LANDSHYPOTEK

INFORMATION REGARDING CAPITAL ADEQUACY AND RISK MANAGEMENT 2012

PILLAR III OF THE BASEL RULES

Contents

1. Introduction

1.1. Introduction and purpose

This report contains information about Landshypotek's risks, risk management and capital adequacy in accordance with Pillar III of the capital adequacy rules.

The purpose of this report is to publish information about material risks for Landshypotek, the management of these risks and the current capital adequacy situation. This report and the Annual Report must comply with the requirements for annual reporting as defined in the Swedish Financial Supervisory Authority's regulations and general guidelines regarding public disclosure of information concerning capital adequacy and risk management (FFFS 2007:5). This report is published at the same time as the Annual Report on Landshypotek's website.

The report encompasses the financial Corporate Group Landshypotek and pertains to the circumstances prevailing on 31 December 2012. Landshypotek ekonomisk förening owns 100 percent of the shares in Landshypotek AB and is the Parent Association of the financial Corporate Group. All borrowers of Landshypotek AB are also members of Landshypotek ekonomisk förening. Landshypotek AB is the Parent Company of the sub-group, which is also where almost all business activities are conducted. Other companies in the sub-group are Landshypotek Jordbrukskredit AB, which is 100-percent owned by Landshypotek AB.

1.2. Basel II and Basel 2.5

Sweden has applied the EU capital adequacy rules since 2007, which correspond to the international rules set out in Basel II and has thereafter implemented those rules designated Basel 2.5, which includes rules governing remuneration and liquidity management. The rules have been implemented across the EU through directives and in Sweden through laws and regulations. The Basel II rules are based on three separate pillars. Pillar I sets minimum capital requirements for credit risks, market risks and operational risks in accordance with the Swedish Capital Adequacy and Large Exposures Act (2006:1371), (The Capital Adequacy and Large Exposures Act). Pillar II imposes requirements on credit institutions to calculate total capital need, using their own methods and models, given all the risks to which the institutions are, or plan in the future to be, exposed to. Pillar III stipulates that information regarding capital adequacy and risk management must be published, which is the purpose of this report.

1.3. The future – Basel III

The most recent financial crisis showed that the current regulations, Basel II and Basel 2.5, did not adequately identify all of the risks in the banks' operations. Accordingly, the Basel Committee has produced a more comprehensive set of rules known as Basel III. Strictly speaking, implementation of these rules should have started from 1 January 2013, but the EU has yet to agree on the exact formulation of the rules when implemented in the EU. Accordingly, it is uncertain when the rules will start to apply, but it is not unlikely that implementation is postponed by one year. These new regulations primarily set out stricter requirements for what is to be included in the capital base and higher capital and liquidity requirements.

Diagram 1 Corporate structure

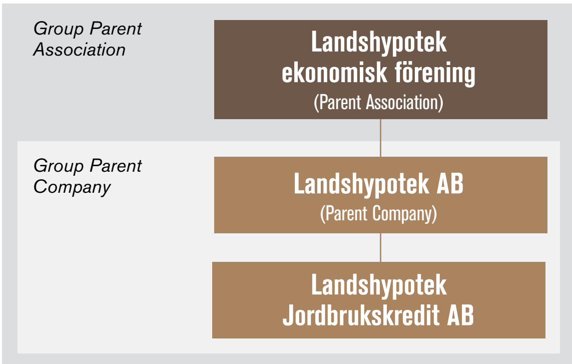


Table 1 Companies that are members of the Landshypotek financial Corporate Group

	Corporate Registration Number	Domicile
Landshypotek ekonomisk förening	769600-5003	Stockholm
Landshypotek AB	556500-2762	Stockholm
Landshypotek Jordbrukskredit AB	556263-8808	Stockholm

The minimum capital requirement for Core Tier 1 capital is expected to increase from 2 percent to 4.5 percent. In addition, a conservation buffer of an additional 2.5 percentage points may be added and, where deemed necessary by the supervisory authority, a countercyclical buffer that can vary from 0-2.5 percentage points. Including Tier 1 and Tier 2 capital requirements, the total capital requirement will vary between 10.5-13 percent for Landshypotek, of which 8 percent is the absolute minimum requirement. This is subject to the prerequisite that Landshypotek is not subject to any additional capital requirements as a bank defined as important to the Swedish system. Under the EU's latest proposal, the raised capital requirements will be implemented in phases and the above levels will be first reached in January 2019. Given that the transitional rules related to Basel I disappear for Landshypotek, which would be reasonable, the raised levels would not require any additional capital for Landshypotek's part. If the transitional rules continue in their current form, Landshypotek will have to further increase its capital base. However, the requirement for increased capital has little impact on Landshypotek, which already has a capital base comprised primarily of core Tier 1 capital.

The proposal by the Swedish Financial Supervisory Authority to raise risk weights for real property credits (15 percent) should not, according to the Authority, impact Landshypotek as long as the current transitional rule to Basel I applies. Landshypotek monitors international and national discussions regarding which changes will be implemented and when as well as which Swedish credit institutions will be included in the various proposals.

2. Description of Landshypotek and its operations

2.1. General description

Landshypotek is a member-owned credit institution for financing agriculture and forestry and has 175 years of tradition. The business operations mainly consist of lending against real property as collateral.

Landshypotek is a member-owned credit institution with the task of providing competitive financing for Sweden's farm and forest owners. The company's history dates back to 1836. Landshypotek ekonomisk förening is the Parent Company of the Landshypotek Group. All borrowers who have loans with property as collateral with Landshypotek automatically become members of the association and thereby also owners of the operations. The association currently has about 47,000 members.

Landshypotek AB is a wholly owned subsidiary of Landshypotek ekonomisk förening, and accounts for approximately 99 percent of the Group's lending. Landshypotek AB grants loans against mortgage deeds in real property within 75 percent of an internally determined loan-to-value (LTV) ratio.

At Landshypotek Jordbrukskredit AB, loans can be granted against mortgage deeds in real property within 75-85 percent of the internally determined loan-to-value ratio. In addition, the company offers loans with EU support as collateral (EU loans) and credit facilities distributed through Sparbanken Öresund are guaranteed in this company. Collateral in the form of mortgage deeds in real property are also required for credit facilities and the maximum LTV ratio is 85 percent. The former subsidiary Lantbrukskredit AB previously financed agriculturally related businesses, however, new lending in this area has now ceased. At the end of 2012, the loan portfolio was sold to Landshypotek Jordbrukskredit AB and the company was merged with Landshypotek AB in May 2012.

All borrowing in the Group now takes place in Landshypotek AB.

2.2. Description of business areas and products

The base product that Landshypotek offers its customers is first mortgages with collateral in Swedish forestry and agricultural properties (maximum LTV ratio of 75 percent). In addition, Landshypotek offers supplementary products to a certain extent under its own auspices, such as second mortgages (maximum LTV ratio of 85 percent), EU loans and savings accounts. The products offered are relatively uncomplicated and thus are simple for both our customers and Landshypotek to understand. This creates excellent conditions for conducting high-quality credit granting and risk management.

In order to offer customers a complete range of financial products, collaborations are in place with business partners. Corporate and private accounts, credit facilities and diverse payment services are included in the products offered in partnership with Sparbanken Öresund. Leasing and hire purchase of agricultural and construction machinery, and light and heavy vehicles with the item as collateral are offered in partnership with DNB. Farm and forestry insurance are examples of insurance provided through our collaboration with Gjensidige Försäkringsbolag.

2.3. 2012 and the future

Landshypotek holds a strong position in the credit market for financing agriculture and forestry. The conditions for operating financial companies are undergoing substantial change in the wake of the 2008 financial crisis. Increased regulation in the form of more stringent capital and liquidity requirements mean that Landshypotek needs to adjust its operations to continue to fulfil its role of putting price pressure on the market. The company's objectives are to expand operations and increase market shares. In addition, the product offering will be expanded so as to be able to offer a complete range of financing solutions for agriculture and forestry in the future. These objectives are part of Landshypotek's vision where the aim is to become:

> **"The preferred choice for financing for agriculture and forestry"**

Growth is to take place at low risk and with healthy and stable profitability. To achieve this growth strategy, Landshypotek intends to diversify its refinancing resources by expanding its deposit offering. Landshypotek plans to offer a number of new deposit accounts to the public in spring 2013, including a forest account. To conduct efficient deposit operations, Landshypotek plans to join data clearing. The combination of receiving deposits and participating in the general payment systems requires a licence for conducting banking operations. Accordingly, Landshypotek applied for such a licence with the Swedish Financial Supervisory Authority in spring 2012 and was granted a licence in November. Landshypotek intends to start to use the licence in 2013.

