

Risk and capital management in the Länsförsäkringar Bank Group 2011

Pillar III of the Basel II regulatory
framework



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Introduction

The aim of this report is to provide detailed information about Länsförsäkringar Bank's risks, risk management and capital adequacy in accordance with the reporting requirements (known as Pillar III) stipulated in the Capital Requirements Directive (CRD) through which Basel II was implemented within the EU. Information requirements were introduced in Sweden on the basis of the regulations and general advice FFFS 2007:5 of the Swedish Financial Supervisory Authority.

Under the Basel II rules, an option for calculation of the capital requirement for credit risk was introduced by utilising either the Standardised Approach or an internal approach. Since the Basel II rules were introduced, Länsförsäkringar has applied the Internal Ratings-based Approach (IRB Approach) in accordance with a permit issued by the Financial Supervisory Authority. The aim of the new rules was to achieve enhanced transparency and risk management, and thereby greater stability in the financial system. The Advanced IRB Approach provides the greatest opportunities to strategically and operationally manage credit risks and is used for all retail exposures. As of 2010, the IRB Approach is also used for agricultural customers and the foundation IRB Approach is applied to agricultural exposures and the Standardised Approach is used until further notice for other exposures to calculate the capital requirement for credit risk. Changes in the capital requirement will emerge gradually since Basel II contains transition rules involving an adaptation period over a number of years.

Future capital adequacy rules (Basel III)

Basel III is a new international capital adequacy and liquidity standard that was adopted by the Basel Committee on Banking Supervision in December 2010. This third Basel agreement was produced in response to the shortcomings in the current banking-supervision regulations, which came to the fore during the recent global financial crisis. In brief, Basel III involves higher capital-requirement levels, changes to what may be credited as capital, changed calculations of capital requirements, new rules regarding liquidity risk and the introduction of a non-risk-sensitive leverage ratio. Basel III will be introduced within the EU through a revised capital requirement directive (CRD IV package), which is expected to come into effect in 2013, be subsequently implemented over a six-year period and be fully implemented by 2019.

Länsförsäkringar Bank Group

Länsförsäkringar Bank AB (publ) is part of the Länsförsäkringar AB Group, with Länsförsäkringar AB (publ) as the Parent Company, which is owned by 23 independent and customer-owned regional insurance companies. The regional insurance companies offer customer products via their three core businesses: banking operations, non-life insurance and life assurance. Länsförsäkringar Bank is 100% owned by Länsförsäkringar AB (publ) (556549-7020). The Bank Group comprises the Parent Company Länsförsäkringar Bank AB (publ) (516401-9878) and the wholly owned

subsidiaries Länsförsäkringar Hypotek AB (publ) (556244-1781), Wasa Kredit AB (556311-9204) and Länsförsäkringar Fondförvaltning AB (publ) (556364-2783). All companies have their registered offices in Stockholm.

Mission

The mission of Länsförsäkringar Bank is, within the Länsförsäkringar AB Group, to conduct business activities, develop products, concepts, channels and tools, and provide service to the regional insurance companies in areas generating economies of scale so that these companies can offer their customers the best possible banking services.

Strategy

The strategy, which has not been changed since 2000 a few years after the bank was founded in 1996, is to offer banking and insurance services to the regional insurance companies' customers. All customer contact takes place at the 125 branches of the 23 regional insurance companies. Customer contact also takes place at Länsförsäkringar Fastighetsförmedling's 143 branches.

The strategy for banking operations is primarily based on the Länsförsäkringar Alliance's existing infrastructure:

- a large customer base,
- a strong brand, and
- the value basis and core values of the customer-owned regional insurance companies.

Large customer base

The Länsförsäkringar Alliance has 3.4 million customers and the prioritised target groups in the banking operations are the 2.9 million private individuals, the 1.8 million home-insurance customers and agricultural customers. The banking offering is tailored to a variety of needs. With the entire banking and insurance offering, customers receive a secure and profitable commitment with Länsförsäkringar, all while the customer relationship is strengthened in the long term.

A strong brand

Länsförsäkringar has one of the strongest financial brands in Sweden according to the 2011 Anseendebaremeter (the "Reputability Barometer"). Brand is of major importance to customer choice particularly in times of financial crisis. Länsförsäkringar, with its 200-year history, represents security and stability.

Local presence

Länsförsäkringar's value basis is a key contributory factor to the success of its strategy. These values have been built on a long-term approach and strong core values for many years. The local presence with customer-owned regional insurance companies make Länsförsäkringar accessible to customers in an essentially unique way.

Objectives

Länsförsäkringar Bank's objectives are as follows:

- Achieve profitable growth
- Have the most satisfied customers
- Help increase the percentage of customers who combine their banking and insurance commitments with Länsförsäkringar.

A strong position

The banking operations' business volumes have grown an average of 12% over the past five years. Profitability is stable with a return on equity of 4.8% in 2011 and an average of 4.7% over the past five

years. The Bank Group strengthened its position in the Swedish and European capital markets during the year. According to the 2011 Swedish Quality Index, Länsförsäkringar has Sweden's most satisfied retail bank customers for the seventh time in eight years and Sweden's most satisfied retail mortgage customers for the seventh consecutive year. The same survey also revealed that Länsförsäkringar is the bank that best met customer expectations and is perceived to be the most reasonably priced. The number of customers who have chosen Länsförsäkringar as their primary bank rose 32 000 to 255,000 in 2011, and of these customers, 93% also have at least one insurance policy with Länsförsäkringar.

Focus of operations

Savings and deposits

Länsförsäkringar has a total offering in savings and is growing in the deposits market. During the year, this offering was enhanced with more products and services to provide customers with a greater range of savings and investment products. Under the fund transfer service, which was launched in the spring of 2011, many customers transferred their fund savings to their primary bank Länsförsäkringar during the year. Deposits increased 19% to SEK 50 billion (42) in 2011. This increase was primarily attributable to the rising number of customers who have chosen Länsförsäkringar as their primary bank. All types of deposit accounts are increasing. Bank services for small businesses is an offering that has been launched gradually, and growth is healthy and progressing according to plan, primarily in deposits. The market share, measured as deposits from households, rose to 3.8% (3.5) in 2011 and the share of market growth was slightly more than 7%, according to data from Statistics Sweden.

