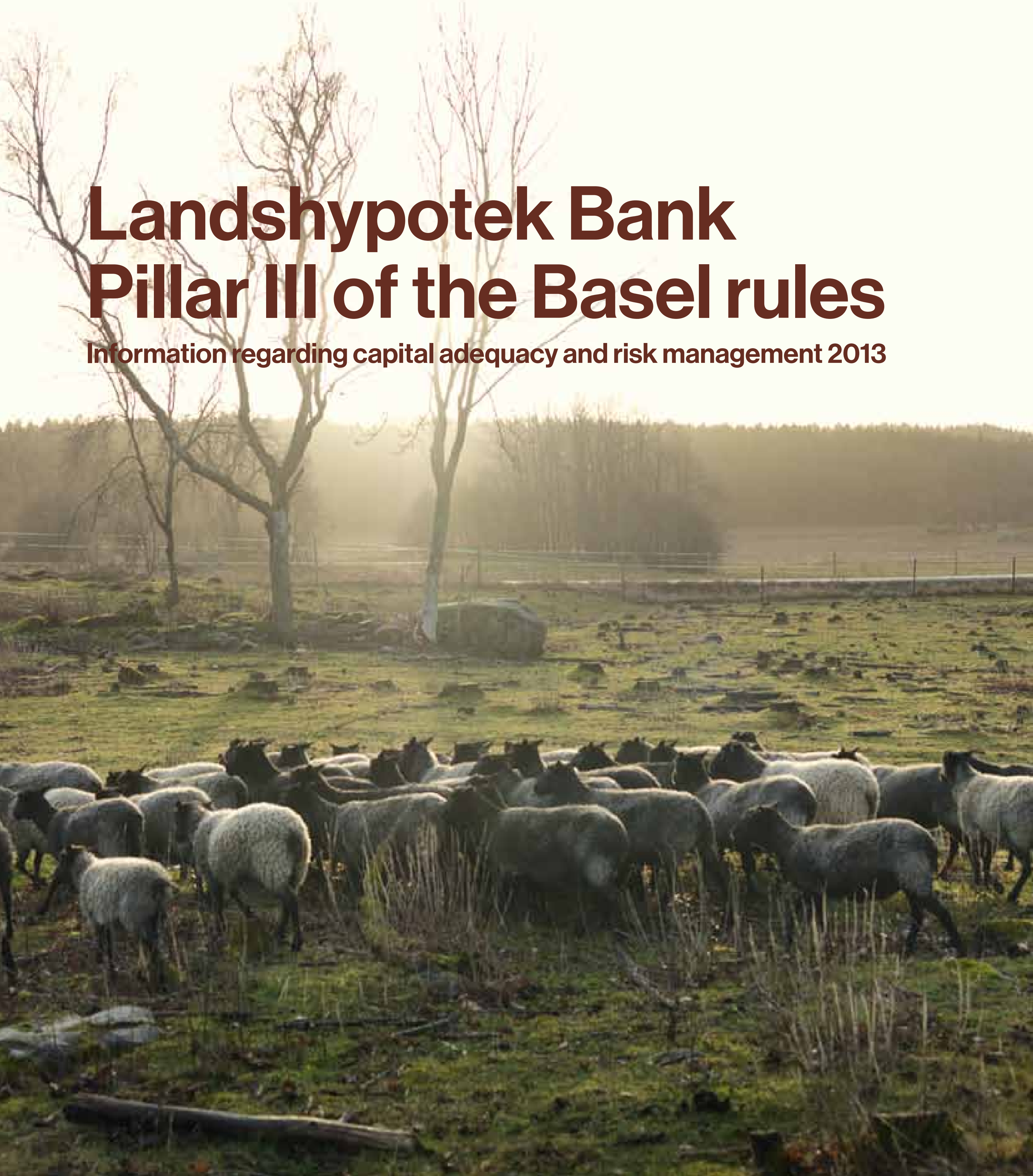
Landshypotek Bank

Landshypotek Bank Pillar III of the Basel rules

Information regarding capital adequacy and risk management 2013



Contents

1. Introduction

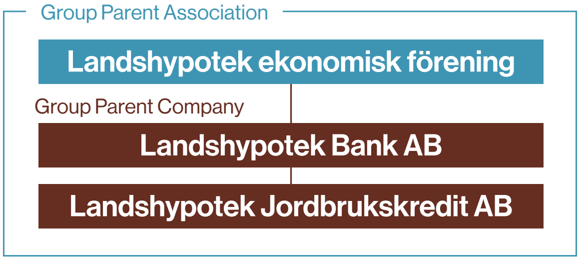
This report contains information about Landshypotek's risks, risk management and capital adequacy under Pillar III of the capital adequacy rules.

1.1. Introduction and purpose

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 shall, in combination with the Annual Report, 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 in conjunction with the Annual Report on Landshypotek's website.

The report encompasses the Landshypotek Financial Corporate Group (Landshypotek) and pertains to the circumstances prevailing on 31 December 2013. Landshypotek ekonomisk förening owns 100 percent of the shares in Landshypotek Bank AB and is the parent association of the Financial Corporate Group. Borrowers of Landshypotek Bank AB are also members of Landshypotek ekonomisk förening. Landshypotek Bank 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 Bank AB.

Diagram 1 **Corporate structure**



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 include rules governing remuneration and liquidity management. The Basel rules have been implemented in 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 regulatory capital requirements for credit risks, market risks and operational risks in accordance with the Swedish Capital Adequacy and Large Exposures Act (2006:1371). Pillar II imposes requirements on credit institutions to calculate total capital requirements, 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 disclosed, which is the purpose of this report.

