the Swedish Special Supervision of Credit Institutions and Investment Firms Act.

Capital contributions

During the year, Länsförsäkringar AB announced its intention to ensure that the Bank will remain well-capitalised according to the new consolidated situation. Länsförsäkringar Bank AB received a conditional shareholders' contribution of SEK 550 million from the Parent Company in 2014. The Board of Directors of Länsförsäkringar AB decided on 10 February 2015, to pay a shareholders' contribution of SEK 500 million to Länsförsäkringar Bank AB during the first quarter of 2015. Calculated proforma as if the contribution had been paid on 31 December 2014, the shareholders' contribution entails that the Bank Group's Common Equity Tier 1 ratio is raised from 16.2% to 17.2%. In addition, the Tier 1 ratio, calculated proforma, increases from 16.2% to 17.2% and the capital adequacy ratio is raised proforma from 20.6% to 21.5%.

Credit-risk quality

The operations are characterised by a low risk profile. The Bank Group and the Parent Company are exposed to a number of risks, primarily comprising credit risks, refinancing risks and market risks. The macroeconomic situation in Sweden is critical for credit risk since all loans originates in Sweden. Market risks primarily comprise interest-rate risks. Loan losses remain low and the refinancing of business activities was highly satisfactory during the year. Business volumes increased 13% to SEK 354 billion during the year, with continued high credit quality.

Rating

Länsförsäkringar Bank AB's credit rating is A/Stable from Standard & Poor's and A3/Stable from Moody's. Länsförsäkringar Hypotek AB's covered bonds have the highest rating of Aaa from Moody's and AAA/Stable from Standard & Poor's. Länsförsäkringar Hypotek AB is thus one of three issuers in the Swedish market for covered bonds with the highest rating from both Standard & Poor's and Moody's.

2 Organisation

This section describes how the consolidation requirements under the CRR and CRD IV prudential and reporting regulations differ from the consolidation requirements under accounting regulations and how it applies to Länsförsäkringar Bank AB.

2.1 The Bank Group

The accounting regulations define the Länsförsäkringar Bank AB Group based on its legal ownership structure. The Bank Group comprises the Parent Company Länsförsäkringar Bank AB, and the wholly owned subsidiaries Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB.

2.2 Consolidated situation

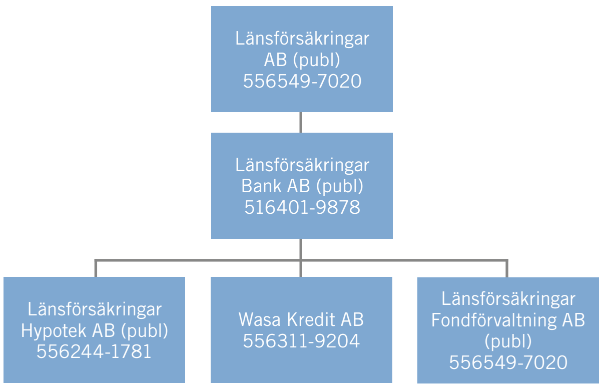
With the introduction of CRR and CRD IV, the parent mixed financial holding company, Länsförsäkringar AB, is to be subject to prudential and reporting requirements. Accordingly, the consolidated situation encompasses: Länsförsäkringar AB, Länsförsäkringar Bank AB, Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB. This structure is defined in the regulations, stated in section 1, as the consolidated situation and its composition do not correspond to the accounting structure.

In addition to Länsförsäkringar Bank AB, Länsförsäkringar AB has the subsidiaries of Länsförsäkringar Fondliv Försäkrings AB, Länsförsäkringar Sak Försäkrings AB and Länsförsäkringar Liv Försäkrings AB. These companies are not subject to prudential requirements for credit institutions and are thus not included in the consolidated situation. They are instead subject to the solvency rules for insurance companies. Capital from companies not included in the consolidated situation may not be included in the own funds. The capital adequacy rules impose requirements that investments in financial companies above a certain level are to be deducted from the capital base. These deductions are explained in more detail in the section on Capital management. For further information about the companies, refer to Länsförsäkringar AB's Annual Report.

There is no current or foreseen material practical or legal impediment in the consolidated situation for transferring funds from the own funds or repayment of liabilities between parent company and subsidiary.

The term "the Bank" is used in this report to refer to the consolidated situation, unless otherwise expressly stated.

FIGURE 1. LEGAL STRUCTURE OF THE CONSOLIDATED SITUATION



All of the Board of Directors of the companies has their registered offices in Stockholm.

TABLE 1. CARRYING AMOUNT AND PARENT COMPANY'S PARTICIPATING INTEREST

Company name	Carrying amount, SEK M	Parent Company's participating interest (%)	Corporate Registration Number	Consolidation method
Länsfärsäkringar AB Parent Company				
Länsförsäkringar Bank AB	7,930	100	516401-9878	Complete
Länsförsäkringar Fondliv Försäkrings AB (publ)	5,205	100	516401-8219	Deducted from the own funds
Länsförsäkringar Sak Försäkrings AB (publ)	3,206	100	502010-9681	Deducted from the own funds
Länsförsäkringar Liv Försäkrings AB (publ)	8	100	516401-6627	Deducted from the own funds
Länsförsäkringar Bank AB Parent Company				
Länsförsäkringar Hypotek AB	5,519	100	556244-1781	Complete
Länsförsäkringar Fondförvaltnings AB	165	100	556364-2783	Complete
Wasa Kredit AB	815	100	556311-9204	Complete

3 Risk management and risk governance

This section outlines the Bank's risks and the Board's risk appetite. It also explains how risks are managed in the operations based on the Bank's risk-management and risk-governance system.

3.1 The Bank's risks

Risks are a natural element of a bank's business activities and are defined in the Bank's risk policy as the possibility of negative deviations from an expected financial outcome.

A summary of the Bank's main risks is presented below.

Credit risk	Credit risk refers to the risk that a counterparty is unable to fulfil its obligations whereby the Bank is affected by a financial loss. The Bank's credit risk primarily arises through loans to private individuals and agricultural operations and, to a lesser extent, through loans to companies. Credit risk also arises due to investments with the aim of ensuring satisfactory liquidity for the Bank.
Market risk	Market risk refers to the risk of loss or lower future earnings due to changes in interest rates and exchange rates. The Bank's primary market risks are interest-rate risk and currency risk. Interest-rate risk mainly arises through different maturities of assets and liabilities, whereas currency risk mainly arises through funding in currencies other than SEK.
Liquidity risk	Liquidity risk refers to the risk that the Bank, due to insufficient cash funds, will be unable to fulfil its obligation or only be able to fulfil its obligations by funding at a significantly higher cost than normal or by divesting assets at a substantial deficit price. The Bank's liquidity risk arises based on the maturity profile of the Bank's assets and liabilities, including derivatives, not coinciding.
Operational risk	Operational risk refers to the risk of losses arising due to inappropriate or faulty internal processes and systems as well as human error or external events, and includes legal and compliance risks.
Business risk	Business risk refers to the risk of lower earnings due to lower volumes, price pressure or other consequences of a changed competitive situation. Business risk comprises earnings risk, strategic risk and reputation risk.

3.2 Risk appetite

The risk appetite is defined as the overall level and type of risk that the Bank intends to be, and can be, exposed to in order to achieve established profitability, capital and rating targets. The Board approves both the bank's risk appetite and the strategic targets that form the basis of the Bank's risk strategy. The bank is to expose itself only to those risks necessary for achieving established targets. The bank's risk appetite is to be characterised by a low risk profile whose lending operations focus on private housing and family-owned agricultural operations. Risk is limited within the framework of the Bank's established risk limits.

3.3 Risk-management and internal-control system

The bank has an effective risk-management system, comprising risk frameworks and risk-management processes that ensure correct monitoring, management and reporting of the Bank's risks. A well-functioning risk-management system aims to maintain a healthy risk culture throughout the entire operations and ensure that the Board has an objective and clear understanding of the overall risk profile of the operations.

3.3.1 Three lines of defence

The bank's risk management follows the division of roles and responsibilities according to the three lines of defence:

First line of defence

The first line of defence pertains to all risk-management activities performed in the business operations. The operations that are exposed to risk also own the risk, which means that the daily risk management takes place within the operations. The operations' are also responsible for ensuring that control processes for monitoring are in place, implemented and reported. All employees assume individual responsibility for working towards a well-functioning risk culture by complying with the Bank's established risk-management guidelines and framework.

Second line of defence

The second line of defence pertains to the Risk Control and Compliance functions, which establish principles and frameworks for risk management and regulatory compliance. Accordingly, duality in risk management is achieved and risk awareness is prevalent in all day-to-day business decisions. Risk Control controls and monitors the Bank's risks and ensures that risk awareness and correct and consistent risk management takes place on a daily basis. Risk Control also provides assistance when the operations introduce procedures, systems and tools for maintaining this continuous risk management. The role of compliance is to provide support and control for ensuring that the operations comply with regulatory requirements.

Third line of defence

The third line of defence is Internal Audit, which comprises the Board's support for quality assurance and evaluation of the organisation's risk management, governance and internal controls. Internal Audit performs independent and regular audits to control, evaluate and ensure, for example, the procedures and processes for financial reporting, the operation and management of information systems and the operations' risk-management system.

3.3.2 Risk framework

The risk framework contains strategies, processes and reporting procedures necessary for continuously identifying, measuring, monitoring, managing and reporting the risks associated with the business activities. All risk activities are based on this risk framework that is adopted by the Board. The risk framework is described in governance documents, including a risk policy, a policy for risk appetites and risk limits and guidelines for the Risk Control function. The risk framework also includes governance documents for the Board's committees.

The bank's risk framework is designed to meet internal needs, sound market practice and regulatory requirements. Accordingly, the risk framework is an integrated part of the decision-making processes and contributes to achieving the operational targets with a high degree of security.

The bank manages and evaluates its exposure to the risks to which its operations are exposed on the basis of:

- Clear and documented descriptions of processes and procedures.
- Clearly defined and documented responsibilities and authorities.
- Risk-measurement methods and system support that are customised to the requirements, complexity and size of the operations.
- Regular incident reporting of the operations according to a documented process.
- Sufficient resources and expertise for attaining the desired level of quality in both the business and control activities.
- Documented and communicated business contingency, continuity and recovery plans.
- Clear instructions for each respective risk area and approval process.

3.4 Risk governance

The bank's risk governance is based on governance documents adopted by the Board and a clear decision process in the operations.

Board of Directors

The Board is responsible for ensuring that an efficient risk-management system is in place and that it is customised to the Bank's risk appetite and risk limits through the adoption of relevant governance documents. The Board approves all significant elements of the internal models used within the Bank and is also responsible for ensuring that regulatory compliance and risks are managed in a satisfactory manner through the Risk Control, Compliance and Internal Audit functions. The Board's Risk and Capital Committee supports the Board in risk and capital issues, and prepares cases ahead of Board decisions that pertain to market, liquidity and credit risk, and capital and internal capital adequacy assessments.