In 2012, the model for profit sharing to members has been changed by basing the profit distributed on the amount of contributed capital that the members have, as opposed to the previous model whereby profit was distributed in the form of a refund based on loan interest paid. The main purpose of the change was to create an incentive for the members to contribute more capital (equity) to the operations, which is necessary for expanding lending based on applicable capital adequacy rules linked to Basel I (meaning transitional rules). Landshypotek's goal is for contributed capital to provide a return of 8-10 percent, which currently generates a return target on equity of 7 percent.

2.4. Organisation

Landshypotek AB is organised into eight regional offices and has 18 sales offices in Sweden. The number of employees is 118. The Group's subsidiaries have no employees. Landshypotek ekonomisk förening has 77 elected members in ten different regional boards of directors whose work duties include appraising properties.

2.5. Corporate governance

Landshypotek ekonomisk förening owns the Landshypotek Group and governs Landshypotek AB through the Annual General Meeting, which is the limited liability company's highest decision-making body. Owners' control of Landshypotek AB is also exercised through the Board of Directors and the Managing Director in accordance with the Swedish Companies Act, Articles of Association, adopted policies and instructions.

The Annual General Meeting of Landshypotek AB appoints a Board of Directors and auditors, and also makes decisions on the setting of fees. The Meeting also adopts income statements and balance sheets, and decides on the matter of discharge from liability of the Board of Directors and the Managing Director. In addition, the members of the Election Committee of Landshypotek AB are appointed, and are tasked with preparing election and remuneration issues prior to the next Annual General Meeting. The Election Committee currently comprises three members.

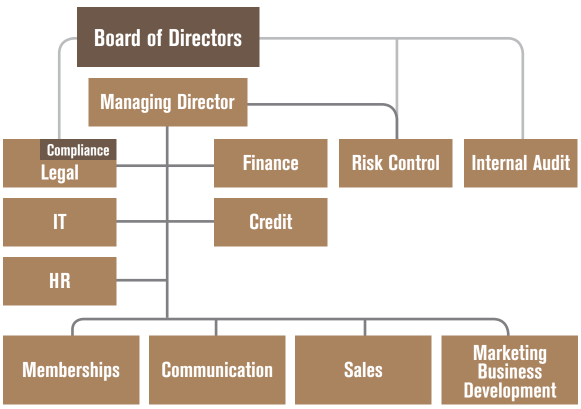
The principle task of the Board of Directors of Landshypotek AB (referred to below as "the Board") is to administer the company's affairs. The Board is ultimately responsible for the organisation and administration of the company. According to the Articles of Association, the Board comprises a minimum of four and maximum of seven members who are elected each year at the Annual General Meeting. The Board is comprised of six individuals. Four of these are also members of Landshypotek ekonomisk förening and one is a Board member of Landshypotek ekonomisk förening. Two of the members are external Board members. The Board's members have extensive experience from trade and industry and/or agriculture and forestry. The Board's work follows the formal work plan adopted annually at the statutory meeting.

The Board has established two committees, the Board's Credit Committee and the Board's Risk and Capital Committee. Minutes are taken of the committees' meetings and submitted to the Board. The Board has adopted a written instruction governing the role and work of the Managing Director. The Managing Director bears responsibility for day-to-day operations pursuant to the Board's instruction and reports regularly to the Board.

The Annual General Meeting appoints external auditors to Landshypotek AB. These auditors must be authorised public accountants. The mandate period of the auditors appointed by the Annual General Meeting is one year. The auditors are responsible for examining the Annual Report and accounts and also the Board's and Managing Director's administration of the company. The auditors report to the Annual General Meeting and, accordingly, are independent in relation to the Board and company management.

The Board of Landshypotek AB has adopted a remuneration policy that specifies the principles behind the Landshypotek AB remuneration system. Information regarding the remuneration system is available on Landshypotek's website. Employees are entitled to remuneration, which may consist of a combination of basic salary, benefits, profit sharing via Landshypotek's profit-sharing trust, bonuses, retirement pension and severance pay. Landshypotek's goal in 2013 is to replace the defined-benefit pension system BTP1 with the new defined-contribution pension system BTP2

Diagram 2 Organisational chart for Landshypotek AB



for new employees and, where possible, even for other employees. This is primarily because provisions made under the defined-contribution system are known and thus reduce uncertainty with regard to pension costs.

Remuneration in Landshypotek AB is reviewed annually through the employees' salary appraisals. Internal audit is tasked with reviewing how remuneration paid by Landshypotek AB complies with the remuneration policy.

2.5.1. Internal governance and control

It is essential that carefully prepared and clear internal governance and control permeate the organisation in order to manage risks satisfactorily. The Board and Managing Director of Landshypotek AB have the ultimate responsibility and also have the support of the independent Risk Control and Compliance functions.

The Risk Control function is responsible for control, analysis and reporting of all of Landshypotek's material risks. The work of the function is to follow established instructions and annual action plans. Furthermore, the function administers and validates the credit risk models (IRB models) that Landshypotek has had approved to use to calculate the capital requirement for its credit risks. The Compliance function is responsible for monitoring that operations are conducted in compliance with the laws and regulations applicable for Landshypotek. Both functions report directly to the Board and are independent of the business operations that they control.

The Internal Audit function follows up and examines the internal control and reports directly to the Board. This work has been performed by an independent external party since 2008.

3. Risk management and risk organisation

3.1. Objectives and basis of risk management

Landshypotek's objective is to maintain a low general risk profile. The operations are permeated by a high degree of risk awareness and a low degree of risk undertaking. As support, an efficient risk organisation is also in place.

Landshypotek is permeated by a high degree of risk awareness and a low degree of risk undertaking. A high degree of risk awareness means that each employee understands the risks implied for the company by the individual's work duties, the degree of risk undertaking that is acceptable and how the individual needs to behave so as to avoid exceeding the acceptable level of risk. A low degree of risk undertaking means that the operations are to be conducted in such a manner that expected and unexpected losses are kept exceedingly low. This is achieved through Board support, a clear decision-making structure with a high level of risk awareness among the staff, shared definitions and assessment policies, as well as sophisticated tools for risk assessment. The operations are to aim for high quality in all of the activities undertaken, be sensitive to changes in the business environment and understand the impact of these changes on customers, the value of assumed collateral and the business model.

3.2. General risk profile

Landshypotek's objective is to maintain a low risk profile. A low risk profile contributes to lower borrowing costs, thereby creating favourable conditions for expanding the operations and increasing market shares.

To maintain a low general risk profile, Landshypotek has identified and classified all material risks so as to be able to understand, manage and potentially quantify each individual risk. Landshypotek focuses on proactively undertaking the types of risks that the operations are best able to understand, manage and reduce or avoid risks that are undesirable.

The single largest risk to which Landshypotek is exposed is the credit risk associated with lending to customers. This risk is directly linked to the business concept and is managed throughout the credit process.

It is also necessary to take certain risks in order to conduct the business activities, including such market risks as interest-rate and liquidity risks. A certain level of acceptance for these types of risks must exist, although Landshypotek aims to keep these risks at a low level.

Finally, risks exist that in themselves are undesirable but for which exposure to is unavoidable, for example, operational risks. These types of undesirable risks may have major consequences for the operations and must be managed and minimised to the greatest degree possible.

3.3. Description of risk organisation

The Board is ultimately responsible for Landshypotek's risk management and has established two committees to assist it in its work, the Board's Risk and Capital Committee and the Board's Credit Committee. The primary tasks of the Board's Risk and Capital Committee are to prepare items for the Board on issues related to the internal control environment and capital adequacy as well as the measurement and management of Landshypotek's material risks.

The Board's Credit Committee is the highest credit-granting body and prepares items for the Board pertaining to credit policy, portfolio strategies and credit quality.

The Risk Control function is responsible for the control, analysis and reporting of all of Landshypotek's risks. The Chief Risk Control Officer reports directly to the Managing Director and Board and is independent of the business operations. In addition, the Chief Risk Control Officer also presents reports to the Board's Risk and Capital Committee.

The Board is also supported by a further two control functions, Compliance and Internal Audit. The Compliance function is responsible for ensuring that the operations are conducted in accordance with applicable laws and regulations. The Compliance function is subordinate to the Chief Legal Officer, but reports directly to the Board on regulatory compliance issues. The Internal Audit function controls the entire Risk Management function, Compliance function and other control functions at Landshypotek and reports directly to the Board.

