



Landshypotek Bank

Landshypotek Bank Information regarding capital adequacy and risk management 2018

Pillar III

For a richer life in the countryside

Contents

1 Introduction	1
1.1. Introduction and objective	1
2 About Landshypotek Bank	2
2.1 A member-owned bank	2
2.2 Credit portfolio	2
2.3 Funding	2
2.4 Deposits	3
2.5 Organisation	3
3 Risk management	4
3.1 The bank's objective with risk management	4
3.2 Development of risk management	4
3.3 Risk appetite and risk limits	4
3.4 The bank's three lines of defence	4
4 Credit risk	6
4.1 Definition	6
4.2 Credit risk	6
4.3 Customers	6
4.4 Management of credit risk in the credit portfolio	6
4.5 Counterparty risk – credit risk in treasury activities	9
4.6 Credit losses	10
5 Liquidity risk	11
5.1 Definition	11
5.2 Liquidity risk	11
5.3 Management of liquidity risk	11
5.4 Stress tests	11
5.5 Encumbered assets	12
6 Market risk	13
6.1 Definition	13
6.2 Market risk	13
6.3 Management of market risk	13
7 Operational risks	15
7.1 Definition	15
7.2 Operational risks	15
7.3 Management of operational risks	15
8 Capital adequacy and capital requirements	16
8.1 Own funds	16
8.2 Capital requirements and the combined buffer requirements	16
8.3 Capital ratios	18
8.4 Internally assessed capital requirement	19
8.5 Leverage ratio	19
9 Definitions and explanations	20

1 Introduction

This capital adequacy and risk management report contains information about Landshypotek Bank and its consolidated situation's risks, risk management, capital adequacy and liquidity in accordance with the Basel III rules regarding information disclosure.

1.1 Introduction and objective

The objective of this capital adequacy and risk management report is to publish information about material risks for the consolidated situation, the management of these risks and the current capital and liquidity situation. The report, together with the information in the bank's Annual Report, interim reports and on its website (www.landshypotek.se), meets the disclosure requirements under the CRR, FFFS 2014:12 and the Commission Implementing Regulation (EU) No 1423/2013. This report is published in conjunction with the Annual Report on Landshypotek Bank's website. This report has been reviewed by the Board's Risk and Capital Committee and adopted by the Board of Directors.

The capital and liquidity-related figures in the report pertain to the consolidated situation at 31 December 2018 unless otherwise specified. For the publication of periodic information, where the bank has determined that more frequent disclosure should be conducted, and for Landshypotek Bank AB's capital situation, please refer to the bank's interim reports.

Section 9 contains a list of definitions and abbreviations used in the report together with their explanations.

A corporate governance report is included in the bank's 2018 Annual Report.

2 About Landshypotek Bank

Landshypotek Bank is a member-owned bank with its main operations financing ownership and entrepreneurship for farming and forestry, and living in the countryside.

2.1 A member-owned bank

Landshypotek Bank is a member-owned bank with its main operations financing ownership and entrepreneurship for farming and forestry, and living in the countryside. The bank has a long history dating back to 1836. In 2018, the bank established operations in a new segment — residential mortgages to the public. Landshypotek Bank has 80,000 customers in the farming and forestry sector, as well as mortgage borrowers and savers. The bank is a wholly owned subsidiary of Landshypotek Ekonomisk Förening, which is a financial holding company. The bank has no active subsidiaries. The bank's borrowers in farming and forestry become members of the association, unlike residential mortgage customers with their homes as collateral. At the end of 2018, the association had about 39,000 members that jointly owned the association, and where each member has a vote at the annual regional meetings. The 43 Board members appointed from the respective regions then represent the members at the Association Meeting. All licensable activities are conducted within the bank.

2.2 Credit portfolio

The bank's primary operations comprise lending to private individuals against collateral in immovable property. The bank's total credit portfolio amounted to SEK 72.5 billion. The exposure-weighted loan-to-value (LTV) ratio for lending against collateral in immovable property was 45 percent.

In addition to credit granting, the bank collaborates with DNB with the aim of offering its customers a broader range of financial products.

Farming and forestry

Lending in this segment is essentially granted against collateral in agricultural and forest properties within 75 percent of an internally determined mortgage lending value. Moreover, a smaller percentage of lending is also offered to customers with higher LTV ratios and customers are also offered lending against other forms of collateral, such as EU subsidies, as well as guarantees to some extent. The bank holds a strong position in the Swedish credit market for financing farming and forestry against collateral in agricultural units, with a market share of 25 percent. The bank's lending to farming and forestry amounted to SEK 68.8 billion.