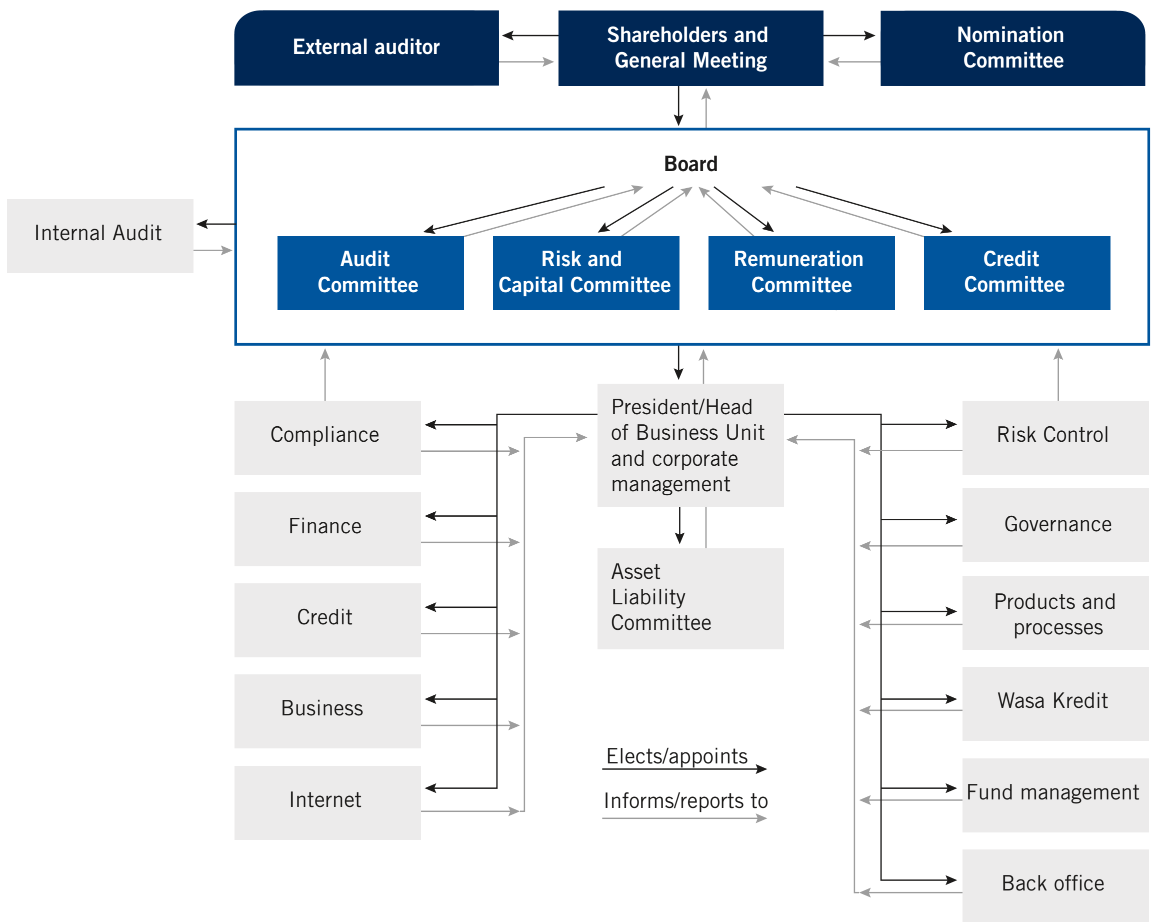
President

The President is responsible for ensuring that daily management takes place in accordance with the strategies, guidelines and governance documents established by the Board. The President also ensures that the methods, models, systems and processes that form the internal measurement and control of identified risks work in the manner intended and decided by the Board. The President is to continuously ensure relevant reporting from each unit, including Risk Control, to the Board. The President is the Chairman of the Asset Liability Committee (ALCO), which follows up on capital and financial matters arising in the Group.

Departments

The bank is organised into different departments, with each department represented in the Bank's management group. Heads of department have the overall responsibility for day-to-day risk

FIGURE 2. THE BANK'S RISK GOVERNANCE STRUCTURE



management in the department's operations and for ensuring that such risk management takes place in accordance with the risk framework.

Risk Control

The Risk Control function is responsible for the independent risk control and objectively reports risks in the banking operations. Risk Control is also responsible for the Bank's capital adequacy reporting. The individual responsible for Risk Control is the Chief Risk Officer (CRO) who is directly subordinate to the President and reports directly to the President, the Risk and Capital Committee, and the Board. The Board approves the appointment and replacement of the CRO. Risk Control's areas of responsibility are defined and documented in the guidelines adopted by the Board.

3.4.1 Monitoring and reporting

Risk Control reports on the Bank's risk development to the Boards, Risk and Capital Committee and the President.

Monitoring risks is a significant part of the Bank's ongoing operations. Controls and risk reports of market and liquidity risk and credit risk with financial counterparties take place every day. Other types of risk reporting take place on an ongoing basis. In addition, an aggregated risk and capital report, containing all risk areas, is submitted to the Board every quarter. Reports are also made to the Board's committees.

An institution is to have a recovery plan in accordance with currently applicable regulations, FFFS 2014:1 and Directive 2013/36/EU. This plan is to describe the measures that institutions can take for the restoration of their financial situation following a significant deterioration. The bank prepared such a plan in 2014 in accordance with the rules.

4 Capital management

4.1 Capital adequacy

Minimum capital requirements and capital buffers

Under CRR, a credit institution is to maintain a capital base that at all times fulfils the minimum requirements, expressed as a percentage of the total Risk Exposure Amount (REA):

- Minimum Common Equity tier 1 ratio of 4.5%.
- Minimum Tier 1 capital ratio of 6%.
- Minimum total capital ratio of 8%.

In addition to minimum capital requirements , CRD IV also includes the introduction of a number of capital buffers, the purpose of which is to manage both cyclical and structural systemic risks. These buffers are:

- Capital conservation buffer of 2.5% of REA.
- Countercyclical buffer of between 0 to 2.5% of REA.
- Systemic risk buffer, the amount of which is proportionate to the bank's significance to the financial system.
- Buffer for systemically important institutions.

All capital buffers are to be comprised of Common Equity Tier 1 capital. Breaching any of these buffers will entail restrictions on the Bank's opportunities to distribute capital, such as dividends and repurchasing shares. In addition to these requirements, a minimum level exists, through the transition rules, corresponding to a capital requirement based on 80% of the risk-weighted assets under the former Basel I rules. The Swedish Financial Supervisory Authority decided on 8 September 2014 that the countercyclical capital buffer for Sweden would be activated and the buffer amount would be 1%. This buffer amount is to be applied from 13 September 2015 and currently corresponds to an additional capital requirement of SEK 602 million for the Bank. On 8 September 2014, the Swedish Financial Supervisory Authority also decided on a capital requirement for Swedish Banks. In connection with this, a decision was made to raise the already existing risk weight floor for Swedish mortgages from 15% to 25%. The risk weight floor is applied under the requirements of Pillar II to the retail exposure class for exposures secured by real estate collateral. Due to the increase in the risk weight floor, the Bank needs to withhold an additional SEK 1,132 million in capital.

The Bank's Common Equity Tier 1 capital ratio on 31 December 2014 amounted to 13.9% (11.3) and the capital adequacy ratio to 17.5% (15.0). The Bank's surplus of capital, according to the Basel I floor, on the same date amounted to SEK 2,342 million (1,226).

TABLE 2. TREND IN CAPITAL ADEQUACY MEASURES

	Consolidated situation		Bank Group	
SEK M	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014
Common Equity Tier 1 capital	8,369	6,577	8,564	7,255
Tier 1 capital	8,369	6,577	8,564	7,255
Tier 2 capital	2,145	2,169	2,305	2,329
Capital base	10,514	8,746	10,869	9,584
Total own funds Risk Exposure Amount	60,250	58,466	52,822	51,405
Capital requirement	4,820	4,677	4,226	4,112
Common Equity Tier 1 capital ratio	13.9%	11.3%	16.2%	14.1%
Tier 1 capital ratio	13.9%	11.3%	16.2%	14.1%
Capital ratio	17.5%	15.0%	20.6%	18.6%
Capital conservation buffer	1,506	–	1,321	–
Capital requirement according to Basel I floor	8,642	7,986	8,579	7,920
Own funds adjusted to Basel I floor	10,984	9,212	11,339	10,050
Surplus capital according to Basel I floor	2,342	1,226	2,761	2,130

4.2 Internal capital adequacy assessment and capital planning

The Bank's internal capital adequacy assessment process (ICAAP) is part of the capital planning and is to ensure that the Bank, at any given time, has a sufficiently amount of capital in relation to its current risk exposure level. A buffer of the statutory minimum capital requirements, the owner's yield requirements and external requirements from investors and rating agencies are taken into account in addition to the assessment of the Bank's capital requirements performed under the ICAAP. The ICAAP is also to take the development of the operations into consideration. A capital forecast is prepared when the capital requirements are established. The forecast is prospective and is to provide a view of the capital requirements over both the long and the short term. The purpose of the forecast is to ensure that the Bank has a sufficiently own funds and the correct composition of capital. The capital forecast is followed up four times a year by the ALCO, the Risk and Capital Committee and the Board.

The CRO of Länsförsäkringar Bank AB is responsible for conducting the process work that leads to an internal capital adequacy assessment for the Bank and forms the basis for business planning and Board decisions concerning capital forecasts. The Bank's ICAAP is designed based on the requirements of the Basel rules and the requirements established for the operations by the Board of Directors. The rules are principle-based and general in nature, meaning that the Bank largely determines the process itself. The procedures, implementation and results are to be documented and reported to the Financial Supervisory Authority annually.

The process is to be carried out at least annually and includes the following activities:

- Identifying all risks
- Risk assessment
- Stress tests
- Capital calculations

All of the Bank's identified risks are included in the calculation of the capital requirements in the ICAAP. The Bank bases its calculation on the methods used to calculate the capital requirements under the framework of Pillar I. For risks not covered by Pillar I, known as Pillar II risks, internal models are used to allocate a capital requirement to each risk. The following additional risks are allocated a capital requirement under the Pillar II framework.

- Credit related concentration risk
- Interest-rate risk in the bank book, credit-spread risk and currency basis spread risk
- Business risk, comprising strategic risk, earnings risk and reputation risk
- Pension risk

The internal capital requirement provides a view of the Bank's current position. Scenario analyses and stress tests are performed under the ICAAP framework to ensure that the Bank is well-capitalised for the future. The basic prerequisites for stress tests are to be reviewed by the Board of Directors at least once annually. This discussion provides guidance for the continuing work involving stress tests. Work on stress tests is based on a number of scenarios and how these scenarios will impact the risk in the Bank. The basic scenario is based on the most probable trend in volumes, earnings and loan losses and the bank's business plan. Assumptions in this basic scenario are stress-tested by applying the most unfavourable conditions in the external business world for the bank that could be expected to occur once every 20–25 years. The purpose of the stress-test scenario is to ensure that the amount and composition of the bank's capital base are sufficient enough to absorb losses. Also, a comparison between the bank's basic scenario and the stress-test scenario provides a basis for the amount of the capital planning buffer. The aim of the buffer is to ensure that the bank can maintain a high level of capitalisation even in the event of unforeseen circumstances.