Fund market and IPS

Länsförsäkringar is Sweden's fifth largest fund company with an unchanged market share in 2011 of 3.9%, according to statistics from the Swedish Investment Fund Association. Fund volumes fell 8% to SEK 67 billion (72) due to the negative trend in asset values in the equities market during the year. A total of 33 (32) mutual funds with different investment orientations are managed. The fund offering comprises funds under Länsförsäkringar's own brand, supplemented with external funds selected by Länsförsäkringar and other funds offered in the market. The majority of own-brand funds have external managers who are also continuously evaluated to ensure that they meet return targets. Selected external funds are also continuously evaluated to ensure that they meet Länsförsäkringar's return targets. The number of new fund savers making monthly deposits rose 11,000 during the year, demonstrating that Länsförsäkringar has an attractive fund offering. The IPS service, Individual Pension Savings, achieved major success again in 2011. Volumes continued to increase relatively sharply despite the weak year for the stock market.

Equities and other securities

The trend in volumes of equities and other securities is steadily growing. The number of deposits rose 11,000 and the volume of capital-protected investments doubled during the year.

Household and retail mortgages

Länsförsäkringar has a highly attractive mortgage offering and is growing steadily in the market. First-lien mortgages for agricultural properties experienced robust growth and Wasa Kredit's leasing, hire purchase and unsecured loans are steadily increasing. The banking operations' loans rose 14% to SEK 134 billion (118) in 2011, of which retail mortgages in Länsförsäkringar Hypotek increased 11% to SEK 89 billion (80). Mortgages up to 75% of the market value on the granting date are deposited with Länsförsäkringar Hypotek and other mortgages are offered by Läns-

försäkringar Bank. The market share for household and retail mortgage lending increased to 4.6% (4.4) in 2011 and Länsförsäkringar captured a favourable share of market growth during the year, according to data from Statistics Sweden. The banking operations' loans rose 18% to SEK 118 billion (100) in 2010, of which retail mortgages in Länsförsäkringar Hypotek increased 18% to SEK 80 billion (68). First-lien mortgages up to 75% of the market value are deposited with Länsförsäkringar Hypotek and other housing loans with Länsförsäkringar Bank. The market share for household and retail mortgage lending in 2010 increased to 4.4% (4.0) and Länsförsäkringar's share of market growth in 2010 was nearly 9%, according to data from Statistics Sweden.

Agricultural loans

Länsförsäkringar offers loans to forestry and agricultural properties and is the fourth largest company in agricultural lending in Sweden with a market share that strengthened to 8.5% (7.8) during the year, according to Agricultural Barometer. Agricultural loans rose 21% to SEK 16.7 billion (13.8), of which first-lien mortgages to agricultural properties increased 27% to SEK 13.7 billion (10.8). Some 83% (81) of agricultural customers have at least one insurance policy with Länsförsäkringar.

Other loans

Wasa Kredit's lending volume rose 12% to SEK 12.0 billion (10.7). All leasing, hire purchase and unsecured loan products increased in 2011 and the largest volume increase was in leasing.

Bank cards and payments

The number of cards is rising steadily and are being continuously developed to ensure that customers can feel secure and receive good service in their payment services.

Income from payment mediation continued to increase in 2011 and bank card transactions accounted for the largest payment transaction volumes. The number of bank cards rose 15% to 306,000 (266,000) and the number of Länsförsäkringar ATMs increased to 98 (88). In-store bank card transactions rose 23% and payment transactions increased to a total of SEK 130 M (108), up 20%.

Regional insurance companies' own bank

The bank offers primarily savings and payment services to the 23 regional insurance companies and the Länsförsäkringar AB Group. Business is expanding and the number of payment transactions rose during the year. The regional insurance companies' deposits are also growing at a stable rate.

Risks and risk management

Risk management is to be performed by the employees working in the banking operations.

Accordingly, risk awareness is prevalent in all day-to-day business decisions. This decentralised method of working and managing risk is a requirement for compliance with the risk tolerance set forth by the Board. The banking operations are to be characterised by a low risk profile whose lending operations focus on private housing and family-owned agricultural operations.

The Bank Group's risks can be divided into the following groups:

- Credit risk
- Market risk
- Liquidity risks
- Business risk
- Operational risks

Credit risk consists of the counterparty's inability to fulfil its commitments and that Bank Group is affected by a financial loss. Market risks, which primarily comprise interest-rate risk and currency risk, are managed in accordance with a Financial Policy adopted by the Board, which stipulates that interest-rate risks should be as low as possible and that liquidity be invested solely in Swedish securities with high credit quality. Operational risks are measured against a risk-tolerance scale established by the Board. Business risk mainly comprises earnings risk, and pertains to fluctuations in the Bank Group's earning capacity. The overall guidelines for risk tolerance and the strategies for risk-taking state that volume growth and higher profitability should not be generated at the expense of a higher number or greater risks. This requires that risks inherent in the business activities be independently identified, measured, controlled, valued and reported on a continuous basis and that risks be proportionate to the size, product development and growth of the operations. Total risks are complied and compared with the capital in the Bank Group to ensure a favourable level of capitalisation.

Board of Directors

The Board of Directors is ultimately responsible for the Bank Group's operations and, as a result, for safeguarding the Group's assets and creating risk awareness in the Group. The Board achieves this goal, for example, by annually establishing central risk tolerances and risk strategies that ensure a sound and well-balanced process for risk-taking and risk management. Such a process should be characterised by a deliberate focus on changes in the operations and their surroundings. The Board is also responsible for establishing all of the methods, models, systems and processes that form the internal measurement, control and reporting of identified risks. Through the Bank Group's Compliance, Risk Control and Internal Audit functions, the Board is also responsible for ensuring that the company's regulatory compliance and risks are managed in a satisfactory manner.

President

The President is responsible for the ongoing administration of the company in accordance with the risk tolerances and risk strategies established by the Board. This means that the President is responsible for ensuring that the methods, models, systems and processes that form the internal measurement, control and reporting of identified risks work in the manner intended and decided by the Board. The President is the Chairman of the Asset Liability Committee (ALCO), whose main task is to follow up on capital and financial matters arising in the Bank Group.

Risk Control

Risk Control is an independent unit and has an independent position in relation to the corporate operations that it has been assigned to monitor and control. Risk Control is under the supervision of the President and is responsible to the Board of Directors for ensuring that risk policies are complied with, risk limits are monitored and non-compliance is reported to the President and Board. In addition, Risk Control is responsible for the validation of the risk-classification system (the IRB Approach) and its use in the operations.

One of the most important tasks of the Risk Control is to work proactively to ensure that the operations have active risk management and that the risk tolerance established by the Board is converted into limits according to which the operations can conduct their activities. Risk Control is responsible for reporting violations of limits to the President and the Board.

Risk Control is responsible for continuously reporting to management, the ALCO and Board. For credit risk, these reports include information on developments and trends in exposure amounts, risk weights and capital requirements. For financial risk, these reports primarily contain information about interest-rate risk and liquidity positions. In addition, the reports include information about operational risk.