1.3. Moving forward – Basel III

The most recent financial crisis has shown 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. The new European capital adequacy rules have been adopted and implemented as regulations under the Capital Requirements Regulation (CRR) on 1 January 2014 in the EU. The Swedish implementation of the Capital Requirements Directive (CRD IV) is expected, at the earliest, on 1 July 2014. The transitional rules linked to Basel I have been extended further until 31 December 2017 and the Swedish Financial Supervisory Authority's proposal is that no Swedish institution should be exempted from these rules. These new regulations primarily set out stricter requirements for what is to be included in the capital base as well as higher capital and liquidity requirements.

Table 1 **Companies that are members of the Landshypotek Financial Corporate Group**

	Corporate Registration Number	Domicile
Landshypotek Ekonomisk Förening	769600-5003	Stockholm
Landshypotek Bank AB	556500-2762	Stockholm
Landshypotek Jordbrukskredit AB	556263-8808	Stockholm

The minimum regulatory capital requirement for Core Tier 1 capital increases from 2 percent to 4.5 percent. In addition, a capital conservation buffer of an additional 2.5 percentage points may be added and, when deemed necessary by the supervisory authority, a countercyclical buffer that can vary from 0-2.5 percentage points. Including the Tier 1 and Tier 2 regulatory capital requirements, the total regulatory capital requirement will vary between 10.5 and 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 regulatory capital requirements for systemically important banks. In 2013, the Swedish Financial Supervisory Authority also implemented a floor for the average risk weights for exposures secured by real estate (15 percent) under the Pillar II framework. None of the above amended capital adequacy requirements impact Landshypotek's capital requirement as long as the transitional rules linked to Basel I apply, since these continue to require more capital.

Liquidity requirements in the form of liquidity coverage ratio [1] (LCR) will apply from 1 January 2015 (60 percent), which will then be successively raised to 100 percent. Implementation of the net stable funding ratio [2] (NSFR) is planned, at the earliest, for 2018.

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. .

[1] *The liquidity coverage ratio is defined as the size of the liquidity reserve in relation to net outflows over a 30-day significant stress period.*

[2] *The net stable funding ratio: requirements applying to maturity matching.*

2. Description of Landshypotek and its operations

Landshypotek Bank AB is a member-owned bank for financing agriculture and forestry and has 177 years of tradition. The business operations mainly consist of lending against real property as collateral.

2.1. General description

Landshypotek Bank AB is a member-owned bank tasked with providing competitive financing to Sweden's farmers and foresters. The company's history dates back to 1836. Landshypotek ekonomisk förening is the Parent Association of the Landshypotek Group. Borrowers who have loans with Landshypotek automatically become members of the association and thereby also owners of the operations. The association currently has about 45,000 members.

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

At Landshypotek Jordbrukskredit AB, loans can be granted against mortgage deeds in real property within 75-85 percent of the internally determined LTV ratio. In addition, the company offers loans with EU support as collateral (EU loans) and Landshypotek Jordbrukskredit AB also guarantees credit facilities distributed through Sparbanken Öresund. Collateral in the form of mortgage deeds in real property is also required for credit facilities and the maximum LTV ratio is 85 percent.

In order to offer customers a broader range of financial products, in addition to credit facilities, corporate and private accounts as well as various payment services are offered through the 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 the collaboration with Gjensidige Försäkringsbolag.

2.2. 2013 and the future

Landshypotek holds a strong position in the Swedish credit market for financing agriculture and forestry with a market share of 28.5 percent. The conditions for operating financial companies are undergoing substantial change in the wake of the 2008 financial crisis. One effect is increased regulation, which leads to higher fixed costs, in the form of more personnel at risk control and compliance units among other items. Another effect is increased focus on liquidity risks, which must be managed. This means that Landshypotek needs to adjust its operations to continue to fulfil its role of undercutting market prices. The company's objectives are to expand operations and increase market shares. To achieve this, the product offering will be expanded so as to be able to offer a complete range of financing solutions for agriculture and forestry moving forward. These objectives are part of Landshypotek's vision where the aim is to become:

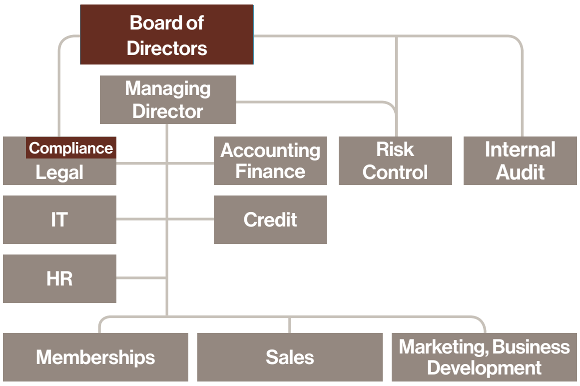
The preferred choice for financing agriculture and forestry

Growth is to take place at low risk and with healthy and stable profitability. To, among other things, improve liquidity in any market stress situation and, thereby, also improve preconditions for a favourable external rating, Landshypotek has started to offer deposit accounts to the public. Landshypotek's target is for deposits to account for 20 percent of funding within five years. In 2011 Landshypotek offered deposit accounts for the first time. Landshypotek was granted a banking licence by the Swedish Financial Supervisory Authority in 2012 and thereby improved the possibilities to offer efficient deposit services. In spring 2013, Landshypotek supplemented the existing deposit account range with a forest account and forest-damage account and in February 2014, Landshypotek launched three more deposit accounts and an online bank to allow customers to digitally open deposit accounts and transfer funds to and from other banks. This was implemented in conjunction with the launch of a new brand, which will also assist in attracting deposits. In 2014, further deposit accounts are planned as well as lending with other collateral as security. 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.

2.3. Organisation

Landshypotek Bank AB is organised into eight regions and has 19 offices across Sweden. The number of employees is 130. 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.