Residential mortgages

Following the bank's entry into a new market by launching home loans against collateral in houses in autumn 2017, the bank started to establish itself as a mortgage provider in this segment in 2018. The mortgage product means the bank can offer loans against collateral in houses to within 75 percent of an internally assessed mortgage lending value. The bank has targeted its offering toward residents throughout Sweden, with a primary target group comprising the general public in areas close to urban environments outside the largest cities. The offering does not encompass lending with collateral in tenant-owner apartments. The bank's lending against collateral in houses amounted to SEK 3.7 billion.

2.3 Funding

Landshypotek Bank funds operations primarily through the Swedish capital and money markets, but also to a lesser extent through international funding. Since 2013, the bank has had a deposit offering, primarily aimed at the bank's members and the general public in Sweden, which has accounted for a growing share of the bank's funding. The bank's funding strategy is to attain an appropriate maturity balance between assets and liabilities.

The bank has a Swedish MTN programme for covered funding within a limit of SEK 60 billion. Moreover, the bank has an EMTN programme for international funding, under which the bank can issue subordinated and senior debt. The programme also allows for the issue of subordinated debt in the form of dated subordinated loans. The limit for the EMTN programme is EUR 3.5 billion, or a corresponding amount in other currencies.

Diagram 1 Maturities of market funding

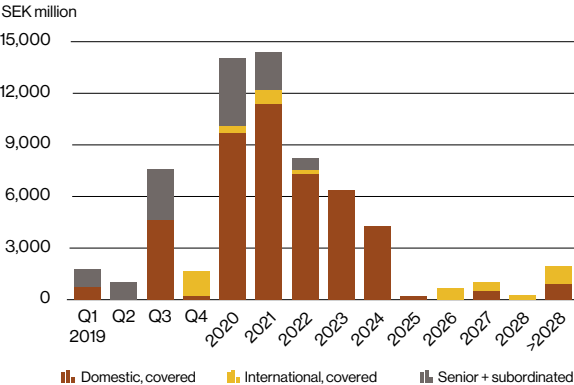
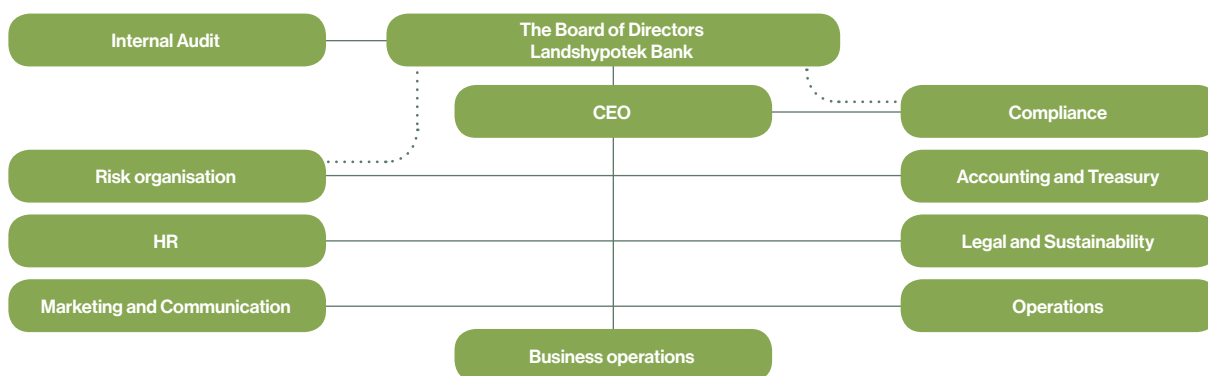


Illustration 1 Organisational overview



A Swedish commercial paper programme of SEK 10 billion covers the bank's short-term funding. While the programme is used sparingly over time, it is used, among other things, for bridge financing when temporary liquidity is needed.

At 67 percent, the covered bonds comprised a majority of the bank's funding at year end. At the same time, senior and subordinated debt comprised 15 percent of funding. The bank had no certificate-based debt outstanding at year end. Deposits are growing as a funding source and comprised 18 percent of funding at year end.

The Swedish National Debt Office has assigned a minimum requirement for own funds and eligible liabilities of SEK 8.3 billion or 10.1 percent of the bank's total liabilities and own funds. Furthermore, the bank is to meet the requirement in terms of the recapitalisation amount pursuant to the liability proportion principle corresponding to SEK 3.5 billion. The bank's MREL eligible liabilities amounted to SEK 11.6 billion to meet the minimum requirement and SEK 5.0 billion to meet the liability proportion principle.

The net stable funding ratio (NSFR), a long-term funding metric, is as yet not a requirement and how it should be calculated has yet to be finally established. The bank is following developments pertaining to the NSFR as a regulatory requirement.

For information about maturities of market funding, see diagram 1.

The bank's issuance strategy is to make one large public issue each year to create greater bond liquidity for investors. Other issues are primarily carried out through smaller private placements initiated by the investor. When it is economically possible, the bank tries to work actively buying back and extending debt to reduce refinancing risks.