Capital base and capital requirements

The bank's Board of Directors decided on a capital adequacy target entailing a Tier 1 ratio of 12 percentage points when Basel II is fully implemented. A deviation of +/- 0.5 percentage points is permitted for the target.

The basis for determining the capital adequacy target was the Bank Group's internal capital adequacy assessment process, which considered all risks requiring capital. Consideration was also given to the Tier 1 ratios of comparable financial companies. Internal calculations show that the Bank Group is well capitalised in relation to its total risks.

Basel II is scheduled to take full effect in 2012. However, in a bill presented in March 2011, the Swedish government proposed an extension of the transition rules.

Basel III will make major regulatory changes as expected by the banking sector in recent years. Based on the requirements that have already been announced, Länsförsäkringar deems that the bank will be able to meet the new capital adequacy and liquidity targets.

CAPITAL-ADEQUACY ANALYSIS

SEK M	Dec. 31, 2011	Dec. 31, 2010
Tier 1 capital, gross ¹⁾	6,454.0	5,773.6
Less intangible assets	-438.6	-372.7
Less deferred tax assets	-6.0	-3.1
Less/plus IRB deficit/surplus	-261.9	-214.8
Tier 1 capital, net	5,747.4	5,183.0
Tier 2 capital	1200.0	960.0
Deductions for Tier 2 capital	-261.9	-214.8
Total capital base	6,685.5	5,928.2
Risk-weighted assets according to Basel II	47,617.4	43,944.2
Risk-weighted assets according to transition rules	71,572.8	63,161.2
Capital requirement		
Capital requirement for credit risk according to Standardised Approach	679.3	725.4
Total capital requirement for credit risk according to IRB Approach	2,984.2	2,656.4
Capital requirement for operational risk	145.9	133.8
Capital requirement according to Basel II	3,809.4	3,515.5
Adjustment according to transition rules	1,916.4	1,537.4
Total capital requirement	5,725.8	5,052.9
Tier 1 ratio according to Basel II, %	12.07	11.79
Capital adequacy ratio according to Basel II, %	14.04	13.49
Capital ratio according to Basel II ²⁾	1.75	1.69
Tier 1 ratio according to transition rules, %	8.03	8.21
Capital adequacy ratio according to transition rules, %	9.34	9.39
Capital ratio according to transition rules ²⁾	1.17	1.17
Special disclosures		
IRB Provisions surplus (+)/deficit (-)	-523.8	-429.6
- IRB Total reserves (+)	237.8	241.5
- IRB Expected loss (-)	-761.7	-671.1

¹⁾ of which a Tier 1 capital contribution of SEK 290 M.

²⁾ Capital ratio = total capital base/total capital requirement.

SEK M	Dec. 31, 2011	Dec. 31, 2010
Credit risk according to Standard Approach		
Exposures to institutions	77.8	77.3
Exposures to corporates	195.2	167.3
Retail exposures	93.1	190.2
Exposures secured on residential property	126.3	97.7
Past due items	0.4	1.0
Covered bonds	169.2	173.6
Other items	17.2	18.2
Total capital requirement for credit risk according to Standardised Approach	679.3	725.4
Credit risk according to IRB Approach		
Retail exposures		
Exposures secured by real estate collateral	1,420.3	1,241.0
Other retail exposures	670.5	626.4
Total retail exposures	2,090.7	1,867.4
Exposures to corporates	892.7	787.9
Non credit-obligation assets	0.8	1.0
Total capital requirement for credit risk according to IRB Approach	2,984.2	2,656.4
Operational risks		
Standardised Approach	145.9	133.8
Total capital requirement for operational risk	145.9	133.8
Capital-adequacy analysis according to Basel I		
Tier 1 capital	6,009.4	5,397.8
Tier 2 capital	1,200.0	960.0
Total capital base	7,209.4	6,357.8
Risk-weight assets	97,651.5	85,663.8
Capital requirement for credit risk	7,812.1	6,853.1
Tier 1 ratio, %	6.15	6.30
Capital adequacy ratio, %	7.38	7.42
Capital ratio ²⁾	0.92	0.93

The capital base includes the Board's proposed appropriation of profit.

In addition to the Parent Company Länsförsäkringar Bank AB (publ) (516401-9878), the financial corporate group includes the wholly owned and fully consolidated subsidiaries Länsförsäkringar Hypotek AB (publ) (556244-1781), Wasa Kredit AB (556311-9204) and Länsförsäkringar Fondförvaltning AB (publ) (556364-2783).

Credit risk

Credit risk is defined as the risk of incurring losses as a result of a counterparty not being able to fulfil its commitments to the Bank Group and the risk that the counterparty's pledged collateral will not cover the company's receivables. The Bank Group calculates all retail exposures in accordance with the advanced Internal Ratings-based Approach (IRB), which corresponds to about 81% (81) of the Bank Group's loan portfolio. This means that a considerable portion of its credit exposure is calculated using a method that aims to identify and classify risk for each individual counterparty. The bank uses the foundation IRB Approach for the portion of the loan portfolio pertaining to agricultural operations. The percentage of retail mortgages of the total loan portfolio is 72% (74) and agricultural loans 12% (12). The Standardised Approach is used for other exposures. The lending portfolio is entirely comprised of loans in Sweden, which has a favourable geographic spread throughout the country. Concentration risk is primarily attributable to the product concentration in mortgages.

Credit process

The banking operations carry out balanced and consistent loan origination, with a strong system support. Loan origination is to achieve favourable and homogenous credit quality. Origination is primarily targeted toward retail mortgages for private individuals and small-scale family-owned agricultural operations with a low risk level. The maximum lending level for various types of loans and limits for the regional insurance companies' loan origination are stipulated in the Board's guidelines. Decision-making authorities are dependent on the size of the loans. The banking operations impose strict requirements in terms of customer selection and customers' repayment capacity.

Credit scoring of retail loans is supported by a credit research system, which is largely automated in accordance with the Advanced IRB Approach, and a joint credit scoring model for Länsförsäkringar's banking operations. Credit scoring of agricultural loans is supported by a credit research system with built-in controls to achieve favourable credit quality. Both credit scoring systems are supported by a number of decision-making bodies and a quality audit. Loan origination is primarily managed by the regional insurance companies, which also have credit responsibility for all loans. The credit rules are established by the bank's Board of Directors and apply to all regional insurance companies.

The regional insurance companies are knowledgeable about their customers, possess excellent local market awareness and have a full-service customer approach that benefits the entire business. The credit scoring model, combined with the knowledge and credit responsibility of the regional insurance companies, creates excellent conditions for balanced and consistent loan origination. The regional insurance companies continuously monitor and review the quality of the loan portfolio and borrowers' repayment capacity.