The Risk Organisation also comprises three sub-committees: the Risk and Capital Council, the Credit Sub-Committee and the Finance Sub-Committee.

The Risk and Capital Council, chaired by the Chief Risk Control Officer, deals with issues relating to all the risks to which Landshypotek is exposed. The Council also addresses the design of stress tests, the relationship between risk and capital and other capital issues. The Council is comprised of the Chief Financial Officer, Chief Credit Officer and Compliance Officer.

The Credit Sub-Committee, chaired by the Chief Credit Officer, is responsible for regularly reviewing credit-granting rules and submitting proposal for changes to the Board's Credit Committee.

The Finance Sub-Committee, chaired by the Chief Financial Officer, is responsible for Landshypotek's market and liquidity risks and makes decisions concerning borrowing, deposit and lending interest rates.

In the business operations, the Credit Department is responsible for the credit approval process. It is also responsible for analysing the credit portfolio and managing insolvency matters. The Chief Credit Officer reports to the Managing Director and present reports on credit matters to the Board's Credit Committee.

The Finance Department is responsible for Landshypotek's borrowing, management of equity, liabilities and liquidity as well as risk management in this area. Operations are regulated by the finance policy established by the Board. The Chief Financial Officer is responsible for the Finance Department and reports to the Managing Director of Landshypotek.

3.4. Risk management process

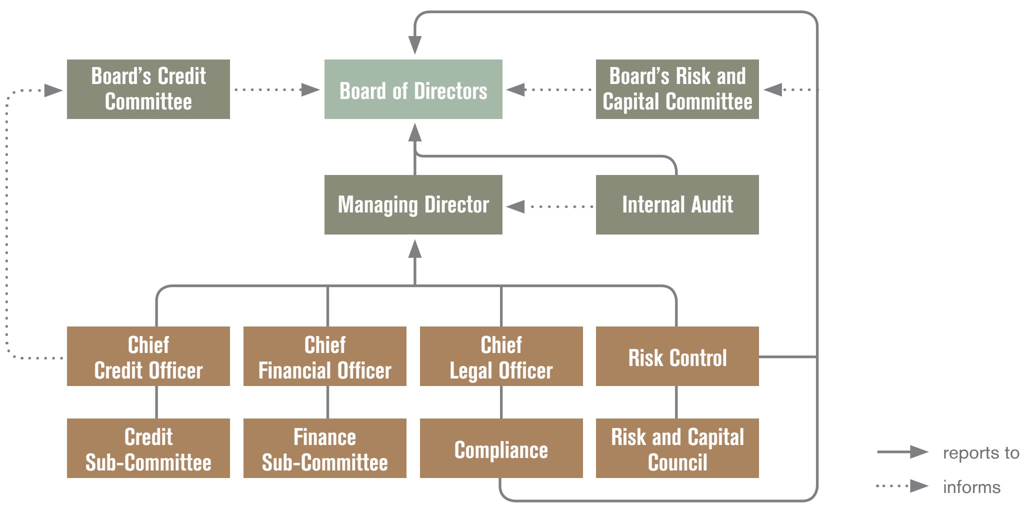
A high degree of risk awareness is to permeate the entire organisation and all employees at Landshypotek are responsible for managing the risks inherent in the operations. The risk management process can be described in terms of three different lines of defence.

The first line of defence consists of the business operations, which is the risk owner. This is where customer contact takes place and the conditions for understanding the related risks are best. The first line of defence's risk management activities are characterised by customer knowledge, well-defined guidelines and procedures, and effective communication with the control functions.

The second line of defence consists of the risk control and compliance functions. These functions are responsible for controlling, monitoring and supporting the work of the first line of defence with the risks that Landshypotek is exposed to and the regulations that encompass Landshypotek. The second line of defence's functions work independently of the business operations and report directly to the Managing Director and Board.

The third line of defence consists of the Internal Audit function. The tasks of this function include ensuring that Landshypotek's internal governance and control are conducted efficiently by controlling the company management, the second line of defence's control activities and the understanding and compliance of the rest of the operations. The Internal Audit function works independently of the business operations and is directly subordinate to the Board.

Diagram 3 **Risk and control organisation**



4. Capital base and capital requirements

The significance of sound risk management and a substantial buffer of capital and liquidity was clearly illustrated by the 2008/2009 financial crisis. More stringent requirements have been imposed by government agencies, rating agencies and the market.

4.1. Capital base

The items permitted to be included in the capital base are regulated in the capital adequacy rules.

Landshypotek has a capital base that for capital adequacy purposes comprises equity (Tier 1 capital) and subordinated loans (Tier 2 capital). Landshypotek's Tier 1 capital comprises only Core Tier 1 capital in the form of paid-up share capital (contributed capital) and retained earnings. Landshypotek does not have any capital contributions of any kind. Landshypotek's capital base on 31 December 2012 amounted to MSEK 4,631, of which MSEK 3,971 comprised Tier 1 capital, as shown in table 2.

Changes in value from assets classified as available-for-sale financial assets are not permitted, in accordance with the Swedish Financial Supervisory Authority's regulations, to affect the amount of the capital base. Deductions are made from Tier 1 capital for deferred tax assets. One half of the difference between actual provisions and expected losses in line with the internal risk-classification model for credit risk (IRB model) is deducted from Tier 1 capital. The other half of the amount reduces Tier 2 capital. Tier 2 capital comprises subordinated term loans with a nominal value of MSEK 700. After deductions, Tier 2 capital amounted to MSEK 659. Subordinated loans are specified in table 3.

4.2. Capital requirements

The calculation of the capital requirement is based on the minimum rules (Pillar I) that encompass credit risk, market risk and operational risk. The capital requirement for the majority of credit risk is calculated by applying the IRB model, the use of which Landshypotek has received approval for from the Swedish Financial Supervisory Authority. For the remaining credit risk, the standardised approach is used for capital adequacy purposes. Exposures are to be classified based on type of counterparty, which for Landshypotek is almost exclusively retail exposures.

Landshypotek is not exposed to any market risks for which capital adequacy is required in accordance with the Pillar I rules. Operational risks are measured and capital adequacy provided via the base method.

Landshypotek's capital requirements are presented in table 4.

4.3. Capital adequacy requirements

A company is, at any point in time, to have a capital base that as a minimum corresponds to the total capital requirements for credit risks, market risks and operational risks(Pillar I capital requirements). This capital requirement is calculated in accordance with the Capital Adequacy and Large Exposures Act and is presented in table 4.

It is also the responsibility of each credit institution to describe and assess all material risks in addition to those addressed in the capital requirement calculation under Pillar I. The total capital adequacy requirement is to be evaluated in light of the overall risk for the

Table 2 Capital base, Financial Corporate Group

SEK thousand	31 Dec. 2012	31 Dec. 2011
Tier 1 capital	**3,971,166**	**3,762,200**
Share capital paid in or equivalent, after deduction for cumulative preference shares	1,232,232	1,076,094
Equity component of reserves and profit or loss brought forward from preceding financial year	2,764,851	2,385,114
Net profit for the year	72,235	383,003
Deduction for deferred tax assets	−22,349	−18,278
Deduction for intangible non-current assets	−35,312	−14,058
Deduction in accordance with Chapter 3, Section 8 of the Capital Adequacy and Large Exposures Act	−40,491	−49,675
Tier 2 capital	**659,430**	**500,274**
Subordinated term loans in accordance with Chapter 3, Sections 18-30	699,921	549,949
Deduction in accordance with Chapter 3, Section 8 of the Capital Adequacy and Large Exposures Act	−40,491	−49,675
Capital base	**4,630,596**	**4,262,474**

Table 3 Subordinated loans

Name of loan	Currency	Nominal amount	Outstanding nominal amount	First possible redemption date	Interest rate	Interest rate after first possible redemption date	Due date
EMTN31	SEK	200,000	200,000	18 June 2015	4,60 %	3 M STIBOR +2,30 %	8 June 2020
EMTN47	SEK	70,000	70,000	1 June 2017	5,82 %	3 M STIBOR +3,85 %	1 June 2022
EMTN48	SEK	430,000	430,000	1 June 2017	3 M STIBOR +3,85 %	3 M STIBOR +3,85 %	1 June 2022

Table 4 Capital requirement and risk-weighted assets (Pillar I) Financial Corporate Group

