Risk and capital management at the Länsförsäkringar Bank Group 2013

Pillar III of the Basel 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 the Basel regulations were implemented within the EU. Information requirements were introduced in Sweden on the basis of regulation FFFS 2007:5 of the Swedish Financial Supervisory Authority.

Under the Basel rules, an option for calculation of the capital requirement for credit risk was introduced by utilising either the Standardised Approach or the Internal Ratings-based Approach (IRB Approach). The Bank Group applies the IRB Approach, in accordance with a permit issued by the Financial Supervisory Authority. The advanced IRB Approach is used for all retail exposure and exposures to corporates and the agricultural sector up to SEK 5 M. The Foundation Internal Ratings-based Approach is used for counterparty exposures to corporates and the agricultural sector in excess of SEK 5 M. The Standardised Approach is used for other exposures.

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.

Strategy and goals

Länsförsäkringar Bank was founded in 1996 and is the fifth largest retail bank in Sweden with a business volume of SEK 314 billion. The banking operations are conducted only in Sweden and business volumes have grown on a broad front 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. Länsförsäkringar has great potential to offer banking services to the 3.5 million customers of the Länsförsäkringar Alliance based on its already strong customer relationships. The main target groups are the 2.9 million retail customers, of which 1.8 million are home-insurance and agricultural customers and small businesses.

The aim is, based on low risk, to continue to have growth in volumes and profitability, have the most satisfied customers and increase the share of customers who have both banking and insurance with Länsförsäkringar.

For eight of the past ten years, Länsförsäkringar Bank has had Sweden's most satisfied retail customers and has more satisfied customers than its four main competitors, the major banks, according to the 2013 Swedish Quality Index. With a comprehensive banking and insurance offering at Länsförsäkringar, customers receive a secure commitment for their private finances.

Customer ownership

The Länsförsäkringar Alliance consists of 23 local, customer-owned regional insurance companies and the jointly owned Länsförsäkringar AB, which is the bank'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. Security for customers is inherent in Länsförsäkringar's mission that dates back 200 years. The bank has low risk tolerance, which provides a stable performance over time. Lending is characterised by low risk and the in-depth, local customer and market knowledge of the regional insurance companies, combined with the conservative view of risk, generates growth with high credit quality.

Customer meetings and local market knowledge

The regional insurance companies are responsible for customer contact. Business decisions are made locally and the regional insurance companies' commitment and network provide broad and in-depth customer and market knowledge. The banking operations' network consists of 130 branches of the regional insurance companies. Personal customer meetings are a high priority at Länsförsäkringar since they create trust and long-term relationships.

Mobile app and Internet bank simplify

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

Customer-driven and effective business model

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

A strong brand

The bank's successful growth and position in the market is largely based on Länsförsäkringar's strong brand, local presence and customer ownership. Länsförsäkringar has the highest reputation among banking and insurance companies, according to Nordic Brand's brand ranking and the Reputability Barometer for 2013.

Focus of operations

Länsförsäkringar Bank offers a total offering to private individuals, agricultural customers and small businesses.

Savings provide security

The bank is growing broadly in the savings area and offers a range of different products. These products include fund savings in various funds, Investment Savings Accounts (ISK) that simplify savings in shares, funds and other types of securities, equities savings, equity-linked bonds and various deposit products.

The advisory services strive to ensure that customers have balanced private finances in which savings and repayments comprise a key element.

The largest portion of the bank's deposits, totalling a market share of 4.5%, comprises household deposits and has risen stably in recent years. The bank's percentage of market growth in household deposits was 8% in 2013.

Fund and securities savings

Länsförsäkringar has a market share of 3.9% of the fund market and the fund offering includes some 80 funds, of which more than 30 are under Länsförsäkringar's own brand. The average return for funds during the year amounted to 17%. Valuations are carried out continuously to further enhance the attractiveness of the funds.

Länsförsäkringar is to be a leader while maintaining high quality in sustainable investments and Länsförsäkringar Fondförvaltning has several partnerships for consistently working on these issues.

Trading in equities and other securities is growing steadily among customers and the number of deposits rose during the year. Structured products are also offered, such as equity-linked bonds. The Investment Savings Account (ISK) displayed healthy growth during the year, as did Individual Pension Savings (IPS).