Credit quality

The loan portfolio exclusively comprises loans in Sweden, with lending for private housing in the form of single-family homes and tenant-owned apartments accounting for 72% (74) of lending.

First-lien mortgages with loan-to-value ratios amounting up to 75% of the market value at the time the mortgage is granted account for the largest percentage of retail mortgages. Low loan-to-value ratios, combined with a favourable geographic distribution and local presence, are the core pillars in ensuring that the loan portfolio maintains a high level of credit quality. The rules regarding loan origination for mortgages have also been tightened with a maximum loan-to-value ratio of 85%.

Loans to the agricultural segment accounted for 12% (12) of the loan portfolio. The lending segment is an excellent complement to the bank's mortgages since a large share pertains to loans to family-owned farming businesses. Together with mortgages, this segment accounts for approximately 84% (86) of the Bank Group's loan portfolio.

Implementation plan for the IRB Approach

In December 2006, Länsförsäkringar Bank was granted permission by the Swedish Financial Supervisory Authority to apply the advanced Internal Ratings-based Approach (IRB Approach) in the calculation of the capital requirement for credit risk for retail exposures, which accounts for most of the loan portfolio. The IRB Approach has been applied for these exposures since February 2007. In December 2009, Länsförsäkringar Bank was then granted permission by the Financial Supervisory Authority to apply the foundation IRB Approach in the calculation of the capital requirement for credit risk for exposures to corporates and agricultural exposures, and the IRB Approach has been applied to these exposures since January 1, 2010. Internal models will be implemented for other exposures to corporates at Länsförsäkringar Bank and Länsförsäkringar Hypotek in 2012. Internal models will be implemented after 2012 for other minor loan portfolios in the Bank Group. Permanent exemptions have been granted for exposures to governments, local governments, county councils and banks. This complies with the implementation plan approved by the Swedish Financial Supervisory Authority.

IRB system

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

- Credit process
- Monitoring and reporting
- Calculation of capital requirement
- Capital allocation

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

The Probability of Default (PD) is the probability that a counterparty will default over a 12-month period. A counterparty is considered to be in default if a payment is more than 60 days past due or if there is reason to expect that the counterparty cannot meet its undertaking to the bank.

A PD is initially calculated for each counterparty and is to reflect the risk of default within the next 12 months. This PD is subsequently

adjusted to reflect the average proportion of default over several economic cycles. Finally, a safety margin is added to the PD to ensure that the risk is not underestimated. Following the calculation of PD, all counterparties are ranked and are divided into the bank's PD scale. The PD scale comprises 11 risk classes (grades) for non-defaulted counterparties and one risk category for defaulted counterparties.

PD grade Dec. 31, 2011, SEK 000s	PD (%)	EAD
1	0.05	2,310,140
2	0.10	8,005,724
3	0.20	30,506,118
4	0.40	53,447,822
5	0.80	17,285,907
6	1.60	8,656,224
7	3.20	3,515,697
8	6.40	1,843,318
9	12.80	1,035,220
10	25.60	594,588
11	51.20	589,604
Default	100.00	553,238
Total		128,343,600

Comparison of PD grades	PD (%)	Indicative credit rating from Standard & Poor's
Internal		
1-4	< 0.53	AAA to BBB-
5-6	0.53-2.13	BB+ to BB-
7-8	2.13-8.53	B+ to B-
9-11	> 8.53	C
Fallissemang	100	D

The information that is most relevant to each type of counterparty has been taken into consideration in the development of models for calculating PD. The division of PD into grades for retail exposures takes place using models based on statistical analysis (credit scoring), while the division of PD into grades for exposures to corporates is partly based on individual expert assessment. These models take both internal and external information into consideration.

Loss Given Default (LGD) is the anticipated share of exposure that will be lost in the event of default. Internal estimates of LGD are calculated for retail exposures. These estimates are based on internal information on loss portions, loan-to-value ratios and products. A safety margin is added to these estimates to ensure that the risk is not underestimated. Finally, the estimate is adjusted to reflect the expected loss portion in a recession. The LGD amounts prescribed by the Financial Supervisory Authority are applied to exposures to corporates with agricultural businesses.

Exposure at Default (EAD) is the exposure amount that the counterparty is expected to utilise upon default. For commitments completely within the balance sheet, EAD is defined as capital liability plus accrued and past due unpaid interest and fees. For commitments wholly or partly off the balance sheet, EAD is calculated by multiplying the counterparty's unutilised amount by a Conversion Factor (CF). Internal estimates of conversion factors are calculated for

retail exposures. These estimates are calculated on the basis of internal information regarding degree of realisation, degree of utilisation and products. A safety margin is added to these estimates to ensure that the risk is not underestimated. The CF amounts prescribed by the Financial Supervisory Authority are applied to exposures to corporates with agricultural businesses.

Expected Loss (EL, %) is the PD multiplied by LGD. The expected loss amount is obtained by multiplying EAD by the EL percentage. The Risk Weight (RW) is calculated using functions supplied by the Swedish Financial Supervisory Authority. The bank's internal estimates of risk parameters serve as input data for these functions. Risk-Weighted Assets (RWA) are calculated by multiplying EAD by the risk weight. The capital requirement is 8% of RWA.

Expected Loss in relation to outcome

The presentation below shows the PD, LGD and EL estimates to be applied in capital adequacy reports, meaning those estimates that include safety margins and adjustments for economic conditions.

The exposure-weighted PD estimate for all non-defaulted exposures encompassed by IRB at December 31, 2010 was 1.08%, distributed on the basis of 0.85% for exposures secured by real estate collateral and 2.31% for other retail exposures. The percentage of these exposures in default in 2011 was 0.42%, distributed on the basis of 0.16% for exposures secured by real estate collateral and 1.98% for other retail exposures.

The exposure-weighted LGD estimate for all non-defaulted exposures encompassed by IRB at December 31, 2009 was 28.1%, distributed on the basis of 23.8% for exposures secured by real estate collateral and 53.3% for other retail exposures. The actual loss rate for the exposures in default in 2010 was 16.2% for exposures secured by real estate collateral and 51.33% for other retail exposures. The calculation of actual loss rates took into account recoveries up to and including December 31, 2011, meaning that the average recovery period is one and a half years.

The EL percentage for all non-defaulted exposures within the scope of IRB at December 31, 2009 was 0.41%, distributed on the basis of 0.21% for exposures secured by real estate collateral and 1.58% for other retail exposures. The percentage of these exposures in default in 2010 was 0.22%, distributed on the basis of 0.04% for exposures secured by real estate collateral and 1.20% for other retail exposures. Most loan losses derive from unsecured loans and personal accounts with only one borrower.