4.3 Own funds

Own funds consists of capital that can be used to cover the regulatory capital requirement defined in CRR/CRD and is based on equity according to applicable accounting regulations. Only capital from companies included in the consolidated situation may be included in the own funds. The own funds is the total of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital, less items defined in the capital adequacy rules for deduction. Common Equity Tier 1 capital is to be readily available to absorb losses and is the most subordinated capital in the event of liquidation. Tier 2 capital comprises perpetual and dated subordinated loans. The basic principle for subordinated liabilities in the capital base is the order of priority in the event of default or bankruptcy. Tier 2 capital must be subordinate to the Bank's deposits and also to liabilities to non-priority creditors. Subordinated liabilities are to be repaid after all other liabilities, but before liabilities to shareholders.

TABLE 3. CAPITAL BASE

	Consolidated situation		Bank Group	
SEK M	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014
Equity	17,143	15,784	9,597	8,407
of which, share capital	1,007	975	955	955
of which, share premium reserve	4,906	4,438		
of which, retained earnings	4,773	4,773	804	804
of which, accumulated comprehensive income	152	102	183	103
of which, other reserves	4,801	4,801	6,943	6,393
of which, net profit for the period	1,504	695	712	153
Non-verified profit		–129		–153
Foreseeable charge or dividend				
Equity for capital adequacy	17,143	15,655	9,597	8,254
Intangible assets	–421	–494	–310	–377
Cash-flow hedges	–15	30	–47	29
Unrealised changes in value of financial assets	–138	–133	–138	–133
IRB Provisions deficit (–)/surplus (+)	–478	–498	–478	–498
Adjustments for prudent valuation	–51		–49	
Deferred tax assets		–14	–	–9
Threshold deduction: financial companies (10%)	–7,660	–7,958	–1	–1
Qualifying holdings outside the financial sector	–10	–10	–10	–10
Common Equity Tier 1 capital	8,369	6,577	8,564	7,255
Additional Tier 1 capital instruments			–	–
Tier 1 capital	8,369	6,577	8,564	7,255
Tier 2 capital instruments	2,137	2,137	2,297	2,297
IRB Provisions deficit (–)/surplus (+)	8	33	8	32
Tier 2 capital	2,145	2,169	2,305	2,329
Total own funds	**10,514**	**8,746**	**10,869**	**9,584**

4.3.1 Common Equity Tier 1 capital

Equity comprises share capital, capital contributed and reserves. The amount of SEK 1,504 million is included in net profit for the year, without deductions for dividends, in accordance with the Board's proposed appropriation of profits. During the period, equity increased net due to dividends received, the shareholders' contribution and net profit for the year. Changes in equity attributable to cash-flow hedges, negative SEK 15 million (pos: 30), may not be included in the own funds and is adjusted in Common Equity Tier 1 capital. The same applies to the item "Unrealised changes in value of financial assets" which is related to available-for-sale financial assets, in the amount of a negative SEK 138 million (neg: 133). Common Equity Tier 1 capital includes a deduction of SEK 51 million, which arose due to the regulatory requirements regarding prudent valuation of items in the accounting category of fair value. This deduction complies with Article 105 of CRR.

Adjustments for the IRB deficit when, according to the accounts, the reserves are less than the calculated expected loss of the capital adequacy, are to be made within Common Equity Tier 1 capital. If the reserves exceed the anticipated loss, a limited portion may be included in the Tier 2 capital (maximum 0.6% of IRB REA). On 31 December 2014, SEK 478 million was deducted from Common Equity Tier 1 capital and SEK 8 million (33) was included in Tier 2 capital.

Deferred tax assets recognised in the balance sheet are to reduce Common Equity Tier 1 capital if they meet certain criteria and exceed certain thresholds. The deferred tax assets that existed on 31 December 2014 in the companies in the consolidated situation did not give rise to any deductions in the own funds. Recognised intangible assets and goodwill, where applicable, are also designed to reduce Common Equity Tier 1 capital. The deduction in the consolidated situation includes SEK 421 million (494) pertaining to intangible assets.

According to the regulation, deductions for investments in financial companies are to be made in Tier 1 capital if the invested capital exceeds 10% of the Common Equity Tier 1 capital. Amounts under the threshold are risk-weighted and assigned a risk weight of 250%. The deduction in the consolidated situation primarily derives from Länsförsäkringar AB's holdings in subsidiaries. The total carrying amount of these holdings of Common Equity Tier 1 instruments amounted to SEK 8,420 million on 31 December 2014. There are no outstanding financial instruments that are included as Additional Tier 1 instruments, which mean that the amounts for Common Equity Tier 1 capital and Tier 1 capital on 31 December 2014 were the same.

4.3.2 Tier 2 capital

Tier 2 capital instruments must be subordinate to other receivables from the company, except for equity instruments and Additional Tier 1 instruments. Fixed-term subordinated debt that is included may not be covered or guaranteed in any form by an issuing institution or institution in the consolidated situation.

Except for a small amount from the surplus from IRB Provisions, Tier 2 capital exclusively comprises fixed-term subordinated debt, of which externally invested amounts totalled a nominal SEK 2,300 million. These loans meet the CRR/CRD IV requirements for being included in the own funds as Tier 2 capital. However, due to the transition rules, a deduction of SEK 160 million is made on consolidation according to the new group rules.

TABLE 4. TIER 2 CAPITAL

Borrower	Länsförsäkringar Bank AB	Länsförsäkringar Bank AB	Länsförsäkringar Bank AB
Loan amount (SEK M)	1,100	445	755
Loan date	28 March 2013	30 Jun 2011	30 Jun 2011
Repayment date	28 March 2023	30 Jun 2021	30 Jun 2021
Premature redemption (break-off date)	28 March 2018	30 Jun 2016	30 Jun 2016
Step-up	No	No	No, but fixed interest rate changes to variable interest rate
Regulatory call	Yes, after consulting Financial Supervisory Authority	Yes, after consulting Financial Supervisory Authority	Yes, after consulting Financial Supervisory Authority

4.4 Capital requirement

Risk Exposure Amounts are calculated in accordance with CRR and CRD IV. The Bank calculates most of its exposure by applying the Internal Ratings-based Approach (IRB Approach). The Bank calculates all of its retail exposures in accordance with the Advanced IRB Approach, which corresponds to 89% (89) of the Bank's credit portfolio, meaning loans to households and companies. This means that a considerable portion of its credit-risk exposure is calculated using a method that aims to identify and classify risk for each individual counterparty, which includes own estimates of Loss Given Default (LGD), Probability of Default (PD) and Conversion Factor (CF).

Retail exposures pertains primarily to private individuals, but also small and medium-sized businesses. Exposures to corporates in Länsförsäkringar Bank AB and Länsförsäkringar Hypotek AB are calculated in accordance with the foundation IRB, while the Standardised Approach is applied to exposures in Wasa Kredit AB. Other exposure classes are managed by applying the Standardised Approach.

The Standardised Approach is usedin calculations of the capital requirement for credit valuation adjustment risk and operational risk, except for operational risk in Länsförsäkringar AB for which the Basic Indicator approach is applied.

REA in the consolidated situation on 31 December 2014 amounted to SEK 60,250 million (58,466). The increase in risk exposure under the IRB Approach remained related to the continued growth in lending, primarily to households in the form of mortgages which rose SEK 1,078 million during the period. Under the Standardised Approach, REA increased a total of SEK 145 million during the period, which was primarily driven by increased lending in Wasa Kredit AB's retail exposures and equity exposures related to Länsförsäkringar AB's holdings in insurance companies. The increase was counterbalanced by a lower holding in covered bonds and lower exposures to institutions and credit valuation adjustment risk. Credit value adjustment risk is due to the Bank receiving permission during the year to apply credit-risk reducing netting agreements in its capital-adequacy calculations for the most significant derivative counterparties in Länsförsäkringar Bank AB and Hypotek AB.

TABLE 5. CAPITAL REQUIREMENT AND RISK EXPOSURE AMOUNT

	Consolidated situation				Bank Group			
	31 Dec 2014		31 Mar 2014		31 Dec 2014		31 Mar 2014	
SEK M	Capital requirement	REA	Capital requirement	REA	Capital requirement	REA	Capital requirement	REA
Credit risk according to Standardised Approach								
Exposures to institutions	77	960	129	1,615	72	903	108	1,355
Exposures to corporates	141	1,763	137	1,712	139	1,740	137	1,712
Retail exposures	77	964	61	759	77	964	61	759
Exposures secured by immovable property	0	0	0	0	0	0	0	0
Defaulted exposures	12	146	6	71	12	146	6	71
Covered bonds	262	3,272	291	3,632	262	3,272	291	3,632
Exposures to CIUs	14	171	18	228	0	0	0	3
Equity exposures	153	1,912	121	1,516	0	3	0	0
Other items	115	1,438	76	948	55	682	32	403
Total capital requirement and Risk Exposure Amount for credit risk, Standardised Approach	**850**	**10,627**	**839**	**10,482**	**617**	**7,710**	**635**	**7,934**
Credit risk according to IRB								
Retail exposures	2,521	31,512	2,433	30,409	2,521	31,512	2,433	30,409
of which secured by immovable property	1,752	21,899	1,666	20,821	1,752	21,899	1,666	20,821
of which other retail exposures	769	9,613	767	9,588	769	9,613	767	9,588
Exposures to corporates	725	9,061	662	8,272	725	9,061	662	8,272
Non credit-obligation assets	0	0	0	0	0	0	0	0
Total capital requirement and Risk Exposure Amount for credit risk, IRB	**3,246**	**40,573**	**3,094**	**38,681**	**3,246**	**40,573**	**3,094**	**38,681**
Operational risk								
Standardised Approach	210	2,619	210	2,619	210	2,619	210	2,619
Basic Indicator approach, Länsförsäkringar AB	361	4,507	361	4,507	0	0	0	0
Total capital requirement for operational risk	**570**	**7,126**	**570**	**7,126**	**210**	**2,619**	**210**	**2,619**
Credit valuation adjustment								
Standardised Approach	154	1,925	174	2,178	154	1,921	174	2,171
Total capital requirement and Risk Exposure Amount	**4,820**	**60,250**	**4,677**	**58,466**	**4,226**	**52,822**	**4,112**	**51,405**

5 Credit risk

Credit risk refers to the risk that a counterparty is unable to fulfil its obligations whereby the Bank is affected by a financial loss.