Lending

The bank continues to have favourable growth in lending and loans are granted at low risk. The market share for household lending amounted to 5.0%.

The largest product is retail mortgages, which comprises 71% of the loan portfolio. Retail mortgages are mostly granted by Länsförsäkringar Hypotek, which offers mortgages up to 75% of the market value on the granting date, and other mortgages are offered by Länsförsäkringar Bank. The bank also offers loans to tenant-owners' associations and to multi-family housing.

Länsförsäkringar is the fourth largest provider of agricultural loans in Sweden. The bank's agricultural loans are primarily targeted to family-owned agricultural operations that are insurance customers with Länsförsäkringar. The percentage of agricultural customers that have both banking and insurance with Länsförsäkringar was 97% at year-end. On average, agricultural lending has small commitments and the percentage of first-lien mortgages amounted to 89%. Prior to 2008, first-lien mortgages in agricultural lending were offered in collaboration with another provider. Länsförsäkringar has subsequently offered first-lien mortgages. The rate of growth in agricultural lending slowed during the year.

Wasa Kredit offers leasing, hire purchase and unsecured loans and the growth in lending for the year was favourable in a fiercely competitive market.

Small-business offering

The offering to small businesses performed well, particularly due to robust growth in deposits. Deposits from small businesses rose 15% to SEK 8.6 billion during the year and loans to small businesses increased 6% to SEK 1.7 billion.

Bank cards and payments

The number of bank cards increased 12% to 388,000 and the card business displayed a healthy trend during the year. The number of payment transactions increased 16% to 24 million and the number of in-store bank card transactions rose 22% to 15 million. Income from payment mediation continued to increase during the year.

The Swish service performed well during the year. Länsförsäkringar Bank, which is one of the drivers of the Swish partnership, owns 10% of the company that manages and develops the service.

Attractive offering to young people

The bank's offering to young people is highly competitive and one of the best in the Swedish market. The card and payment service offered to young people from the age of 16, comprising a young person's account including a bank card, Internet and telephone banking and digital services – performed well during the year.

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 whereby 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 almost exclusively in Swedish securities with high credit quality. Only 1% of the liquidity reserve comprises foreign (German) government securities. 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 compiled 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's responsibility also includes establishing more detailed regulations for the risk-management system within the framework determined 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 risk-classification system (the IRB Approach) and continuously validating its quantitative components and its use in the operations.

One of the most important tasks for Risk Control is to ensure that the operations have active risk management and that the risk tolerance established by the Board is converted into limits upon 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 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. Pending a decision on the final structure of the new capital adequacy regulations, the Board of Directors of Länsförsäkringar Bank decided in February 2013 that the Bank Group's Core Tier 1 ratio should be approximately 13% and the total capital ratio approximately 16%. The Board intends to announce a new capital target once the final structure of the capital adequacy regulations has been determined.

Capital-adequacy analysis

SEK M	Dec 31, 2013	Dec 31, 2012
Tier 1 capital, gross	8,149.8	7,336.0
Less intangible assets	–397.1	–445.8
Less deferred tax assets	–9.2	–12.3
Less/plus IRB deficit/surplus	–302.4	–265.9
Tier 1 capital, net	**7,441.1**	**6,612.0**
Tier 2 capital	2,296.9	1,200.0
Deductions for Tier 2 capital	–302.4	–265.9
Total capital base	**9,435.6**	**7,546.1**
Risk-weighted assets according to Basel II	**50,465.0**	**48,359.4**
Risk-weighted assets according to transition rules	**88,816.1**	**83,233.6**
Capital requirement		
Capital requirement for credit risk according to Standardised Approach	647.2	678.4
Total capital requirement for credit risk according to IRB Approach	3,211.3	3,034.2
Capital requirement for operational risk	178.7	156.2
Capital requirement according to Basel II	**4,037.2**	**3,868.8**
Adjustment according to transition rules	3,068.1	2,789.9
Total capital requirement	**7,105.3**	**6,658.7**
Tier 1 ratio according to Basel II, %	14.7	13.7
Core Tier 1 ratio according to Basel II, %	14.7	13.1
Capital adequacy ratio according to Basel II, %	18.7	15.6
Capital ratio according to Basel II [1)]	2.34	1.95
Tier 1 ratio according to transition rules, %	8.4	7.9
Core Tier 1 ratio according to transition rules, %	8.4	7.6
Capital adequacy ratio according to transition rules, %	10.6	9.1
Capital ratio according to transition rules [1)]	1.33	1.13
Special disclosures		
IRB Provisions surplus (+)/deficit –)	–604.8	–531.8
– IRB Total provisions (+)	386.5	291.1
– IRB Anticipated loss (–)	–991.3	–822.9