Loan receivables and accounts receivable

Loans receivable and accounts receivable are financial assets that are not derivatives, that have fixed or fixable payments and that are not listed on an active market. These receivables are represented by the balance-sheet items "Loans to credit institutions," "Loans to the public" and "Other assets" in the balance sheet. For further information, see Länsförsäkringar Bank's 2011 Annual Report.

Impaired loans

A loan receivable is considered impaired if a payment is more than 60 days past due or if the counterparty for other reasons cannot

meet its undertaking. The loan receivable is considered impaired to the extent that its whole amount is not covered by collateral. A non-performing loan receivable has a non-performing payment that is more than nine days and up to 60 days past due. This analysis pertains exclusively to loans to the public.

There are no loans within the banking and mortgage operations whose terms were renegotiated during the year and that would otherwise have been recognised as impaired.

Agreements concerning payment plans are made to a limited extent within the leasing and hire purchase operations if it is deemed beneficial for the customer and lessor.

Impaired loans amounted to SEK 233 M (209), corresponding to 0.17% (0.17) of the total loan portfolio before reserves. Loan losses totalled SEK 48 M (42), corresponding to a loan loss of 0.04% (0.03). Impaired loans and loan losses continued to account for a minor percentage of total loans.

Impaired loans by product, SEK M	Dec. 31, 2011	Dec. 31, 2010
Retail mortgages	2.7	15.4
Agricultural loans	0.3	
Unsecured loans	114.8	103.6
Leasing	69.4	54.2
Hire purchase	37.6	27.5
Multi-family homes		
Other	8.7	8.1
Total	233.3	208.8

Non-performing loan receivables not included in impaired loans, SEK M	Dec. 31, 2011	Dec. 31, 2010
Receivables 10–19 days past due ¹⁾	0.0	0.3
Receivables 20–39 days past due	292.7	265.2
Receivables 40–60 days past due	5.9	7.6
Total	298.6	273.1

¹⁾ Excluding Wasa Kredit.

Non-performing loan receivables not included in impaired loans, Dec. 31, 2011, SEK M	Läns-försäkringar Bank	Läns-försäkringar Hypotek	Wasa Kredit	Group
Receivables 10–19 days past due ¹⁾	0	0	0	0
Receivables 20–39 days past due	29.0	39.4	224.3	292.7
Receivables 40–60 days past due	0	0	5.9	5.9
Total	29.0	39.4	230.2	298.6

¹⁾ Exklusive Wasa Kredit.

Impairment

A continuous assessment is made as to whether objective circumstances exist suggesting indications of impairment for both impaired loans and the part of the loan portfolio where the assessment is that cash flow has deteriorated. Indications of impairment are based on objective circumstances, for example delayed or non-payment, bankruptcy or a decline in the value of the collateral, and on a reduced repayment capacity according to risk-based assessments and assumptions.

Counterparty risk

Counterparty risk is the risk of a counterparty being unable to fulfil its commitments to Länsförsäkringar Bank, which could lead to losses. In this context, counterparty refers to counterparties for interest-rate and currency swaps. The Bank Group has a number of swap counterparties, all with high ratings and established ISDA agreements. For Länsförsäkringar Hypotek's covered bond operations, ISDA agreements are in place, as well as accompanying unilateral CSA agreements. CSA agreements involve commitments concerning delivery and receipt of collateral in the event of market changes affecting swap exposures.

Derivatives, fair value, SEK M	Positive values Dec. 31, 2011
AA-/Aa2	269.2
A/Aa2	172.2
A+/Aa3	
A+/Aa3	174.8
A/Aa3	268.2
	884.2

Positive and negative values netted per counterparty. Only positive values, netted, are included in the table.

Concentration risk

Concentration risk is defined as the risk of large, important or significant volumes and/or commitments being concentrated to a limited number of customers, a certain industry, product or geographic area. This means that such positions and relations increase in vulnerability since the effect on the operations could be relatively great. Risk spreading is therefore limited.

Concentration risk can be divided into two types of categories. The first involves individual exposures to a certain counterparty or a group of counterparties that can be grouped together from a risk perspective. This category can primarily be attributed to a large exposure. Large exposures are regulated by and reported to the Swedish Financial Supervisory Authority. As this reporting is completed, a quarterly report is prepared detailing all exposure that exceeds 10% of the capital base.

The second type of concentration risk involved general exposures that can be divided into a certain category driven by an underlying variable, for example, a geographic division, product, market or collateral type. The Bank Group must take into account the following sectors when assessing the existence of concentrations:

- Geographic division
- Product and market division
- Types of collateral
- Nature of customer and counterparty

TOTAL AND AVERAGE EAD

SEK 000s	Dec. 31, 2011	Average 2011
<i>Exposure classes, IRB Approach</i>		
Retail exposures	108,586,249	105,325,372
Exposures to corporates	19,757,251	18,736,284
Non credit-obligation assets	9,737	10,656
Total IRB Approach	128,353,237	124,072,312
<i>Exposure classes, Standardised Approach</i>		
Governments and central banks	12,050,606	8,551,426
Regional and local authorities	317,470	312,816
Exposures to institutions	7,591,768	5,666,578
Exposures to corporates	2,440,496	2,383,904
Retail exposures	1,551,192	2,177,065
Exposures secured on residential property	3,732,340	3,494,631
Past due items	4,642	10,250
Exposures in the form of covered bonds	21,147,696	23,193,984
Other items	988,230	663,225
Total Standardised Approach	49,824,440	46,453,879

RECOGNISABLE COLLATERAL

Dec. 31, 2011, SEK 000s	EAD	Secured through recognisable collateral
<i>Exposure classes, IRB Approach</i>		
Exposures to corporates	19,757,251	15,724,705
Total IRB Approach	19,757,251	15,724,705
<i>Exposure classes, Standardised Approach</i>		
Governments and central banks	12,050,606	0
Regional and local authorities	317,470	0
Exposures to institutions	7,591,768	0
Exposures to corporates	2,440,496	0
Retail exposures	1,551,192	0
Exposures secured on residential property	3,732,340	3,732,340
Past due items	4,642	1,067
Exposures in the form of covered bonds	21,147,696	0
Other items	988,230	0
Total Standardised Approach	49,824,440	3,733,407

**EAD FOR EXPOSURES SECURED BY REAL ESTATE COLLATERAL,
BY GEOGRAPHIC REGION**

Dec. 31, 2011, SEK 000s, Geographic region	Retail exposures		Exposures to corporates ¹⁾	
	EAD	Proportion of EAD (%)	EAD	Proportion of EAD (%)
West Sweden	20,009,545	21.5	3,075,647	22.5
Eastern Central Sweden	19,757,300	21.3	3,742,799	27.3
Stockholm	14,515,452	15.6	72,264	0.5
South Sweden	12,594,344	13.5	2,433,554	17.8
Northern Central Sweden	9,832,004	10.6	689,615	5.0
Småland and islands	8,644,856	9.3	2,480,023	18.1
Upper Norrland	4,048,231	4.4	559,598	4.1
Central Norrland	3,565,414	3.8	641,820	4.7
Total	92,967,146	100.0	13,695,320	100.0

¹⁾ First-lien mortgages for agricultural mortgages.