Diagram 2 Organisational chart for Landshypotek Bank Group



2.4. Corporate governance

Landshypotek ekonomisk förening owns the Landshypotek Group and governs Landshypotek Bank AB through the Annual General Meeting (AGM), which is the joint-stock company's highest decision-making body. The owners' control of Landshypotek Bank AB is also exercised through the Board of Directors and the Managing Director in accordance with the Swedish Companies Act and Articles of Association as well as adopted policies and instructions.

The AGM of Landshypotek Bank 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 Bank AB are appointed, and are tasked with preparing election and remuneration issues prior to the next AGM. The Election Committee currently comprises three members.

The principal task of the Board of Directors of Landshypotek Bank AB (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 AGM. The Board comprises 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 AGM appoints external auditors to Landshypotek Bank AB. These auditors must be authorised public accountants. The mandate period of the auditors appointed by the AGM 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 General Meeting and, accordingly, are independent in relation to the Board and company management.

The Board of Landshypotek Bank AB has adopted a remuneration policy that specifies the principles behind the Landshypotek Bank 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. In 2014, Landshypotek will replace the defined-benefit pension system BTP2 with the new defined-contribution pension system BTP1 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 Bank AB is reviewed annually through the employees' salary appraisals. Internal audit is tasked with reviewing how remuneration paid by Landshypotek Bank AB complies with the remuneration policy.

2.4.1. 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 Bank AB have the ultimate responsibility and also have the support of the independent Risk Control, Compliance and Internal Audit functions.

The Risk Control function is responsible for measurement, control, analysis and reporting, at portfolio level, of all of Landshypotek's material risks. Furthermore, the function is responsible for the credit risk models (IRB models) that Landshypotek has had approved for use in calculating the regulatory 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. The Compliance function will, from April 2014, be organisationally subordinate to the Managing Director and thereby the entire second line of defense will be fully independent of the business operations that they control.

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

3. Risk management and risk organisation

Landshypotek's objective is to maintain a low general risk profile. Landshypotek strives to achieve a high degree of risk awareness and a low degree of risk undertaking.

3.1. Objectives and basis of risk management

A proper risk culture is a high priority at Landshypotek. Landshypotek strives to achieve 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 and, thereby, creating favourable conditions for expanding the operations and increasing market shares.

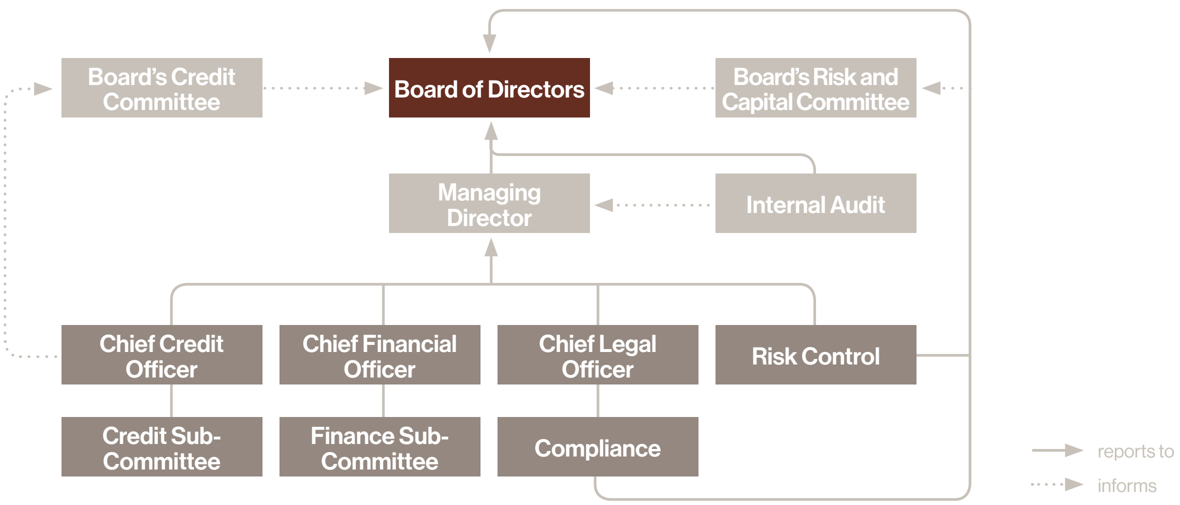
To maintain a low general risk profile, Landshypotek has identified and categorised all material risks so as to be able to understand, manage and potentially quantify each individual risk. Landshypotek focuses on assuming the types of risks that the operations are best able to understand and manage.

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 other risks in order to conduct the business activities, including such risks as market 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 risks may have major consequences for the operations and must be managed and minimised to the greatest degree possible.

Diagram 3 Risk and control organisation



Landshypotek aims to retain its AAA rating on the Group's covered bonds and the long-term A rating (Standard & Poor's) for Landshypotek Bank AB.

3.3. Risk organisation

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 Bank AB have ultimate responsibility for the above.

As mentioned earlier, the Board 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 measurement and management of risk. The Board's Credit Committee is the highest credit-granting body. The Committee also prepares items for the Board on issues related to the Credit Policy, decision mandates for granting credit and valuation instructions.

Landshypotek applies a three-lines of defence approach to its risk management process. Each of the lines of defence is responsible for managing the risks inherent in the operations.

The first line of defence consists of the business operations, which has daily operational responsibility for risk.

The Risk Control Function and the Compliance Function represent the second line of defence. The Risk Control Function is responsible for control, analysis and reporting of all risks on a portfolio basis within Landshypotek. The Chief Risk Control Officer is the secretary and presents agenda items at the Board's Risk and Capital Committee. The function is independent of business operations and reports directly to the Managing Director and the Board.