1) Capital ratio = total capital base/total capital requirement

SEK M	Dec 31, 2013	Dec 31, 2012
Credit risk according to Standardised Approach		
Exposures to institutions	80.4	104.4
Exposures to corporates	164.8	167.9
Retail exposures	54.9	108.6
Exposures secured on residential property	0.0	0.0
Past due items	0.0	0.0
Covered bonds	292.7	259.4
Other items	54.4	38.2
Total capital requirement for credit risk according to Standardised Approach	**647.2**	**678.4**
Credit risk according to IRB Approach		
Retail exposures		
Exposures secured by real estate collateral	1,684.8	1,537.0
Other retail exposures	789.5	709.3
Total retail exposures	**2,474.3**	**2,246.3**
Exposures to corporates	736.0	787.1
Non credit-obligation assets	0.9	0.7
Total capital requirement for credit risk according to IRB Approach	**3,211.2**	**3,034.2**
Operational risk		
Standardised Approach	178.8	156.2
Total capital requirement for operational risk	**178.8**	**156.2**
Capital-adequacy analysis according to Basel I		
Tier 1 capital	7,743.5	6,877.9
Tier 2 capital	2,296.9	1,200.0
Total capital base	**10,040.4**	**8,077.9**
Risk-weighted assets	120,469.7	112,351.2
Capital requirement for credit risk	9,637.6	8,988.1
Tier 1 ratio, %	6.43	6.12
Capital adequacy ratio, %	8.33	7.19
Capital ratio [1)]	1.04	0.90

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 losses occurring 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 87% (88) 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 Internal Ratings-Based Approach (F-IRB) for the portion of the loan portfolio pertaining to counterparty exposures to corporates and the agricultural sector in excess of SEK 5 M. The percentage of retail mortgages of the total loan portfolio is 71% (71) and agricultural loans 13% (13). The Standardised Approach is used for other exposures. The lending portfolio is entirely comprised of loans in Sweden, which is well-diversified geographically 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 homogeneous 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 almost exclusively takes place supported by a central, highly automated credit research system, which includes the integrated sub-processes of quality checks, decision-making steps and risk assessments under the IRB Approach. 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 knowledge and credit responsibility of the regional insurance companies, combined with the joint systems support for automated risk classification under the IRB Approach, provides 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 71% (71) of lending. First-lien mortgages with loan-to-value ratios amounting up to 75% of the market value at 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. Loan origination for mortgages takes place at a maximum loan-to-value ratio of 85%.

Loans to the agricultural segment accounted for 13% (13) 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% (84) 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. After receiving permission in December 2009, the Foundation Internal Ratings-Based Approach was applied to the calculation of the capital requirement for credit risk for exposures to corporates and the agricultural sector. In June 2012, the bank received permission to apply an internal approach for all exposures to corporates and permission to allocate exposures to corporates up to SEK 5 M to the Retail exposure class and thus apply the Advanced IRB Approach to such exposures. These approaches have been applied to calculations of capital requirements since June 30, 2012. Internal models will be implemented for other minor loan portfolios in the Bank Group, in accordance with the implementation plan approved by the Financial Supervisory Authority. Permanent exemptions have been granted for exposures to governments, local governments, county councils and banks.

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, 2013, SEK 000s	PD (%)	EAD
1	0.05	19,008,142
2	0.10	22,456,273
3	0.20	42,570,942
4	0.40	35,902,732
5	0.80	24,766,104
6	1.60	10,470,143
7	3.20	5,058,422
8	6.40	2,691,175
9	12.80	1,640,615
10	25.60	862,097
11	51.20	683,667
Default	100.00	900,816
Total		**167,011,128**

Comparisons of PD grades Internal	PD (%)	Indicative credit rating from Standard & Poor's
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
Default	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 predictive statistical analysis (credit scoring), while the division of PD into grades for exposures to corporates, in addition to a strict predictive statistical analysis, is partly based on individual expert assessment. These risk 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 where the counterparty's total exposure exceeds SEK 5 M.

