

Länsförsäkringar **Bank**

2017

Risk and capital management



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1 | Introduction

This document "Risk and capital management Länsförsäkringar Bank AB" has been prepared in accordance with the requirements set out in the Regulation CRR (EU) 575/2013 and the Capital Requirements Directive CRD 2013/36/EU. The purpose of the document is for the institution to provide detailed and clear information on the risks to which the institution is exposed, the structure of its risk management and the compliance of the institution's capital situation with the regulatory capital requirements.

The Bank Group comprises the Parent Company Länsförsäkringar Bank AB and its subsidiaries, Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB (referred to below as the "Bank Group").

With the introduction of CRR and CRD IV, the parent mixed financial holding company, Länsförsäkringar AB, is also subject to prudential and reporting requirements. As a result, Länsförsäkringar AB is consolidated with the Bank Group. The consolidated situation comprises Länsförsäkringar AB, Länsförsäkringar Bank AB, Länsförsäkringar Hypotek AB, Wasa Kredit AB, Länsförsäkringar Fondförvaltning AB and the property company Utile Dulci 2 HB (referred to below as the "Consolidated Situation"). The comparative period is per 31 December 2016.

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 520 billion. The banking operations are conducted only in Sweden and business volumes are continuing to grow 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 potential customer base with the Länsförsäkringar Alliance's 3.8 million customers. The main target groups are the 3.2 million retail customers, of whom 2.3 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, have the most satisfied customers and increase the share of customers who have both banking and insurance with Länsförsäkringar. According to the 2017 Swedish Quality Index customer satisfaction survey, Länsförsäkringar Bank is the single player on the bank market with the most satisfied retail customers, an accolade that Länsförsäkringar Bank has won twelve times in the past fourteen years. For the first time, Länsförsäkringar Bank was also named the single player with the most satisfied corporate customers and the player with the most satisfied mortgage and corporate customers for property loans. This is confirmation of the banking operations' clear customer focus and high quality. 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 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 owner. The Bank Group 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 customer and market knowledge. Banking services are offered at the 128 branches of the regional insurance companies throughout Sweden. Trust, security and long-term relationships – high priorities for Länsförsäkringar – are created through personal customer meetings.

Mobile app and Internet bank simplify

Digital services make it convenient and easy for customers to do their banking. The number of business transactions is increasing via both Länsförsäkringar's award-winning mobile app and the Internet bank. For the third consecutive year, Länsförsäkringar Bank won "Mobile Bank of the Year" and "Best Mobile Site and App" at the Web Service Award. The Bank Group's goal is to be the leader in digital services.

Customer-driven and effective business model

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

A strong brand

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

Credit-risk quality

The operations are characterised by a low risk profile. The Bank Group is exposed to a number of risks, primarily comprising credit risk, market risk, liquidity risk and operational risk. The macroeconomic situation in Sweden is critical for credit risk, since all loans are granted in Sweden. Loan losses remained low. The Bank Group has highly diversified funding and a liquidity reserve comprising securities with high liquidity and creditworthiness. Lending improved to SEK 261 billion (227) and the loan portfolio continued to maintain high credit quality.

Rating

Länsförsäkringar Bank's long-term credit rating is A/Stable from Standard & Poor's and A1/Stable from Moody's. The short-term credit ratings are A-1 from Standard & Poor's and P-1 from Moody's. Länsförsäkringar Hypotek's covered bonds maintained the highest credit rating of Aaa from Moody's, and AAA/Stable from Standard & Poor's. Länsförsäkringar Hypotek 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.

Regulatory development

Regulatory changes are expected to continue to have a major impact on banks. During the year, the European Commission and Basel Committee continued their own work on the ongoing overview of current capital adequacy regulations.

At the end of 2016, the European Commission published its proposed reviews of the existing capital adequacy rules - both the regulation and the directive. EU negotiations are under way and are expected to be completed at the end of 2018. The effective date is currently uncertain.

In December 2017, the Basel Committee published its regulatory reforms to complete the applicable Basel III rules. These reforms

entail major changes and are proposed to come into effect on 1 January 2022, with a phase-in period of five years. For Sweden, these reforms must first be incorporated into EU law.

In December 2017, the Swedish National Debt Office announced its decision on resolution plans and minimum requirements for own funds and eligible liabilities (MREL) for the ten institutions that have business activities that are deemed to be critical to the Swedish financial system, including Länsförsäkringar Bank.

The implementation of the new accounting rules under IFRS 9 was also completed during the year and will impact the method used for provisions for loan losses in 2018.

In addition to capital adequacy and accounting related rules, the Bank is also impacted by a number of other operational regulations. Examples of this are MiFID 2 that has been gradually implemented into the operations and that comes into effect at the start of 2018 and the PSD 2 Payment Services Directive, which is another set of regulations that will have a major effect on banks in the future.

Länsförsäkringar Bank is highly prepared and well capitalised for impending changes, even if it is slightly unclear at this stage what the effects will be. Read more about forthcoming regulatory changes in section 4.4.

2 | Organisation

This section describes the Consolidated Situation based on the consolidation requirements of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV) and how these differ from the consolidation requirements under accounting regulations.

2.1 THE BANK GROUP

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

2.2 CONSOLIDATED SITUATION

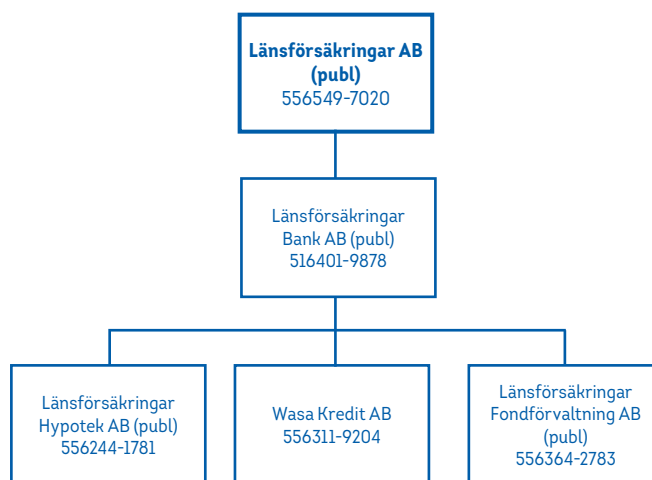
The Consolidated Situation encompasses: Länsförsäkringar AB, Länsförsäkringar Bank AB, Länsförsäkringar Hypotek AB, Wasa Kredit AB, Länsförsäkringar Fondförvaltning AB and the property company Utile Dulci 2 HB. Länsförsäkringar AB owns 46% of the property company and it is considered to be an associated company in the Consolidated Situation. This structure is defined in the CRR and CRD IV as the Consolidated Situation and its composition does 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. Only capital from companies

included in the Consolidated Situation may be included in own funds. The capital adequacy rules impose requirements that investments in financial entities above a certain level are to be deducted from own funds. For more information about the Group, 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 own funds or repayment of liabilities between parent company and subsidiary.

Figure 2.1 Legal entities in the Consolidated Situation¹⁾



All of the Boards of Directors of the companies have their registered offices in Stockholm.

¹⁾ The Consolidated Situation also includes Utile Dulci 2 HB.

Table 2.1 Carrying amount and Parent Company's participating interests

Company name	Carrying amount SEK M	Parent Company's participating interest (%)	Corporate Registration Number	Consolidation method
Länsförsäkringar AB Parent Company				
Länsförsäkringar Bank AB	8,429.6	100	516401-9878	Complete
Länsförsäkringar Fondliv Försäkrings AB	5,255.4	100	516401-8219	Deducted from own funds
Länsförsäkringar Sak Försäkrings AB	3,206.5	100	502010-9681	Deducted from own funds
Länsförsäkringar Liv Försäkrings AB	8.2	100	516401-6627	Deducted from own funds
Utile Dulci 2 HB	1,014.1	45.6	916601-0067	Complete
Länsförsäkringar Bank AB Parent Company				
Länsförsäkringar Hypotek AB	8,559.2	100	556244-1781	Complete
Länsförsäkringar Fondförvaltning AB	165.0	100	556364-2783	Complete
Wasa Kredit AB	1,039.8	100	556311-9204	Complete

3 | Risk management and risk governance

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

3.1 CONSOLIDATED SITUATION'S RISKS

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

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

Credit risk	Credit risk pertains to the risk that a counterparty is unable to fulfil its commitments and that any collateral provided does not cover the receivable. Credit risk encompasses lending risk, issuer risk, counterparty risk, settlement risk and creditworthiness risk.
Market risk	Market risk pertains to the risk of loss arising that are directly or indirectly caused by changes in the level or volatility in the market price of assets, liabilities and financial instruments, including losses caused by shortcomings in the matching between assets and liabilities. Market risk includes interest rate risk, currency risk, spread risk, equities risk, property risk, commodities risk, infrastructure risk, option risk and pension risk.
Liquidity risk	Liquidity risk is defined as the risk that payment commitments cannot be fulfilled due to insufficient cash funds. Liquidity risk includes structural liquidity risk, financing risk, rollover risk and intraday liquidity risk.
Operational risk	Operational risk refers to the risk of losses arising due to inappropriate or faulty internal processes, human error, faulty systems and external events, and includes legal and compliance risks. Operational risk includes product and process risk, personnel risk, security risk, IT risk, legal risks, compliance risks and model risk.
Business risk	Business risk pertains to the risk of lower earnings, higher expenses or loss of confidence from customers or other stakeholders. Business risk encompasses strategic risk, reputation risk and conduct risk.

Risks are continuously monitored and evaluated. As the external business environment changes new risks emerge to manage, one of which is climate risk. Climate risk refers to risks arising from the direct and indirect consequences of climate change, such as a higher average temperature on Earth, more instances of extreme weather conditions and gradually rising sea levels.

3.2 RISK APPETITE

The risk appetite is defined as the overall level per risk type to which the Consolidated Situation intends to be, and can be, exposed in order to achieve established strategic targets. The Board approves both the Consolidated Situation's risk appetite and the strategic targets that form the basis of the Consolidated Situation's risk strategy. The Consolidated Situation is to expose itself only to those risks necessary for achieving established targets. The Consolidated Situation'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 risk limits established by the Board.

3.3 RISK-MANAGEMENT AND INTERNAL-CONTROL SYSTEM

The Consolidated Situation has an effective risk-management system, comprising risk frameworks and risk-management processes that ensure correct monitoring, management and reporting of the Consolidated Situation'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 Consolidated Situation'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 established risk-management guidelines and framework.

Second line of defence

The second line of defence pertains to the independent Risk Management and Compliance functions, which establish principles and frameworks for risk management and regulatory compliance. Accordingly, duality in risk management and risk control, risk culture and risk awareness is prevalent in all day-to-day business decisions. Risk Management controls and monitors the Consolidated Situation's risks and ensures that risk awareness and correct and consistent risk management takes place on a daily basis. Risk Management 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-management system

The risk-management system consists of strategies, processes, procedures, internal rules, limits, controls and reporting procedures needed to ensure that the Consolidated Situation is able to continuously identify, measure, monitor, govern, manage, report and have control over the risks to which the operations are, or could be expected to become, exposed to, and the interdependence of these risks.

All risk activities are based on the risk framework that is adopted by the Board. The risk framework is described in governance documents, including a risk policy, a policy for risk and risk limits, and guidelines for the independent Risk Management function. The risk framework also includes governance documents for the Board's Committees.