SEK thousand	31 Dec. 2012 Capital requirement	31 Dec. 2012 Risk-weighted assets	31 Dec. 2011 Capitall requirement	31 Dec. 2011 Risk-weighted assets
Credit risk, IRB				
Non credit-obligation assets	4,526	56,579	1,400	17,498
Retail exposure	416,094	5,201,178	417,872	5,223,405
Total IRB	**420,621**	**5,257,757**	**419,272**	**5,240,903**
Credit risk, Standardised Approach				
Corporate exposure	251,567	3,144,587	204,453	2,555,662
Retail exposure	26,062	325,778	21,488	268,599
Institutional exposure	101,498	1,268,724	97,296	1,216,196
Local governments and comparable associations and authorities	0	0	0	0
Non-performing items	2,193	27,417	3,334	41,677
Exposure to governments and central banks	0	0	0	0
Covered bonds	171,289	2,141,114	140,528	1,756,601
Other items	0	0	0	0
Total Standardised Approach	**552,610**	**6,907,620**	**467,099**	**5,838,735**
Total credit risk	**973,230**	**12,165,377**	**886,371**	**11,079,638**
Operational risk	**95,248**	**1,190,602**	**82,017**	**1,025,215**
Total minimum requirements	**1,068,478**	**13,355,979**	**968,388**	**12,104,853**
Additional requirement in accordance with transitional rules	**2,861,786**	**35,772,325**	**2,715,480**	**33,943,500**
Total capital requirement and RWA including transitional rules	**3,930,264**	**49,128,304**	**3,683,868**	**46,048,353**

operations. The supporting data and conclusions in this internal capital adequacy assessment process (ICAAP) must be communicated to the Swedish Financial Supervisory Authority on an annual basis. Landshypotek's ICAAP is described in section 9. Given the current situation, Landshypotek believes that, from a risk perspective, there is no need to reserve additional capital other than that regulated in Pillar I under the transitional rules.

The background for this assessment is that the IRB Approach, for which Landshypotek received permission from the Swedish Financial Supervisory Authority in 2007 to apply for calculation of the capital requirement for credit risks, indicate that there is an extremely low level of credit risk in Landshypotek's lending with collateral in Swedish forestry and agricultural properties.

However, under the current transitional rules, the capital requirement may not fall below 80 percent of the capital requirement calculated with Basel I. In accordance with the Basel I rules, lending with collateral in forestry and agricultural properties has a risk weight of 100 percent, which is just as high as lending against, for example, unsecured loans. This can be compared with lending with collateral in private homes for which the risk weight is 50 percent under Basel I. This difference in capital adequacy does not at all reflect the risk in lending with collateral in Swedish forestry and agricultural properties.

As presented in table 4, Landshypotek's capital requirement under Basel II is one fourth compared with the current transitional rules: MSEK 1,068 compared with MSEK 3,930. Even taking into account Landshypotek's internal capital adequacy assessment and Pillar II risks, the current Pillar I capital requirement is not in proportion to the risk undertaken by the company. For this reason, Landshypotek sees no risk-based need to have any more capital than that required by the current transitional rules. However, Landshypotek must comply with the Swedish Financial Supervisory Authority's rules and, therefore, must maintain a buffer over and above the Pillar I capital requirement.

Table 5 Capital adequacy, Financial Corporate Group

SEK thousand	31 Dec. 2012	31 Dec. 2011
Tier 1 capital	3,971,166	3,762,200
Tier 2 capital	659,430	500,274
Total capital	**4,630,596**	**4,262,474**
Without transitional rules		
Risk-weighted assets	13,355,979	12,104,853
Tier 1 ratio	29.73 %	31.08 %
Capital ratio	34.67 %	35.21 %
Capital adequacy ratio	4.33	4.40
With transitional rules		
Risk-weighted assets	49,128,304	46,048,353
Tier 1 ratio	8.08 %	8.17 %
Capital ratio	9.43 %	9.29 %
Capital adequacy ratio	1.18	1.16

5. Credit risks

Credit risk is the greatest risk in Landshypotek and represents 91 percent of the capital requirement under Pillar I rules without taking the transitional rules into consideration. Accordingly, it is of paramount importance that Landshypotek has clear rules for credit risk management.

5.1. Definition

Landshypotek has defined credit risk as follows:

The risk that Landshypotek does not receive payment as agreed and the risk that the value of the collateral is not adequate and therefore will not cover the outstanding claim.

5.2. Credit process

All granting of credit at Landshypotek is to be based on customers' repayment capacity and loans are only granted if, based on sound reasoning, commitments can be expected to be fulfilled. To further protect Landshypotek against loan losses, forestry and agricultural properties are taken as collateral, in addition to other collateral in accordance with the credit instruction. The collateral is to guarantee the loan receivable by a healthy margin. However, collateral of a high value can never replace the requirements imposed on the repayment capacity of the customers. Moreover, credit granting must always be in proportion to the cash flows that are to cover loan payments.

The credit policy provides frameworks and guidelines for the principles applicable, at any time, for granting credit in Landshypotek. Credit granting is the result of analysis of the individual customer and/or household as a whole when applicable. This results in risk classification being performed on a scale of 1-6 or alternatively A-H[1]. Furthermore, in addition to the customer's/household's total capacity to repay the loan, collateral is analysed, which primarily comprises real property in the form of agricultural and forestry properties.

All granting of credit is performed pursuant to a credit mandate matrix approved by the Board, which is governed by parameters such as ceiling amount, risk class and loan-to-value ratio. All credit decisions are taken by the Credit Sub-Committee utilising a level structure that complies with the aforementioned credit mandate matrix. The Credit Sub-Committee requires that a minimum of two officers jointly form a Committee. In the highest decision-making body for day-to-day credit cases, the Board's Credit Committee, each case should already have been recommended by the Credit Sub-Committee.

[1] *Risk class 1-6 for private individuals and A-H for legal entities where 1 and A represent the lowest risk of default, and 6 and H represent risk classes for credits in default.*

5.2.1. Overview of credit portfolio

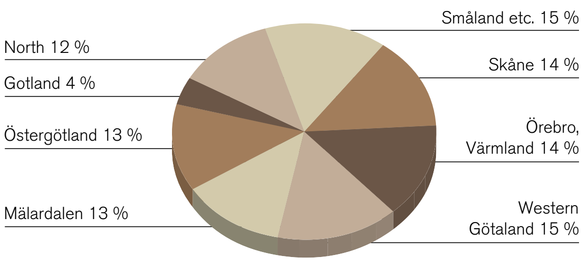
Landshypotek's total loans to customers on 31 December 2012 amounted to slightly more than SEK 58.9 billion. Lending encompasses lending to farm and forest owners primarily against collateral in forestry and agricultural properties. All lending takes place in Sweden. The geographic distribution of Landshypotek's credit portfolio presented in diagram 4 mirrors where the agricultural properties are located and shows that the geographic distribution in Sweden is favourable and is not concentrated to a certain city or district. The credit portfolio has grown by SEK 18 billion since 2007, corresponding to average lending growth of 9 percent per year over the past five years. Average lending per customer of Landshypotek AB amounted to MSEK 1.25 on 31 December 2012. The exposure-weighted LTV ratio on the same date was 43 percent.

Landshypotek divides its customers into two categories: Rural Living (RL); the repayment capacity of these customers is more dependent on income from employment rather than on any operations that may be conducted on the property and Rural Enterprise (RE), who conduct agricultural activities and whose income is mostly derived from business activity. The largest proportion of these RE customers conducted crop cultivation, followed by dairy farming and forestry. Furthermore, most RE customers have diversified their operations and thus have incomes from several different types of business activities. Total lending to RL customers amounted to SEK 28 billion and to RE customers to SEK 30 billion on 31 December 2012.

5.2.2. Definition and classification of credit portfolio

One of the fundamental conditions for applying the IRB models to capital requirement calculations is that each counterparty is defined and classified in accordance with IRB rules. The documentation and systems support that have been prepared provide detailed descriptions of the division of exposure classes.

Diagram 4 The geographic distribution specified by sales district of Landshypotek AB's lending portfolio



All individual persons are classified in the retail exposure segment, in the sub-group "secured by real estate" to which the IRB Approach is applied. Landshypotek's legal counterparties are classified as corporate exposure with a risk weight of 100 percent under the Standardised Approach.

The exposure class of "non credit-obligation assets" is also used under the IRB Approach. Non credit-obligation assets are defined as exposure which does not require any deliveries from a counterparty (for example, intangible and tangible non-current assets, real estate holdings, etc.)