The Compliance Function is responsible for ensuring that the business operations are conducted in accordance with current laws and regulation (internal and external). The Compliance function, which reports directly to the Board, is currently subordinated the Chief Legal Officer, which is subordinated the Managing Director. In April 2014 the Compliance Function will become subordinated the Managing Director.

The Internal Audit function comprises the third line of defence and is tasked with functions including the examination of the work of the second line of defence and reports directly to the Board. This work has been performed by an independent external party since 2008.

The operational risk organisation also comprises two advisory committees: the Credit Advisory Committee and the Finance Advisory Committee.

The Credit Advisory Committee, chaired by the Chief Credit Officer, is responsible for regularly reviewing credit-granting rules and submitting proposals for changes to the Board's Credit Committee. The Finance Advisory Committee, chaired by the Chief Financial Officer, makes decisions concerning funding, deposit and lending interest rates.

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 matters. The Chief Credit Officer reports to the Managing Director and to the Board and presents reports on credit matters to the Board's Credit Committee.

The Finance Department is responsible for Landshypotek's financial risk management with regard to funding and management of equity, liabilities and liquidity. 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.

4. Capital base and regulatory capital requirement

The significance of sound risk management and a substantial buffer of capital and liquidity was clearly illustrated by the most recent 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 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 2013 amounted to MSEK 4,886, of which MSEK 4,246 comprised Tier 1 capital, as shown in table 2.

Deductions are made from Tier 1 capital for deferred tax assets. One half of the difference between expected losses in line with the internal ratings-based model for credit risk (IRB model) and actual provisions 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 640. Subordinated loans are specified in table 3.

4.2. Regulatory capital requirement

The calculation of the regulatory capital requirement is based on the minimum rules (Pillar I) that encompass credit risk, market risk and operational risk. For the majority of Landshypotek's lending, the regulatory capital requirement for credit risk is calculated by applying the IRB model, the use of which Landshypotek has received

Table 2 **Capital base, Financial Corporate Group**

SEK thousand	31 Dec. 2013	31 Dec. 2012
Tier 1 capital	**4,246,027**	**3,971,166**
Share capital paid in or equivalent, after deduction for cumulative preference shares	1,288,322	1,232,232
Equity component of reserves and profit or loss brought forward from preceding financial year	2,844,094	2,764,851
Net profit for the year	228,233	72,235
Deduction for deferred tax assets	–10,351	–22,349
Deduction for intangible non-current assets	–44,590	–35,312
Deduction in accordance with Chapter 3, Section 8 of the Capital Adequacy and Large Exposures Act	–59,681	–40,491
Tier 2 capital	**640,239**	**659,430**
Subordinated term loans in accordance with Chapter 8, Sections 18-30	699,921	699,921
Deduction in accordance with Chapter 3, Section 8 of the Capital Adequacy and Large Exposures Act	–59,682	–40,491
Capital base	**4,886,266**	**4,630,596**

Table 3 **Subordinated loans**

Name of loan	Currency	Nominal amount , TSEK	Nominal amount outstanding, TSEK	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 **Regulatory capital requirement and risk-weighted assets (Pillar I) Financial Corporate Group**

SEK thousand	31 Dec. 2013		31 Dec. 2012	
	Regulatory capital requirement	Risk-weighted assets	Regulatory capital requirement	Risk-weighted assets
Credit risk, IRB				
Non credit-obligation assets	5,472	68,404	4,526	56,579
Retail exposure	630,763	7,884,541	416,094	5,201,178
Total IRB	**636,235**	**7,952,945**	**420,621**	**5,257,757**
Credit risk, standardised approach				
Corporate exposure	254,127	3,176 585	251,567	3,144,587
Retail exposure	28,795	359,947	26,062	325,778
Institutional exposure	58,223	727,783	101,498	1,268,724
Local governments and comparable associations and authorities	0	0	0	0
Non-performing items	5,392	67,403	2,193	27,417
Exposure to governments and central banks	0	0	0	0
Covered bonds	147,579	1,844,737	171,289	2,141,114
Other items	0	0	0	0
Total standardised approach	**494,116**	**6,176,455**	**552,610**	**6,907,620**
Total credit risk	**1,13, 351**	**14,129,401**	**973,230**	**12,165,377**
Operational risk	**93,035**	**1,162,931**	**95,248**	**1,190,602**
Total minimum requirements	**1,223,387**	**15,292,332**	**1,068,478**	**13,355,979**
Additional requirement in accordance with transitional rules	**2,733,244**	**34,165,550**	**2,861,786**	**35,772,325**
Total regulatory capital requirement and riskweighted assets including transitional rules	**3,956,631**	**49,457,882**	**3,930,264**	**49,128,304**

approval for from the Swedish Financial Supervisory Authority. For the remaining credit risk, the standardised approach is used for capital adequacy purposes.

Landshypotek is not exposed to any market risks for which capital adequacy is required in accordance with the Pillar I rules. The basic indicator approach is used to calculate capital requirements for operational risks.

Landshypotek's regulatory capital requirement is presented in table 4.

4.3. Capital requirements

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

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

Table 5 **Capital adequacy, Financial Corporate Group**

SEK thousand	31 Dec. 2013	31 Dec. 2012
Tier 1 capital	4,246,027	3,971,166
Tier 2 capital	640,239	659,430
Total capital	**4,886,266**	**4,630,596**
Without transitional rules		
Risk-weighted assets	15,292,332	13,355,979
Tier 1 ratio	27.77 %	29.73 %
Capital ratio	31.95 %	34.67 %
Capital adequacy ratio	3.99	4.33
With transitional rules		
Risk-weighted assets	49,457,882	49,128,304
Tier 1 ratio	8.59 %	8.08 %
Capital ratio	9.88 %	9.43 %
Capital adequacy ratio	1.23	1.18

evaluated in light of the overall risk for the 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 has made the assessment that there is no need to reserve additional capital other than that regulated in the transitional rules linked to Basel I. 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 adequacy requirement for credit risks, indicates that there is a very low level of credit risk in Landshypotek's lending with collateral in Swedish agricultural and forestry properties.