2.4 Deposits

In addition to lending, the bank also has a savings offering to the general public, mainly through digital services. The bank currently has a number of savings accounts for the public and forest and forest-damage accounts. The bank's deposit accounts are encompassed by the deposit insurance in accordance with the decision by the Swedish National Debt Office. In 2018, deposits increased SEK 1.4 billion and, at 31 December 2018, deposits totalled SEK 14.1 billion (12.7), representing 18 percent of the bank's funding.

2.5 Organisation

The bank's credit and deposit activities are conducted as one business area encompassing lending to farming and forestry, and for homes. The business area is also responsible for the customer offering and customer service. Loan customers in the farming and forestry sector are primarily processed at local branches. In 2018, the operations were organised into eight districts and have 19 offices across Sweden. The account managers have a good level of local knowledge and expertise in farming and forestry criteria, as well as entrepreneur-driven operations in the countryside. Smaller residential customers in farming and forestry as well as mortgage customers borrowing for houses are processed centrally from Linköping, to handle these smaller customers efficiently and in the same manner. The account managers are well versed in consumer credit granting and have extensive experience with mortgage loans. Contact with customers managed through this organisation is mostly through digital channels and by telephone. A customer service desk is located in Linköping to provide all customers with support. At 31 December 2018, the bank had around 190 employees. The bank is domiciled in Stockholm. Illustration 1 above provides an overview of the bank's organisation.

3 Risk management

Landshypotek Bank has a low risk appetite and promotes a sound risk culture and a low degree of risk undertaking throughout its operations.

3.1 The bank's objective with risk management

A sound risk culture is a high priority at Landshypotek Bank. The bank strives to achieve a high degree of risk awareness in the organisation and a low degree of risk undertaking. A high degree of risk awareness means that each employee understands the risks implied for the bank by the individual's work duties, the degree of risk undertaking that is acceptable and how to behave to avoid exceeding the acceptable level of risk. A low degree of risk undertaking is achieved through setting low levels for risk appetite and risk limits, a clear risk framework with a high level of risk awareness among staff, where customer responsibility also includes responsibility for profitability and the risk in each unique commitment.

The bank's employees are tasked with maintaining high quality in all of the activities undertaken, being sensitive to changes in the macro environment and understanding the impact of these changes on customers, the value of assumed collateral and the bank's business model.

3.2 Development of risk management

Customers, legislators, investors and general macro environmental developments are continuing to raise the requirements for companies in the financial sector. Concurrently, structural changes in the farming and forestry sectors require increasingly larger operations if they are to be competitive. Therefore, the bank continuously develops its operations to meet customer expectations, increased regulation and the structural changes. The bank has continued to work with these challenges in 2018. In addition to enhancing processes, customer offerings and completing comprehensive systems development, the bank continued its goal-oriented efforts to improve the implementation of applicable and new regulations in its operations. This applied not least to regulatory frameworks pertaining to governance, risk management and control. In 2018, the bank's Board also kept focus on corporate governance issues, and revised and adopted a number of policies.

Moreover, a number of improvements were implemented across the bank, and include proactive risk analysis based on the bank's main processes. The measures led, inter alia, to a reduction in risks and a general increase in the efficiency of the bank's risk management.

3.3 Risk appetite and risk limits

Landshypotek Bank has a number of overarching appetites, targets and limits. The bank's rating targets are a key component of the risk appetite and mean that the bank must retain a AAA rating for its covered bonds in line with its Swedish competitors. The bank has an overarching risk appetite for the bank's credit loss level. Over an average economic cycle, the bank's average annual credit losses for the credit portfolio must remain in an interval of 0.025–0.075 percent of the bank's total volume of loans outstanding.

To ensure risk undertaking does not exceed the risk appetite, the bank has identified, categorised and limited all material risks. The bank focuses on assuming only the types of risks that the operations are best able to understand and manage.

The single largest risk to which the bank is exposed is credit risk associated with loans to the public. This risk is directly linked to the business model and is managed throughout the credit process.

Conducting business activities also requires taking certain other risks, including liquidity, market and operational risks. A certain level of acceptance for these types of risks must exist, although the bank aims to keep them at a low level.

3.4 The bank's three lines of defence

To ensure appropriate risk management — to identify, analyse, rectify, monitor and report risk — and internal control, responsibility is divided between various functions based on the three lines of defence principle.

The model differentiates between functions responsible for risk and regulatory compliance (first line of defence), functions for monitoring and control (second line of defence) and functions for independent review (third line of defence).

The first line of defence — business operations

A core principle is that the line organisation forms the first line of defence with responsibility for internal control and risk management. Responsibility for self-assessment is thus located where risk originates. This means that each employee is responsible for managing the risks in their own areas of responsibility. Therefore, internal control and risk management includes all employees.