The Consolidated Situation'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 business objectives with a high degree of certainty.

The Consolidated Situation 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 a documented process for approving new or considerably amended products, services, markets, processes and IT systems, as well as major changes to operations and organisation.

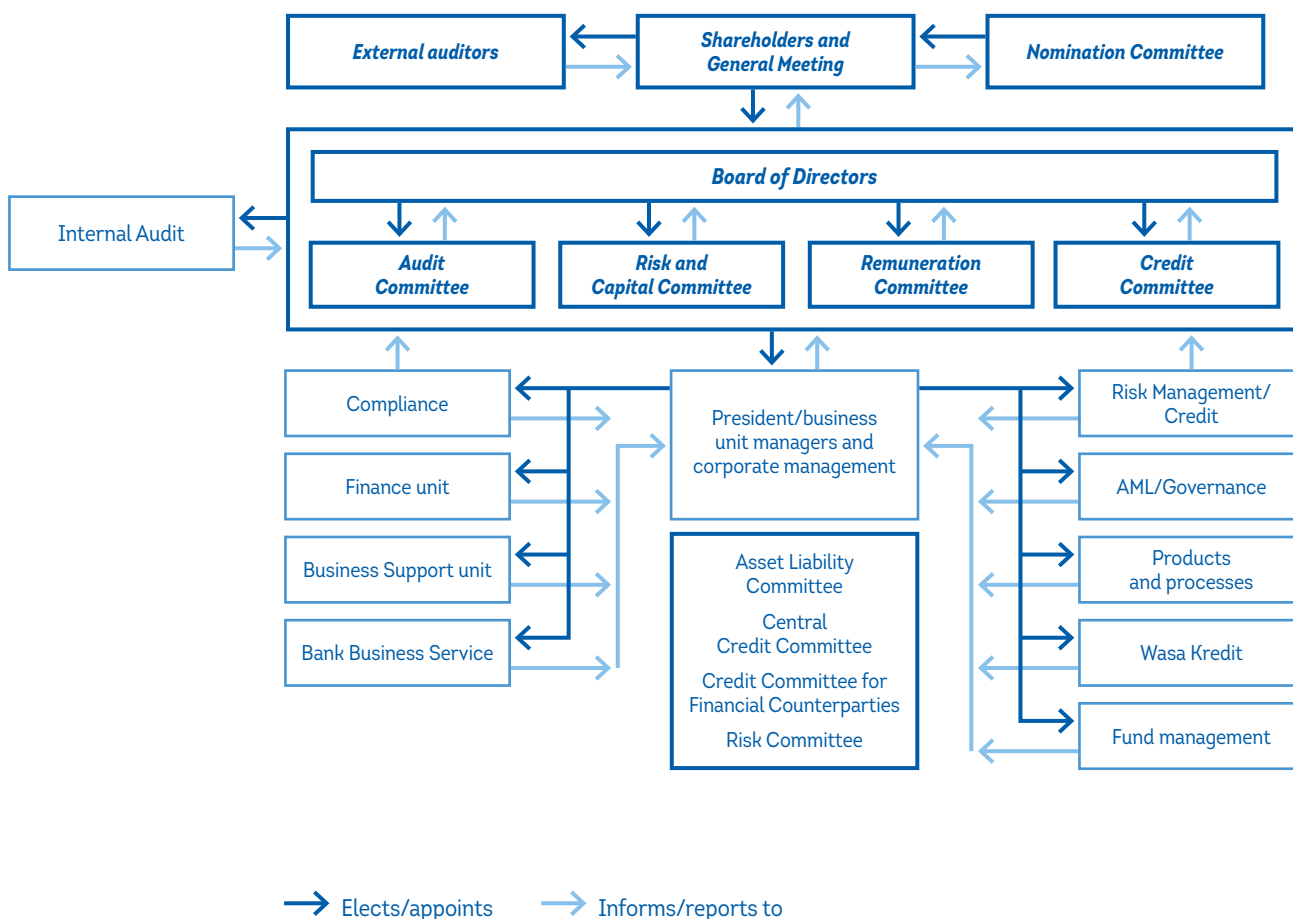
3.4 RISK GOVERNANCE

The Consolidated Situation'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 Consolidated Situation's risk profile. The Board determines risk appetite and risk limits by adopting relevant governance documents. The Board approves all significant elements of the internal models used within the Consolidated Situation and is also responsible for ensuring that regulatory compliance and risks are managed in a satisfactory manner through the independent Risk Management, Compliance and Internal Audit functions.

Figure 3.1 Bank Group's risk governance structure



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 Management, to the Board. The President is the Chairman of the Asset Liability Committee (ALCO), which follows up on capital and financial matters, as well as the Chairman of the Risk Committee, which follows up on all risks, limits and internally assessed capital requirements.

Operations

Company managers have the overall responsibility for day-to-day risk management in their respective areas and for ensuring that such risk management takes place in accordance with the risk framework. The operations assume risk and also own the risk.

Risk Management

The task of Risk Management is to provide support to the business, Board, President and management to ensure that proper risk man-

agement and risk control have been carried out for all business operations and to ensure that risks are managed in line with the risk framework established by the Board. Risk Management is to carry out its activities independently from the business activities, based on the structure of an independent support section and an independent control section.

The individual responsible for Risk Management is the Chief Risk Officer (CRO), who is directly subordinate to the President and reports directly to the President, the Risk and Capital Committee, the Audit Committee and the Board. The Board approves the appointment and replacement of the CRO. Risk Management's areas of responsibility are defined and documented in the guidelines adopted by the Board. Risk Management is also responsible for the Consolidated Situation's capital-adequacy process.

3.4.1 Monitoring and reporting

Risk Management reports on the Consolidated Situation's risk development to the Board, the Risk and Capital Committee, the Risk Committee, the ALCO and the President.

Monitoring risks is a significant part of the Consolidated Situation'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 and the Board's Committees every quarter.

4 | Capital management

4.1 CAPITAL ADEQUACY

Capital requirements are divided into Pillar I requirements, which are general minimum requirements for all institutions, and Pillar II requirements that are based on individual assessments performed by each institution. The minimum capital requirements under Pillar I are expressed as a percentage of the Risk Exposure Amount (REA), which at all times must meet the following:

- A Common Equity Tier 1 capital ratio of 4.5%
- A Tier 1 ratio of 6%
- A total capital ratio of 8%

Alongside the minimum capital requirement, there are additional capital requirements in the form of a combined buffer. These capital buffers are regulated in Swedish Capital Buffers Act (2014:966). There are five different buffers, three that cover systemic risk, a capital conservation buffer and a countercyclical capital buffer, which is to be held in the form of Common Equity Tier 1 capital. Breaching these buffer requirements means restrictions on paying dividends and interest payments on Additional Tier 1 instruments. The Consolidated Situation is subject to the requirement of satisfying two of these buffers: a capital conservation buffer of 2.5% and a countercyclical capital buffer of 2%.

Under the transition rules, a minimum level is also calculated that corresponds to a capital requirement based on 80% of the risk-weighted assets under the former Basel I rules. These transition rules form a "safety catch" for the lowest level of the own funds requirement that was introduced in connection with the transition to Basel II and that applies for the last time until 31 December 2017, after which the requirement will cease to apply.

There is the additional requirement that institutions are to make their own assessments of their internal capital requirement, usually named Pillar II, which is to include a margin for the risks that the institution is exposed to but that are not managed under Pillar I. Capital requirements are described in detail in section 4.3 below.

The Consolidated Situation's Common Equity Tier 1 capital ratio on 31 December 2017 amounted to 23.3% (21.2) and the total capital

ratio to 28.1% (27.6). The surplus capital (profits) under the Basel I floor on the same date amounted to SEK 5,663 million (5,548).

Internal capital and liquidity adequacy assessment processes

The Consolidated Situation's internal capital adequacy assessment process (ICAAP) is part of the capital planning and are to ensure that the Consolidated Situation, at any given time, has a sufficiently large amount of capital in relation to its current and future 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 Consolidated Situation's internal 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 Consolidated Situation has sufficient own funds base and the correct capital composition. The capital forecast is reported four times a year by the ALCO, the Risk and Capital Committee and the Board.

The CRO of Länsförsäkringar Bank is responsible for conducting the process work that leads to an ICAAP for the Consolidated Situation and forms the basis of business planning, capital policy, and Board decisions concerning capital forecasts. The Consolidated Situation's ICAAP is designed based on the requirements of CRR and CRD IV and the requirements established by the Board of Directors for the operations. The procedures, implementation and results of the ICAAP, which is to be performed at least once annually, are documented and reported to the Swedish Financial Supervisory Authority. The process includes the following activities:

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

TABLE 4.1 Trend in capital adequacy measures

SEK M	Consolidated Situation		Bank Group	
	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016
Common Equity Tier 1 capital	14,992	12,617	11,767	11,054
Tier 1 capital	15,936	13,817	12,967	12,254
Tier 2 capital	2,163	2,592	2,592	2,592
Own funds	18,100	16,409	15,559	14,846
Risk Exposure Amount	64,379	59,513	48,432	44,498
Capital requirement	5,150	4,761	3,875	3,560
Common Equity Tier 1 capital ratio	23.3%	21.2%	24.3%	24.8%
Tier 1 ratio	24.8%	23.2%	26.8%	27.5%
Total capital ratio	28.1%	27.6%	32.1%	33.4%
Capital conservation buffer	1,609	1,488	1,211	1,112
Countercyclical capital buffer	1,288	893	969	667
Capital requirement according to Basel I floor	12,880	11,254	12,512	10,911
Own funds adjusted to Basel I floor	18,544	16,802	16,003	15,239
Surplus capital according to Basel I floor	5,663	5,548	3,492	4,328

All of the Consolidated Situation's identified risks are included in the calculation of the capital requirements in the ICAAP. The Consolidated Situation applies methods used to calculate the capital requirement under the framework of Pillar I. For risks not included in Pillar I, known as Pillar II risks, internal models are used to allocate a capital requirement to each risk. The following additional risks are taken into account in the calculation of capital requirements under the Pillar II framework:

- Credit-related concentration risk
- Credit risk in exposures to governments
- Credit risk related to exposures to corporates
- Market risk, comprising currency risk, interest rate risk in the bank book and spread risk
- Pension risk

The Financial Supervisory Authority's method for assessing total capital requirements includes, in addition to this, the capital requirement for the capital conservation buffer, the countercyclical capital buffer and the risk weight floor for Swedish mortgages.

The internal capital requirement provides a view of the Consolidated Situation's current position. Scenario analyses and stress tests are performed under the ICAAP framework to ensure that the Consolidated Situation is well-capitalised and forward-looking. 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 the impact of these scenarios on the Consolidated Situation. The basic scenario is based on the business plan and the most probable trend in volumes, earnings and loan losses. Assumptions in this basic scenario are stress-tested by applying the most unfavourable conditions in the external business world for the Consolidated Situation 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 Consolidated Situation's own funds are sufficient to absorb losses arising as a result of a serious and stressed financial situation. The performance in this scenario thus forms the basis for calculating a capital planning buffer by taking into account the change in the capital requirement and own funds under stressed conditions.

The Consolidated Situation also carries out an ILAAP every year, with the aim of ensuring that the Consolidated Situation has sufficient liquidity, robust strategies and processes to manage liquidity risk over time. The ILAAP describes the internally assessed liquidity requirements and the liquidity reserve that the Bank Group has at its disposal, in relation to the liquidity and financing risk to which the Consolidated Situation is exposed.