However, under the current transitional rules, the capital base may not fall below 80 percent of the regulatory capital requirement calculated with Basel I. In accordance with the Basel I rules, lending with collateral in agricultural and forestry properties has a risk weight of 100 percent, which is just as high as lending against, for example, unsecured loans. The regulatory capital requirements under the Basel I rules are not particularly sensitive to risk and, in Landshypotek's assessment, overestimate the risks associated with the Group's operations.

As presented in table 4, Landshypotek's Pillar I regulatory capital requirement under Basel II is about one third compared with the current transitional rules: MSEK 1,223 compared with MSEK 3,957. Even taking into account Landshypotek's internal capital adequacy assessment process and Pillar II risks, the current Pillar I regulatory 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 regulatory capital requirement under the transitional rules linked to Basel I.

5. Credit risks

Credit risk is the greatest risk in Landshypotek and represents 92 percent of the regulatory 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, agricultural and forestry 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 may 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 reflecting the risk of default on a scale of 1-6 for private individuals and A-H for legal entities. Furthermore, in addition to the customer's/household's total repayment capacity, collateral is analysed, which principally 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 loan limit, risk class and LTV ratio. All credit decisions are taken by a credit subcommittee utilising a level structure that complies with the aforementioned credit mandate matrix. A credit subcommittee requires that a minimum of two officers jointly form a committee. The highest decision-making body for day-to-day credit cases is the Board's Credit Committee.

5.2.1. Overview of credit portfolio

Landshypotek's total loans to customers on 31 December 2013 amounted to slightly more than SEK 60.7 billion. Lending encompasses lending to farmers and foresters primarily against collateral in agricultural and forestry 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. The credit portfolio has grown by SEK 19 billion since 2008, corresponding to average lending growth of 8 percent per year over the past five years. Average lending per customer of Landshypotek Bank AB amounted to MSEK 1.33 on 31 December 2013. The exposure-weighted LTV ratio on the same date was 47.6 percent.

Landshypotek divides its customers into two categories: Rural Living (RL) where the repayment capacity of the 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 conduct 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. Loans outstanding amounted to SEK 29 billion to RL customers and SEK 32 billion to RE customers on 31 December 2013.

5.2.2. Definition and classification of credit portfolio

One of the fundamental conditions for applying the IRB models to regulatory 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.

All private individuals are classified in the retail exposure segment, in the sub-group "exposures 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.

Diagram 4 **Geographic distribution of Landshypotek AB's lending portfolio, by sales district**

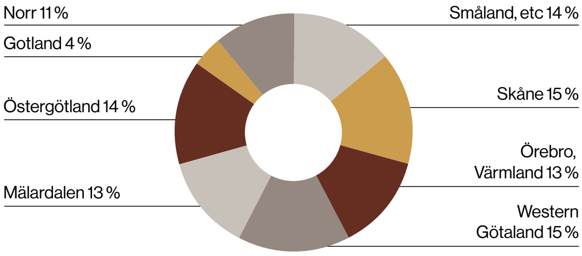


Table 6 **Capital adequacy data per exposure class**

31 Dec. 2013, SEK thousand	Exposure	Of which off balance sheet before conversion factor	Exposure after conversion facto	Of which off balance sheet after conversion factor	Risk-weighted assets	Regulatory capital requirement	Average risk weight	Expected loss
Credit risk recognised in accordance with IRB Approach								
Retail exposure	58,839,404	514,821	58,993,210	550,859	7,884,541	630,763	13 %	177,070
Non credit-obligation assets	68,404		68,404		68,404	5,472	100 %	
Total credit risk in accordance with IRB Approach	**58,907,808**	**514,821**	**59,061,614**	**550,859**	**7,952,945**	**636,235**	**14 %**	**177,070**
Credit risk recognised in accordance with standardised approach								
Exposure to governments and central banks	468,164	0	468,164	0	0	0	0 %	
Exposure to municipalities, similar entities and authorities	4,486,772	0	4,486,772	0	0	0	0 %	
Institutional exposure	1,998,599	0	1,998,599	0	727,783	58,223	36 %	
Corporate exposure	3,242,912	253,747	3,176,585	187,420	3,176,585	254,127	100 %	
Retail exposure	1,140,765	825,525	479,929	165,105	359,947	28,795	75 %	
Non-performing items	53,913	0	45,265	0	67,403	5,392	149 %	
Covered bonds	10,776,233	0	10,776,233	0	1,844,737	147,579	17 %	
Other items	0	0	0	0	0	0	0 %	
Total credit risk in accordance with standardised approach	**22,167,358**	**1,079,272**	**21,431,547**	**352,525**	**6,176,455**	**494,116**	**29 %**	
Total	**81,075,166**	**1,594,093**	**80,493,161**	**903,384**	**14,129,401**	**1,130,351**	**18 %**	

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 exposures in the "exposures secured by real estate" sub-group. Exposure including accrued interest for these assets amounted to SEK 59 billion. The capital requirement for other exposures is calculated using the standardised approach.

The total exposure amount was SEK 81 billion (see table 6). The risk-weighted assets for these exposures amounted to SEK 14 billion, of which SEK 8 billion was recognised in accordance with the IRB Approach and the remainder in accordance with the standardised approach. The average risk weight for retail exposures recognised in accordance with the IRB Approach amounted to 13.4 percent and exposure recognised in accordance with the standardised approach to 28.8 percent.

58 percent of the portfolio[3] has less than three months remaining until the next date of condition changes (see table 7).

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

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.