5.1 Risk appetite

The Bank's risk-taking regarding credit risk is to be based on a sound credit process and a highly diversified credit portfolio with an overall low risk level. The regional insurance companies' local presence and market knowledge are important for ensuring a credit portfolio of high quality.

5.2 Risk management

This section presents the Bank's credit process, risk classification system and method for calculating the capital requirement for credit risk.

5.2.1 Credit process

The banking operations impose strict requirements in terms of customer selection, customers' repayment capacity and the quality of collateral.

Länsförsäkringar Bank AB is responsible for ensuring that loan origination is carried out according to uniform procedures based on the Board's adopted guidelines, which ensures a common view on loan origination throughout the organisation. Together with the Bank Group, the regional insurance companies continuously monitor and review the quality of the credit portfolio and borrowers' repayment capacity. Combined with the risk classification system this leads to a balanced and consistent loan origination.

The Board's adopted credit regulation form the foundation for all loan origination and apply for all regional insurance companies and the Bank Group. The credit decision level is determined by the size of the loan and the level of risk. The highest instance is a credit decision made by the Board and the lowest instance is a credit decision at local level. Mandates for granting credit at the respective decision-making instance are set out in the credit regulations.

The credit regulations also set out minimum requirements regarding underlying documentation for credit-granting decisions. Compliance with the credit regulations is monitored by the regional insurance companies as well as the Bank Group. The credit regulations and credit process combined with local customer- and market knowledge ensures a credit portfolio with high credit quality.

5.2.2 IRB system

The IRB system is a core component of the credit process and consists of methods, models, processes, controls and IT systems to support and further develop the quantification of credit risk. The IRB system is specifically used in:

- Credit process for risk assessment and credit-granting decisions
- Calculation of portfolio reserves
- Calculation of risk-adjusted returns
- Monitoring and reporting to management and the Board
- Calculation of capital requirements
- Capital allocation

Some of the core concepts in the IRB system are described below.

Exposure at Default (EAD)

Exposure at Default is the exposure amount that the counterparty is expected to utilise upon default. For commitments on-balance sheet items EAD is defined as capital liability plus accrued and overdue unpaid interest and fees. For off-balance sheet items EAD is calculated in using a conversion factor for the counterparty's unutilised exposure.

Probability of Default (PD)

The Probability of Default is the probability that a counterparty will default within a 12-month period. A counterparty is considered to be in default if a payment is more than 60 days past due[1]. Further, based on other reasons, a counterparty, is also considered to be in default if the counterparty is expected to be unable to meet its obligation to the Bank.

An initial PD is calculated for each counterparty adjusted to reflect the average proportion of default over several business cycles. Finally, a safety margin is added to the PD estimate to ensure that the risk is not underestimated. Following the calculation of PD, all non-defaulted counterparties are ranked and divided into the Bank's eleven risk classes.

In the development of models for calculating PD the information that is most relevant, for each type of counterparty, has been taken into consideration. The division of exposures into risk classes are called scoring. The scoring process for retail exposures takes place using models based on predictive statistical analysis, while the scoring process for corporate exposures, in addition to a strict predictive statistical analysis, is based on individual expert assessments. These risk models take both internal and external information into consideration.

Loss Given Default (LGD)

Loss Given Default is defined as the expected loss in percent of the total counterparty exposure given default. An internal estimate of LGD is used for the Advanced IRB Approach, which is based on internal information about factors such as loss ratio, loan-to-value (LTV) and product type. To ensure that the risk is not underestimated a safety margin is added to the LGD estimate, before a final LGD adjustment is made to reflect the loss ratio in a period of recession.

Conversion Factor (CF)

The Conversion Factor is used to calculate off-balance sheet commitments that are expected to be utilised by the counterparty in the event of default. An internal estimate of CF is calculated for the Advanced IRB Approach, which is based on internal information about factors such as degree of realisation, degree of utilisation and product type. Lastly a safety margin is added to these estimates to ensure that the risk is not underestimated.

Validation

Every year the entire IRB system is validated in accordance with applicable regulations and internally adopted guidelines. The quantitative models used to measure risk are evaluated based on predic-

[1] 90 days is applied for Wasa Kredit AB.

tive ability and risk-differentiating properties. Concerning model stability, high attention is given to ensure that models are stable over time. In addition to the purely quantitative aspects of the IRB system, the use and integration of the system is evaluated as well , to ensure that risk is uniformly and consistently measured. The entire validation process is performed by the Bank's Risk Control function.

5.2.3 Method for calculating capital requirements for credit risk

This section provides an overview of the exposures calculated by the Standardised Approach and IRB Approach respectively, as well as the dates and portfolios for which the bank has received approval to apply the IRB Approach.

Standardised Approach

Exposures calculated according to the Standardised Approach primarily comprise exposures to governments and institutions, and holdings of covered bonds in the Bank Group's liquidity reserve. All holdings have a very high credit rating.

Internal Ratings-based Approach (IRB)

The Bank applies the IRB Approach for retail- and corporate exposure classes [2]. The Foundation Internal Ratings-Based Approach is applied to corporate exposures, where prescribed amounts are used for LGD and CF. The Bank has received permission from the Financial Supervisory Authority to apply the IRB Approach as follows:

- In December 2006, permission was granted to apply the IRB Approach for retail exposures. This Approach has been applied to capital requirement calculations since February 2007.
- In December 2009, permission was granted to apply the Foundation IRB Approach to capital requirement calculations for companies with agricultural operations. This Approach has been applied since March 2010.
- In May 2012, permission was granted to apply the IRB Approach for corporate exposures excluding Wasa Kredit AB. This Approach has been applied since June 2012.

5.3 Credit quality

This section describes the Bank's credit-risk exposure based on approach, exposure class and geographic- and industry distribution. Further, the Bank's IRB exposure is reported by risk class.

The Bank's retail and corporate exposure increased during the period due to organic growth. At the same time the average risk weight for these exposure classes has declined, as shown in Table 6. Amounts and risk weights are reported separately for small and medium-sized businesses (SMEs) in the retail and corporates exposure classes.

[2] Some exposures in Wasa Kredit AB to which the Standardised Approach is applied are included in the IRB roll-out plan approved by the Financial Supervisory Authority.

TABLE 6. EXPOSURE BY EXPOSURE CLASS

	31 Dec 2014			31 Mar 2014			Period average	
Exposure class, SEK M	Original exposure	EAD	RW (%)	Original exposure	EAD	RW (%)	Original exposure	EAD
Standardised Approach								
Central governments and central banks	8,352	8,352	0	9,209	9,208	0	7,604	7,604
Regional governments or local authorities	3,116	3,116	0	2,972	2,972	0	3,003	3,003
Multilateral development banks	363	363	0	127	127	0	186	186
Institutions	11,809	4,801	20	22,493	8,075	20	19,815	6,404
Corporates	2,113	2,111	84	2,032	2,030	84	2,096	2,093
of which, SMEs	1,476	1,474	77	1,383	1,382	77	1,443	1,441
Retail	1,769	1,285	75	1,288	1,011	75	1,532	1,149
of which, SMEs	–	–	–	–	–	–	–	–
Exposures in default	114	98	149	63	48	146	104	88
Covered bonds	32,716	32,716	10	36,324	36,324	10	31,630	31,630
Claims in the form of CIU	1,225	1,225	14	1,259	1,259	18	1,179	1,179
Equity Exposures	769	769	249	613	613	247	716	716
Other items	1,391	1,391	103	1,153	1,153	82	1,185	1,185
Total, Standardised Approach	**63,737**	**56,228**	**19**	**77,531**	**62,821**	**17**	**69,050**	**55,238**
IRB								
Corporates	21,278	21,027	43	19,031	18,921	44	20,224	20,056
of which, SMEs	21,093	20,844	43	18,749	18,641	43	19,966	19,801
Retail	168,371	165,905	19	155,267	152,436	20	161,803	159,008
of which, SMEs	25,027	24,706	22	23,555	23,239	23	24,215	23,898
of which secured by immovable property	145,998	144,180	15	132,603	130,435	16	139,119	136,978
Of which, other retail credits	22,372	21,724	44	22,664	22,001	44	22,684	22,030
Total, IRB	**189,649**	**186,931**	**22**	**174,298**	**171,357**	**23**	**182,027**	**179,065**
Total	**253,386**	**243,159**	**21**	**251,830**	**234,178**	**21**	**251,077**	**234,303**

Table 7 presents the distribution by exposure calculated per country, under the Standardised Approach.

TABLE 7. DISTRIBUTION OF EXPOSURE PER COUNTRY, STANDARDISED APPROACH

	31 Dec 2014		31 Mar 2014	
Exposure class, SEK M	**Original exposure**	**EAD**	**Original exposure**	**EAD**
Sweden	56,528	51,762	67,931	57,974
Germany	925	925	585	585
Finland	807	807	1,014	1,014
Luxembourg	363	363	127	127
Switzerland	828	403	346	346
Denmark	3,832	1,537	7,059	2,305
Norway	408	385	471	471
Ireland	47	47		
Total	**63,737**	**56,228**	**77,531**	**62,821**

All IRB exposure originate from Sweden. The Bank's exposure per county is presented in Table 8. The exposure is well-diversified with a slight concentration to the metropolitan areas, specifically the counties of Stockholm, Skåne and Västra Götaland. Exposures secured by immovable property amounted to SEK 163.1 billion of a total of SEK 186.9 billion at 31 Dec 2014.

TABLE 8. DISTRIBUTION OF EXPOSURE PER COUNTRY, IRB

	31 Dec 2014				31 Mar 2014			
	Total		Of which, exposures secured by immovable property		Total		Of which, exposures secured by immovable property	
County, SEK M	**EAD**	**%**	**EAD**	**%**	**EAD**	**%**	**EAD**	**%**
Blekinge	3,390	1.8	2,908	1.8	3,118	1.8	2,646	1.8
Dalarna	8,477	4.5	7,509	4.6	7,885	4.6	6,903	4.7
Gotland	4,707	2.5	4,223	2.6	4,395	2.6	3,896	2.6
Gävleborg	5,603	3.0	4,832	3.0	5,336	3.1	4,559	3.1
Halland	10,229	5.5	9,055	5.6	9,741	5.7	8,492	5.7
Jämtland	3,733	2.0	3,293	2.0	3,523	2.1	3,073	2.1
Jönköping	7,364	3.9	6,523	4.0	6,662	3.9	5,850	4.0
Kalmar	4,547	2.4	3,884	2.4	4,159	2.4	3,504	2.4
Kronoberg	3,480	1.9	3,004	1.8	3,096	1.8	2,644	1.8
Norrbotten	2,482	1.3	2,001	1.2	2,187	1.3	1,716	1.2
Skåne	22,614	12.1	19,278	11.8	20,526	12.0	17,290	11.7
Stockholm	25,072	13.4	21,373	13.1	23,542	13.7	20,057	13.6
Södermanland	5,797	3.1	5,059	3.1	5,383	3.1	4,635	3.1
Uppsala	9,696	5.2	8,919	5.5	8,901	5.2	8,156	5.5
Värmland	3,059	1.6	2,558	1.6	2,779	1.6	2,272	1.5
Västerbotten	6,006	3.2	5,440	3.3	5,417	3.2	4,870	3.3
Västernorrland	2,963	1.6	2,480	1.5	2,633	1.5	2,172	1.5
Västmanland	5,851	3.1	5,502	3.4	5,474	3.2	5,118	3.5
Västra Götaland	30,101	16.1	26,481	16.2	26,909	15.7	23,289	15.7
Örebro	7,812	4.2	6,371	3.9	7,160	4.2	5,710	3.9
Östergötland	13,948	7.5	12,425	7.6	12,528	7.3	11,021	7.5
Total	**186,931**	**100**	**163,118**	**100**	**171,357**	**100**	**147,875**	**100**

Table 9 describes the distribution of exposure over exposure classes and industries. Most of the exposure comprises loans to private individuals and agricultural customers constituting 90% of the total IRB exposure.