4.2 OWN FUNDS

Own funds is the total of Tier 1 capital and Tier 2 capital, less items indicated in the capital adequacy rules.

Tier 1 capital comprises the institution's Common Equity Tier 1 capital and a limited share of perpetual subordinated debt (Tier 1 instruments). Common Equity Tier 1 capital comprises equity according to applicable accounting regulations with deductions for certain items as defined in the capital adequacy rules.

Tier 2 capital comprises perpetual and dated loans with subordinated preferential rights.

Common Equity Tier 1 capital

Equity comprises share capital, capital contributed, reserves and net profit for the year. During the period, equity included in the Common Equity Tier 1 capital in the consolidated situation increased net, primarily due to profit generated from the Bank Group. Profit may be included prior to a decision by a general meeting only if approved by the Swedish Financial Supervisory Authority, after deductions have been made for proposed dividends or other foreseeable charges and the company's auditors have verified the profits. A deduction for the expected, proposed dividend from the Parent Company Länsförsäkringar AB to the shareholders of SEK 300 M was made from Common Equity Tier 1 capital.

Changes in equity attributable to cash-flow hedges may not be included in own funds, which is why this effect is excluded. Common Equity Tier 1 capital is also adjusted due to the regulatory requirements regarding prudent valuation of items measured at fair value. Adjustments for the IRB deficit when, according to the accounts, the reserves for loan losses are less than the expected losses in capital adequacy, are to be made within Common Equity Tier 1 capital. If the reserves in the accounts exceed the expected loss, a limited portion may be included in the Tier 2 capital.

Common Equity Tier 1 capital is to be reduced by deductions for significant investments in financial companies if the invested capital comprises Common Equity Tier 1 instruments and exceeds 10% of gross Common Equity Tier 1 capital, or 17.65% of the net Common Equity Tier 1 capital when aggregated with deferred tax assets. Amounts under the threshold are risk-weighted at 250%. The deduction in the Consolidated Situation derives from Länsförsäkringar AB's holdings in the insurance sector.

Deferred tax assets recognised in the balance sheet are to reduce Common Equity Tier 1 capital if they meet certain criteria and exceed certain threshold amounts. The deferred tax assets that existed on 31 December 2017 did not give rise to any deductions but are included in the calculation of the threshold levels above.

Other deductions from Common Equity Tier 1 capital that are applicable to the Consolidated Situation are intangible assets and goodwill. Common Equity Tier 1 capital after applicable deductions amounted to SEK 14,992 M (12,617).

Tier 1 capital

Additional Tier 1 capital in the consolidated situation solely comprises Additional Tier 1 instruments. Additional Tier 1 instruments are subordinated liabilities which fulfil certain conditions in order to be included as Tier 1 capital when calculating the size of own funds. Länsförsäkringar Bank issued an Additional Tier 1 Capital loan of SEK 1,200 M (1,200). In November 2017, the European Banking Authority published a Q&A on an interpretation regarding how restrictions on the inclusion of capital instruments in own funds. Following clarification provided in the Q&A, the applicability of the rules has been re-interpreted. On 31 December 2017, the consolidated situation only includes capital instruments issued externally by Länsförsäkringar Bank to the portion of capital required to cover the capital requirements of Länsförsäkringar Bank and its subsidiaries. On 31 December 2017, the capital requirement is based on the transition provisions under Basel 1. According to the new interpretation, eligible Tier 1 capital amounted to SEK 944 M.

Table 4.2 Own funds and capital requirements

Presentation of own funds in accordance with Article 5 of the European Commission Implementing Regulation (EU) No 1423/2013.

Rows that are empty in the presentation in accordance with the Regulation have been excluded in the table below to provide a better overview.

There are no items encompassed by the provisions applied before Regulation (EU) No 575/2013 or any prescribed residual amounts under the Regulation.

SEK M	Consolidated Situation		Bank Group	
	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016
Common Equity Tier 1 capital: instruments and reserves				
Capital instruments and the related share premium accounts	11,314.6	11,314.6	1,238.6	1,231.0
<i>Of which, share capital</i>	1,042.5	1,042.5	954.9	954.9
Retained earnings	8,781.4	7,246.3	10,626.4	9,531.0
Accumulated Other comprehensive income	474.8	448.3	26.5	83.8
Independently reviewed interim profits net after any foreseeable charge or dividend	2,550.2	1,570.3	1,235.1	1,134.6
Common Equity Tier 1 capital before legislative adjustments	23,121.0	20,579.5	13,126.5	11,980.4
Common Equity Tier 1 capital: legislative adjustments				
Additional value adjustments	-52.1	-48.3	-51.4	-47.4
Intangible assets (net of related tax liability)	-1,739.3	-1,319.1	-969.3	-488.3
Fair value reserves related to gains or losses on cash-flow hedges	105.9	16.1	105.9	3.0
Negative amounts resulting from the calculation of expected loss amounts	-444.3	-393.1	-444.3	-393.1
Direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities	-5,999.3	-6,214.9	-	-
Amount exceeding threshold of 15%	-	-3.2	-	-
<i>Of which: direct, indirect and synthetic holdings by the institution of Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities</i>	-	-1.7	-	-
<i>Of which: deferred tax assets arising from temporary differences</i>	-	-1.5	-	-
Total regulatory adjustments to Common Equity Tier 1 capital	-8,129.1	-7,962.6	-1,359.1	-925.9
Common Equity Tier 1 capital	14,991.9	12,616.9	11,767.4	11,054.5
Additional Tier 1 capital: instruments				
Capital instruments and the related share premium accounts	-	1,200.0	1,200.0	1,200.0
<i>Of which: classified as equity under applicable accounting standards</i>	-	1,200.0	1,200.0	1,200.0
Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital issued by subsidiaries and held by third parties	944.3	-	-	-
Additional Tier 1 capital	944.3	1,200.0	1,200.0	1,200.0
Tier 1 capital (Tier 1 capital = Common Equity Tier 1 capital + Additional Tier 1 instruments)	15,936.2	13,816.9	12,967.4	12,254.5
Tier 2 capital: instruments and provisions				
Capital instruments and related share premium accounts	-	2,591.7	2,591.7	2,591.7
Qualifying own funds instruments included in consolidated Tier 2 capital issued by subsidiaries and held by third parties	2,163.3	-	-	-
Tier 2 capital	2,163.3	2,591.7	2,591.7	2,591.7
Total capital (total capital = Tier 1 capital + Tier 2 capital)	18,099.5	16,408.6	15,559.1	14,846.2
Total risk-weighted assets	64,379.2	59,512.8	48,432.2	44,498.3
Capital ratios and buffers				
Common Equity Tier 1 capital (as a percentage of the total risk-weighted exposure amount)	23.3%	21.2%	24.3%	24.8%
Tier 1 capital (as a percentage of the total risk-weighted exposure amount)	24.8%	23.2%	26.8%	27.5%
Total capital (as a percentage of the total risk-weighted exposure amount)	28.1%	27.6%	32.1%	33.4%
Institution-specific buffer requirement	9.0%	8.5%	9.0%	8.5%
<i>Of which: capital conservation buffer requirement</i>	2.5%	2.5%	2.5%	2.5%
<i>Of which: countercyclical buffer requirement</i>	2.0%	1.5%	2.0%	1.5%
<i>Of which: systemic risk buffer requirement</i>	-	-	-	-
<i>Of which: buffer for globally systemically important institution or for another systemically important institution</i>	-	-	-	-
Common Equity Tier 1 capital available to meet buffers (as a percentage of the risk-weighted exposure amount)	18.8%	16.7%	19.8%	20.3%
Capital requirement according to the Basel I floor *)	12,880.4	11,253.8	12,511.5	10,911.2
Own funds adjusted according to the Basel I floor	18,543.8	16,801.7	16,003.4	15,239.4
Surplus capital according to the Basel I floor	5,663.4	5,547.9	3,491.9	4,328.2

*) From 1 January 2018, the capital requirement under the Basel I floor based on Article 500(1) of the Regulation No 575/2013/EU on prudential requirements ceases to apply.

Table 4.3 Outstanding subordinated loans 31 December 2017

Borrower	Loan amount	Loan date	Repayment date	Premature redemption (break-off date)
Additional Tier 1 instruments - External				
Länsförsäkringar Bank AB	SEK 1,200 M	9 June 2015	Perpetual	Optional first redemption date: 9 June 2020
Tier 2 capital - External				
Länsförsäkringar Bank AB	SEK 1,100 M	28 March 2013	28 March 2023	28 March 2018
Länsförsäkringar Bank AB	SEK 500 M	26 April 2016	26 April 2026	26 April 2021
Länsförsäkringar Bank AB	SEK 1,000 M	26 April 2016	26 April 2026	26 April 2021

For more detailed information about the most significant elements of the own funds instruments presented in accordance with the European Commission's Implementing Regulation (EU) No 1423/2013, see the disclosures on own funds on the Länsförsäkringar Bank website.

Tier 2 capital

Tier 2 capital 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.

Tier 2 capital primarily comprises fixed-term subordinated debt, of which externally invested amounts totalled SEK 2,592 M. As a result of the same Q&A described under Tier 1 capital above, the consolidated situation also made a new interpretation of eligible Tier 2 capital. According to the new interpretation, eligible Tier 2 capital amounted to SEK 2,163 M.

4.3 CAPITAL REQUIREMENT

Risk Exposure Amount

The advanced Internal Ratings-based Approach (IRB) for retail exposures is applied in order to calculate REA. The Foundation IRB Approach (F-IRB) is used for exposures to corporates and the Standardised Approach is used for other exposure classes. The Standardised Approach is applied to the calculation of capital requirements for operational risk and credit valuation adjustment risk.

Total REA in the consolidated situation on 31 December 2017 amounted to SEK 64,379 M (59,513). Continued growth in lending, primarily to households in the form of mortgages, led to an increase in REA. REA for operational risk has increased since the preceding year due to the annual upward adjustment of the income included in the calculation according to the Standardised Approach.

Buffer requirement

The purpose of the capital conservation buffer is that it can be used during critical periods and is to amount to 2.5% of REA, which corresponded to SEK 1,609 M on 31 December 2017. The aim of the countercyclical capital buffer is to strengthen banks' resilience and ensure that sufficient capital exists for maintaining access to credit during stressed scenarios in the financial system. The Financial Supervisory Authority has set the requirement of the countercyclical capital buffer in Sweden at 2%, which corresponded to SEK 1,288 M on 31 December 2017.

Both buffers are to be covered by Common Equity Tier 1 capital. The Pillar I capital requirement for the Consolidated Situation amounted to 12.5% (12.0), including the capital conservation buffer and countercyclical capital buffer.

Internally assessed capital requirement

The internally assessed capital requirement for the Consolidated Situation on 31 December 2017 amounted to SEK 6,367 M. This amount includes an assessment of the increased capital requirement due to the application of the Financial Supervisory Authority's new assessment method for the probability of default for exposures to corporates. The Bank Group has applied to apply a model compatible with this method.

Pillar II stipulates a capital requirement for the risk weight floor for Swedish mortgages of 25%, resulting in a capital requirement of SEK 5,077 M. Own funds that meet the capital requirement under the Pillar I and Pillar II requirements, including buffers, amounted to SEK 18,100 M.