The Credit Department is responsible for the credit approval process and ensuring compliance with the internal rule book for credit granting. The Credit Department is also tasked with monitoring individual counterparty commitments and for managing insolvency cases (Section 5.7).

The Risk Control function is responsible for measuring, analysing and reporting the status of credit risks at portfolio level and at region 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.

Landshypotek has not identified any major concentration to any particular part of the agriculture or forestry sector or geographic area within Sweden.

5.4. Application of the IRB models

In addition to the IRB models being used for calculation of the regulatory capital requirement and capital requirement, they are highly integrated into the credit process. 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 limit determine the credit decision procedure and any credit decision is based on the aforementioned risk classes. In addition, the Board and Bank Management 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 it. The Risk Control function has operational responsibility for ensuring that the IRB models adequately measure risk for Landshypotek and meet the applicable requirements set by the Swedish Financial Supervisory Authority.

Landshypotek's PD estimates are based on the long-term default rate for the respective risk classes. Since Landshypotek's risk-classification model is not entirely point-in-time, in other words, it is not fully impacted by economic fluctuations, for individual years, the outcome at a portfolio level can exceed the average portfolio PD estimate in years that are slightly below average for Sweden's farmers and foresters. In 2013, which was a slightly below par year from both a loan loss perspective and a model perspective, the outcome at portfolio level exceeded the average portfolio PD estimate. In terms of LGDs, the estimates represent a period of decline which means that, as long as a real downturn does not occur, they are well above the outcome. Table 8 shows that this is the case in 2013.

5.5. Description of the IRB Approach

5.5.1. Method

Landshypotek calculates its own risk estimates PD, exposure at default (EAD) and LGD, which are used for the retail exposure class to calculate regulatory capital requirements and expected losses for credit risk. PD is the likelihood that a customer defaults within a twelve-month period.

5.5.2. Models and permits for calculation of regulatory 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, if 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 more than 90 days with their payments to Landshypotek. 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 are used as a basis and, in addition, a conservative business cycle adjustment is 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 2.1 percent on 31 December 2013. Further stress is applied to the above PD risk class through a formula from the Swedish Financial Supervisory Authority for the calculation of the regulatory capital requirement. Diagram 5 illustrates the retail exposure by PD risk class.

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

31 December 2013, SEK thousand	< 3 months	3-12 months	1-5 years	>5 years
Exposure classes, IRB Approach				
Retail exposure	33,780,663	7,377,684	16,621,593	1,213,270
Total IRB	**33,780,663**	**7,377,684**	**16,621,593**	**1,213,270**
Standardised approach				
Corporate exposure	1,944,811	296,041	594,349	189,702
Retail exposure	380,072	2,740	2,442	0
Non-performing items	48,927	423	13,651	0
Total standardised approach	**2,373,810**	**299,203**	**610,442**	**189,702**

Table 8 **Estimate 31 December 2012 vs. outcome in 2013**

%	PD estimate weighted by number of loans for capital adequacy	Realised default outcome weighted by number of loans	Exposure-weighted LGD estimate for capital adequacy *	Realised exposure-weighted LGD outcome
Retail exposure	1.8 %	2.6 %	6.6 %	0.5 %

** Downturn-LGD*

The assessment of how much of the outstanding claim Landshypotek stands to lose in the event of default (LGD) 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 2013 amounted to 7.9 percent. Diagram 6 illustrates the retail exposure by LGD risk class.

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[4], where parts of the commitments are off balance sheet items, 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 limit 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 sufficiently conservative 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 instances including the Board's Risk and Capital Committee.

Landshypotek's PD risk-classification model captures fluctuations in the business cycle relatively well and, accordingly, customers migrate between risk classes as an effect of fluctuations in the business cycle, which leads to a cyclical regulatory 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.

[4] *The customer utilises when needed as much as wanted within the granted limit.*

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 %

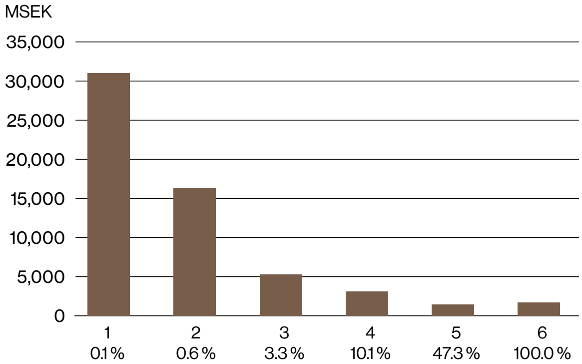
5.6. Collateral

Landshypotek lends money against collateral in agricultural and forest 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 Bank AB grants loans against mortgage deeds in real property within 75 percent of an internally determined lending value of the collateral.

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

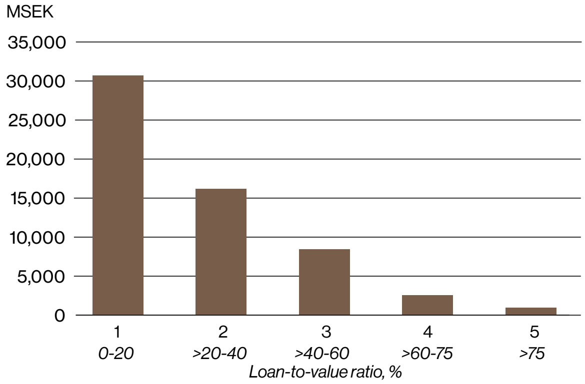
31 December 2013, MSEK	Total amount of exposure in lending portfolio	Amount of exposure for receivables overdue	Amount of exposure for exposure with individual provisions	Individual provisions	Total amount of exposures in lending portfolio after individual provisions
Gotland	2,642	75	31	5	2,637
Mälardalen	8,015	169	18	8	8,007
North	6,702	174	28	4	6,698
Skåne	8,872	97	4	3	8,868
Småland, etc.	8,389	308	54	14	8,376
Western Götaland	9,301	130	14	6	9,296
Örebro, Värmland	8,173	228	17	10	8,164
Östergötland	8,642	117	2	2	8,640
	60,737	**1,297**	**169**	**52**	**60,685**

Diagram 5 Exposure per PD risk class*



** PD estimates used for capital adequacy purposes are shown under the respective PD risk class.*

Diagram 6 Exposure per LGD risk class**



*** An exposure with av loan-to-value ratio of above 75 % is distributed over all five LGD risk classes.*

This value 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 lending value of the collateral.