EAD, BY CONTRACTUAL MATURITY¹⁾

Dec. 31, 2011, SEK 000s	< 3 months	3 – 6 months	6 – 12 months	1 – 3 years	3 – 5 years	> 5 years
<i>Exposure classes, IRB Approach</i>						
Retail exposures	71,718,084	5,799,563	6,369,740	19,352,413	4,136,473	1,209,976
Exposures to corporates	13,049,094	1,055,230	1,158,973	3,521,168	752,631	220,155
Non credit-obligation assets	9,737	0	0	0	0	0
Total IRB Approach	84,776,915	6,854,793	7,528,713	22,873,581	4,889,104	1,430,131
<i>Exposure classes, Standardised Approach</i>						
Governments and central banks	3,534,991	0	0	2,312,703	6,202,912	0
Regional and local authorities	2,233	3,989	13,228	154,519	130,368	13,133
Exposures to institutions	2,141,999	78,840	45,796	4,989,523	13,763	321,848
Exposures to corporates	1,611,877	130,346	143,161	434,949	92,968	27,194
Retail exposures	1,024,518	82,849	90,994	276,456	59,091	17,285
Exposures secured on residential property	2,465,103	199,343	218,941	665,184	142,179	41,589
Past due items	4,642	0	0	0	0	0
Exposures in the form of covered bonds	103,339	4,997,590	798,109	11,852,002	3,396,655	0
Other items	988,230	0	0	0	0	0
Total Standardised Approach	11,876,932	5,492,957	1,310,230	20,685,336	10,037,936	421,050

¹⁾ The residual maturity of agreements with periodically restricted terms should be calculated as the time up until the next date for a change in terms.

AVERAGE RISK WEIGHT FOR IRB EXPOSURES

Dec. 31, 2011, SEK 000s	Exposure	EAD	RW (%)	Risk-weight assets	Capital requirement
<i>Exposure classes, IRB Approach</i>					
Retail exposures	109,088,135	108,586,249	24	26,134,163	2,090,733
Exposures to corporates	20,144,668	19,757,251	56	11,158,782	892,703
Non credit-obligation assets	9,737	9,737	100	9,737	779
Total IRB Approach	129,242,540	128,353,237	29	37,302,682	2,984,215
<i>Exposure classes, Standardised Approach</i>					
Governments and central banks	12,050,606	12,050,606	0	0	0
Regional and local authorities	393,762	317,470	0	0	0
Exposures to institutions	6,800,985	7,591,768	13	973,064	77,845
Exposures to corporates	3,113,944	2,440,496	100	2,440,496	195,240
Retail exposures	5,176,154	1,551,192	75	1,163,394	93,072
Exposures secured on residential property	3,735,971	3,732,340	42	1,579,272	126,342
Past due items	13,095	4,642	118	5,461	437
Exposures in the form of covered bonds	21,147,696	21,147,696	10	2,114,770	169,182
Other items	988,230	988,230	22	215,122	17,210
Total Standardised Approach	53,420,443	49,824,440	17	8,491,578	679,326

DISTRIBUTION BY PD GRADE

PD grade	Retail exposures					
	Exposures secured by real estate collateral		Other retail exposures		Exposures to corporates	
	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)
Dec. 31, 2011, SEK 000s						
1	0	0	0	0	2,310,140	16
2	5,146,705	6	1,728,507	13	1,130,512	25
3	23,879,937	10	2,094,021	19	4,532,160	37
4	45,754,139	16	2,408,215	36	5,285,468	52
5	10,950,470	28	3,614,437	55	2,721,000	71
6	4,694,663	42	2,253,124	78	1,708,437	89
7	1,139,983	66	1,571,169	82	804,545	105
8	582,254	95	745,806	100	515,258	130
9	281,966	128	510,767	118	242,487	172
10	176,960	165	281,591	155	136,037	211
11	255,408	130	123,079	161	211,117	195
Default	104,661	319	288,487	143	160,090	0
Total	92,967,146	19	15,619,203	57	19,757,251	56

EXPOSURE-WEIGHTED LGD FOR IRB EXPOSURES

Dec. 31, 2011	Exposure-weighted LGD (%) ¹⁾
Retail exposures	27.8

¹⁾) Note that this value is prospective as of December 31, 2010.

UNUTILISED UNDERTAKINGS FOR IRB EXPOSURES

Dec. 31, 2011, SEK 000s	Exposure	Average CF (%)
Retail exposures	2,701,711	81.5

LOAN LOSSES, NET

SEK M	2011	2010
Specific reserve for individually assessed loan receivables		
Write-off of confirmed loan losses during the year	-92.7	-105.1
Reversed earlier impairment of loan losses recognised in the year-end accounts as confirmed loan losses	92.5	105.3
Impairment of loan losses during the year	-200.7	-109.2
Payment received for prior confirmed loan losses	41.5	26.2
Reversed impairment of loan losses no longer required	62.2	17.3
Covering of losses from related companies		10.0
Net expense for the year for individually assessed loan receivables	-97.2	-55.5
Collective reserves for individually assessed receivables		-
Collectively assessment of homogenous groups of loan receivables with limited value and similar credit risk		
Provision/reversal of impairment for loan losses	48.7	13.9
Net expense for the year for collectively assessed receivables	48.7	13.9
Net expense for the year for fulfilment of guarantees	0.3	-
Net expense of loan losses for the year	-48.2	-41.6

All information pertains to receivables from the public.

LOANS TO THE PUBLIC

Loan receivables are geographically attributable in their entirety to Sweden.