TABLE 9. EXPOSURE BY INDUSTRY AND EXPOSURE CLASS, IRB

		31 Dec 2014			31 Mar 2014		
Exposure class, SEK M	**Industry**	**EAD**	**%**	**Risk weight**	**EAD**	**%**	**Risk weight**
Retail							
	Private individuals	141,066	75	18	129,160	75	19
	Agricultural operations	13,339	7	12	12,522	7	12
	Other businesses	11,500	6	34	10,754	6	35
	Total retail	**165,905**	**89**	**19**	**152,436**	**89**	**20**
	of which, SMEs	24,706	–	22	23,239		23
Corporates							
	Agricultural operations	13,475	7	40	12,437	7	39
	Other businesses	7,551	4	49	6,484	4	51
	Total corporates	**21,027**	**11**	**43**	**18,921**	**11**	**44**
	of which, SMEs	20,844	–	43	18,641		43
Total		**186,931**	**100**	**22**	**171,357**	**100,0**	**23**

Figure 3 and Table 10 present the Bank's credit risk exposure, calculated according to IRB, specified according to the Bank's risk grades. The results show a distribution of exposure, with 72 (71) % of exposure found in the grades 1–4 and deemed to have a PD of less than 0.5%. A contributing reason for the increase in these risk grades is that a higher percentage of lending takes place in the form of mortgages to private individuals, for which the probability of default is significantly lower than in other portfolios.

FIGURE 3. EXPOSURE DISTRIBUTION BY RISK GRADE, IRB

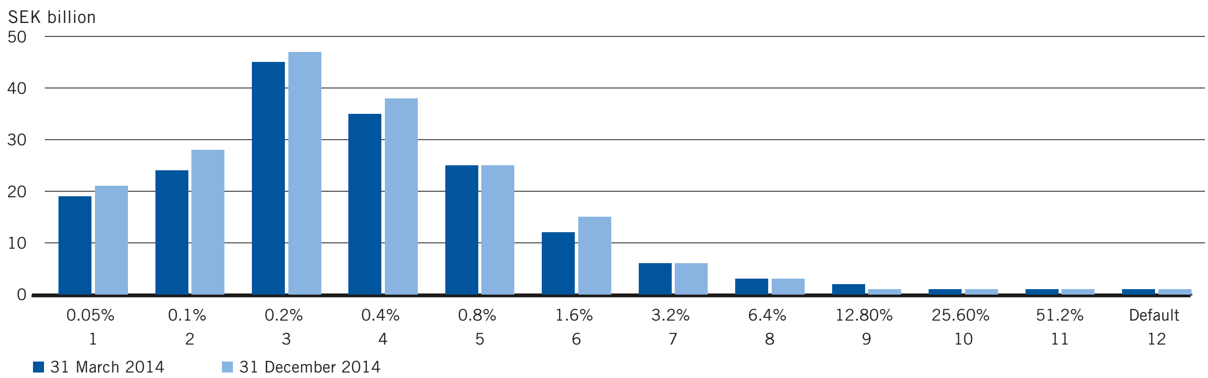


TABLE 10. EXPOSURE DISTRIBUTION BY RISK GRADE AND EXPOSURECLASS

	Retail exposures									
	Secured by immovable property		Other exposures		Total		Exposures to corporates		Total	
PD grade, 31 Dec 2014, SEK M	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)
1	18,212	3	779	4	18,992	3	2,091	11	21,083	4
2	25,973	5	1,462	13	27,435	6	590	18	28,025	6
3	40,017	9	2,691	20	42,708	10	4,297	26	47,006	11
4	30,425	15	2,865	28	33,290	16	5,078	37	38,368	19
5	17,595	25	4,490	41	22,085	29	3,187	51	25,272	31
6	6,994	40	4,343	53	11,338	45	3,424	65	14,762	49
7	2,331	59	2,541	60	4,871	59	1,017	77	5,888	62
8	1,252	86	1,125	72	2,377	79	503	95	2,880	82
9	655	117	583	80	1,237	100	245	126	1,483	104
10	248	123	251	115	499	119	134	153	633	126
11	248	119	209	104	457	112	70	122	527	113
Default	230	251	386	158	616	193	390	–	1,006	118
Total	**144,180**	**15**	**21,724**	**44**	**165,905**	**19**	**21,027**	**43**	**186,931**	**22**
Of which, unutilised undertakings	3,708		4,245		7,953		1,001		8,954	

	Retail exposures				
	Secured by immovable property	Other exposures	Total	Exposures to corporates	Total
PD (%)[1)]	**0.75**	**2.45**	**0.87**	**1.34**	**0.92**
LGD (%)[1)]	**21.9**	**46.2**	**25.1**	**–**	**–**
KF (%)[2)]	**51.0**	**86.0**	**69.7**	**–**	**–**

[1)] Exposure-weighted average, non-defaulted exposures.
[2)] Only for unutilised undertakings.

A mapping between the Bank's internal grades and external rating, that the Bank find a reasonable comparison, is presented below.

TABLE 11. MAPPING OF INTERNAL GRADES AND EXTERNAL RATING (STANDARD & POOR'S)

Internal risk grade	PD (%)	Indicative credit rating, S&P
1–4	< 0.5	AAA to BBB–
5–6	0.5–2.1	BB+ to BB–
7–8	2.1–8.5	B+ to B–
9–11	> 8.5	C
Default	100	D

Expected Loss and actual outcome

The Expected Loss Percentage (EL) is calculated based on the parameter estimates of PD and LGD. EL as a percentage of all non-defaulted exposures in the retail exposure class was 0.40% and the outcome was 0.13% [3)]. EL for the Retail exposures secured by immovable property was 0.27% and the outcome was 0.02%. For other retail exposures, EL was 1.25% and the outcome was 0.96%. One of the reasons that EL is higher than the actual outcome is that the parameter estimate for PD is significantly higher than the observed default percentage.

[3)] The estimate is based on non-defaulted exposures at 31 December 2012. Outcome is calculated as confirmed loan losses for defaulted exposures in 2013 with a follow-up period until 31 December 2014.

5.3.1 Risk mitigation measures and contractual maturities

The starting point of the Bank's credit assessment is always the customer's repayment capacity, with the approach that collateral received can never compensate for a low repayment capacity. However, collateral received can significantly counteract the Bank's losses in the event of a credit default. The Bank conducts operations whereby loans are granted against property collateral for which the Bank has extensive experience and robust procedures in place. The market value of properties is updated on an annual basis following established procedures. The relationship between the credit portfolio and the underlying assets, expressed as the weighted average loan-to-value (LTV) ratio, was 66%.

Other significant risk mitigation measures comprise the netting agreements that the Bank has signed with institutional counterparties. Table 12 presents exposure secured by immovable property. Other than the financial collateral reported for institutions, only exposures from secured by immovable property in the corporate- and retail exposure classes are taken into account. Total provided collateral amount to SEK 160.7 billion.

TABLE 12. RECOGNISABLE COLLATERAL FOR CAPITAL ADEQUACY PURPOSES

SEK M	Exposure amount covered by collateral
Standardised Approach	
Central governments and central banks	–
Regional governments or local authorities	–
Multilateral development banks	–
Institutions	7,066
Corporates	–
– of which, SMEs	
Retail	–
– of which, SMEs	–
Exposures in default	–
Covered bonds	–
Claims in the form of CIU	–
Equity exposures	–
Other items	–
Total	**7,066**
IRB	
Corporates	18,170
– of which, SMEs	17,995
Retail	142,505
– of which, SMEs	14,274
Total IRB Approach	**160,675**
Total	**167,741**

Table 13 presents exposures distributed by exposure class and remaining fixed-interest periods.

TABLE 13. EXPOSURES BY FIXED-INTEREST PERIODS

SEK M	<3 months	3–6 months	6–12 months	1–3 years	3–5 years	> 5 years	Total
Standardised Approach							
Central governments and central banks	2,032	0	3,006	2,019	1,295	0	8,352
Regional governments or local authorities	245	0	537	2,014	320	0	3,116
Multilateral development banks	0	0	11	272	79	0	363
Institutions	4,764	0	37	0	0	0	4,801
Covered bonds	3,063	1,897	3,446	12,115	11,585	611	32,716
Corporates	2,035	45	45	26	29	2	2,182
Retail	1,313	0	0	0	0	0	1,313
Claims in the form of CIU	541	196	159	134	128	66	1,225
Equity exposures	769	0	0	0	0	0	769
Other items	1,391	0	0	0	0	0	1,391
Total, Standardised Approach	**16,153**	**2,139**	**7,241**	**16,581**	**13,436**	**679**	**56,228**
IRB							
Corporates	6,437	5,233	1,850	5,361	1,665	480	21,027
Retail	85,883	29,074	10,154	30,567	8,716	1,511	165,905
– Of which secured by immovable property	64,317	29,020	10,114	30,529	8,691	1,509	144,180
– Of which other exposures	21,565	55	40	38	25	2	21,724
Total IRB Approach	**92,320**	**34,308**	**12,004**	**35,929**	**10,381**	**1,991**	**186,931**
Total	**108,473**	**36,447**	**19,244**	**52,509**	**23,817**	**2,669**	**243,159**

5.4 Non-performing receivables, impaired loans and loan losses

Non-performing receivables, impaired loans, and loan losses are based in their entirety on the total credit portfolio from an accounting perspective.

Non-performing receivables

A loan receivable is considered non-performing if it has an outstanding payment that is more than nine days and up to 60 days past due.

Impaired loans

A loan receivable is considered impaired if a payment is more than 60 days past due or if there is reason to expect that the counterparty cannot meet its undertaking. A loan receivable is considered impaired to the extent that its whole amount is not covered by collateral.

Impaired loans amounted to SEK 316 million (388), corresponding to 0.17% (0.23) of the total credit portfolio before reserves.

Loan losses

The item Loan losses comprises confirmed loan losses, probable loan losses, recoveries of loan losses that were previously recognised as confirmed and reversals of probable loan losses no longer required. Confirmed loan losses pertain to the entire receivable when there is no realistic possibility of recovery.