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 expertise 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 manages problem loans at an operational level. Any need for a provision is made on a case-by-case basis and receivables defined as doubtful or defaulted are examined on an ongoing basis. Subsequent to individual assessment, doubtful loan receivables are recognised where payments will probably not be discharged pursuant to the contract terms and/or where the value of the collateral is probably insufficient to cover the value of the receivable

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		1,443,544	10,767,268
AA+		3,043,190	
AA–	162,419		
A+	228,781		
A–	261,147		
Total	**652,348**	**4,486,733**	**10,767,268**

** Market values including accrued interest.*

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.

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).

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
- inancial institutions.

New counterparties are to be approved and limited by the Finance Advisory 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. International Swaps and Derivatives Association master agreements (ISDAs) and credit support annexes (CSAs) 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 level 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 limits are reviewed at least once a year by the Finance Advisory Committee.

6. Liquidity risks

Since Landshypotek's operations are naturally exposed to liquidity risks, liquidity risk management is assigned high priority. The 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. As stated in Section 2.3, Landshypotek has started to accept deposits to diversify its sources of funding and to increase funding stability during periods of market stress. Deposits are expected to increase substantially in 2014 and Landshypotek's target is for deposits to account for 20 percent of funding within five years.

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 reserve must be able to cover all payment obligations for the forthcoming 180 days of normal operations without the possibility of refinancing. On 31 December 2013, Landshypotek had sufficient funds available to be able to cover all payment obligations for about 390 days. Landshypotek also applies limits for the liquidity reserve pursuant to the LCR ratio that

Table 12 **Maturity analysis for financial assets and liabilities**

31 Dec. 2013, SEK thousand	< 3 months	3-12months	1-3 years	3-5 years	> 5 years	Total
Financial assets						
Loans to credit institutions	263,957					263,957
Loans to the public	30,693,208	10,654,471	13,868,770	5,646,657	1,336,087	62,199,193
Bonds and other interest-bearing securities	47,592	2,671,720	10,567,250	2,244,500	-	15,531,062
Derivatives	1,486,031	909,312	5,350,336	2,869,389	6,759,510	17,374,577
Total	**32,490,788**	**14,235,502**	**29,786,356**	**10,760,546**	**8,095,598**	**95,368,789**
Financial liabilities						
Liabilities to credit institutions	256,890					256,890
Borrowing/deposits from customers	2,103,007					2,103,007
Granted credit facilities	679,129					679,129
Debt securities in issue	7,826,630	5,809,905	32,365,416	18,113,523	9,059,699	73,175,173
Derivatives	1,684,297	865,901	4,944,898	2,344,352	5,462,729	15,302,176
Subordinated liabilities	5,365	13,274	217,348	504,074	-	740,061
Total	**12,555,317**	**6,689,081**	**37,527,661**	**20,961,949**	**14,522,428**	**92,256,436**
Net cash flow	**19,935,471**	**7,546,422**	**–7,741,305**	**–10,201,403**	**–6,426,830**	**3,112,353**
Refinancing risk	19,935,471	7,546,422	–7,741,305	–10,201 403	–6,426,830	
Accumulated refinancing risk	19,935,471	27,481,892	19,740,587	9,539,183	3,112,353	

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 the public. Future rates of interest are calculated based on forward rates plus any credit spreads.

Landshypotek reports to the Swedish Financial Supervisory Authority based on the Regulations Regarding the Reporting of Liquidity Risks for Credit Institutions and Investment Firms (FFFS 2011:37) with the amendment that Landshypotek should withstand a 33 day period for contracted flows instead of the Swedish Financial Supervisory Authority's 30-day period. This ratio, with a limit value of 1.0, was 3.74 as of 31 December 2013. None of the liquidity limits was exceeded in 2013.

Landshypotek's holdings in its liquidity reserve are of the type that may be sold or 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 reserve 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 market value of the liquidity reserve was SEK 15.3 billion on 31 December 2013, of which 92 percent was placed as collateral in the pool for covered bonds and of which 80 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 Risk Control function is responsible for daily measurements and reporting of liquidity risks in accordance with the Board's adopted policies. 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 reserve (–10 percent)
- customers stop making interest and amortization payments on their loans (only 50 percent of contracted interest payments and capital repayments are carried out)
- withdrawal of external credit facilities
- full utilisation of flexible loans in the first month
- withdrawals from deposits (50 percent).

The stress tests carried out by Landshypotek have indicated a very healthy payment capacity even if several different events that have a negative effect on liquidity were to occur simultaneously. At 31 December 2013, Landshypotek was able to meet its payment obligations for about 265 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 342 days. Lower market values of the investments in the liquidity reserve comprise 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, currency risk, basis-spread risk and credit-spread risk. The first two risks are reduced through the use of derivatives.

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 events that are company-specific.

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 market 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 makes a parallel move up or down by one percentage point. The total risk is measured and limited, and divided into different time slots (3 months, 1 year, 2 years, etc.). The risk appetite is set by placing Landshypoteks equity in customers' loans outstanding, which have an average maturity of about one year. Measured with the aforementioned market valuation method, this corresponded to an interest-rate risk of about MSEK 26 at 31 December 2013. In addition, the Finance Department has a deviation mandate with a limit of MSEK +/–85[5] under the market valuation method. Accordingly, the total interest-rate risk limit was MSEK 111 at year end.