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 where the counterparty's total exposure exceeds SEK 5 M.

Expected Loss Percentage (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 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 used in capital adequacy reports, meaning those 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, 2012 was 1.04%, distributed on the basis of 0.75% for exposures secured by real estate collateral and 2.36% for other retail exposures. The percentage of these exposures in default in 2012 was 0.36%, distributed on the basis of 0.19% for exposures secured by real estate collateral and 1.82% for other retail exposures.

The exposure-weighted LGD estimate for all non-defaulted exposures encompassed by IRB at December 31, 2011 was 27.0%, distributed on the basis of 23.5% for exposures secured by real estate collateral and 47.4% for other retail exposures. The actual loss rate for the exposures in default in 2012 was 15.0% for exposures secured by real estate collateral and 56.7% for other retail exposures. The calculation of actual loss rates took into account recoveries up to and including December 31, 2013, 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, 2011 was 0.36%, distributed on the basis of 0.20% for exposures secured by real estate collateral and 1.28% for other retail exposures. The percentage of these exposures in default in 2012 was 0.18%, distributed on the basis of 0.03% for exposures secured by real estate collateral and 1.15% for other retail exposures. Most loan losses derive from unsecured loans and personal accounts with only one borrower.

Loans and receivables

Loans and receivables are financial assets that are not derivatives, that have fixed or determinable 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 2013 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. The results below pertain exclusively to loans to the public.

There are no loans in 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 393 M (298), corresponding to 0.23% (0.19) of the total loan portfolio before reserves. Loan losses totalled SEK 126 M (91), corresponding to a loan loss of 0.08% (0.06). Impaired loans and loan losses continued to account for a minor percentage of total loans.

Impaired loans by product, SEK M	Dec 31, 2013	Dec 31, 2012
Retail mortgages	25.3	5.4
Agricultural loans	71.4	4.1
Unsecured loans	113.6	112.5
Leasing	111.3	115.7
Hire purchase	46.4	46.5
Multi-family housing	–	–
Industrial properties	–	–
Other	25.4	13.7
Total	**393.4**	**297.9**

Non-performing loan receivables not included in impaired loans, SEK M	Dec 31, 2013	Dec 31, 2012
Receivables overdue by 10–19 days [1]	1.3	0.8
Receivables overdue by 20–39 days	343.6	472.7
Receivables overdue by 40–60 days	10.0	30.3
Total	**354.9**	**503.8**

[1] Excluding Wasa Kredit.

Non-performing loan receivables not included in impaired loans, SEK M	Länsförsäkringar Bank	Länsförsäkringar Hypotek	Wasa Kredit	Group
Receivables overdue by 10–19 days [1]	0.8	0.5	0.0	1.3
Receivables overdue by 20–39 days	32.2	43.4	268.0	343.6
Receivables overdue by 40–60 days	0.0	0.0	10.0	10.0
Total	**33.0**	**43.9**	**278.0**	**354.9**

[1] Excluding 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, 2013
AA–/Aa3	112.7
A+/A1	127.8
A+/A2	–
A/Aa2	275.7
Total	**516.2**

Positive and negative values are 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 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, 2013	Average 2013
Exposure classes, IRB Approach		
Retail exposures	148,579,021	145,710,339
Exposures to corporates	18,432,107	18,064,656
Non credit-obligation assets	11,631	9,378
Total IRB Approach	**167,022,759**	**163,784,373**
Exposure classes, Standardised Approach		
Governments and central banks	8,292,292	9,005,529
Regional and local authorities	2,943,042	3,000,446
Exposures to institutions	6,204,475	8,387,847
Exposures to corporates	2,060,303	2,097,037
Retail exposures	914,593	909,957
Exposures secured on residential property	0	0
Past due items	0	0
Exposures in the form of covered bonds	36,593,603	30,329,407
Exposures to CIUs	76,875	85,103
Other items	1,283,276	1,130,742
Total Standardised Approach	**58,368,458**	**61,340,587**