4.4 NEW AND AMENDED RULES

New IFRS and interpretations that have not yet been applied and their effect on capital adequacy

The new or amended standards and interpretations described below will not take effect until the next fiscal year, and have not impacted the consolidated financial statements or capital adequacy.

IFRS 9 Financial Instruments applies from 1 January 2018. IFRS 9 contains a new expected loss impairment model, new requirements for the classification and measurement of financial instruments and new hedge accounting rules.

Provisions for loan losses in the accounts will increase with the transition to IFRS 9 since some provisions are to be based on expected rather than occurred loss events as under IAS 39. However, the effect on own funds is marginal since the bank applies the IRB Approach to most of its loan portfolio. Institutions can use the reserves calculated under the accounting rules in their own funds to meet expected losses calculated according to the IRB Approach. An increase in accounting reserves is thus counterbalanced by the IRB deficit. Since the effect on own funds is expected to be marginal for both the transition to IFRS 9 and in the future, the bank has decided not to apply the capital adequacy rules that permit a phase-in of expected credit losses in own funds.

The new regulations on the recognition and measurement are not expected to have any effect on own funds. The bank has chosen the option of continuing to apply the hedge accounting rules in IAS 39, which also do not have any impact on own funds.

IFRS 15 Revenue from Contracts with Customers will apply from 1 January 2018. The new standard contains a single, five-step model for recognising revenue from contracts with customers that is not encompassed by other standards (for example, IFRS 4 or IFRS 9).

The new model for revenue recognition will not have any significant effect on the consolidated financial statements or capital adequacy.

IFRS 16 Leases will apply from 1 January 2019 and will then replace the existing standard IAS 17. For lessees, the new standard means that essentially all leases are to be recognised in the balance sheet. The Group currently has a project in progress to analyse the effects of IFRS 16, but the impact on the accounts and capital adequacy has not yet been determined.

For detailed information about forthcoming accounting standards and their effects on the consolidated financial statements, refer to the accounting policies in the Annual Report.

Capital adequacy rules

Impending changes to capital adequacy rules

At the end of 2016, the European Commission published its proposed reviews of the existing capital adequacy rules – both the regulation and the directive. The proposed amendments to the regula-

tion include a binding minimum requirement for the leverage ratio, net stable funding ratio and eligible liabilities for global systemically important institutions. New methods are also proposed for calculating market risk, counterparty risk as well as stricter rules on large exposures. The new directive proposal includes a revised Pillar II framework and revisions of calculation methods and materiality assessments of interest rate risk in the banking book. EU negotiations are under way and are expected to be completed at the end of 2018. The effective date is currently uncertain.

In December 2017, the Basel Committee published its regulatory reforms to complete the applicable Basel III rules. These reforms entail major changes for banks and include restrictions on the use of internal models and changes to the Standardised Approach for credit risk, a new Standardised Approach for operational risk, changes to the leverage ratio and a capital floor of 72.5%. The capital floor entails that the risk-weighted assets for a bank that applied internal models may not, in total, be lower than 72.5% of the risk-weighted amount

Table 4.4 Capital requirement and Risk Exposure Amount

	Consolidated situation 31 Dec 2017		Consolidated situation 31 Dec 2016		Bank Group 31 Dec 2017		Bank Group 31 Dec 2016	
	Risk exposure amount	Capital requirement	Risk exposure amount	Capital requirement	Risk exposure amount	Capital requirement	Risk exposure amount	Capital requirement
SEK M								
Credit risk according to Standardised Approach								
Exposures to institutions	1,293.5	103.5	1,396.2	111.7	1,242.7	99.4	1,340.9	107.3
Exposures to corporates	1,723.9	137.9	1,697.1	135.8	1,695.8	135.7	1,697.1	135.8
Retail exposures	1,730.7	138.5	1,527.4	122.2	1,730.7	138.5	1,527.4	122.2
Defaulted exposures	56.2	4.5	64.0	5.1	56.2	4.5	64.0	5.1
High risk items	15.0	1.2	30.0	2.4	15.0	1.2	30.0	2.4
Covered bonds	2,989.4	239.2	2,779.3	222.3	2,917.3	233.4	2,695.2	215.6
Equity exposures	5,296.0	423.7	4,748.6	379.9	40.6	3.2	38.0	3.0
Other items	4,538.0	363.0	3,978.4	318.3	1,002.7	80.2	628.8	50.3
Total capital requirement and Risk Exposure Amount	17,642.7	1,411.4	16,220.9	1,297.7	8,701.0	696.1	8,021.4	641.7
Credit risk according to IRB Approach								
<i>Retail exposures</i>								
Secured by immovable property, small and medium-sized businesses	2,217.4	177.4	2,226.9	178.2	2,217.4	177.4	2,226.9	178.2
Secured by immovable property, other	13,118.6	1,049.5	11,453.0	916.2	13,118.6	1,049.5	11,453.0	916.2
Other retail exposures, small and medium-sized businesses	4,375.0	350.0	4,008.5	320.7	4,375.0	350.0	4,008.5	320.7
Other retail exposures	7,087.4	567.0	6,422.1	513.8	7,087.4	567.0	6,422.1	513.8
Total retail exposures	26,798.4	2,143.9	24,110.4	1,928.8	26,798.4	2,143.9	24,110.4	1,928.8
Exposures to corporates	7,349.7	588.0	7,038.7	563.1	7,349.7	588.0	7,038.7	563.1
Total capital requirement and Risk Exposure Amount	34,148.1	2,731.8	31,149.1	2,491.9	34,148.1	2,731.8	31,149.1	2,491.9
Operational risk								
Standardised Approach	11,346.2	907.7	10,717.4	857.4	4,340.9	347.3	3,902.5	312.2
Total capital requirement for operational risk	11,346.2	907.7	10,717.4	857.4	4,340.9	347.3	3,902.5	312.2
Credit valuation adjustment, Standardised Approach	1,242.2	99.4	1,425.3	114.0	1,242.2	99.4	1,425.3	114.0
Total capital requirement and Risk Exposure Amount	64,379.2	5,150.3	59,512.8	4,761.0	48,432.2	3,874.6	44,498.3	3,559.9

calculated according to the Standardised Approach. The proposed new rules will lead to higher capital requirements, primarily due to the floor rule. The rules are proposed to come into effect on 1 January 2022, with a phase-in period of five years.

Combined, this will entail extensive changes for many banks. Länsförsäkringar Bank is following regulatory developments and is highly prepared and well capitalised for impending changes, even if it is unclear at this stage what the effects of a capital requirement will be.

Crisis management

Sweden has had new rules for managing failing banks since February 2016. These rules are based on the European Parliament and Council's Crisis Management Directive (2014/59/EU). The key aim is to prevent banks' problems from becoming a burden for the tax payer. The Swedish National Debt Office is responsible for applying the regulations. The rules establish a special procedure for handling a failing institution without putting it into bankruptcy. This procedure is called resolution. It means that the government, through the National Debt Office, can take control of the failing bank. The National Debt Office has a number of tools available to reconstruct or discontinue banks in a structured manner. To facilitate efficient resolution, the National Debt Office has prepared resolution plans

for the institutions that it considers have critical operations for the financial system. As part of its work, the National Debt Office will determine minimum requirements for own funds and eligible liabilities that can be used to cover losses in a failing institution.

In December 2017, the National Debt Office announced its decision on resolution plans and minimum requirements for own funds and eligible liabilities (MREL) for the ten institutions that have business activities that are deemed to be critical to the Swedish financial system. MREL for the consolidated situation is 6.2% of total liabilities and own funds. This MREL level of 6.2% is divided into a loss absorption amount of 2.6% that is to be covered by own funds instruments and a recapitalisation amount of 3.6% that is to be covered by bail-inable liabilities. According to the decision, the bail-inable liabilities are to be issued by Länsförsäkringar Bank. Bail-inable liabilities includes senior unsecured funding with a remaining term of more than one year. A requirement that bail-inable liabilities are to be subordinated will be gradually phased in for certain banks over the period until 1 January 2022. The National Debt Office will announce in 2018 whether the consolidated situation will be subject to the subordination requirement. On 31 December 2017, Länsförsäkringar Bank had SEK 28.7 billion in outstanding senior unsecured funding with a remaining term of more than one year, which exceeds MREL by a very high margin.

5 | Credit risk

Credit risk refers to the risk that a counterparty is unable to fulfil its commitments and that any collateral provided does not cover the receivable so that a financial loss arises.

5.1 RISK APPETITE

The risk-taking for credit risk is based on a sound credit process and the credit portfolio is highly diversified with an overall low risk level. Risk is limited within the framework of the Consolidated Situation's established risk appetite and risk limits.

5.2 RISK MANAGEMENT

This section presents the credit process, risk-classification system and method for calculating the Consolidated Situation's 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 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. The quality of the loan portfolio and borrowers' repayment capacity are continuously monitored and reviewed. Combined with system support for risk classification, this leads to balanced and consistent loan origination.

The Board's adopted credit regulations form the foundation of all loan origination that takes place. The size of the loan and level of risk determine the decision level, where the highest instance is the Board and the lowest instance a decision by an advisor. 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 for underlying documentation for credit-granting decisions. Compliance with the credit regulations is regularly monitored. The credit regulations and credit process, combined with local customer and market knowledge, create a loan portfolio that maintains high credit quality.

Environmental and climate risks

Environmental risks and environmental responsibility for agriculture and companies are regulated by the extensive external rules of a variety of supervisory authorities. Environment-related risks are addressed in the loan application process based on, for example, licensable and non-licensable operations and a comprehensive assessment of the company's operations. In 2017, the bank analysed and participated in discussions with other Swedish banks on "Recommendations of the Task Force on Climate-related Financial Disclosures." The bank will continue this work in 2018 and initiate climate-related scenario simulations of its loan portfolio.

5.2.2 IRB system

An Internal Ratings-based Approach is used in the area of credit risk, or IRB Approach, to calculate the capital requirement for credit risk. This complies with the requirements set by the CRR and forms

the basis of the IRB risk-classification 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 risks. The IRB system is specifically used in:

- Credit process for risk assessment and credit-granting decisions
- Calculation of credit loss provisions
- Calculation of risk-adjusted returns
- Monitoring and reporting to management and the Board
- Calculation of capital requirement
- 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 for on-balance sheet item, EAD is defined as capital liability plus accrued and overdue unpaid interest and fees. For off-balance sheet commitments, EAD is calculated by using a conversion factor.

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 due¹⁾. A counterparty is also considered to be in default if there are other reasons to expect that the counterparty cannot meet its undertakings.

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

The information that is most relevant to each type of counterparty has been taken into consideration in the development of models for estimating PD. The PD estimate for retail exposures is calculated entirely by using models based on predictive statistical analysis, while the PD estimate for exposures to corporates is based on a strict predictive statistical analysis combined with 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 percentage 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 such factors as loss portions, loan-to-value (LTV) ratio and product type. A safety margin is added to these estimates to ensure that the LGD is not underestimated, 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

¹⁾90 days is applied for Wasa Kredit.

event of default. An internal estimate of CF is calculated for the Advanced IRB Approach, which is based on internal information about such factors as degree of realisation, degree of utilisation and type of product. A safety margin is added to these estimates to ensure that the CF is not underestimated.