Landshypotek reports the vast majority of its assets as retail exposure in the "secured by real estate" sub-group. Exposure including accrued interest for these assets amounted to SEK 56 billion. The capital requirement for other exposures is calculated using the standardised approach.

The total exposure amount was SEK 80 billion (see table 6). The risk-weighted assets for these exposures amounted to SEK 12 billion, of which SEK 5.3 billion was recognised in accordance with IRB Approach and the remainder in accordance with the Standardised Approach. The average risk weight for exposure recognised in accordance with the IRB Approach amounted to 9.3 percent and exposure recognised in accordance with the Standardised Approach was 29.5 percent.

Some 49 percent of the portfolio[2] has less than three months remaining until the next date of condition changes (see table 7).

5.3. Description of credit risk management

All credit decisions are to be preceded by a careful risk assessment and risk classification. Consequently, making a credit decision requires knowledge about regional and industry-specific factors that may impact customers' repayment capacity and the value trend of the collateral.

Before new products or services are introduced, the operations are to carefully analyse any potential credit risks that these may give rise to and ensure that the risks can be satisfactorily managed.

[2] *Based on exposure after application of a conversion factor.*

Table 6 Amount of exposure per exposure class

31 December 2012, SEK thousand	Exposure	Of which off balance sheet before conversion factor	Exposure after conversion factor	Of which off balance sheet after conversion factor	Risk weighted assets	Capital require-ment	Average risk weight	Expected loss
Credit risk recognised in accordance with IRB Approach								
Retail exposure	56,404,734	451,591	56,552,304	483,203	5,201,178	416,094	9 %	107,980
Non credit-obligation assets	56,579	-	56,575	-	56,579	4,526	100 %	-
Total credit risk in accordance with IRB Approach	**56,461,313**	**451,591**	**56,608,879**	**483,203**	**5,257,757**	**420,620**	**9 %**	**107,980**
Credit risk recognised in accordance with Standardised Approach								
Exposure to governments and central banks	92,861	-	92,861	-	0	0	0 %	
Exposure to municipalities, similar entities and authorities	3,492,587	-	3,492,587	-	0	0	0 %	
Institutional exposure	3,781,334	-	3,781,334	-	1,268,724	101,498	34 %	
Corporate exposure	3,159,246	281,951	3,144,586	267,291	3,144,586	251,567	100 %	
Retail exposure	740,846	377,268	434,371	75,454	325,778	26,062	75 %	
Non-performing items	22,400	-	18,416	-	27,417	2,193	149 %	
Covered bonds	12,261,890	-	12,261,890	-	2,141,114	171,289	17 %	
Other items	1	-	1	-	0	0	0 %	
Total credit risk in accordance with Standardised Approach	**23,551,165**	**659,219**	**23,226,046**	**342,745**	**6,907,619**	**552,610**	**30 %**	
Total	**80,012,477**	**1,110,810**	**79,834,925**	**825,948**	**12,165,376**	**973,230**	**15 %**	

Table 7 Amount of exposure specified by next date of condition changes

31 December 2012, SEK thousand	< 3 months	3-12 months	1-5 years	> 5 years
Exposure classes, IRB Approach				
Retail exposure	27,638,934	11,414,644	16,542,996	955,731
Total IRB	**27,638,934**	**11,414,644**	**16,542,996**	**955,731**
Exposure classes, Standardised Approach				
Corporate exposure	1,502,959	634,337	573,700	165,982
Retail exposure	252,599	6,664	14,866	-
Non-performing items	22,400	-	-	-
Total Standardised Approach	**1,777,958**	**641,001**	**588,566**	**165,982**

Both the Credit Department and Risk Control function continuously monitor the quality of the credit portfolios. The Credit Department is responsible for ensuring compliance with the internal rule book for credit granting and monitoring individual commitments. In addition, the credit portfolio is regularly reviewed by industry, geographically, by risk class and per limit group. Landshypotek has been unable to identify any major concentration to any particular part of the agriculture or forestry sector or geographic area within Sweden.

In the business operations, the Credit Department is responsible for the management and governance of the credit approval process. It is also responsible for analysing the credit portfolio and managing insolvency cases (section 5.7).

The Risk Control function is responsible for measuring, monitoring, analysing and reporting the status of credit risks at portfolio level and at district level. The Risk Control function is also responsible for measuring and reporting on the status of the portion of the loan portfolio that is not permitted to be included in the collateral base for the covered bonds.

5.4. How the IRB model is applied in the credit process

Landshypotek's IRB models are highly integrated into the credit process. The development and management of the IRB models take place in collaboration with the Risk Control function and Credit Department. The customer's/limit group's Probability of Default (PD) risk class and Loss Given Default (LGD) risk class combined with the customer's/limit group's loan amount determine the credit decision procedure and any credit decision is based on the aforementioned risk classes.

The Board and Management Group receive regular reports on the status of the credit portfolio, based on such factors as PD risk classes, loan-to-value ratios and expected losses.

The Board assumes the ultimate responsibility for the IRB system as a whole and is to make decisions on any significant changes to them. The Risk Control function has operational responsibility for ensuring that the IRB system adequately measures risk for Landshypotek and meets the applicable requirements set by the Swedish Financial Supervisory Authority.

Landshypotek makes conservative estimates for PD and LGD, and, as illustrated by table 8, the outcome for 2012 was lower than estimated.

5.5. Description of the IRB Approach

5.5.1. Method

Landshypotek calculates its own risk estimates PD (Probability of Default), EAD (Exposure at Default) and LGD (Loss Given Default), which are used for the Retail exposure class to calculate capital requirements and expected loss. Probability of Default (PD) is the likelihood that a customer defaults within a twelve-month period.

Table 8 Estimate 31 December 2011 vs. outcome in 2012 (%)

	PD estimate weighted by number of loans for capital adequacy	Realised default outcome weighted by number of loans	Exposure-weighted LGD estimate for capital exposure*	Realised exposure-weighted LGD outcome
Retail exposure	2.20	1.94	6.50	0.71

** Downturn-LGD*

5.5.2. Models and permits for calculation of statutory capital requirements

Landshypotek's PD model comprises internal payment history statistics and a UC model (UC AB, the business and credit information provider) as explanatory factors. However, new customers are risk graded based only on the UC model. The PD model is a statistical model that is used to predict the probability of the customer defaulting within one year. Landshypotek uses two default categories "soft defaults" and "technical defaults". Soft defaults are registered manually, since Landshypotek's assessment is that the customer will not be able to meet its commitments and collateral will have to be realised. Technical defaults occur automatically when customers, who are not already in a soft default process, are late by 90 days or more with their interest payments and/or mortgage repayments. The PD model allocates credits to various risk classes (1-6), where risk class 1 represents the highest credit quality and risk class 6 is for credits in default. Landshypotek estimates the PD for each risk class. For the purpose of calculating the PD per risk class for an average year, the past nine years of actual data is used as a basis and a conservative business cycle adjustment applied that also takes into account outcomes from the financial crises years in the early 1990s as well as a safety margin. Based on these risk-class estimates, which are used for calculating capital adequacy, the PD estimate of the portfolio weighted by number of loans for performing loans was 1.75 percent on 31 December 2012. Further stress was applied to the above risk class PD through a formula from the Swedish Financial Supervisory Authority for the calculation of the capital requirement. Those risk class estimates used internally are lower since they do not include business cycle adjustment or safety margins. Diagram 5 illustrates the Retail exposure by PD risk class.

The assessment of how much of the outstanding claim Landshypotek stands to lose in the event of default (LGD, Loss Given Default) is based on internal loss data gathered during the period 1995 to 2008, where the time value of money and administrative expenses were also taken into account. This data is then adjusted upwards to correspond to an LGD during unfavourable economic conditions (downturn-LGD). Landshypotek has used data from 1994 to perform this upwards adjustment. LGD classes are divided into five loan-to-value classes. The exposure-weighted portfolio LGD estimate on 31 December 2012 amounted to 6.73 percent. Diagram 6 illustrates the retail exposure by LGD risk class.

Table 9 LGD estimate per LGD class

LGD class	Loan-to-value ratio	LGD including downturn adjustment and safety margin
1	0-20 %	0.94 %
2	21-40 %	7.51 %
3	41-60 %	16.21 %
4	61-75 %	36.79 %
5	>75 %	88.93 %

Exposure At Default (EAD) is the amount of exposure that the counterparty is expected to have in the event of a default. For standard loans, EAD is calculated as the outstanding loan debt. For Landshypotek's flexible first mortgage product[3] where parts of the commitments are off the balance sheet, EAD is calculated by multiplying the counterparty's total credit limit granted by a conversion factor (CF). This conversion factor is calculated on the entire credit ceiling of the flexible first mortgage product and, conservatively, amounts to 107 percent.