Recognisable collateral

Dec 31, 2013, SEK 000s	EAD	Secured through recognisable collateral
Exposure classes, IRB Approach		
Exposures to corporates	18,432,107	16,233,211
Total IRB Approach	**18,432,107**	**16,233,211**
Exposure classes, Standardised Approach		
Governments and central banks	8,292,292	0
Regional and local authorities	2,943,042	0
Exposures to institutions	6,204,475	0
Exposures to corporates	2,060,303	0
Retail exposures	914,593	0
Exposures secured on residential property	0	0
Past due items	0	0
Exposures in the form of covered bonds	36,593,603	0
Exposures to CIUs	76,875	0
Other items	1,283,276	0
Total Standardised Approach	**58,368,458**	**0**

EAD for exposures secured by real estate collateral, by geographic region

	Retail exposures		Exposures to corporates	
Dec 31, 2013, SEK 000s Geographic division	EAD	Proportion of EAD (%)	EAD	Proportion of EAD (%)
Western Sweden	27,595,103	21.7	3,308,497	20.1
Eastern Central Sweden	28,737,429	22.6	4,628,100	28.1
Stockholm	18,112,870	14.2	1,384,102	8.4
Southern Sweden	16,501,074	13.0	2,998,932	18.2
Northern Central Sweden	12,659,321	10.0	753,941	4.6
Småland	12,974,062	10.2	2,481,538	15.1
Northern Norrland	5,930,559	4.7	457,983	2.8
Central Norrland	4,682,982	3.7	446,442	2.7
Total	**127,193,401**	**100.0**	**16,459,535**	**100.0**

EAD, by contractual maturity

Dec 31, 2013, SEK 000s	<3 months	3–6 months	6–12 months	1–3 years	3–5 years	> 5 years
Exposure classes, IRB Approach						
Retail exposures	98,270,333	4,810,747	5,162,927	33,188,137	6,287,336	859,540
Exposures to corporates	12,191,016	596,802	640,492	4,117,185	779,981	106,631
Non credit-obligation assets	11,631	0	0	0	0	0
Total IRB Approach	110,472,980	5,407,549	5,803,419	37,305,322	7,067,318	966,171
Exposure classes, Standardised Approach						
Governments and central banks	1,174,487	495,206	317,026	4,503,532	1,802,042	0
Regional and local authorities	20,355	87,785	11,039	1,357,513	1,459,809	6,541
Exposures to institutions	3,346,877	100,592	102,197	1,664,940	7,105	982,763
Exposures to corporates	1,362,687	66,709	71,593	460,210	87,185	11,919
Retail exposures	604,913	29,613	31,781	204,293	38,702	5,291
Exposures secured on residential property	0	0	0	0	0	0
Past due items	0	0	0	0	0	0
Exposures in the form of covered bonds	0	14,696,967	0	11,995,324	9,620,523	280,789
Exposures to CIUs	0	0	76,875	0	0	0
Other items	1,283,276	0	0	0	0	0
Total Standardised Approach	**7,792,594**	**15,476,873**	**610,511**	**20,185,813**	**13,015,365**	**1,287,302**

Average risk weight for IRB exposures

Dec 31, 2013, SEK 000s	Exposure	EAD	RW (%)	Risk-weighted assets	Capital requirement
Exposure classes, IRB Approach					
Retail exposures	150,443,632	148,579,021	21	30,929,391	2,474,351
Exposures to corporates	18,608,452	18,432,107	50	9,199,692	735,975
Non credit-obligation assets	11,631	11,631	100	11,631	930
Total IRB Approach	**169,063,715**	**167,022,759**	**24**	**40,140,714**	**3,211,257**
Exposure classes, Standardised Approach					
Governments and central banks	8,292,687	8,292,292	0	0	0
Regional and local authorities	3,007,490	2,943,042	0	0	0
Exposures to institutions	6,213,017	6,204,475	16	1,004,677	80,374
Exposures to corporates	2,077,878	2,060,303	100	2,060,303	164,824
Retail exposures	1,125,242	914,593	75	685,944	54,876
Exposures secured on residential property	0	0	0	0	0
Past due items	0	0	0	0	0
Exposures in the form of covered bonds	36,593,603	36,593,603	10	3,659,360	292,749
Exposures to CIUs	76,875	76,875	100	76,875	6,150
Other items	1,283,276	1,283,276	47	602,572	48,206
Total Standardised Approach	**58,670,068**	**58,368,459**	**14**	**8,089,731**	**647,179**