Validation

The entire IRB system is validated every year in accordance with applicable regulation and internally adopted guidelines. The quantitative risk models applied to risk estimates are evaluated based on predictive ability and risk-differentiating properties. Great importance is attached to ensuring that the models are stable over time. In addition to the purely quantitative aspects of the IRB system, the use and integration of the system in the operations is evaluated to ensure that the credit risk is consistently and uniformly measured. The entire validation process is performed by the Risk Management department.

5.2.3 Method for calculating capital requirements for credit risk

This section provides an overview of the exposure classes calculated by the Standardised Approach and IRB Approach, and the dates on which approval for applying the IRB Approach to each portfolio was received.

Standardised Approach (SA)

Exposures calculated according to the Standardised Approach primarily comprise exposures to governments and institutions, and holdings of covered bonds. All holdings in securities have a very high credit rating.

Internal Ratings-based Approach (IRB)

The IRB Approach is applied to lending to the retail exposures and exposures to corporates classes²⁾. The Foundation Internal Ratings-Based Approach is applied to exposures to corporates, with PD estimated by using internal models, while prescribed amounts are used for LGD and CF. Permission to apply the IRB Approach was obtained or applied for as follows:

- In December 2006, permission was granted by the Financial Supervisory Authority to apply the IRB Approach to 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 credit risk for companies with agricultural operations, which comprises most of the corporate portfolio. This Approach has been applied since March 2010.

- In May 2012, permission was received to apply the IRB Approach for exposures to corporates, excluding Wasa Kredit AB. This Approach has been applied since June 2012.
- In April 2015, Länsförsäkringar Bank AB and the subsidiary Länsförsäkringar Hypotek AB received permission from the Financial Supervisory Authority to change their IRB model for calculating LGD for loans secured by immovable property. This Approach has been applied to capital requirement calculations since May 2015.
- In April 2015, Länsförsäkringar Bank AB and its subsidiaries Länsförsäkringar Hypotek AB and Wasa Kredit AB received approval for all IRB portfolios in the Bank Group to change the limit for what is classified as retail exposures and exposures to corporates. The new limit has been applied to capital requirement calculations since May 2015.
- In July 2015, an application was submitted to the Financial Supervisory Authority for permission to use a new PD model for corporate counterparties in the retail exposure class and exposures to corporates for Wasa Kredit AB.
- In December 2016, an application was submitted to the Financial Supervisory Authority for permission to adjust the PDTTC levels of the models for corporates to meet the requirements of the Authority's new directive³⁾.
- In February 2017, an application was submitted to the Financial Supervisory Authority for permission to adjust the PDTTC levels of the models for retail to meet the requirements of the Authority's new directive³⁾.
- In February 2017, an application was submitted to the Financial Supervisory Authority for permission to change the definition of default in Länsförsäkringar Bank and Hypotek from the current 60 days past due to 90 days past due.

5.3 CREDIT QUALITY

This section describes the Consolidated Situation's credit risk exposure based on approach, exposure class and geographic and industry distribution. The IRB exposure is also reported specified by risk class and an evaluation of the credit risk models is provided.

As described in Table 5.1, the IRB retail exposure increased SEK 34,507 M (16%), while exposures to corporates remained rose SEK 672 M (4%), primarily due to volume growth in mortgages in the retail segment. Volumes grew while retaining the risk weight level, as shown in Table 5.1. Amounts and risk weights are reported separately for small and medium-sized enterprises (SMEs) in the retail and corporates exposure classes.

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

³⁾ See the Swedish Financial Supervisory Authority's memorandum: "FI's supervision of banks' calculations of risk weights for exposures to corporates."

Table 5.1 Exposure by exposure class

SEK M	31 Dec 2017			31 Dec 2016			Period average ¹⁾		
	Original exposure	EAD	RW (%)	Original exposure	EAD	RW (%)	Original exposure	EAD	Average RW (%)
Standardised Approach									
Central governments and central banks	13,489	13,488	0	10,049	10,049	0	13,140	13,139	0
Regional governments or local authorities	4,018	4,018	0	3,569	3,569	0	4,001	4,001	0
Multilateral development banks	1,699	1,699	0	1,382	1,382	0	1,573	1,573	0
Institutions	6,992	4,228	31	7,227	4,236	33	11,307	4,239	31
Corporates	2,034	2,033	85	2,014	2,012	84	2,163	2,161	84
of which, SMEs	1,298	1,298	76	1,323	1,322	76	1,438	1,437	76
Retail	3,549	2,308	75	3,126	2,037	75	3,334	2,169	75
of which, SMEs	0	0	-	0	0	-	0	0	-
Defaulted exposures	70	39	142	73	47	136	73	43	141
Covered bonds	29,894	29,894	10	27,793	27,793	10	29,734	29,734	10
Exposures associated with particularly high risk	10	10	150	20	20	150	18	18	150
Claims in the form of CIU	0	0	-	0	0	-	0	0	-
Equity exposures	2,135	2,135	248	1,916	1,916	248	2,053	2,053	248
Other items	4,529	4,529	100	4,217	4,217	94	4,054	4,054	101
Total, Standardised Approach	68,419	64,381	27	61,386	57,278	22	71,450	63,184	26
IRB Approach									
Corporates	19,502	19,316	38	18,774	18,644	38	19,234	19,086	39
of which, SMEs	19,492	19,308	38	18,595	18,466	38	19,181	19,036	39
Retail	256,600	252,973	11	221,676	218,465	11	244,464	240,193	11
of which, SMEs	36,048	35,668	18	32,968	32,608	19	34,852	34,479	19
of which, secured by immovable property	226,734	223,803	7	195,036	192,510	7	215,504	211,928	7
of which, other retail credits	29,866	29,170	39	26,640	25,955	40	28,960	28,266	39
Total, IRB Approach	276,102	272,289	13	240,450	237,109	13	263,698	259,279	13
Total	344,521	336,670	15	301,836	294,387	16	335,148	322,463	16

¹⁾ Average exposure and risk weight in 2017, calculated by quarter.

Table 5.2 presents the exposure by country calculated according to the Standardised Approach (Consolidated Situation).

Table 5.2 Distribution of exposure per country, Standardised Approach

Standardised Approach, SEK M	31 Dec 2017		31 Dec 2016	
	Original exposure	EAD	Original exposure	EAD
Sweden	60,900	59,072	53,967	52,259
Germany	1,030	1,030	1,131	1,131
Finland	462	462	601	601
Switzerland	938	269	1,456	464
Denmark	4,481	2,944	3,626	2,240
Norway	608	604	604	582
UK	0	0	1	1
Total	68,419	64,381	61,386	57,278

The Consolidated Situation applies external credit rating for exposures to institutions and exposures in the form of covered bonds. The external rating used is the rating from Moody's or Standard & Poor's that gives rise to the highest risk weight. Table 5.3 shows exposure before and after credit-risk-reducing measures by credit quality step.

Table 5.3 Exposure by credit quality step

Credit quality step	31 Dec 2017		31 Dec 2016	
	Original exposure	EAD	Original exposure	EAD
1	32,742.2	32,060.4	30,223.9	30,086.1
2	4,143.7	2,061.2	4,796.2	1,943.6
3	-	-	-	-
4	-	-	-	-
5	-	-	-	-
6	-	-	-	-
Total	36,885.9	34,121.6	35,020.2	32,029.7

All IRB exposure is found in Sweden and Table 5.4 presents the exposure per county. Exposure is well-diversified throughout Sweden 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 242 billion of a total of SEK 272 billion at 31 December 2017.

Table 5.4 Distribution of IRB exposure per county

County, SEK M	31 Dec 2017				31 Dec 2016			
	Total		Of which, exposures secured by immovable property		Total		Of which, exposures secured by immovable property	
	EAD	%	EAD	%	EAD	%	EAD	%
Blekinge	5,016	1.8	4,258	1.8	4,196	1.8	3,670	1.7
Dalarna	11,474	4.2	10,310	4.3	10,208	4.3	9,153	4.3
Gotland	5,560	2.1	5,021	2.1	5,310	2.2	4,859	2.3
Gävleborg	7,360	2.7	6,262	2.5	6,551	2.8	5,781	2.8
Halland	13,144	4.8	12,078	5.0	11,725	4.9	10,633	5.1
Jämtland	5,549	2.0	4,823	2.0	4,641	2.0	4,108	1.9
Jönköping	11,358	4.2	10,300	4.3	9,775	4.1	8,793	4.2
Kalmar	7,147	2.6	6,108	2.4	5,910	2.5	5,116	2.4
Kronoberg	5,506	2.0	4,682	1.9	4,531	1.9	3,973	1.9
Norrbottn	4,008	1.5	3,056	1.3	3,222	1.4	2,669	1.3
Skåne	33,375	12.3	29,522	12.2	28,521	12.0	24,586	11.7
Stockholm	38,370	14.1	33,087	13.7	33,893	14.3	29,350	14.0
Södermanland	8,232	3.0	7,048	2.9	7,087	3.0	6,218	3.0
Uppsala	13,430	4.9	12,193	5.0	11,963	5.0	10,945	5.2
Värmland	5,002	1.8	4,002	1.6	3,970	1.7	3,393	1.6
Västerbotten	9,473	3.5	8,722	3.6	8,097	3.4	7,535	3.6
Västernorrland	4,532	1.7	3,579	1.5	3,715	1.6	3,143	1.5
Västmanland	9,271	3.4	8,256	3.4	7,994	3.4	7,251	3.4
Västra Götaland	45,153	16.6	41,643	17.2	39,307	16.5	35,317	16.8
Örebro	10,253	3.8	9,085	3.8	8,985	3.8	7,893	3.8
Östergötland	19,076	7.0	18,106	7.5	17,508	7.4	15,806	7.5
Total	272,289	100.0	242,141	100.0	237,109	100.0	210,192	100.0

Table 5.5 describes the IRB exposure by industry and exposure class. Most of the exposure comprises loans to private individuals and agricultural customers representing 92% of the total IRB exposure.