The purpose of validating the models is to ensure that Landshypotek estimates credit risk in a conservative and stable manner and that the models adequately grade lending according to risk. The PD, LGD and CF models are validated on an annual basis. The analysis results in a validation report, a summary of which is presented to the Board.

Landshypotek's PD risk classification model captures fluctuations in the business cycle relatively well and thereby migrates customers between risk classes as an effect of fluctuations in the business cycle, which leads to a cyclical capital requirement. The same applies for the LGD model.

Conservative adjustments and safety margins are applied for those risk estimates that are used for capital adequacy, but not for internal purposes, which means that the capital adequacy estimates differ from the internal estimates.

5.6. Collateral

Landshypotek AB lends money against collateral in agricultural and forestry properties and to a certain degree against collateral in the form of EU support. Supplemental collateral may take the form of sureties or chattel mortgages. Landshypotek AB grants loans against mortgage deeds in real property within 75 percent of an internally determined collateral value. This percentage is to represent a long-term sustainable value of the assumed collateral. At Landshypotek Jordbrukskredit AB, loans can be granted against mortgage deeds in real property from 75-85 percent of the internally determined loan-to-value ratio.

[3] *The customer utilizes when needed as much as wanted within the granted limit.*

Diagram 5 **Exposure per PD risk class**

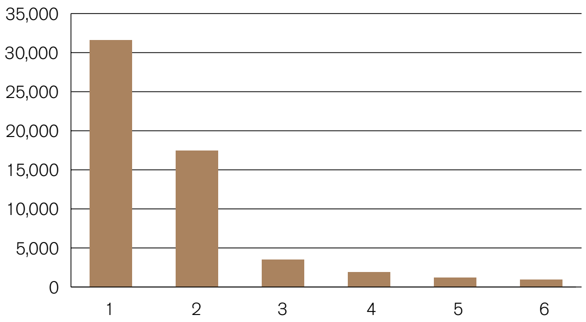
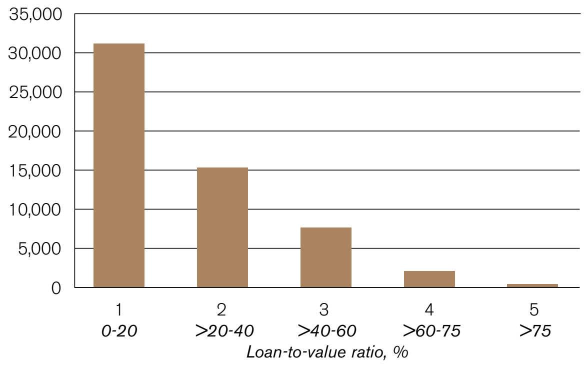


Diagram 6 **Exposure per LGD risk class**



Regional office employees are assisted in the valuation process by the organisation of representatives of Landshypotek ekonomisk förening. The network of representatives ensures that all properties are correctly valued and that the valuations are based on documented industry experience and a high degree of familiarity with local conditions. All of the ten regions of Landshypotek ekonomisk förening have a local Board comprising four to eight members. It is these members that together comprise the organisation of representatives in Landshypotek.

5.7. Insolvency management

Landshypotek applies individual valuation of problem loans. An insolvency group is in place within the Credit Department that together with the customer adviser manages problem credits on an operational level. Any need for a provision is made on a case-by-case basis and receivables defined as doubtful or non-performing are examined on an ongoing basis. Subsequent to individual assessment, doubtful receivables are recognised where payments will probably not be forthcoming pursuant to the contract terms and/or where the value of the collateral is probably insufficient to cover the value of the receivable by a satisfactory margin. The management of unsettled commitments and the settlement of credit commitments is performed with the aim of reducing the risk of loss.

5.8. Counterparty risk

Landshypotek's counterparty risks comprise the risk of default by counterparties in financial transactions. Counterparty risks are a consequence of Landshypotek's management of liquidity risks, interest-rate risks and currency risks. Risk tolerance is generally low. The counterparties accepted by Landshypotek are reviewed annually and limited. Landshypotek's total counterparty exposure comprises:

- the market value of securities
- monetary deposits
- the exposure of derivative instruments calculated based on the "mark-to-market approach" stipulated in the Swedish Financial Supervisory Authority's regulations (FFFS 2007:1).

Table 10 **Exposure specified by sales district of Landshypotek AB**

31 Dec. 2012, MSEK	Total amount of exposure in lending portfolio	Amount of exposure for receivables overdue	Amount of exposure for exposure with individual provisions	Individual provisions	Total amount of exposures in lending portfolio after individual provisions
Gotland	2,613	23	-	-	2,613
Mälardalen	7,596	116	4	0	7,595
Norr	6,751	92	47	5	6,746
Småland etc.	8,576	168	16	6	8,570
Skåne	8,305	52	5	3	8,302
Västra Götaland	9,052	77	11	3	9,049
Örebro, Värmland	8,047	98	26	11	8,036
Östergötland	7,796	69	-	-	7,796
	58,734	**695**	**108**	**28**	**58,706**

Counterparty risk may only be undertaken against:
- public bodies that are assigned 0 percent in risk weight for capital adequacy
- covered bonds issued by financial institutions
- financial institutions.

New counterparties are to be approved and limited by the Finance Sub-Committee. The following aspects are taken into account when approving new counterparties:
- New counterparties for derivative agreements, repurchase agreements and deposits must have a credit rating that is the same as or better than Landshypotek's rating. ISDA and CSA agreements are to be in place with counterparties for derivative agreements.
- New counterparties for investments must have a long-term rating of at least AA from Standard and Poor´s, or the corresponding lev el from another rating agency, and the security must meet the requirements for permissible collateral with the Riksbank, Sweden's central bank.

The counterparties and their credit ceilings are reviewed at least once a year by the Finance Sub-Committee.

Table 11 Derivative instruments and liquidity portfolio specified by rating

SEK thousand	Positive values of derivatives	Municipalities and county councils	Covered bonds in Sweden
AAA		1,093,697	12,261,890
AA+		2,599,357	
AA–	194,668		
A+	177,904		
Total	**372,572**	**3,693,055,**	**12,261,890**

6. Liquidity risks

Since Landshypotek's operations are naturally exposed to liquidity risks, liquidity risk management is assigned high priority. Tolerance level is low and a liquidity reserve exists that will enable Landshypotek to operate even during extended periods of stressed liquidity.

6.1. Definition

Landshypotek defines liquidity risk as follows:

The risk of being unable to refinance maturing loans or being unable to meet demand for additional liquidity as well as needing to borrow at disadvantageous interest rates.

6.2. Management

Landshypotek's operations are naturally exposed to liquidity risk and the consequences of a lack of liquidity can be serious. Therefore, risk tolerance for liquidity risks is low and management of liquidity risks is of high priority. In 2012, Landshypotek started to accept deposits to diversify its sources of financing and to increase the stability of financing. The goal is to substantially increase deposits and, in 2013, Landshypotek plans to widen its deposit offering to the public and, among other items, offer a forest account.

Landshypotek endeavours to secure longer terms for its borrowing than its lending. The maturity analysis (table 12) illustrates that Landshypotek's liabilities have longer tenors than its assets based on the date Landshypotek is entitled to request payment or has an obligation or right to make a repayment.