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-rate 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 risk

Currency risk entails the risk of losses related to changes in exchange rates. Currency risk for Landshypotek arises when certain funding takes place in a currency other than SEK. At 31 December 2013, approximately SEK 12 billion of Landshypotek's funding was in foreign currencies.

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

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	5,345,000	5,345,000	0

** Nominal amounts in local currency, excluding the currency account of SEK 97 thousand.*

The limit for currency risk (MSEK 1) is set by the Board and monitored and controlled by the Risk Control function. Overall, Landshypotek has only a marginal currency risk. Excluding currency other than SEK corresponding to SEK 97 thousand in various currency accounts, Landshypotek had no currency risk at 31 December 2013.

[5] The deviation mandate with a limit of MSEK +/–85 also applies for each time slot. Two or more consecutive deviations with the same risk direction are not permitted to exceed MSEK +/–170.

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

31 Dec. 2012, SEK thousand	< 3 months	3-12months	1-3 years	3-5 years	> 5 years	Total
Assets						
Loans to credit institutions	263,957					**263,957**
Loans to the public	30,690,297	10,122,008	13,161,832	5,409,536	1,253,627	**60,637,300**
Bonds and other interest-bearing securities	6,228,000	1,900,000	5,050,000	1,500,000	-	**14,678,000**
Derivatives	29,545,310	0	7,266,663	6,167,442	6,143,981	**49,123,395**
Total assets	**66,727,564**	**12,022,008**	**25,478,494**	**13,076,978**	**7,397,608**	**124,702,651**
Liabilities						
Liabilities to credit institutions	256,890					**256,890**
Borrowing/deposits from customers	2,103,007					**2,103,007**
Debt securities in issue	42,784,824	901,300	8,464,163	8,397,442	6,893,981	**67,441,709**
Derivatives	29,796,523	6,550,000	10,450,000	2,935,000	429,000	**50,160,523**
Subordinated liabilities	430,000	-	200,000	70,000	-	**700,000**
Total liabilities	**75,371,244**	**7,451,300**	**19,114,163**	**11,402,442**	**7,322,981**	**120,662,129**
Total	–8,643,680	4,570,708	6,364,332	1,674,536	74,627	4,040,523
Interest-rate sensitivity, net	37,764	–32,894	–62,759	–28,104	17,213	
Cumulative interest-rate sensitivity	37,764	4,870	–57,889	–85,993	–68,780	

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

7.2.3. Basis-spread risk and credit-spread risk

Basis-spread risk arises for Landshypotek when the currency risk from borrowing in a currency other than SEK, is reduced through interest and currency swaps. 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 September 2008 would have, with the application of measurement of market value on Landshypotek's portfolio at year-end, generated an impact of about negative MSEK 160 and positive MSEK 145 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. Landshypotek has elected to reduce its funding in foreign currencies as a consequence of the substantial temporary impacts that basis-spread changes can generate.

Credit-spread risk arises from fluctuations in credit spreads in Landshypotek's liquidity portfolio.

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 losses as a result of inappropriate or failed internal processes, human error, faulty systems, external events and legal risks.

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
- Transaction management 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.

One of the tools used by Landshypotek to identify operational risks is an incident reporting system. All employees have access to an online tool for reporting incidents, either suspected or real, and are responsible for reporting these incidents. The Risk Control function is responsible for compiling reported incidents and reporting these to the Bank Management and Board. Anonymous reporting can take place, so the system also functions as a "whistle blower system". The division of reported incidents in 2013 is illustrated in diagram 7. A total of 85 incidents were reported in 2013, for which the cost was TSEK 348.

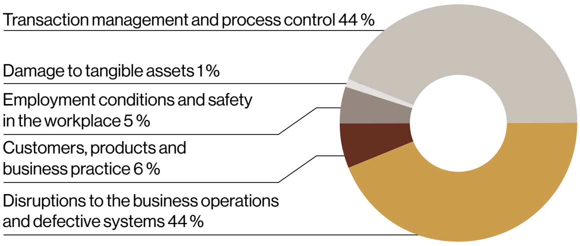
As a complement to the ongoing incident management, a risk analysis is carried out every year by the Risk Control function, where participants from all units at Landshypotek come together to identify operational risks to which the company is exposed. Each risk identified is assessed based on probability 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 Bank Management and Board. The purpose of the annual risk analysis is to, as far as possible, 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 process.

A new enhanced process was prepared for quality assurance and approval of new and changed services, products and systems, etc., the New Product Approval Process (NPAP). This should increase the likelihood of Landshypotek being prepared to manage these changes and, thereby, reduce operational risk. In spring 2013, Landshypotek replaced its proprietary business system with a standardised business system, which is positive from an operational risk perspective over time.

8.3. Regulatory capital requirement for operational risk

Landshypotek utilises the basic indicator approach under Pillar I to calculate its regulatory capital requirement for operational risk, which amounted to MSEK 93 in 2013.

Diagram 7 Specification of reported incidents 2013



No incidents were reported in other categories.

9. Internal Capital Adequacy Assessment Process

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

The 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 and operational risks, the capital requirement is also assessed for risks including interest-rate risks, currency risk, credit-spread risk, basis spread risk, liquidity risk, rating risk, reputational risk and strategic risks. Stress tests are also used for the assessment of the capital requirement.

The Board has overall responsibility for the capital adequacy assessment process. The ICAAP is established by the Board and the Board's Risk and Capital Committee is used as the preparatory body. Landshypotek's Chief Risk Control Officer is responsible for conducting the ICAAP and for compiling the risk report. 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 capital adequacy assessment process 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.

Landshypotek Bank

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