SEK M	Dec. 31, 2011	Dec. 31, 2010
Loan receivables, gross		
Public sector	2,246.1	236.5
Corporate sector	9,658.6	8,723.1
Retail sector	122,390.4	109,233.4
Other	0	3.7
Total loan receivables, gross	134,295.1	118,196.7

Impairment of individually reserved loan receivables

Corporate sector	-61.3	-40.5
Retail sector	-120.6	-95.3
Total individual reserves	-181.9	-135.8

Impairment of collectively reserved loan receivables

Corporate sector	-24.0	-24.0
Retail sector	-77.9	-126.7
Other	0	0
Total collective reserves	-101.9	-150.7
Total impairment	-283.8	-286.5

Loan receivables, net

Public sector	2,246.1	236.5
Corporate sector	9,575.3	8,658.6
Retail sector	122,191.9	109,011.4
Other	0	3.7
Total loans to the public	134,011.3	117,910.2

Remaining term of not more than 3 months	2,921.1	962.5
Remaining term of more than 3 months but not more than 1 year	3,599.6	3,311.6
Remaining term of more than 1 year but not more than 5 years	9,212.3	8,520.4
Remaining term of more than 5 years	118,529.4	105,488.2
Without maturity	-152.2	-
Total nominal cash flows	134,110.2	118,282.7

Impaired loans

Corporate sector	87.8	67.9
Retail sector	145.5	140.9
Total impaired loans	233.3	208.8

Definitions:

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 for any other reason cannot meet its undertaking. The loan receivable is considered impaired to the extent that its whole amount is not covered by collateral.

RECONCILIATION OF IMPAIRMENT OF LOAN LOSSES

SEK M	Dec. 31, 2011			Dec. 31, 2010		
	Individual impairments	Collective impairments	Total	Individual impairments	Collective impairments	Total
Opening balance	-135.8	-150.7	-268.5	-143.5	-164.5	-308.0
Reversed earlier impairment of loan losses recognised in the year-end accounts as confirmed losses	92.5	0	92.5	105.3	1.8	107.1
Reversed impairment of loan losses no longer required	62.1	48.8	110.9	17.4	47.4	64.8
Impairment of loan losses during the year	-200.7	0	-200.7	-115.0	-35.4	-150.4
Closing balance	-181.9	-101.9	-283.8	-135.8	-150.7	-286.5

Market and liquidity risks

The overall framework for the financial operations in the Bank Group is defined in the Financial Policy adopted by the Board. The Financial Policy stipulates the Board's approach to the management of market and liquidity risks.

Interest-rate risk

Interest-rate risk arises if assets, liabilities and derivatives do not have matching fixed-interest periods. Whenever possible, fixed lending should be matched by means of corresponding borrowing or through interest-rate derivatives. In principle, this means that no time differences should exist. In practice, this is impossible, so the Board has established interest-rate risk limits. However, these limits are so conservative that the basic principle for matching still applies. The Financial Policy defines interest-rate risk as a parallel shift in the yield curve of 100 points. On December 31, 2011, an increase in market interest rates of 1 percentage point would have resulted in an increase in the value of interest-bearing assets and liabilities, including derivatives, of SEK 33 M (52).

Currency risk

Currency risk refers to the risk of a currency changing in value in relation to another currency. Currency risks arise because losses may be incurred if the exchange rate changes negatively. All borrowing that takes place in a foreign currency is swapped before settlement in SEK in accordance with the Financial Policy to eliminate currency risk.

Liquidity risk and financing strategy

The Board of Directors of Länsförsäkringar Bank AB decides on a Financial Policy every year which provides a framework for the financial operations of the bank and its subsidiaries. The Board stipulates the objective of market and liquidity risks management in this Policy.

The Board's main target is that liquidity and financing management should be assured by maintaining suitable long-term planning, explicit functional definitions and a high level of control. Limits and guidelines have been established for each type of risk in both the bank's own operations and the Bank Group, and are updated whenever necessary.

The Board also decides on a liquidity and financing strategy, which is based on the business plan for the forthcoming year and supports the fulfilment of established business objectives and financial risk management. Deviations for the established business plan result in updates to the liquidity and financing strategy. This strategy is determined annually and is reviewed at least every six months and continuously by the ALCO, and is updated whenever necessary. Major material deviations are immediately reported to the Board.

Liquidity risks are to be minimised as far as possible. Future liquidity requirements and access to funds are secured by preparing accurate forecasts for the next 12-month period. The strategy is

specified in a financing plan containing key figures and targets for fulfilment of the objectives designated by the Board. The financing plan is prepared every year and adopted by the CFO. The plan is reviewed every day in relation to targets by weekly reports to the CFO. Updates are made as necessary within the framework stipulated in the liquidity and financing strategy and the Financial Policy.

A satisfactory liquidity reserve is to be in place to ensure that sufficient liquidity is always available. The management of and investments in the reserve take place in accordance with the established limits stated in the Financial Policy.

Internal pricing is to reflect the actual cost of maintaining the required liquidity levels to achieve transparency and correct business governance.

Liquidity reserve

The liquidity portfolio totalled SEK 30.5 billion (21.9) on December 31, 2011. All liquidity is invested in Swedish securities with high credit quality. A total of 36% of the liquidity portfolio comprises securities with the government as the counterparty and 64% covered bonds with the highest credit rating. The liquidity of the investments is high and all securities included in the liquidity reserve are eligible for transactions with the Riksbank. By utilising the liquidity reserve, contracted undertakings for almost two years can be met without needing to secure new borrowing in the capital market.

Liquidity management

Liquidity risk is managed by the Treasury unit. Liquidity risk is quantified using liquidity forecasts that contain all financial cash flows and expected cash flows, as well as the net lending increases adopted. The liquidity portfolio is continuously subjected to stress tests according to three scenarios. These scenarios illustrate how long cash and cash equivalents will last, given that

- The operations are being conducted according to plan but no market financing is available
- The growth in loans and deposits remains unchanged, while no market financing is available
- The growth in loans remains unchanged and deposits declined, while no market financing is available.

The Treasury unit is also responsible for the liquidity portfolio. Daily report follow-ups are conducted on the size and structure of the liquidity portfolio. Accordingly, liquidity can be monitored daily based on these reports. The liquidity portfolio is dimensioned to be able to handle approximately three months of "normal" operations without borrowing activities in the capital market.

"Normal" operations also encompass the expected growth of the loan portfolio. Liquidity risk is defined as the risk of the Bank Group, due to insufficient cash and cash equivalents, being unable to fulfil its commitments or only being able to fulfil its commitments by borrowing cash and cash equivalents at a significantly

higher cost. This definition is closely linked to the definition of financing risk. Liquidity risk also refers to the risk of financial instruments that cannot immediately be converted to cash and cash equivalents without decreasing in value. Liquidity risks associated with the risk of financial investments decreasing in value are minimised by essentially investing exclusively in high-liquidity instruments in the form of domestic government securities, domestic covered bonds and mortgage certificates that are pledgeable at the Riksbank.

Contingency plans

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.

General objectives of refinancing strategy

The general objective of borrowing is to ensure that the operations have the requisite refinancing for both the short and long terms and for the desired maturity periods. In addition, borrowing should contribute to the overall profitability and competitiveness of the operations by managing the price and composition of liabilities to ensure that they are in line with those of relevant competitors. Targets are set to control various activities in terms of the market, instruments and composition of borrowing and are based on the following two objectives.