Distribution by PD grade

	Retail exposures					
PD grade	Exposures secured by real estate collateral		Other retail exposures		Exposures to corporates	
Dec 31, 2013, SEK 000s	EAD	RW (%)	EAD	RW (%)	EAD	RW (%)
1	16,749,427	3	790,330	5	1,468,385	13
2	19,864,408	6	2,168,372	13	423,493	20
3	36,108,346	9	1,879,419	19	4,583,177	30
4	26,977,165	16	4,380,901	28	4,544,666	42
5	17,659,844	26	4,674,720	47	2,431,540	57
6	5,009,653	41	2,928,598	67	2,531,892	72
7	2,024,182	61	1,922,545	71	1,111,695	86
8	1,171,232	92	1,031,129	72	488,814	106
9	751,897	123	620,033	91	268,685	142
10	361,052	140	380,863	118	120,182	176
11	292,530	131	204,953	127	186,184	181
Default	223,665	279	403,757	151	273,394	0
Total	**127,193,401**	**16**	**21,385,620**	**47**	**18,432,107**	**50**

Exposure-weighted LGD for IRB exposures

Dec 31, 2013	Exposure-weighted LGD (%) [1]
Retail exposures	24.8

[1] Note that this value is forward-looking as of December 31, 2013.

Unutilised undertakings for IRB exposures

Dec 31, 2013, SEK 000s	Exposure	Average CF (%)
Retail exposures	6,555,227	71.6

Loan losses, net

SEK M	2013	2012
Specific reserve for individually assessed loan receivables		
Write-off of confirmed loan losses during the year	–139.6	–136.2
Reversed earlier impairment of loan losses recognised in the year-end accounts as confirmed losses	131.1	102.8
Impairment of loan losses during the year	–307.6	–147.7
Payment received for prior confirmed loan losses	109.2	85.4
Reversed impairment of loan losses no longer required	63.5	22.4
Covering of losses from related companies	–	–
Net expense for the year for individually assessed loan receivables	**–143.4**	**–73.3**
Collective reserves for individually assessed receivables	**–**	**–**
Collectively assessment of homogenous groups of loan receivables with limited value and similar credit risk		
Provision/reversal of reserve for loan losses	16.8	–19.1
Net expense for the year for collectively assessed receivables	**16.8**	**–19.1**
Net expense for the year for fulfilment of guarantees	0.2	1.1
Net expense of loan losses for the year	**–126.4**	**–91.3**

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, 2013	Dec 31, 2012
Loan receivables, gross		
Public sector	874.0	982.0
Corporate sector	14,200.2	12,754.8
Retail sector	147,350.1	136,530.5
Other	0.5	0.0
Total loan receivables, gross	**162,424.8**	**150,267.3**
Impairment of individually reserved loan receivables		
Corporate sector	–97.1	–69.1
Retail sector	–220.3	–135.3
Total individual reserves	**–317.4**	**–204.4**
Impairment of collectively reserved loan receivables		
Corporate sector	–24.4	–32.4
Retail sector	–79.8	–88.6
Other	0.0	0.0
Total collective reserves	**–104.2**	**–121.0**
Total impairment	**–421.6**	**–325.4**
Loan receivables, net		
Public sector	874.0	982.0
Corporate sector	14,078.7	12,653.3
Retail sector	147,050.0	136,306.6
Other	0.5	0.0
Total loans to the public	**162,003.2**	**149,941.9**
Remaining term of not more than 3 months	1,522.0	1,605.1
Remaining term of more than 3 months but not more than 1 year	5,006.2	5,051.0
Remaining term of more than 1 year but not more than 5 years	10,963.6	10,693.0
Remaining term of more than 5 year	146,138.7	134,082.0
Without maturity	0.0	0.0
Total nominal cash flows	**163,630.5**	**151,431.1**
Impaired loans		
Corporate sector	128.3	118.2
Retail sector	265.1	179.7
Total impaired loans	**393.4**	**297.9**