Probable loan losses pertain to impairment for the year for the loan losses based on a calculated recoverable amount when there is an indication that impairment is required. Recoveries comprise reversed amounts of loan losses that were previously recognised as confirmed. Probable loan losses are reversed when no impairment requirement is deemed to exist.

Only the Bank Group's share of probable and confirmed loan losses are recognised. The regional insurance companies' share of probable and confirmed loan losses is settled against accrued commission. The settlement model, which was introduced on 1 January 2014, regarding the commitment that the regional insurance companies have regarding loan losses related to business they have originated entails that the regional insurance companies cover 80% of the provision requirement on the date when an impairment is identified, by means of an off-set against accrued commissions.

The transition to the model means that the Bank Group's credit reserves attributable to the regional insurance companies' business on the date of introduction will be gradually reversed by SEK 158 million over two years. SEK 67 million was reversed during the year.

Loan losses, after deduction of the regional insurance companies' share of loan losses, amounted to SEK –7 million (110), net, corresponding to loan losses of 0.00% (0.07). Loan losses before reversal remained low and amounted to SEK 60 million, net. Impaired loans and loan losses continued to account for a minor percentage of total loans.

TABLE 14. NON-PERFORMING RECEIVABLES BY COMPANY

SEK M	Länsförsäkringar Bank AB		Länsförsäkringar Hypotek AB		Wasa Kredit AB		Total	
Overdue receivables, days	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014
10–19	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.0
20–39	35.3	64.8	40	89.9	253.7	254.1	329	408.8
40–60	16.6	3.8	0.0	0.0	3	5.2	19.6	9
Total	**52**	**68.6**	**40**	**89.9**	**256.7**	**259.3**	**348.7**	**417.8**

TABLE 15. IMPAIRED LOANS BY EXPOSURE CLASS, INDUSTRY AND COMPANY

SEK M		Länsförsäkringar Bank AB		Länsförsäkringar Hypotek AB		Wasa Kredit AB		Total	
Standardised Approach	Industry	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014	31 Dec 2014	31 Mar 2014
	Private individuals	0.0	0.0	0.0	0.0	30.6	26.8	30.6	26.8
	Agricultural operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Other business	0.0	0.0	0.0	0.0	77.6	100.0	77.6	100.0
Total Standardised Approach		**0.0**	**0.0**	**0.0**	**0.0**	**108.2**	**126.8**	**108.2**	**126.8**
IRB	**Industry**	**31 Dec 2014**	**31 Mar 2014**	**31 Dec 2014**	**31 Mar 2014**	**31 Dec 2014**	**31 Mar 2014**	**31 Dec 2014**	**31 Mar 2014**
Retail	Private individuals	28.0	52.1	0.3	6.0	88.7	83.0	117.1	141.1
	Agricultural operations	16.4	23.8	0.0	0.0	0.0	0.0	16.4	23.8
	Other businesses	9.7	18.8	0.0	0.0	28.9	23.7	38.6	42.5
Total retail		**54.1**	**94.7**	**0.3**	**6.0**	**117.7**	**106.7**	**172.1**	**207.4**
Corporates	Private individuals	5.0	9.9	0.0	0.1	0.0	0.0	5.0	10.0
	Agricultural operations	17.9	30.3	0.0	0.0	0.0	0.0	17.9	30.3
	Other businesses	12.6	13.7	0.0	0.0	0.0	0.0	12.6	13.7
Total corporates		**35.5**	**53.9**	**0.0**	**0.1**	**0.0**	**0.0**	**35.5**	**54.0**
Total IRB Approach		**89.7**	**148.6**	**0.3**	**6.1**	**117.7**	**106.7**	**207.6**	**261.4**
Total		**89.7**	**148.6**	**0.3**	**6.1**	**225.9**	**233.5**	**315.9**	**388.2**

TABLE 16. LOAN LOSSES

Net, SEK M	31 Dec 2014[1)]	31 Mar 2014
Specific reserve for individually assessed loan receivables		
Write-off of confirmed loan losses during the period	–106.2	–135.9
Reversed earlier impairment of loan losses recognised in the year-end accounts as confirmed losses	101.1	129.9
Impairment of loan losses during the period	–123.1	–226.8
Payment received for prior confirmed loan losses	35.1	72.5
Reversed impairment of loan losses no longer required	80.5	50.3
Net expense for the period for individually assessed loan receivables	**–12.6**	**–110**
Collectively assessment of homogeneous groups of loan receivables with limited value and similar credit risk		
Provision/reversal of impairment of loan losses	18.8	–0.6
Net expense for the period for collectively assessed receivables	**18.8**	**–0.6**
Net expense for the period for fulfilment of guarantees	1.1	0.2
Net expense of loan losses for the period	**7.3**	**–110.4**

1) New settlement model from 1 January 2014 entailing a change in impairment is recognised only at 20% in the Bank.

TABLE 17. COLLECTIVE AND INDIVIDUAL IMPAIRMENT BY INDUSTRY

		31 Dec 2014			31 Mar 2014		
Standardised Approach, SEK M	**Industry**	**Collective impairments**	**Individual impairments**	**Total**	**Collective impairments**	**Individual impairments**	**Total**
	Private individuals	2.2	3.2	5.3	2.1	2.4	4.5
	Agricultural operations	0.0	0.0	0.0	0.0	0.0	0.0
	Other business	5.5	8.1	13.5	7.8	8.8	16.6
Sub-total		**7.6**	**11.2**	**18.9**	**9.9**	**11.1**	**21.1**
IRB Approach							
Retail	Private individuals	56.7	145.9	202.6	71.0	170.6	241.7
	Agricultural operations	1.4	16.9	18.3	2.3	28.6	30.9
	Other business	7.7	42.7	50.4	8.6	44.6	53.2
Sub-total		**65.8**	**205.5**	**271.3**	**82.0**	**243.8**	**325.8**
Corporates	Private individuals	0.1	5.0	5.1	0.1	9.9	10.0
	Agricultural operations	12.0	34.1	46.1	16.1	45.8	61.9
	Other business	0.0	2.9	2.9	0.0	4.0	4.1
Sub-total		**12.1**	**42.0**	**54.1**	**16.2**	**59.8**	**76.0**
Total		**85.6**	**258.7**	**344.3**	**108.1**	**314.7**	**422.8**

The settlement model, which was introduced on 1 January 2014, regarding the commitment that the regional insurance companies have regarding loan losses related to business they have originated entails that the regional insurance companies cover 80% of the provision requirement on the date when an impairment is identified, by means of an off-set against accrued commissions. On 31 December 2014, the total credit reserve requirement amounted to SEK 424 million, of which the Bank Group's recognised credit reserve accounted for SEK 344 million and the remainder of SEK 80 million was offset against the regional insurance companies' held funds, according to the model described above. The transition to the settlement model means that the Bank Group's credit reserves attributable to the regional insurance companies' business on the date of introduction will be gradually reversed by SEK 158 million. SEK 67 million was reversed during the period.

5.5 Counterparty credit risk

Counterparty credit risk is the risk of a counterparty being unable to fulfil its commitments to the Bank, which could lead to losses. The Board determines limits on the maximum exposure amount per counterparty. The market-value method is used for calculating capital requirements for counterparty risk regarding derivatives. The bank only has swap counterparties with a high credit rating for which ISDA agreements have been signed. ISDA agreements allow net accounting of positive and negative derivatives, which reduces the risk to the net position per counterpart. The ISDA agreements also have associated CSA agreements. CSA agreements involve commitments concerning delivery and receipt of collateral in the event of market changes. These agreements are unilateral for Länsförsäkringar Hypotek AB's covered-bond operations, with only the counterparty providing collateral. There are no CSA agreements for which the Bank is required to provide collateral for downgrades. Table 18 describes the Bank's derivative exposure.

TABLE 18. DERIVATIVES AT FAIR VALUE

	31 Dec 2014				31 Mar 2014			
Rating, SEK M	**Gross**	**Netting effect**	**Collateral**	**Net exposure**	**Gross**	**Netting effect**	**Collateral**	**Net exposure**
AA-/Aa3	1,948.8	758.2	175.3	1,015.3	955.4	615.9	19.0	320.5
A+/A1	1,794.4	1,354.2	321.8	118.4	967.0	862.4	27.6	80.2
A+	157.1	85.6	64.1	7.4	7.2	0.0	0.0	7.2
A/A1	456.2	0.0	462.2	0.0	68.8	30.6	30.3	8.0
A/A2	164.1	0.0	107.4	56.7	138.5	0.0	107.4	31.1
A/A3	1,739.6	476.6	1,167.9	119.3	160.7	0.0	153.3	7.4
A–/Baa1					486.0	338.6	119.0	28.4
Total	**6,260.3**	**2,674.6**	**2,298.6**	**1,317.0**	**2,783.7**	**1,847.6**	**456.6**	**482.8**

6 Market risk

Market risk refers to the risk of loss or lower future earnings due to changes in interest rates and exchange rates.

6.1 Risk appetite

The Board of Directors determines the risk appetite for market risk. The bank has a low appetite for market risks, meaning that these risks are to be limited to a reasonable extent. Derivatives are only permitted to be used to reduce the Bank's risk.

6.2 Risk management

The aim of risk management is to reduce the immediate effect that an unexpected change in the market could have on the Bank. Day-to-day management of market risks takes place in the Treasury unit. Risk management is done in a cost-efficient manner within set limits. The bank applies a number of supplementary risk measures for market risk, including sensitivity measures and stress tests.

6.2.1 Governance

The overall framework for the financial operations is adopted by the Board in the risk policy. The Board also sets the risk appetite and limits for interest rate risk and currency risk. Limits are also approved by the Board of each company. The methods for calculating market risks are established by the Asset and Liability Committee (ALCO).

6.2.2 Interest rate risk

Interest rate risk is the Bank's primary market risk. It is defined as the risk of negative changes in the fixed-income market and includes interest-price risk, credit spread risk and currency basis spread risk.

Interest rate risk arises in the Bank primarily through different fixed-interest periods for assets and liabilities, but also in ensuring access to a large liquidity reserve and funding in foreign currency.

Interest rate risk is primarily minimised by matching fixed lending with corresponding funding. Secondly, interest rate risk is reduced by usingderivatives. Credit-spread risk arises exclusively in the liquidity reserve. Currency basis spread risks arise when hedging funding in foreign currency.

Interest rate risk is calculated as the effect of a sharp momentary stress scenario. Credit spread and currency basis spread risks are measured using sensitivity measures. The capital requirement calculation for interest rate risk in Pillar II uses a Value-At-Risk model combined with stress scenarios.