In order to maintain good payment capacity, the Board has decided that cash and cash equivalents corresponding to the liquidity requirements of various periods in time must be available. One of the levels is that the liquidity portfolio must be able to cover all payment obligations for the forthcoming 180 days of normal operations without the possibility of refinancing. For all of 2012, liquidity exceeded the stipulated level by a healthy margin and on 31 December 2012, Landshypotek had sufficient funds available to cover all payment obligations for about 300 days. In the first half of 2012, Landshypotek decided to apply limits based on the liquidity coverage ratios (LCRs) that Landshypotek reports to the Swedish Financial Supervisory Authority with the amendment that Landshypotek should withstand a 33 day period instead of

Table 12 Maturity analysis for financial assets and liabilities

31 Dec. 2012, SEK thousand	< 3 months	3-12 months	1-3 years	3-5 years	> 5 years	Total
Financial assets						
Due from financial institutions	646,488					**646,488**
Loans to customers	28,977,782	12,961,504	13,721,096	4,190,165	1,175,676	**61,026,225**
Bonds and other interest-bearing securities	78,251	3,921,281	7,098,520	5,236,250	-	**16,334,302**
Derivatives	359,997	4,151,687	4,553,091	2,599,684	7,526,154	**19,190,614**
Total	**30,062,519**	**21,034,473**	**25,372,707**	**12,026,099**	**8,701,830**	**97,197,629**
Financial liabilities						
Liabilities to credit institutions	620,419					**620,419**
Borrowing/deposits from customers	1,552,308					**1,552,308**
Granted credit facilities	612,622					**612,622**
Debt securities in issue	8,131,582	10,177,363	22,851,913	20,698,607	11,269,521	**73,128,986**
Derivatives	323,574	4,022,972	4,910,217	3,354,785	9,171,841	**21,783,389**
Subordinated liabilities	5,558	13,274	226,548	508,148	-	**753,528**
Total	**11,246,063**	**14,213,609**	**27,988,679**	**24,561,540**	**20,441,362**	**98,451,252**
Net cash flow	**18,816,457**	**6,820,863**	**–2,615,971**	**–12,535,441**	**–11,739,531**	**–1,253,623**
Refinancing risk	18,816,457	6,820,863	–2,615,971	–12,535,441	–11,739,531	
Accumulated refinancing risk	18,816,457	25,637,320	23,021,349	10,485,908	–1,253,623	

The above table includes all contracted cash flows. The amounts are not discounted and are recognised during the time slot when Landshypotek is entitled to request payment or has an obligation or right to repay. Future variable rates of interest have been included in the calculation for derivatives and financial liabilities, but not for loans to customers. Future rates of interest are calculated based on forward rates plus any credit spreads.

the Swedish Financial Supervisory Authority's 30-day period and with a limit value of 1.1 instead of 1.

Landshypotek's holdings in its liquidity portfolio are of the type that may be used as collateral for loans from the Riksbank, Sweden's central bank. In this case, the Riksbank is the "lender of last resort." The liquidity portfolio consists of covered bonds issued by Nordic credit institutions with a high credit rating and to a certain extent bonds issued by Swedish municipalities and county councils. This liquidity reserve gives Landshypotek the opportunity of bridging temporary strains on liquidity, but also provides the opportunity of procuring the necessary funds at times of severe liquidity crises by selling assets in an orderly fashion, or reducing the financing need by calling in maturing loans. The liquidity reserve amounted to SEK 16.0 billion on 31 December 2012, of which 84 percent comprised securities with an AAA rating.

The Chief Financial Officer is responsible for ensuring that liquidity risk management is carried out in the manner stipulated by the Board's and Managing Director's instructions. The Chief Financial Officer also reports to the Managing Director and Chief Risk Control Officer if disruptions to the supply of liquidity were to arise, which is also the procedure stated in the company's instructions for the management of liquidity risks. The Risk Control function is responsible for daily measurements and reporting of liquidity risks in accordance with the adopted policy and instructions. The function is also responsible for continuous stress testing of Landshypotek's liquidity situation.

6.3. Stress tests

In addition to daily limit checks, Landshypotek performs continuous stress tests to ensure that liquidity is sufficient even during unfavourable market conditions. Examples of scenarios that are tested include:

- a stop in the borrowing market
- lower market values of the investments in the liquidity portfolio (10 percent)
- customers payments decline (50 percent of contracted interest payments and capital repayments are made)
- withdrawal of external credit facilities
- full utilisation of flexible loans
- withdrawals from deposits (50 percent).

The stress tests carried out by Landshypotek have indicated an extremely healthy capacity to make payments even if several different events that have a negative effect on liquidity were to occur simultaneously. At 31 December 2012, Landshypotek was able to meet its payment obligations for about 120 days when stress was applied to all parameters. With the same level of stress applied, but with a stop on new lending Landshypotek was able to meet its payment obligations for about 300 days. Lower market values of the investments in the liquidity portfolio is the single scenario that has the most significant negative impact on liquidity. Landshypotek believes that the current payment capacity is satisfactory and corresponds well to the established low level of tolerance.

7. Market risks

The market risks to which Landshypotek's operations are primarily exposed are interest-rate risk and currency risk. These risks are managed with derivative instruments and by controlling and monitoring credit limits.

7.1. Definition

Landshypotek defines market risk as:

The risk, excluding the risk of default, that the value of assets, liabilities and/or financial contracts is negatively affected by changes in general economic conditions or events that affect a large part of the market as well as be events that are company specific.

The market risks to which Landshypotek is exposed are interest-rate risks, currency risks, basis spread risk and credit spread risk.

7.2. Management

The management of market risks is primarily described in Landshypotek's finance policy, which is adopted by the Board. This policy regulates how risks are to be measured and reported and sets the framework for the risk tolerance for market risks in the form of internal limits. The Chief Financial Officer has the overall responsibility for the management of the Group's financial risks, and the Chief Risk Control Officer is responsible for the independent control and reporting of the limits established by the Board.

To manage market risks, Landshypotek also makes use of derivative instruments. These instruments are used to efficiently reduce the effects on assets or liabilities in conjunction with fluctuations in the interest-rate and currency markets.

7.2.1. Interest-rate risks

Interest-rate risks arise when fixed-interest terms for assets and liabilities are mismatched. Landshypotek seeks to always have the same fixed-interest term on borrowing as on lending. Due to actual conditions and availability in the capital market, there may be certain instances of imbalance between borrowing and lending, which gives rise to an interest-rate risk for Landshypotek. Interest-rate risk is measured as the change in value that occurs if the interest-rate curve is moved in parallel up or down by one percentage point. The risk is measured in total and divided into different time slots (3 months, 1 year, 2 years, etc.). Landshypotek has limited interest-rate risk based on its equity for each time slot and on an aggregated basis. The limits are monitored continuously and reported by the Risk Control function to both the Board and Finance Sub-Committee. The interest-rate risk on 31 December 2012 totalled MSEK 105.0.

Landshypotek utilises interest swap agreements as a tool for managing interest-rate risks. For cases in which the fixed-interest terms of borrowing are longer than the fixed-interest terms of lending, interest swaps are made whereby Landshypotek receives fixed interest and pays variable interest. For cases in which the fixed-interest terms of borrowing are shorter than the fixed-interest terms of lending, interest swaps are made in the opposite direction. These mechanisms are an efficient way for Landshypotek to manage interest-rate risks and maintain the level of risk exposure within the established parameters

7.2.2. Currency risks

Currency risk entails the risk of losses related to changes in exchange rates. Currency risk for Landshypotek arises when certain financing takes place in a currency other than SEK.

Landshypotek manages currency risk that arises in conjunction with financing in a currency other than SEK by using derivative instruments to convert Landshypotek's cash flows in foreign currency back to SEK.

7.2.3. Basis spread risk and credit spread risk

Basis spread risk arises for Landshypotek when the currency risk that arises in conjunction with financing in a currency other than SEK, is reduced through interest and currency swaps. From 31 December 2012, Landshypotek started to measure the basis spread at market value. Since basis spreads have been relatively volatile in recent years, measurement at market value can contribute to relatively substantial impacts on earnings. The largest three-month movements in basis spreads (decreases and increases) since the middle of 2008 would have, with the application of measurement of market value on Landshypotek's portfolio at year-end, generated an impact of negative MSEK 180 and positive MSEK185 on earnings. However, if Landshypotek does not exit the swap agreements, the net of the earnings impacts on expiry of the swap agreements would be zero. Credit spread risk arises from fluctuations in credit spreads in Landshypotek's liquidity portfolio.