Borrowing is to:

- Ensure the short and long-term capital requirements
- Ensure that the price of debt securities in issue is in line with the prices of relevant competitors.

Strategy for ensuring short and long-term refinancing

The Group regularly meets with both current and potential investors to ensure that these investors have a clear overview of the operations that facilitates the existence of limits and a willingness to invest in the Group's securities over time.

The Group's refinancing activities are also based on diversification in terms of a variety of investors and markets. To ensure the success of diversification, the Group also needs to issue the type of securities sought after by the investors in each selected market. This secures access to refinancing over time. The instruments that the Bank Group is permitted to use are regulated in the Financial Policy. Investor activities encompass banks, fund managers, insurance companies and central banks.

Furthermore, as part of these activities the Group strives to ensure that as favourable liquidity as possible is maintained in the Group's investments. This also aids the work to secure refinancing options.

	Dec. 31, 2011,	Dec. 31, 2010,
	SEK M	SEK M
Bonds and other interest-bearing securities		
AAA/Aaa	20,628.2	21,203.3
Total	20,628.2	21,203.3

Financing risk

Financing risk means that the Bank Group, in the event of financing maturity, does not successfully refinance the maturity or only succeeds in borrowing at substantially increased costs. This definition is closely linked to the definition of liquidity risk. By using the largest possible number of financing sources with expanded investor bases and by distributing financing maturities over time, the Bank Group's financing risk decreases. The Financial Policy also stipulates that the average term of borrowing is to exceed the average term of the loan portfolio. In recent years, the Bank Group has also had a stable rating from Standard & Poor's and Moody's. Länsförsäkringar Hypotek's covered bonds also have the highest rating from both Moody's and Standard & Poor's.

Business risk

According to the Bank Group's definition, business risk comprises the following risks:

- Strategic risk
- Earnings risk
- Reputation risk

Strategic risk

The Bank Group has identified strategic risk as a significant business risk that must be taken into consideration. Strategic risk refers to institutional changes and changes in basic market conditions that may occur. Strategic risk also includes the ability of the Board of Directors and President to plan, organise, follow up on and control the operations and to continuously monitor market conditions.

Operational risks

Operational risk is defined as the risk of losses arising due to inappropriate or unsuccessful internal processes, human error, incorrect systems or external events. This definition also includes legal risks. Based on this definition, operational risk encompasses the entire Bank Group. Operational risk is primarily categorised into the following areas:

- Internal fraud
- External crime
- Legal risks
- Damage to physical assets
- Interruptions and disturbances to operations and systems
- Business conditions
- Transaction management and process control
- Working conditions and work environment.

All significant processes in the Bank Group and the banking operations of the regional insurance companies are required to perform an analysis of the operational risk associated with the process. These risk analyses are included in the Bank Group's total risk assessment in accordance with the Basel regulations. Since the operations, their external environment and threat scenario are constantly changing, the processes must be subjected to regular quality assurance. This is carried out to ensure that the risks remain within the Bank Group's tolerance level. Risk analysis is one of the tools used to prepare the basis for decision-making in order to introduce measures for managing significant risks. The purpose of risk analysis is to:

- Identify and reduce significant operational risks
- Plan security activities
- Create awareness of operational risks
- Comply with the Swedish Financial Supervisory Authority's requirements for measuring and assessing operational risk.

Earnings risk

Earnings risk is defined by the Bank Group as volatility in earnings that creates a risk of lower income due to an unexpected decrease in income as a result of such factors as competition or volume reductions. Earnings risk is associated with all of the Bank Group's products and portfolios. A considerable portion of the Bank Group's business operations involves retail mortgages. Retail mortgages have a low level of volatility.

Reputation risk

Reputation risk is difficult to assess, but this type of risk could be devastating for an operation such as Länsförsäkringar, which is based on a well-established brand. Reputation risk is the risk of a tarnished reputation among customers, owners, employees, authorities and other parties resulting in reduced income.

Every part of the organisation is responsible for planning an annual risk analysis, carrying out the analysis and managing the results in an action list.

The risk analysis model is based on:

- Predefined events, and
- Other events.

The analysis is normally performed in two stages:

- Stage 1, Risk analysis – Risks are defined and assessed based on their consequences and probability. Risk analyses are conducted once annually.
- Stage 2, Action planning – Action is to be taken for significant risks. Proposed solutions are discussed and implemented. This is carried out continuously within the process in order to manage risk.

Incident management

The Bank Group has developed an IT system for reporting operational risk events or incidents. This system enables all employees to report possible incidents. The system automatically divides the incidents into the categories established by the Swedish Financial Supervisory Authority. Risk Control periodically prepares a summary of the incidents in its reports. Incident management is an important part of the Bank Group's operational risk management. Incident statistics contribute to the annual assessment and forecast of operational risk. Incident reporting enables the company to quickly identify critical problems and act upon these.

Model for assessing operational risk

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 – how will the operations be affected if the risk occurs?
- Probability – how likely is it that the risk will occur?

These factors are aggregated to determine a target value for the operational risk. Management of the Bank Group is responsible for performing the risk analyses, meaning identifying and assessing operational risk, within its area of responsibility. All employees have a responsibility to report incidents. Management is responsible for taking action against intolerable risks in their areas of responsibility.

Internal Capital Adequacy Assessment Process (ICAAP)

The Bank Group's internal capital adequacy assessment process (ICAAP) was designed based on the requirements of the Basel II rules, the requirements established by the Board of Directors for the operations and the internal demands of an increasingly complex business operation. The regulations aimed at the internal capital adequacy assessment processes of financial companies are based on principles and are comprehensive in nature. To a large extent, this means that Länsförsäkringar Bank has the option and an obligation to independently design its process and, in the long run, its scope and level of sophistication. The Bank Group's procedures, implementation and results are to be reported to the Swedish Financial Supervisory Authority annually. The CFO of Länsförsäkringar Bank is responsible for conducting the process work that leads to an internal capital adequacy assessment for the Bank Group and forms the basis for business planning and Board decisions concerning capital targets and capital forecasts. The CFO is responsible for developing a methodology document that describes the process and shall include at least the following:

- A detailed description of the capital assessment process and the areas of responsibility associated with the process
- A detailed description of methods for calculating total capital that take Pillar I risks, Pillar II risks and conducted stress tests into consideration.

The process shall be carried out annually and shall include at least the following activities:

- Review of all risks
- Risk assessment
- Stress tests
- Capital calculations.

At least once annually, the basic prerequisites for stress tests are to be reviewed by the Board of Directors. This review should act as a guide for the continuing work involving stress tests. Work involving stress tests is based on a number of scenarios and the impact of these scenarios on risk in the Bank Group.