Table 5.5 Exposure by industry and class, IRB

Exposure class	Industry	31 Dec 2017			31 Dec 2016		
		EAD	%	RW (%)	EAD	%	RW (%)
Retail	Private individuals	217,262	80	9	185,858	78	10
	Agriculture	20,832	8	10	19,192	8	11
	Other business	14,879	5	30	13,415	6	31
	Total retail	252,973	93	11	218,465	92	11
	of which, SMEs	35,668	-	18	32,968	-	19
Corporates	Agriculture	11,038	4	36	10,539	5	35
	Other business	8,278	3	41	8,105	3	41
	Total corporates	19,316	7	38	18,644	8	38
	of which, SMEs	19,308	-	38	18,466	-	38
Total		272,289	100	13	237,109	100	13

Figure 5.1 and Table 5.6 present the credit risk exposure, calculated according to IRB, specified according to risk grades. The results show a distribution of exposure, with 78% (78) of exposure found in the best grades 1-4. A contributing reason for the higher amount in these grades is that a high 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 5.1. Exposure by risk class, IRB

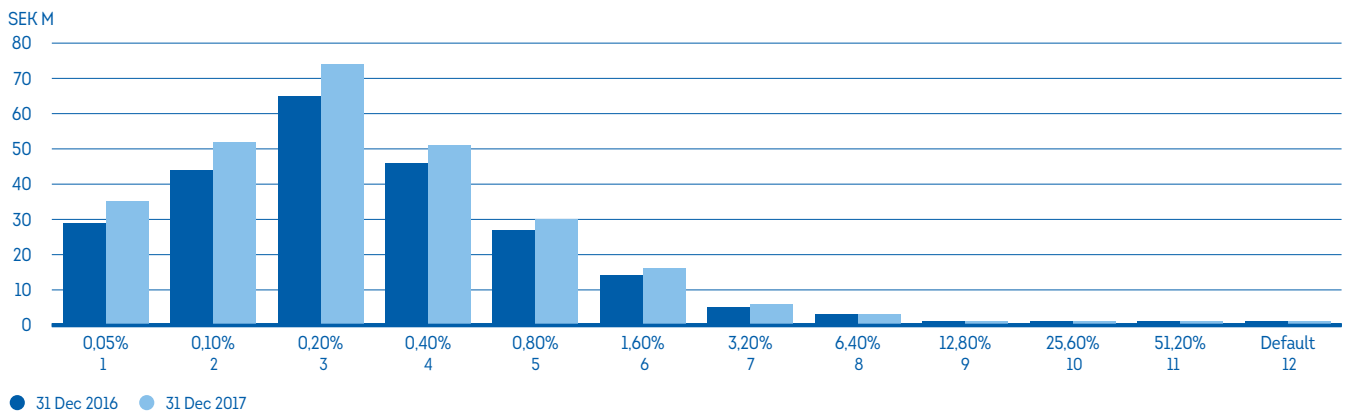


Table 5.6. Exposure by PD grade and class, IRB

PD grade, 31 Dec 2017, SEK M	Retail exposures					Exposures to corporates				
	Secured by immovable property		Other exposures		Total	Secured by immovable property		Other exposures		Total
	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)
1	31,410	1	1,004	4	32,413	1	2,477	12	34,891	2
2	49,248	3	2,251	13	51,498	3	812	18	52,310	3
3	65,829	5	3,728	20	69,557	6	4,760	26	74,317	7
4	42,813	8	2,605	29	45,419	9	5,728	37	51,146	12
5	20,885	14	6,817	35	27,703	19	2,754	50	30,457	22
6	8,448	22	6,357	48	14,805	33	1,354	64	16,159	36
7	2,468	31	3,198	58	5,667	46	578	82	6,245	50
8	1,322	46	1,613	62	2,935	55	503	101	3,439	62
9	651	63	710	75	1,361	69	61	124	1,422	72
10	305	77	355	79	659	78	28	157	687	81
11	243	68	229	103	472	85	110	150	582	97
Default	181	131	303	93	484	107	151	0	634	82
Total	223,803	7	29,170	39	252,973	11	19,316	38	272,289	13

Table 5.7. Exposure-weighted PD, LGD and CF, IRB

	Retail exposures		Exposures to corporates	
	Secured by immovable property	Other exposures	Total	Total
PD (%) ¹⁾	0.50	2.36	0.71	1.04
LGD (%) ¹⁾	11.0	43.3	14.7	-
CF (%) ²⁾	51.3	88.0	69.0	-

¹⁾ Exposure-weighted average, non-defaulted exposures.

²⁾ Only for unutilised undertakings.

A correlation between the internal grades for IRB exposures and external rating that the bank believes is a reasonable comparison is presented below.

Table 5.8. Correlation between internal PD grades and external rating (Standard & Poor's)

Internal	PD (%)	Indicative credit rating from 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	B- to C
Default	100	D

Expected Loss and actual outcome

The Expected Loss Percentage (EL) is expressed as a percentage of the exposure and calculated based on the internal parameter estimates of PD and LGD.

EL on 31 December 2015 as a percentage for all non-defaulted exposures in the retail exposure class was 0.22% and the actual outcome was 0.09%³⁾. EL for retail exposures secured by immovable property was 0.09% and the outcome was 0.01%. For other retail exposures, EL was 1.17% and the outcome was 0.74%. 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 2015. Outcome is calculated as confirmed loan losses for default in 2016 with a follow-up period until 31 December 2017.

5.3.1 Risk-reducing measures and contractual maturities

The starting point of the 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 losses in the event of a credit default. Loans are mostly granted against collateral in property, for which the operations has extensive experience and robust procedures in place. The market value of properties is updated on an annual basis, or when necessary, following established procedures. The relationship between the loan portfolio and the underlying assets expressed as the weighted average loan-to-value (LTV) ratio was 60% (61).

Table 5.9. Retail mortgages by loan-to-value ratio interval (LTV)

EAD, SEK M	31 Dec 2017	%	31 Dec 2016	%
0-50%	161,801	82	135,713	80
51-60%	18,891	9	16,308	10
61-70%	11,477	6	10,723	6
71-75%	2,976	2	3,019	2
75%-	2,828	1	2,974	2
Total	197,973	100	168,737	100

Other significant risk-reducing measures in the Consolidated Situation are the netting agreements signed with institutional counterparties.

Table 5.10 presents exposure amounts covered by eligible collateral. Collateral for exposures to institutions comprises financial collateral, while collateral for the corporate and retail exposure classes comprises properties for which the covered amount totalled SEK 240 billion on 31 December 2017.

TABLE 5.10. Eligible collateral for capital adequacy purposes

SEK M	31 Dec 2017		31 Dec 2016	
	Original exposure	Exposure amount covered by collateral	Original exposure	Exposure amount covered by collateral
Standardised Approach				
Central governments and central banks	13,489		10,049	0
Regional governments or local authorities	4,018		3,569	0
Multilateral development banks	1,699		1,382	0
Institutions	6,992	2,763	7,227	2,988
Corporates	2,034		2,014	0
of which, SMEs	1,298		1,323	0
Retail	3,549		3,126	0
of which, SMEs	0		0	0
Defaulted exposures	70		73	0
Covered bonds	29,894		27,793	0
Exposures associated with particularly high risk	10		20	0
Claims in the form of CIU	0		0	0
Equity exposures	2,135		1,916	0
Other items	4,529		4,217	0
Total, Standardised Approach	68,419	2,763	61,386	2,988
IRB Approach				
Corporates	19,502	17,213	18,774	16,518
of which, SMEs	19,492	17,213	18,595	16,349
Retail	256,600	223,244	221,676	191,156
of which, SMEs	36,048	21,653	32,968	20,227
Total, IRB Approach	276,102	240,457	240,450	207,674
Total	344,521	243,220	301,836	210,662

Table 5.11 presents exposures distributed by exposure class and remaining fixed-interest periods.

Table 5.11. Exposures by fixed-interest periods

31 Dec 2017, SEK M	<3 months	3-12 months	1-5 years	>5 years	Total
Standardised Approach					
Central governments and central banks	4,915	3,631	415	4527	13,488
Regional governments or local authorities	1,463	1,082	124	1,349	4,018
Multilateral development banks	620	457	52	570	1,699
Institutions	413	991	2,630	194	4,228
Covered bonds	2,921	7,005	18,599	1,369	29,894
Corporates	1,973	62	4	-	2,039
Retail	2,351	-	-	-	2,351
Claims in the form of CIUs	-	-	-	-	-
Equities	2,135	-	-	-	2,135
Other items	4,529	-	-	-	4,529
Total, Standardised Approach	21,230	13,228	21,824	8,009	64,381
IRB Approach					
Corporates	10,154	4,507	4,309	346	19,316
Retail	151,962	59,448	39,812	1,751	252,973
- Of which, secured by immovable property	123,219	59,304	39,638	1,642	223,803
- Of which, other exposures	28,743	144	174	109	29,170
Total, IRB Approach	162,116	63,955	44,121	2,097	272,289
Total	186,436	77,183	65,945	10,106	336,670

5.4 Non-performing receivables, impaired loans and loan losses

This section describes the Bank Group's non-performing receivables, impaired loans, and loan losses that are based in their entirety on the total loan portfolio from an accounting perspective.

5.4.1 Non-performing receivables

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

Table 5.12. Non-performing receivables by company

Overdue receivables, days	Länsförsäkringar Bank AB		Länsförsäkringar Hypotek AB		Wasa Kredit AB		Total	
	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016
1-39 days	34.5	14.9	49.3	26.5	280.6	234.1	364.4	275.5
40-60 days	-	-	0.4	-	7.9	4.4	8.3	4.4
Total	34.5	14.9	49.7	26.5	288.5	238.5	372.7	279.9

5.4.2 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 it is not covered by collateral. Impaired loans amounted to SEK 278 M (240), corresponding to 0.11% (0.11) of the total loan portfolio before reserves.

Table 5.13. Impaired loans by exposure class, industry and company

Standardised Approach	Industry	Länsförsäkringar Bank AB		Länsförsäkringar Hypotek AB		Wasa Kredit AB		Total	
		31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016	31 Dec 2017	31 Dec 2016
	Private individuals	0.0	0.0	0.0	0.0	50.0	34.6	50.0	34.6
	Agriculture	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	1.8	3.1	1.8	3.1
Total, Standardised Approach		0.0	0.0	0.0	0.0	51.8	37.7	51.8	37.7
IRB Approach									
Retail	Private individuals	2.9	4.3	0.0	0.0	118.7	108.4	121.6	112.7
	Agriculture	2.0	4.5	0.0	0.0	0.0	0.0	2.0	4.5
	Other business	1.5	0.6	0.0	0.0	95.3	72.3	96.8	72.8
Total retail		6.4	9.4	0.0	0.0	214.0	180.7	220.4	190.1
Corporates	Private individuals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Agriculture	5.7	12.4	0.0	0.0	0.0	0.0	5.7	12.4
	Other business	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total corporates		5.7	12.4	0.0	0.0	0.0	0.0	5.7	12.4
Total, IRB Approach		12.1	21.8	0.0	0.0	214.0	180.7	226.1	202.5
Total		12.1	21.8	0.0	0.0	265.8	218.4	277.9	240.2

5.4.3 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 due to impairment requirements no longer being deemed necessary. 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 when there is an indication that impairment is required. Recoveries comprise reversed amounts of loan losses that were previously recognised as confirmed.

Only the Bank Group's share of probable and confirmed loan losses are recognised. The settlement model, which was introduced on 1 January 2014, regarding the commitment that the regional insurance companies have for loan losses related to the business they have originated, entails that the regional insurance companies cover 80% of the provision requirement in the Bank Group (exclud-

ing Wasa Kredit AB), on the date when an impairment is identified, by off-setting this against a buffer of accrued commission. On 31 December 2017, the total credit reserve requirement amounted to SEK 355 M (380), of which the Bank Group's recognised credit reserve accounted for SEK 268 M (250) and the remainder of SEK 87 M (130) was offset against the regional insurance companies' withheld funds, according to the model described above.

On 1 January 2018, the total credit reserve requirement under IFRS 9 amounted to SEK 496 M. For information on the impact on own funds and capital adequacy, refer to section 4.4.

Loan losses remained very low and amounted to SEK 58 M (38), net, corresponding to loan losses of 0.02% (0.02). Impaired loans and loan losses continued to account for a minor percentage of total loans.