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

	Dec 31, 2013			Dec 31, 2012		
SEK M	Individual impairments	Collective impairments	Total	Individual impairments	Collective impairments	Total
Opening balance	**–204.4**	**–121.0**	**–325.4**	**–181.9**	**–101.9**	**–283.8**
Reversed earlier impairment of loan losses recognised in the year-end as confirmed losses	131.1	0.0	131.1	102.8	–4.3	98.5
Reversed impairment of loan losses no longer required	63.5	16.8	80.3	22.3	–14.8	7.5
Impairment of loan losses during the year	–307.6	0.0	–307.6	–147.6	0.0	–147.6
Closing balance	**–317.4**	**–104.2**	**–421.6**	**–204.4**	**–121.1**	**–325.4**

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 funding 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 the effect of a parallel shift in the yield curve of 1 percentage point. On December 31, 2013, 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 40 M (70).

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 funding 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 reserve totalled a nominal amount of SEK 45.9 billion (37.5) on December 31, 2013. The liquidity reserve is invested in securities with very high credit quality, of which 76% comprises Swedish covered bonds, 12% Swedish government bonds, 11% other Swedish bonds with a credit rating of AAA/Aaa, and 1% German government securities. The liquidity of the investments is high and all Swedish securities included in the liquidity reserve are eligible for transactions with the Riksbank and, where appropriate, with the ECB. By utilising the liquidity reserve, contractual undertakings for about 1.5 years can be met without needing to secure new funding in the capital market. The Group's Liquidity Coverage Ratio (LCR) amounted to an average of 253% during the fourth quarter of 2013. The LCR in EUR amounted to 1,847% on December 31, 2013.

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 funding activities in the capital market, under all circumstances. 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 funding 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 funding is to ensure that the operations have the requisite refinancing for both the short and long terms and for the desired maturities. In addition, funding 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 funding and are based on the following two objectives. Funding 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.

Bonds and other interest-bearing securities	Dec 31, 2013, SEK M	Dec 31, 2012, SEK M
AAA/Aaa	34,333.7	31,111.7
Total	**34,333.7**	**31,111.7**

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 funding 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 funding is to exceed the average term of the loan portfolio. The highest credit rating from both standard and Poor's (AAA) and Moody's (Aaa) for Länsförsäkringar Hypotek's covered bonds and A and A3, respectively, for the Bank Group's senior funding have ensured that the Bank Group's name is well received in the capital market, both in Sweden and eurozone market.

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.

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 like 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.

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
- 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 Financial Supervisory Authority's requirements for measuring and assessing operational risk.

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 and continuity 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 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, and enables the company to quickly identify critical problems and act upon these. Serious incidents may lead to a crisis. A crisis may arise, for example, due to fire, IT failure or similar serious event. The Group works constructively to prevent this type of incident from arising. Nevertheless, if a serious event were to occur, business continuity plans have been produced in the operations to support employees and managers in a crisis. Crisis training is conducted periodically to ensure that the plans are suitable.

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.

Compliance risk

Compliance risk pertains to the risk that Länsförsäkringar Bank does not comply with legislation, regulations, ethical guidelines, good market practice or other relevant regulations for the licensable operations and is thus exposed to the risk of incurring sanctions or other remarks from the Financial Supervisory Authority, negative publicity in the media and a decline in confidence among customers or other stakeholders.

Länsförsäkringar Bank's internal regulations contain rules on managing compliance risks, with the central part comprising the Compliance instruction decided on by the Board. The purpose of the internal rules is to ensure that Länsförsäkringar Bank, at any given time, meets the quality and conduct requirements demanded by customers and supervisory authorities.

New capital adequacy rules

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 to be implemented in the EU through CRD IV/CRR

Basel III will be implemented into EU law through a revised Capital Requirement Directive (CRD IV) and a Capital Requirements Regulation (CRR), which was decided in 2013, and will be introduced in Sweden with no transitional period. CRR came into effect on January 1, 2014, while CRD IV will come into effect after it has been incorporated into Swedish law.