TABLE 19. IMPACT OF INTEREST RATE RISK

SEK M	31 Dec 2014	31 Mar 2014
Interest rate risk	46.4	83.9

TABLE 20. INTEREST RATE RISK PER CURRENCY

SEK M	31 Dec 2014	31 Mar 2014
CHF	0.0	0.0
EUR	–0.2	–0.3
NOK	–0.1	0.0
SEK	46.7	84.2
USD	0.0	0.0
Total	**46.4**	**83.9**

Table 19 shows the changes in present value arising from 100 basis point increase in market interest rates. The analysis does not include equity that the Bank has or the possibility of adapting to changed interest rate levels. Table 20 shows interest rate risk specified by currency. Interest rate risk is almost exclusively in SEK and has reduced due to natural fluctuations in interest rate risk, arising from different reset days for assets and liabilities.

Table 21 shows the reset period of assets, liabilities and derivative for the consolidated situation.

6.2.3 Currency risk

Currency risk refers to the risk of a currency changing in value in relation to another currency in a negative direction for the Bank.

Currency risk arises when funding in foreign currency, primarily in the currencies of EUR, CHF and NOK. Currency risk is measured as the effect of a momentary +/–10% change of the exchange rate. Currency risk is managed for each transaction by converting the funding to SEK using swap contracts. Accordingly, no significant currency risk will remain. The total currency risk, with the least advantageous change for each currency added together, was only SEK 0.3 million at 31 December 2014. The corresponding figure for 31 March 2014 was SEK 4.4 million.

6.2.4 Monitoring and reporting

All market risks are measured and controlled on a daily basis. The bank's Risk Control function monitors the Board's limits every day. The CRO makes continuous reports to the Board, both in writing and verbally, at least once every quarter.

TABLE 21. FIXED-INTEREST PERIOD OVER NUMBER OF MONTHS

SEK M	<1 month	>1 month <3 months	>3 months <6 months	>6 months < 1 year	>1 month < 3 years	> 3 years < 5 years	> 5 years	Without interest	Total
Assets									
Cash and balances with central banks	26	0	0	0	0	0	0	0	26
Treasury bills and other eligible bills	0	0	0	2,877	1,548	984	0	0	5,409
Loans to credit institutions	1,748	239	0	42	0	0	0	0	2,028
Loans to the public	74,397	41,059	4,830	12,687	35,496	9,301	1,655	0	179,424
Bonds and other interest-bearing securities	108	3,281	1,879	4,044	14,957	12,407	678	0	37,354
Other assets	0	0	0	0	0	0	0	18,758	18,758
Total assets	**76,278**	**44,579**	**6,709**	**19,650**	**52,002**	**22,692**	**2,333**	**18,758**	**243,000**
Liabilities									
Due to credit institutions	3,390	0	0	0	0	0	0	0	3,390
Deposits and funding from the public	52,072	15,065	6,280	1,609	1,046	375	0	0	76,447
Debt securities in issue	2,484	15,402	9,605	6,527	44,197	30,143	21,997	0	130,354
Other liabilities	500	173	0	0	0	488	0	12,218	13,379
Subordinated liabilities	0	0	0	20	1,180	1,100	0	0	2,300
Equity	0	0	0	0	0	0	0	17,130	17,130
Total liabilities and equity	**58,446**	**30,639**	**15,885**	**8,157**	**46,422**	**32,105**	**21,997**	**29,349**	**243,000**
Difference assets and liabilities	17,832	13,940	–9,176	11,493	5,580	–9,413	–19,664	–10,590	0
Interest rate derivatives, nominal values	–3,052	1,307	1,135	–14,872	–16,967	12,370	21,101	0	2,721
Net exposure	**13,080**	**15,246**	**–7,042**	**–3,379**	**–8,988**	**2,956**	**1,437**	**–10,590**	**2,721**

7 Liquidity risk

Liquidity risk refers to the risk that the Bank, due to insufficient cash funds, will be unable to fulfil its commitments or only be able to fulfil its commitments by funding at a significantly higher cost than normal or by selling assets at a substantial deficit price.

7.1 Risk appetite

The Bank's risk appetite for liquidity risk is very low. This means that liquidity risks are minimised and prevented as far as possible, mainly by applying effective long-term planning. The Bank's risk appetite for liquidity risk is determined by the Board, which also establishes the direction of liquidity risk management and establishes liquidity risk limits that reflect the Bank's risk appetite.

7.2 Risk management

The objective of the liquidity management is that the Bank, at any given time, has sufficient cash and other liquid assets to fulfil its commitments under both normal and stressed market conditions.

The overall strategy for managing liquidity risk is based on highly diversified funding regarding investor base, instruments, currencies and maturities, and a satisfactory liquidity reserve comprising highly liquid assets, most of which are eligible as pledge with central banks.

In accordance with CRR, Länsförsäkringar AB is included in the consolidated situation for LCR and encumbered assets reporting. The operational liquidity risk management in the Bank Group is based on the requirement that the operations at all times are to meet their liquidity and funding undertakings.

Action plans for managing disruptions that affect the Bank Group's liquidity are in place and must be updated annually. A liquidity contingency group has been appointed and action plans are prepared and adopted by the ALCO.

7.2.1 Governance

The Bank Group's liquidity risk is governed through a liquidity and funding strategy to ensure compliance with the Board's low risk tolerance. The strategy is to support the fulfilment of established business objectives and financial risk management. Also, the Board regulates the instruments that the Bank Group is permitted to use.

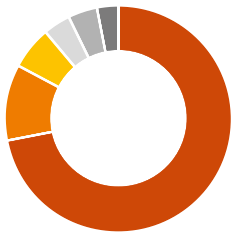
The liquidity and funding strategy is broken down into a funding plan which is based on the business plan for the forthcoming year. It contains key figures and targets for the direction determined by the Board. The funding plan is set annually and adopted by the Board. Outcomes are monitored against the plan every ALCO and Board meeting. The plan is updated when necessary. The Bank Group's Treasury department is responsible for daily monitoring and liquidity risk management.

Liquidity reserve

A satisfactory liquidity reserve ensures that sufficient liquidity is always available. Treasury monitors and manages the liquidity reserve on a daily basis and is responsible for that the size of the reserve lives up to the minimum limits set by the Board. The liquidity reserve is invested in securities with very high credit quality, the vast majority of which are eligible for repo transactions with the Riksbank and, where appropriate, with the ECB or the Federal Reserve. In total, this means that the reserve can be quickly converted to cash.

On 31 December 2014, the liquidity reserve amounted to SEK 44.1 billion (45.9), according to the Swedish Bankers' Association's definition, and 72% (72) of the reserve comprise Swedish covered bonds.

FIGURE 4. LIQUIDITY RESERV



- Swedish covered bonds AAA/Aaa **72%**
- Swedish government bonds **11%**
- Other Swedish bonds AAA/Aaa **6%**
- Deposits with Swedish National Debt **4%**
- AAA/Aaa-rated bonds issued or guaranteed by European states and multinational development **4%**
- Nordic AAA/Aaa-rated cover bonds **3%**

Funding

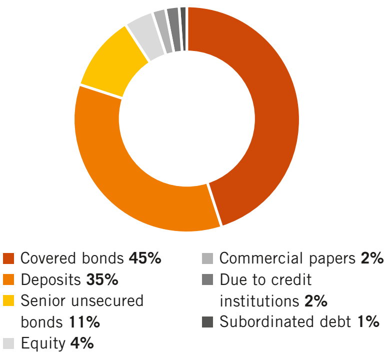
Funding is managed in a way that creates a sound maturity profile and avoids maturity concentrations. The refinancing activities are based on broad diversification in terms of a variety of investors and markets. Diversification is achieved, for example, through proactive work on creating long-term investor relations.

The major source of funding is through covered bonds since the majority of the Bank Group's assets comprise Swedish mortgages, although funding through senior debt and short-term commercial paper programme are also used. Refinancing primarily takes place in the market for SEK, EUR, CHF and NOK. The Bank Group endeavours to regularly launch issuances in these markets to create long-term confidence in the international capital markets.

In its funding operations, the Bank Group is to act predictably and actively in the market and aim at achieving as high liquidity as possible in outstanding debt to build up long-term confidence among investors. Regular meetings are held with both Swedish and international investors to ensure that these investors have a good understanding of the Bank Group's operations and high-quality risk management. These proactive efforts ensure that credit lines are in place with investors, and promote a long-term interest in and desire to invest in the Bank Group's securities over time.

In recent years, Länsförsäkringar Bank AB has had a stable rating from Standard & Poor's and Moody's, which has been positive for the Bank's ability to finance its operations at low costs on the capital market. In addition, Länsförsäkringar Hypotek AB's covered bonds have the highest rating from both Moody's and Standard & Poor's.

FIGURE 5. FUNDING SOURCES



The largest sources of funding in the Bank Group are covered bonds and deposits, representing 45% and 35%, respectively.

FIGURE 6. FUNDING BY CURRENCY

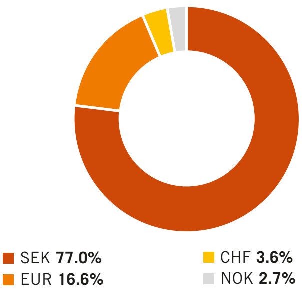


FIGURE 7. MATURITY STRUCTURE

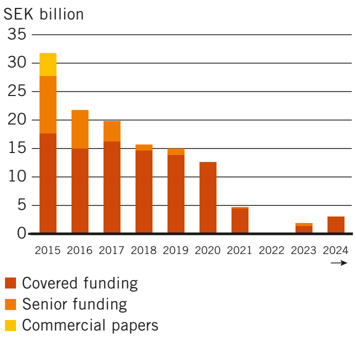
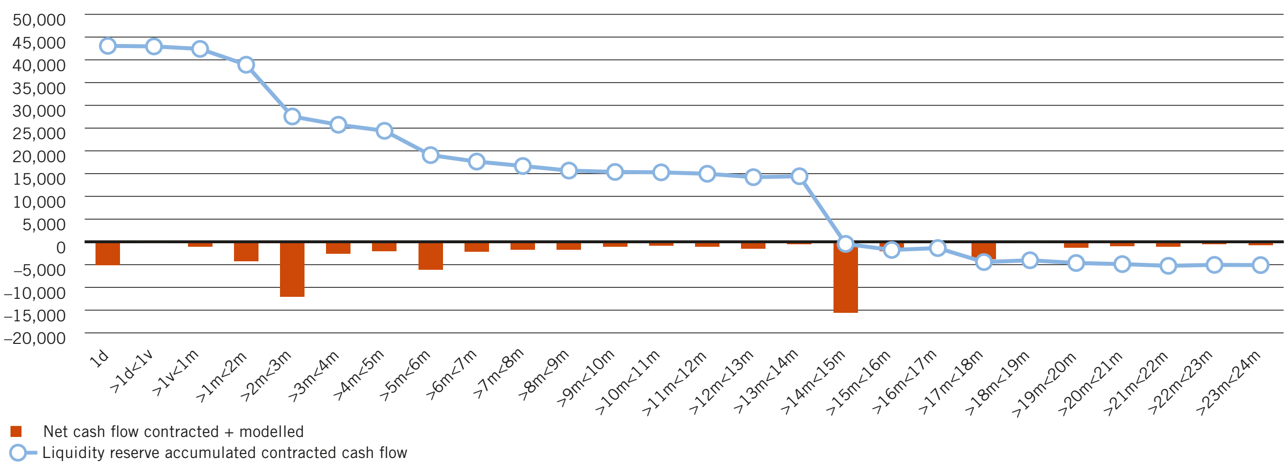


FIGURE 8. SURVIVAL HORIZON



7.2.2 Risk measurement

Liquidity risk is quantified using daily liquidity forecasts based on all contracted cash flows and expected business volumes of deposits and lending. The central measure in the management of liquidity risk is the "survival horizon," meaning the period of time during which the Bank Group is able to meet its commitments without access to new funding.