Table 5.14. Loan losses

Loan losses, net (SEK M)	31 Dec 2017 ¹⁾	31 Dec 2016 ¹⁾
Specific impairment for individually assessed loan receivables		
Write-off of confirmed loan losses during the period	-131	-135.1
Reversed earlier impairment of loan losses recognised as confirmed losses	118.4	133.3
Impairment of loan losses during the period	-147.5	-140.9
Payment received for prior confirmed loan losses	90.3	66.8
Reversed impairment of loan losses no longer required	9.9	67.1
Net expense for the period for individually assessed loan receivables	-59.9	-8.8
Collectively assessment of homogeneous groups of loan receivables with limited value and similar credit risk		
Provision/reversal of impairment of loan losses	1.9	-29.1
Net expense for the period for collectively assessed receivables	1.9	-29.1
Net expense for the period for fulfilment of guarantees	0.3	0.3
Net expense of loan losses for the period	-57.7	-37.6

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

Table 5.15. Collective and individual impairment by industry

Standardised Approach	Industry	31 Dec 2017			31 Dec 2016		
		Collective impairments	Individual impairments	Total	Collective impairments	Individual impairments	Total
	Private individuals	3.5	18.6	22.1	3.6	13.7	17.3
	Agriculture	0.0	0.0	0.0	0.0	0.0	0.0
	Other business	1.1	0.6	1.7	2.6	4.2	6.8
Total, Standardised Approach		4.6	19.2	23.8	6.2	17.9	24.1
IRB Approach							
Retail	Private individuals	41.1	82.7	123.8	38.2	71.2	109.3
	Agriculture	0.4	3.9	4.3	0.5	6.1	6.6
	Other business	18.6	49.8	68.4	12.9	35.1	48.0
Total retail		60.1	136.4	196.5	51.6	112.4	164.0
Corporates	Private individuals	0.2	0.0	0.2	0.0	0.0	0.0
	Agriculture	40.4	5.7	46.1	49.5	11.8	61.3
	Other business	0.1	0.8	0.9	0.0	0.7	0.7
Total corporates		40.7	6.5	47.2	49.5	12.5	62.0
Total, IRB Approach		100.8	142.9	243.7	101.1	124.9	226.0
Total		105.4	162.1	267.5	107.2	142.9	250.1

5.5 COUNTERPARTY RISK FOR DERIVATIVES

Counterparty risk is the risk of a counterparty being unable to fulfil its commitments, 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 Consolidated Situation has only swap counterparties with a high credit rating and for which ISDA agreements have been prepared. 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 unilat-

eral for Länsförsäkringar Hypotek's covered-bond operations, with only the counterparty providing collateral. There are no CSA agreements for which the Consolidated Situation is required to provide collateral for downgrades. Table 5.16 presents the derivative exposure for the Consolidated Situation. Exposure to central counterparties is recognised without any rating. The entire exposure to central counterparties and banks on 31 December 2017 comprised exposure to Nasdaq Clearing AB. Nasdaq Clearing AB does not have any rating but is a very strong counterparty due to the strong statutory regulations that apply to Nasdaq Clearing AB and other central counterparties. Nasdaq Clearing AB has been certified by the Swedish Financial Supervisory Authority as an EMIR counterparty and is subject to the supervision of the Authority.

Table 5.16. Derivatives at fair value

Rating, SEK M	31 Dec 2017					31 Dec 2016				
	Gross	Netting gain	Collateral	Net exposure	EAD	Gross	Netting gain	Collateral	Net exposure	EAD
AA-/Aa3	1,680	379	199	1,120	1,846	2,085	732	110	1,243	1,777
A+/A1	731	279	306	147	1,481	850	377	477	0	457
A/A2	2,624	285	2,390	8	148	3,271	445	2,595	238	1,401
n/a	90	90	6	0	226	11	11	0	0	46
Total	5,125	1,034	2,900	1,274	3,701	6,217	1,565	3,181	1,481	3,680

6 | Market risk

Market risk pertains to the risk of loss arising due to changes in the market price of assets, liabilities and financial instruments.

6.1 RISK APPETITE

The Board of Directors determines the risk appetite for market risk. The Consolidated Situation has a low appetite for market risks, meaning that these risks are to be limited to a reasonable extent. Derivatives are permitted to be used only to reduce the Consolidated Situation's risk. The Consolidated Situation does not have a trading book.

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 Consolidated Situation. The daily management of market risks takes place in the Treasury unit. The management takes place in a cost effective manner, within set limits. The Consolidated Situation applies a number of supplementary risk measures and stress tests to measure market risk.

The Consolidated Situation's primary market risk is interest rate risk. Interest rate risk is primarily minimised by matching fixed lending with corresponding funding. Secondly, interest rate risk is reduced by utilising interest rate derivatives.

6.2.1 Governance

The overall framework for the financial operations is adopted by the Board in the Risk Policy. The Board also adopts the limits for interest rate risk, spread risk and currency risk. Limits are determined by the Board of each company. The methods for calculating market risks are established by the Risk Committee.

6.2.2 Interest rate risk

Interest rate risk is defined as the risk of losses due to changes in the market interest rates.

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

Interest rate risk is calculated as the effect of a sharp momentary stress scenario. The capital requirement calculation for interest rate risk in Pillar II uses a Value-At-Risk model.

Table 6.1. Interest rate risk per currency

SEK M	31 Dec 2017	31 Dec 2016
SEK	39.1	-2.3
CHF	0.0	0.0
EUR	-0.1	-0.1
NOK	-0.1	-0.1
GBP	0.0	0.0
USD	0.0	0.0
Total	39.3	-2.5

Table 6.1 shows the changes in present value arising from a 100-basis-point shift in market interest rates, specified by currency. The analysis does not include equity that the Consolidated Situation has or the possibility of adapting to changed interest rate levels. Interest rate risk is almost exclusively in SEK and has changed due to natural fluctuations arising from different interest rate fixing periods for assets and liabilities. Table 6.2 shows the interest rate fixing period of assets, liabilities and derivatives for the Consolidated Situation. Non-interest-bearing assets and liabilities have been excluded.

Table 6.2. Fixed-interest periods for assets and liabilities - Interest-rate exposure

Group 2017, SEK M	Up to 3 months	3-12 months	1-5 years	More than 5 years	Total
Loans	194,513.2	21,624.7	43,675.9	1,895.4	261,709.1
Bonds, etc.	11,004.1	7,864.2	26,382.5	1,718.9	46,969.7
Total	205,517.3	29,488.9	70,058.4	3,614.3	308,678.9
Deposits	97,994.9	4,577.8	532.5	0	103,105.2
Debt securities in issue, etc.	26,610.1	12,338.1	114,871.8	37,183.1	191,003.2
Total	124,605.0	16,915.9	115,404.3	37,183.1	294,108.4
Difference assets and liabilities	80,912.3	12,573.0	-45,345.9	-33,568.8	
Interest-rate derivatives, nominal values, net	-73,490.2	-8,700.5	49,689.1	34,846.5	
Net exposure	7,422.1	3,872.5	4,343.1	1,277.6	

6.2.3 Spread risk

Spread risk is defined as the risk of losses arising due to changes in spreads between market interest rates.

In the Consolidated Situation, credit spread risk arises in the liquidity reserve and currency-basis spread risk arise when hedging funding in foreign currency. Credit-spread and currency-basis spread risk are measured using sensitivity measures for each spread. The capital requirement calculation for spread risks in Pillar II uses a Value-At-Risk model.

6.2.4 Currency risk

Currency risk is the risk of losses arising due to exchange-rate fluctuations and is calculated as the total of the absolute amounts of the change in value per currency.

Currency risk arises in funding in foreign currency, primarily in EUR, CHF and NOK, and is measured as the effect of a momentary +/-10% change in the exchange rate. This risk is managed for each funding by converting the funding to SEK using swap contracts, which then results in no significant currency risk. Total currency risk on 31 December 2017 amounted to SEK 0.7 M (0.7).

6.2.5 Monitoring and reporting

All market risks are measured and controlled on a daily basis. Risk Management 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.

7 | Liquidity risk

Liquidity risk is defined as the risk that payment commitments cannot be fulfilled due to insufficient cash funds, or are only able to be fulfilled by funding at a significantly higher cost than normal or by divesting assets at a substantial deficit price.

7.1 RISK APPETITE

The Consolidated Situation's risk appetite for liquidity risk is low. The Board establishes the risk appetite, liquidity risk limits and the direction of liquidity risk management.

7.2 RISK MANAGEMENT

Liquidity risk is minimised and mitigated by forecasting future liquidity requirements, high access to funds, explicit functional definitions and a high level of control. Liquidity risk is managed by the Treasury unit, which is also responsible for meeting the limits for liquidity risk set by the Board. The objective of liquidity-risk management is that the Consolidated Situation, at any given time, is to have sufficient 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. The operational liquidity risk management is based on the Bank Group, but also takes into account Länsförsäkringar AB with regard to LCR, NSFR and ALMM, with the requirement that the operations at all times are to meet their liquidity and financing undertakings.

7.2.1 Governance

Governance of the Consolidated Situation is based on limits, governance documents and established business targets. The central measure in the management of liquidity risk comprises the Bank Group's "survival horizon," meaning the period of time during which the Bank Group is able to meet its commitments without requiring access to new financing. The liquidity limit for the survival horizon has been set at 12 months.

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

Figure 7.1 illustrates the Bank Group's survival horizon at 31 December 2017. The graph shows that contractual undertakings can be satisfied within 29 months (29) by utilising the liquidity reserve alone.

Liquidity reserve

The Bank Group's liquidity reserve comprises securities of very high liquidity, credit quality and deposits with the Riksbank or the Swedish National Debt Office. Most of the securities holdings are eligible for transactions with the Riksbank and, where applicable, with the ECB or the Federal Reserve, and can be quickly converted to cash and cash equivalents. The Treasury unit monitors and manages the liquidity reserve on a daily basis and is responsible for the amount of the reserve totalling the limits set by the Board.

On 31 December 2017, the liquidity reserve amounted to SEK 48.1 billion (41.6) and 58% (61) of the reserve comprised Swedish covered bonds. For a specification of the liquidity reserve, see figure 7.2.