The directive comprises such areas as bank authorisation, supervision principles (including Pillar II measures), corporate governance, capital buffers and sanctions. The directive contains more detailed provisions in regard to the capital base, calculation of capital requirements for credit risk, market risk and operational risk, and regulations for large exposures, liquidity, gross leverage and disclosure requirements. By establishing detailed provisions in the form of a regulation (CRR), the aim is to create conditions for a harmonised framework for all European banks.

Capital base

The new capital adequacy regulations contains a revised definition of the capital base. The aim is to provide incentive for banks to hold the highest quality form of capital, thus strengthening the loss-absorption capacity of the financial system.

In future, the dominant form of Tier 1 capital will be ordinary shares and/or retained earnings. Requirements for including instruments in the Core Tier 1 capital are more restrictive, and deductions from the capital base will primarily be taken from the Core Tier 1 capital.

Capital requirement

Implementation of the CRD IV/CRR will apply the following minimum standards on capital adequacy:

- Minimum Core Tier 1 of 4.5%
- Minimum Tier 1 ratio of 6%
- Minimum total capital ratio of 8% (unchanged in relation to current regulations)

The minimum standards on common equity Tier 1 and Tier 1 will be introduced gradually and be fully implemented as of 2019. However, the regulations also allow Member States to implement the changes more quickly. In addition to minimum standards on bank capital adequacy above, CRD IV also permits a number of capital buffers to be introduced, the purpose of which is to manage both cyclical and structural systemic risks:

- Capital Conservation Buffer amounting to 2.5% of risk-weighted assets
- Counter-cyclical buffer of between 0 to 2.5% of risk-weighted assets
- Systemic risk buffer, the amount of which is proportionate to the bank's significance to the financial system
- Buffer for systemically important institutions

All capital buffers are to be comprised of Core Tier 1 capital. Breaching any of these buffers will entail restrictions on a bank's opportunities to distribute capital, such as dividends and repurchasing shares, or paying bonuses to employees.

Risk-weighted assets

For banks that apply an IRB Approach to the calculation of risk-weighted assets for credit risk, the current regulatory framework contains a transition rule, prescribing that risk-weighted assets must not be less than 80% of the risk-weighted assets required under Basel I. This floor requirement should have expired by December 2013, but according to the current proposal from the Financial Supervisory Authority, the transition rules will continue to apply until at least December 31, 2017.

Implementation of the CRD IV/CRR will also entail that the calculation of risk-weighted assets for counterparty credit risk, such as derivative transactions will become more stringent. A risk-weight floor of 15% for Swedish mortgage portfolios was also introduced as part of the Financial Supervisory Authority's combined capital assessment (Pillar II) of companies under supervision. Since implementation of the risk weight floor has been introduced as part of Pillar II, the recognised capital ratios will not be affected since these calculations are made by applying the Pillar I rules. The floor entails that institutions must hold a higher amount of capital, where they do not at present hold capital that exceeds the floor level for Swedish mortgages.

New liquidity risk regulations

Implementation of the CRD IV/CRR also entails new regulations regarding liquidity risk, in the form of quantitative requirements for the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio

(NSFR). Briefly, the LCR aims to regulate the amount of liquid assets a company needs to hold in its liquidity reserve in order to manage a stressed situation for a period of 30 days. If a bank has liquidity problems, it must be possible to convert the liquidity reserve into cash, thus enabling management of the outflows that take place during the period. The requirement is expressed as a ratio comparing the relationship between the liquid assets and the net cash flow during a 30 calendar-day stress scenario. Sweden has chosen not to await EU regulations on liquidity risk and has introduced quantitative LCR requirements for credit institutions, securities companies and financial corporate groups with total assets in excess of SEK 100 billion. These Swedish rules are valid from January 1, 2013.

As a supplement to the LCR, a long-term, structural measurement known as the Net Stable Funding Ratio (NSFR) will be reported in parallel from 2014. The purpose of this measurement is to ensure that banks increasingly finance their long-term assets with long-term liabilities. The idea is that the financial system will become more stable if banks better match the durations in their financing. The final structure of this ratio has not yet been formulated and may be changed until its scheduled introduction in 2018.

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 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 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. A methodology document is also produced that describes the process and as a minimum is to include 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 is to be carried out annually and as a minimum is to include the following:

- 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. 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.