Figure 8 illustrates the Bank Group's survival horizon at 31 December 2014. The graph shows that contractual undertakings can be satisfied within slightly more than 14 months by utilising the liquidity reserve alone. Wholesale funding primarily takes place in the Swedish market and in SEK.

The liquidity portfolio is regularly stress-tested using highly disadvantageous scenarios. Two stress tests illustrate how long cash and cash equivalents will last, given that capital markets are entirely closed and:

- Business volumes are constant (survival horizon).
- Lending volume growth is modelled according to the business plan and bank deposits reduce markedly.

Furthermore, the cover pool is stress-tested in various scenarios with housing prices assumed to fall between 5% and 30%.

To comprehensively analyse the liquidity risk, the liquidity limit is supplemented with a number of structural and quantitative risk measures adapted to the Bank's risk profile, including a minimum requirement for unutilized capacity in the cover pool for the issuance of covered bonds.

The analysis is prospective and based on measurement methods accepted in the market, including analysis of future cash flows, scenario analyses and key figures stipulated by authorities.

The bank's Liquidity Coverage Ratio (LCR), as defined by the Swedish Financial Supervisory Authority's regulation, amounted to an average of 213% (253) during the fourth quarter of 2014. The LCR in EUR amounted to 68,580% (1,847) on 31 December 2014.

7.2.3 Monitoring and reporting

Liquidity risk is measured, controlled and reported on a daily basis. Outcomes are monitored against the Board's established guidelines and strategies at every ALCO and Board meeting. Material deviations are immediately reported to the Board.

7.2.4 Encumbered assets

Encumbered assets are the portion of the company's assets that is pledged in some form. Asset encumbrance entails restrictions on the asset's area of use since the assets serves as collateral and its availability must be ensured at all times. The Bank's main business area is mortgage lending and to enable market funding via covered bonds the Bank has a high percentage of encumbered assets that comprise the cover pool in Länsförsäkringar Hypotek AB.

Except the encumbered assets in the cover pool due to the issuance of covered bonds, the asset encumbrance is generally low within the Bank Group.

TABLE 22. ENCUMBERED ASSETS

SEK M	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
The Bank's assets	114,544		128,468	
Shares and participations	0	0	1,269	1,269
Bonds and other interest-bearing instruments	12,606	12,606	29,560	29,560
Other assets	101,938		97,639	

TABLE 23. ENCUMBERED COLLATERAL

SEK M	Fair value of encumbered collateral for received and own issued bonds	Fair value of collateral received or issued own bonds
The Bank's collateral received		1,500
Bonds and other interest-bearing instruments		1,500

7.3 Regulations on liquidity risk and funding

Implementation of CRR/CRD IV entails new regulations regarding liquidity risk, in the form of quantitative requirements for LCR and Net Stable Funding Ratio (NSFR). Briefly, the LCR aims to regulate the amount of liquid assets a company needs to hold in its liquidity reserve in order to manage a stressed situation for a period of 30 days. If a bank has liquidity problems, it must be able to convert the liquidity reserve into cash, thus enabling management of the outflows that take place during the period. The requirement is expressed as a ratio comparing the relationship between the liquid assets and the net cash flow during a 30 calendar-day stress scenario.

Sweden has chosen not to await EU regulations on liquidity risk and has introduced quantitative LCR requirements for credit institutions, securities companies and financial corporate groups with total assets exceeding SEK 100 billion. These Swedish rules came into effect on 1 January 2013.

As a supplement to LCR, a more long-term, structural measure NSFR is reported to the Financial Supervisory Authority in parallel from 2014. The purpose of this measurement is to ensure that banks increasingly finance their long-term assets with long-term debt. The idea is that the financial system will become more stable if banks better match the durations in their funding. The final structure of this ratio has not yet been formulated and may be changed until its scheduled introduction in 2018.

The reporting requirements for encumbered assets were introduced on 31 December 2014 through FINREP and the EBA's documentation on Implementing Technical Standards (ITS).

8 Operational risk

Operational risk refers to the risk of losses arising due to inappropriate or faulty internal processes and systems as well as human error or external events, and includes legal and compliance risks.

8.1 Risk appetite

The risk appetite for operational risk is defined as the overall level and type of operational risk that the Bank intends to be, and can be, exposed to in order to achieve strategic targets. The Bank's operational risk is to be limited as far as possible.

8.2 Risk management

Operational risk encompasses the entire banking operations. All employees are responsible for actively managing operational risk within their individual operations. The department that takes the risk owns the risk, which means that the daily management of operational risk primarily takes place in the Bank's first line of defence, meaning the business operations. Risks are minimised by proactive preventive measures and awareness of operational risk in every decision-making situation. There is also structured monitoring of trends in operational risk.

8.2.1 Risk assessment

Operational risk is mainly categorised as one of the risk types described in Table 23, which are the main operational risk types to which the Bank is exposed.

The Bank using a model for operational risk that is applied throughout the operations. Each identified risk is assessed based on consequence (the effect a risk has on the operations) and probability (the likelihood of the risk occurring).

TABLE 23. THE BANK'S OPERATIONAL RISK TYPES

Process and product risk	Encompasses the operational risk that may arise in the business and support processes that the Bank has. Also includes the risk attributable to the product offerings to customers.
Personnel risks	Encompasses risks attributable to the Bank's personnel. This includes risks regarding staffing levels, skills and conflicts of interest.
Legal risks	Encompasses risks that the Bank faces due to its legal commitments. This may include risks arising as a result of agreements or in the Bank's regulatory compliance (compliance risk).
IT risks	Encompasses the risks that may arise in the Bank's IT environment, such as the risk of IT failures and IT security risks.
Security risks	Encompasses the risk of the Bank and its customers being the victim of external crime. This includes fraud or threats. The risk of internal fraud is also included in this risk area.

8.2.2 Risk management process

The risk management process for operational risk comprises the following main stages:

Self-assessment for assessing operational risk

All significant processes in the anking operations perform a self-assessment of the operational risk associated with the processes to highlight changes in the operations, external business environment or threat scenarios. Process analyses, incidents and implemented and future changes in the process are part of each business area's self-assessment. These analyses are part of the operations' overall risk assessment. Self-assessments are one of the tools used to identify operational risks and to plan risk-limiting measures.

Risk indicators

The aim of use of risk indicators is to create conditions for better insight into the Bank's risk profile and the risks that are increasing or reducing at that point in time and over time. The Bank has established a number of risk indicators tailored to the Bank's operations. The Bank works continuously on adjusting and improving these risk indicators and they are updated at least once annually.

Approval process

For 2014, the Bank has a revised process for approving new or significantly changed products, services, markets, processes, IT systems and for major changes to the Bank's operations and organisation. The purpose of the Bank's approval process is to achieve efficient and appropriate management of the risks that may arise in connection with change work, to ensure compliance with applicable regulations and to create customer value. The established risk model is applied to the assessment of each individual risk, as it is to all operational risks. Risk Control and Compliance are two of the stakeholders in implementing the approval process.

Incident reporting

Incidents that occur in the Bank's operating activities are to be reported using the incident reporting system, which all employees have access to. Incidents are to be reported and managed as far as possible in the business area or the process in which the risk arises. The responsibility for analysing incidents and taking measures lies with the head of the process or operations.

Risk Control continuously monitors incidents reported in the business activities. Reported incidents are categorised in one of the following established incident types.

- Customers, products and business practices
- Interruptions and disturbances to operations and systems
- Performance, delivery and process control
- Working conditions and work environment
- Damage to physical assets
- Internal fraud
- External FRAUD

Continuity management

Serious incidents may lead to a crisis. A crisis may arise, for example, due to fire, IT failure or another serious incident. The Bank works constructively to prevent this type of incident from arising. Relevant plans have been produced to support employees and managers in a crisis situation. Crisis training is conducted periodically to ensure that the plans are suitable. A joint crisis exercise was conducted in the Bank Group at the end of 2014, in which each company's crisis management team participated.

8.2.3 Monitoring and reporting

Risk Control reports continuously on trends in the Bank's operational risks to the President and relevant heads of department. In addition, an aggregated operational risk report is submitted to the Board and relevant committees every quarter.

9 Remuneration policy

The company's remuneration policy is designed in accordance with the supervisory authority's guidelines and is binding for operations in Länsförsäkringar AB and its subsidiaries (Länsförsäkringar AB Group). The internal policy contains guidelines on how to identify and manage conflicts of interest that may arise in connection with remuneration issues.

Länsförsäkringar's internal remuneration policy is designed to promote sound and efficient risk management and counteract excessive risk-taking. The basis of the remuneration model is that it must contribute to generating favourable conditions for the Länsförsäkringar AB Group to satisfactorily perform its task from the owners. The policy applies to all employees in the Länsförsäkringar AB Group and encompasses all forms of remuneration and benefits in the scope of employment. Variable remuneration is a rarely utilised form of remuneration at the Länsförsäkringar AB Group and is paid in the form of a gratuity.

Separate limitations apply to employees who work duties have a material impact on the company's risk profile and to employees who can influence the company's risk level. If variable remuneration were to be paid to this employee category, it could be withheld and paid at 60% only after three years, on the condition that the company's financial situation is sufficient enough to make such a payment.

The Board of Länsförsäkringar AB and its subsidiaries that are subject to the supervision of the Swedish Financial Supervisory Authority are to each appoint a Remuneration Committee with the task of preparing Board decisions in certain remuneration issues. The composition and duties of the Remuneration Committee are regulated in the formal work plan of each Board. The Remuneration Committee meets at least once a year and additional meetings may be held if new appointments are made to senior executives or if an executive leaves the company. Employees in control functions are not entitled to any form of variable remuneration.

Furthermore, the company performs an annual analysis to identify persons in risk positions. . Decisions on changes to the remuneration system and material changes to the remuneration policy are always preceded by an analysis of the risk associated with the remuneration system and remuneration policy. The risk analysis is prepared by the company's Risk Control function.

No variable remuneration, shares or options were paid during the year to employee categories that can significantly influence the risk profile in the institution or to senior executives. No remuneration of this type was paid to employees in this category who were recently recruited or who left the company. For further information about salaries and remuneration, refer to Länsförsäkringar Bank AB's 2014 Annual Report.