Figure 7.1 Survival horizon

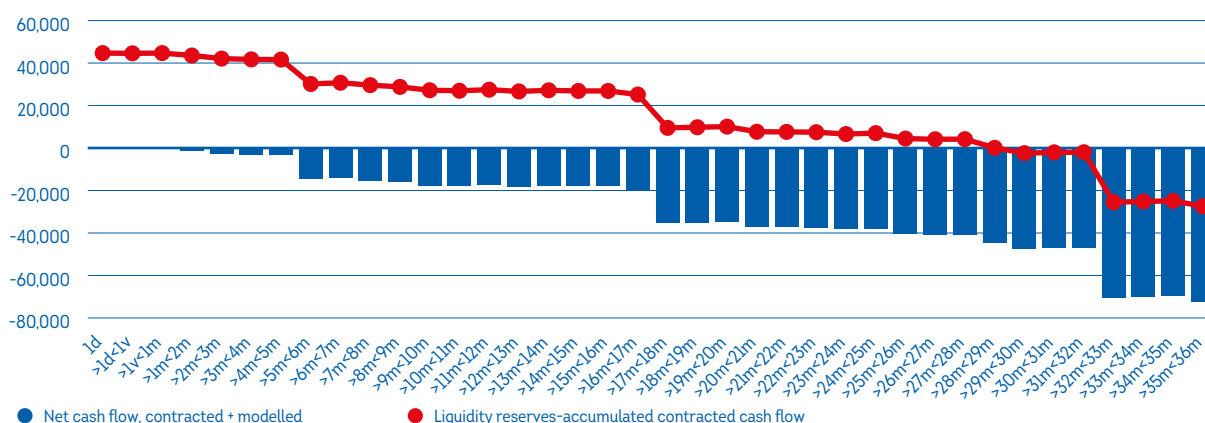


Figure 7.2 Liquidity reserve

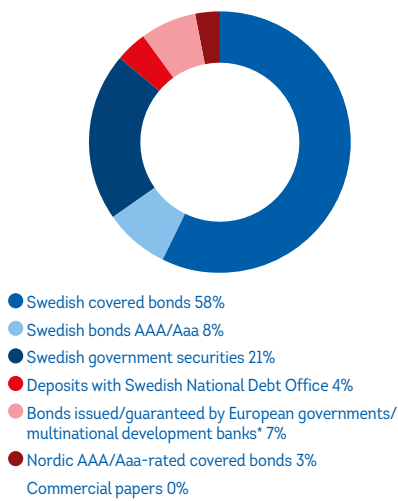


Figure 7.3 Funding sources

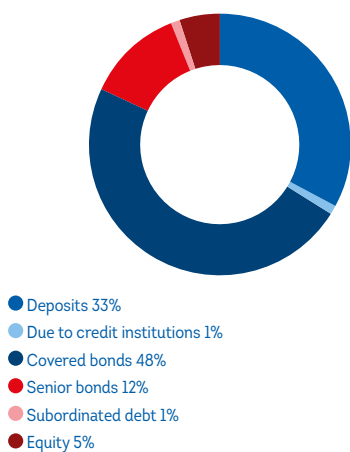
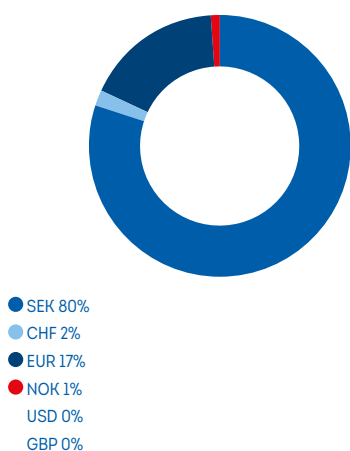


Figure 7.4 Funding by currency



Funding

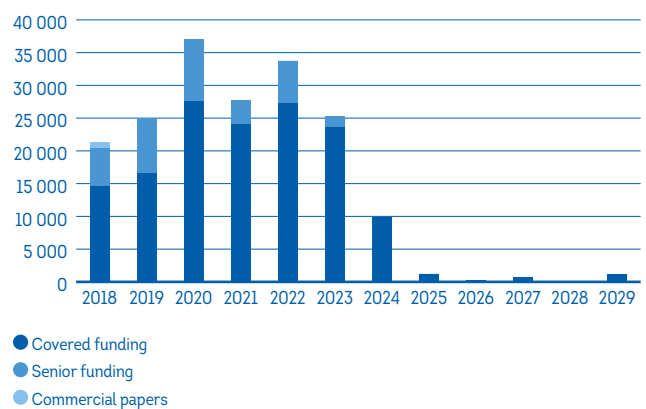
Every year, the Board decides on a funding plan that states the funding requirements and planned liquidity for the Bank Group. The financing plan contains key figures and targets for fulfilment of the objectives. Outcomes are monitored against the plan at every ALCO and Board meeting, and the plan is updated as required.

Funding takes place in a manner that creates a sound maturity profile without maturity concentrations, and is broadly diversified in terms of investors and markets. The Bank Group also endeavours to regularly launch issuances to build trust in the international capital markets. Funding takes place primarily through covered bonds since the majority of the Bank Group's lending comprises Swedish mortgages, although senior debt and short-term commercial paper programme are also used. Wholesale funding primarily takes place in the Swedish market and in SEK. Other funding primarily takes place in SEK, EUR, CHF and NOK. For a specification of the Bank Group's funding and maturity structure by currency, see figure 7.4 and figure 7.5.

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 ensure healthy diversification and maintain investors' interest and credit limits. Regular meetings are held with both Swedish and international investors to ensure that these investors have a clear overview of the Consolidated Situation's operations, low risk profile and high-quality risk management.

Länsförsäkringar Bank's credit rating from Moody's and S&P remained unchanged at A1/Stable and A/Stable, respectively, during 2017. The stability of Länsförsäkringar Bank's credit rating from rating agencies is positive for the bank's ability to finance its operations at low costs in the capital markets. In addition, Länsförsäkringar Hypotek's covered bonds have the highest rating from both Moody's and Standard & Poor's.

Figure 7.5 Maturity structure



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 liquidity portfolio is regularly stress-tested using highly disadvantageous scenarios for the Bank Group. Two stress tests illustrate how long the liquid assets will last, given that the funding market is entirely closed and

- Business volumes are constant (survival horizon).
- Lending growth is modelled according to the business plan and 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 Consolidated Situation's risk profile, including a minimum requirement for unutilised amount in the cover pool for the issuance of covered bonds.

The Consolidated Situation's Liquidity Coverage Ratio, as defined by the Swedish Financial Supervisory Authority's regulation (FFFS 2012:6), amounted to 202% (169) on 31 December 2017. The LCR according to the European Commission's delegated act amounted to 339% (342). LCR is not reported for EUR or USD since the Consolidated Situation on 31 December 2017 did not have any flows for the next 30 days in these currencies. Reporting under the Financial

Supervisory Authority's regulation (FFFS 2012:6) ended on 1 January 2018 since the liquidity coverage requirement of 100% under the European Commission's delegated act has now been fully phased in.

The Net Stable Funding Ratio (NSFR) for the consolidated situation amounted to 116%¹⁾ (113) on 31 December 2017.

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, following guidelines established by the Board.

7.2.4 Encumbered assets

Encumbered assets are the portion of the company's assets that are 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 Consolidated Situation's main business area is mortgages and to enable market financing via covered bonds, the Consolidated Situation has a high percentage of encumbered assets that comprise the cover pool in Länsförsäkringar Hypotek AB.

¹⁾ The calculation is based on Länsförsäkringar Bank's interpretation of the Basel Committee's most recent Net Stable Funding Ratio proposal.

Table 7.1 Encumbered assets

SEK M	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Consolidated Situation's assets	169,852	-	158,903	-
Shares and participations	0	0	55	55
Bonds and other interest-bearing instruments	880	839	46,090	45,369
Other assets	168,972	-	112,757	-

Table 7.2 Encumbered collateral

SEK M	Fair value of encumbered collateral for received and own issued bonds	Fair value of collateral received or issued own bonds
Consolidated Situation's collateral received	-	0
Bonds and other interest-bearing instruments	-	0

8 | Operational risk

Operational risk refers to the risk of losses due to inadequate or failed internal processes, human error, erroneous systems or external events and includes legal and compliance risk.

8.1 RISK APPETITE

The risk appetite for operational risk is determined by the Board. The Consolidated Situation has a low appetite for operational risk, meaning that these risks are 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 business operations. Risks are mitigated by proactive preventive measures and awareness of operational risk in every decision-making situation. There is also a structured monitoring of trends in operational risk.

8.2.1 Risk assessment

Operational risk is categorised according to Table 8.1, which are the main operational risk categories to which the Consolidated Situation is exposed.

Assessment of identified operational risk is based on a model that is applied throughout the operations. Each identified risk is assessed on the following basis:

- Consequence – Effect on the operations
- Probability – how likely it is that an incident will occur.

Table 8.1 Consolidated Situation's operational risk categories

Product and process risks	Refers to the risk of losses arising due to established work procedures not functioning well, being unknown to employees or not being appropriate.
Personnel risks	Refers to the risk of losses arising due to unclear areas of responsibility, inadequate know-how needed for work duties, or a shortage of personnel in relation to work duties.
Legal risks	Refers to the risk of the Consolidated Situation not ensuring or monitoring compliance with laws, regulations or other relevant rules and recommendations, or that signed agreements or other legal documents are correct and valid, not archiving agreements and other legal documents or not managing and following up legal processes.
Compliance risks	Refers to the risk that the Consolidated Situation does not comply with laws and regulations, general advice from the Financial Supervisory Authority or European authorities or equivalents.
IT risks	Refers to the risk of IT systems not being available to the extent decided or not being sufficiently secure. Cyber risk, defined as risks inherent in the use or transfer of digital data, is included in IT risk.
Security risks	Refers to the risk of losses arising due to the Consolidated Situation being exposed to external crimes or internal fraud. It also encompasses the risk of damage to physical assets in the Consolidated Situation.
Model risks	Refers to the risk of losses arising due to decisions that are primarily based on the results of models on the basis of errors in the production, implementation or use of such models.

8.2.2 Risk management process

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

Self-assessment and monitoring controls for assessing operational risk

A self-assessment of the operational risk is performed for all significant processes in the banking operations 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 using risk indicators is to create conditions for better insight into the Consolidated Situation's risk profile and the risks that are increasing or decreasing at that point in time and over time. The Consolidated Situation has established a number of risk indicators tailored to the Consolidated Situation's operations. The Consolidated Situation works continuously on adjusting and improving these risk indicators, which are updated at least once annually.

Approval process

The Consolidated Situation has a process for approving new or significantly changed products, services, markets, processes, IT systems and for major changes to the Consolidated Situation's operations and organisation. The purpose of the Consolidated Situation'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, to impact capital 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 Management and Compliance are two of the stakeholders in implementing the approval process.

Incident reporting

Incidents that occur in the Consolidated Situation'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 Management continuously monitors incidents reported in the business activities. Reported incidents are categorised in one of the following established incident types:

- Clients, products and business practice
- Business disruption and systems failures
- Execution, delivery, and process management
- Employment practices and workplace safety
- Damage to physical assets
- Internal fraud
- External fraud

Active monitoring takes place to detect, for example, money laundering and financing terrorist activities. Other attempts at fraud are monitored, for example, card fraud.

Continuity management

Serious incidents may lead to a crisis. A crisis may arise, for example, due to fire, IT failure, liquidity disruptions or other serious incident. The Consolidated Situation 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.

8.2.3 Monitoring and reporting

Risk Management reports continuously on trends in the Consolidated Situation's operational risks to the CEO and relevant heads of departments. 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 was designed in accordance with the supervisory authority's guidelines for operations in Länsförsäkringar AB and its subsidiaries (Länsförsäkringar AB Group). Conflicts of interest that may arise in connection with remuneration issues are to be identified and managed in accordance with internal guidelines.

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. The Länsförsäkringar AB Group's remuneration model comprises fixed remuneration that is predetermined at an amount or range that is not linked to financial results or risk-taking. Guaranteed variable remuneration does not exist, except for new employment for which guaranteed remuneration may be paid for special reasons in accordance with a separate decision process.

The Board of Länsförsäkringar AB and its subsidiaries, which are subject to the supervision of the 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.

The company performs an annual analysis to identify employees whose work duties have a material impact on the company's risk profile or specially regulated staff.

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 purpose of the risk analysis is to assess whether the remuneration system satisfactorily takes into account all types or risks and liquidity and capital levels and whether the remuneration policy is designed in such a manner that it is consistent with and promotes healthy and effective risk management. The aspect of consumer protection must also be taken into consideration, particularly as regards remuneration of personnel that prepare, offer, grant or broker mortgage agreements or provide advisory services on mortgages, including personnel who directly lead or are responsible for such work duties. The remuneration policy must also be consistent with the Länsförsäkringar AB Group's business strategy, targets, corporate culture, values and long-term interests. 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 2017 Annual Report.

In accordance with the Financial Supervisory Authority's regulation FFFS 2011:1, information pertaining to the Remuneration Policy of Länsförsäkringar Bank AB and its application must be published on the bank's website.