Table 13 Currency exposure including derivative payments, SEK thousand*

Currency	Assets	Liabilities	Exposure
CHF	400,000	400,000	0
EUR	555,000	555,000	0
NOK	7,895,000	7,895,000	0

** Nominal amounts in local currency, excluding the currency account of MSEK 0.8.*

Table 14 Fixed-interest terms for the Group's interest-bearing assets and liabilities

2012-12-31, TSEK	< 3 months	3-12 months	1-3 years	3-5 years	> 5 years	Total
Assets						
Due from financial institutions	646,488					**646,488**
Loans to customers	28,524,349	12,199,849	12,864,277	3,933,758	1,040,533	**58,562,766**
Bonds and other interest-bearing securities	4,231,000	2,830,000	4,150,000	3,900,000	-	**15,111,000**
Derivatives	36,132,265	1,956,438	1,567,485	9,006,048	8,242,443	**56,904,679**
Total assets	**69,534,102**	**16,986,287**	**18,581,763**	**16,839,806**	**9,282,976**	**131,224,933**
Liabilities						
Liabilities to credit institutions	620,419					**620,419**
Borrowing/deposits from customers	1,552,308					**1,552,308**
Debt securities in issue	40,597,437	2,869,438	4,440,322	10,096,048	8,842,443	**66,845,688,**
Derivatives	28,868,111	12,700,000	11,058,663	4,550,000	499,000	**57,675,774**
Subordinated loans	430,000	-	200,000	70,000	-	**700,000**
Total liabilities	**72,068,275**	**15,569,438**	**15,698,985**	**14,716,048**	**9,341,443**	**127,394,189**
TOTAL	**−2,534,173**	**1,416,849**	**2,882,777**	**2,123,758**	**−58,467**	**3,830,744**
Interest-rate sensitivity, net	40,009	−27,628	−62,535	−60,221	5,411	
Cumulative interest-rate sensitivity		12,381	−50,154	−110,375	−104,964	

The above table includes all contracted cash flows. Nominal amounts are carried under the time slots when interest is reset.

Limits for currency risk are set by the Board and monitored and controlled by the Risk Control function. Overall, Landshypotek has only marginal currency risk. Excluding currency other than SEK corresponding to MSEK 0.8 in various currency accounts, Landshypotek had no currency risk at 31 December 2012.

8. Operational risks

Operational risk occurs in all forms of business activities and Landshypotek's operations are no exception. Efficient incident identification and management of operational risks reduces the risk of losses.

8.1. Definition

Landshypotek defines operational risk as:

The risk of loss due to inadequate or failed internal processes, human error, defective systems or external events that impact business operations. This definition includes compliance risk.

Operational risk is mainly categorised into the following areas:

- Internal fraud
- External fraud
- Employment conditions and safety in the workplace
- Customers, products and business practice
- Damage to tangible assets
- Disruptions to the business operations and defective systems
- Implementation, delivery and process control.

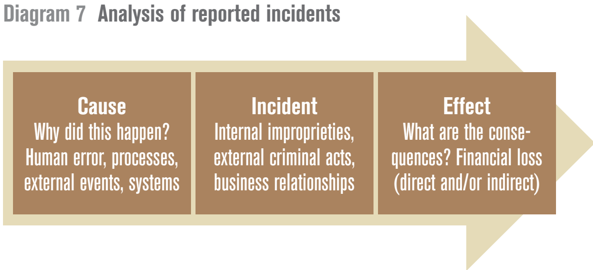
8.2. Management

Operational risk occurs in all of Landshypotek's operations. All unit and regional managers are obligated to act to reduce operational losses. In addition, a person is designated with responsibility for information security and physical security who reports directly to the Managing Director. The Risk Control function assumes the overall responsibility for the methods utilised for identifying and quantifying operational risks and for reporting these risks to the Board and Management Group.

Landshypotek continuously manages operational risk through a system of incident reporting. All employees have access to a online tool for reporting operational incidents either suspected or real, and have a responsibility for reporting these incidents. The Risk Control function is responsible for compiling reported incidents and reporting these to the Board and Management Group. Incident management forms the basis of Landshypotek's continuous work with managing operational risks and makes it possible to identify critical problems and take action based on such problems.

Continuous incident reporting is analysed based on cause, incident and effect (diagram 7). The division of reported incidents in 2012 is illustrated in diagram 8.

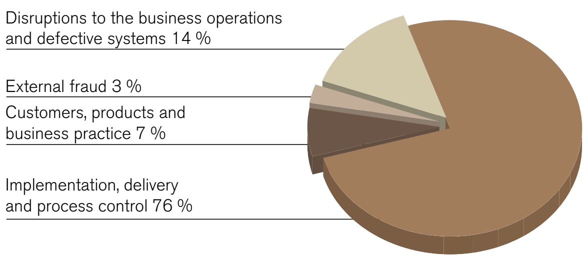
Diagram 7 **Analysis of reported incidents**



As a complement to the ongoing incident management, a risk analysis of operational risks is carried out every year where participants from all units at Landhypotek come together to identify operational risks. Each risk identified is assessed based on probability and consequence, meaning the effect of the risk on the operations if it were to occur and how likely it is that the risk will occur. The results of this annual risk analysis and proposed actions are presented to the Board and Management Group. The purpose of the annual risk analysis is, as far as possible, to identify material operational risks and take measures to ensure these risks do not materialise. Incident reporting and the annual risk analysis are also used as supporting data for the annual internal capital adequacy assessment.

For all new or materially changed products, services and systems, a risk analysis is performed that also includes operational risks. Contingency plans are also in place for managing serious disruptions to the operations.

Diagram 8 **Specification of reported incidents 2012**



No incidents were reported in other categories.

8.3. Compliance risk

Compliance risk is part of operational risk and can be defined as the risk of paying fines, incurring a loss or having a bad reputation in the market because the operations are not conducted in accordance with applicable regulations for the licensable activities.

The Compliance function identifies compliance risks continuously and analyses, reports and monitors such risks. Compliance also examines a business activity or part of it, for example, the entire credit process or the limited unit of credit audits. In such cases, compliance examines all processes, instructions and legal documents to ensure that they comply with the requirements of internal and external rules.

Compliance works on preventing compliance risks through active advice and governance and by providing support to managers and employees in the daily operations. Compliance assists the business operations in assessing, managing and minimising compliance risks, for example, through control and follow-up systems. The independence of the Compliance function is assured by its non-participation in any business decisions.

Compliance issues information about and monitors developments and provides training in internal and external rules. Compliance is responsible for preparing and updating a list of internal regulations on the intranet. Compliance is responsible for ensuring that each unit manager prepares internal governance documents that reflect the requirements imposed on Landshypotek in order for the company to conduct its business operations in accordance with external regulations. This responsibility includes ensuring that such governance documents are reviewed following an established plan.

The Board annually adopts a compliance plan that contains an overall assessment of compliance risk based on changes in the analysis of the external environment, external regulations, such internal reports as the Managing Director's report, risk and audit reports, follow-ups, operational risk analysis, any incident reports and planned activities for the year. Each unit manager also submits an annual report to the Compliance function that identifies compliance risks at unit level.

Landshypotek's compliance plan is risk-based and is founded on the Compliance function, in dialogue with Management Group, identifying and ranking material compliance risks that should be addressed in Landshypotek's operations.

8.4. Capital requirements for operational risk

Landshypotek utilises the base method under Pillar I to calculate its capital requirement for operational risk, which amounted to MSEK 95 in 2012. Landshypotek believes that the capital requirement is sufficient to cover the operational risks to which the company is exposed.

9. Internal Capital Adequacy Assessment Process

Landshypotek performs an internal capital adequacy assessment process on an annual basis, which results in a comprehensive assessment of the bank's risks and their associated capital adequacy requirements.

The internal capital adequacy assessment process (ICAAP) under Pillar II of the Basel rules is to ensure that Landshypotek has sufficient capital. This assessment takes into consideration the existing and planned business operations and the consequent risk exposure of these operations, rating targets, return targets and regulatory requirements. The ICAAP results in a detailed report of the capital position including Landshypotek's current risk profile and risk profile in the medium term (covering at least the next three years), the methods Landshypotek uses to measure and manage risks, risk limits and an assessment of capital per relevant risk category. The capital base constitutes a buffer against unexpected losses.

The ICAAP includes all types of risks that are believed to have an impact on operations. In addition to credit risks, market risks and operational risks, the capital adequacy requirement is also assessed for risks including interest-rate risks, liquidity risks and strategic risks. Stress tests are also used for the assessment of the capital adequacy requirement.

The Board has overall responsibility for the capital adequacy assessment. The ICAAP is established by the Board and the Board's Risk and Capital Committee is used as the preparatory body. The Risk Control Unit is responsible for leading the work with ICAAP, producing a detailed report of Landshypotek's risk profile, performing stress tests and assessing what impact future events and changes in the operating environment will have on Landshypotek's capital adequacy requirement, as well as the preparation of ICAAP documents. The Chief Financial Officer is responsible for capital planning and management of Landshypotek's capital base in line with the capital strategy adopted by the Board.

Landshypotek's ICAAP is to be documented in a manner that allows internal and external auditors, as well as the Swedish Financial Supervisory Authority, to evaluate Landshypotek's ICAAP.

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