Illustration 2 Overview of the bank's policies

A–H Internal governance and control policies							
A.0 Internal control and governance policy	B.1 Risk Policy	C.1 Ethics Policy	D.1 Communication Policy	E.1 Product & Partner Policy	F.1 IT Policy	G.1 Security Policy	H.1 HR Policy
A.1 Board Diversity Policy	B.2 Credit Policy	C.2 Sustainability Policy				G.2 Contingency Planning Policy	H.2 Remuneration Policy
A.2 Eligibility Assessment Policy	B.2.A Risk Strategy for Credit Risk	C.3 Customer Complaints Policy				G.3 Information and Cyber-Security Policy	
A.3–6 and 13–14 Work plans	B.3 Operational Risk Policy	C.4 Policy for counteracting money laundering and financing of terrorism				G.4 Policy for Personal Data	
A.7 Board's Reporting Plan	B.4 Financial Risk Policy						
A.8 CEO's Terms of Reference	B.5 Policy for Capital and Liquidity Assessment	C.5 Insider Policy					
A.9 Risk Organisation Policy	B.7 Dividend Policy	C.6 Conflict of Interest Policy					
A.10 Compliance Policy							
A.11 Internal Audit Policy							
A.12 Policy for Independence of External Auditor							

The second line of defence — independent control functions

The risk organisation and compliance are independent control functions and comprise the second line of defence. These functions monitor the business areas' risk management and regulatory compliance. The second line of defence maintains policies and frameworks for the first line of defence's risk management and validates the first line's methods and models for risk measurement and control.

Risk organisation

The risk organisation is responsible for structured and systematic measurement, control, analysis and continuous reporting on all material risks in the bank. The risk organisation's responsibilities include the performance of relevant stress tests and in-depth risk analyses in risk areas where higher risks may exist. The work is conducted pursuant to a policy decided by the Board that describes its responsibilities and an annual plan. The risk organisation is independent from operations and the Chief Risk Officer is directly subordinate to the CEO and the Board.

Compliance

Compliance is tasked with advising and supporting the CEO and employees with ensuring that the bank's operations are conducted pursuant to the regulatory frameworks that govern licensable activities and to identify and report compliance risks. The work is conducted pursuant to a policy decided by the Board that describes its responsibilities and an annual plan. The Compliance unit is independent from business operations and the Chief Compliance Officer reports directly to the CEO and Board.

Third line of defence — internal audit

The third line of defence, internal audit, evaluates the bank's overall management of risk and regulatory compliance, and reviews the work of the first and second lines of defence. Internal audit work aims to examine and evaluate internal governance and controls as well as provide an image of how well processes and procedures contribute to the operational goals. This includes, not least, the evaluation of the effectiveness of the risk management efforts and the work of the control function. The internal audit review initiatives are conducted pursuant to a policy decided by the Board that describes its responsibilities and an annual plan. During 2018, the bank's internal audit was carried out by Deloitte AB.

4 Credit risk

Credit risk is the most significant risk for Landshypotek Bank; therefore, the bank has clear rules for credit risk management.

4.1 Definition

The bank defines credit risk as follows:

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

4.2 Credit risk

Landshypotek Bank's loans to the public totalled SEK 72.5 billion and all lending takes place in Sweden. Lending mainly encompasses private individuals resident in the countryside against collateral in immovable property, primarily agricultural and forest properties. In 2018, lending against collateral in houses grew to slightly more than SEK 3.7 billion. The allocation of the bank's credit portfolio presented in Table 3 mirrors the customer focus and shows that the geographic distribution in Sweden is favourable. The credit portfolio has grown by SEK 11.8 billion since 2013, corresponding to average lending growth of 3.6 percent per year over the past five years. Average lending per bank customer amounted to SEK 1.7 million. The exposure-weighted LTV ratio was 45 percent for lending related to collateral in agricultural and forest properties and 43 percent for lending related to collateral in houses. The bank uses the IRB approach to cover the capital adequacy requirements for more than 99 percent of the exposure value in the credit portfolio and attributes loans within the IRB approach to the following exposure classes *Retail – real estate collateral* and *Corporates*. The exposure value for both these exposure classes totalled SEK 74.2 billion.

4.3 Customers

The bank's customers are primarily private individuals who either conduct operations as a sole trader or have salaried employment. A significant majority of Swedish agriculture and forestry is conducted in sole trader format, mainly due to rules pertaining to land acquisitions and the ownership of arable land and forest in Sweden. Only a smaller portion of the bank's customers have farming and forestry as their primary income sources. Most customers live off salaried income, in other cases, salaried income is supplemented with secondary income from business activities, and to a certain extent the bank also has customers who only have income from business activities.

As regards the bank's loans to the public, customers are placed in the following categories: i) Individuals,

ii) Micro-enterprises, iii) Small enterprises or iv) Medium-sized enterprises based on data pertaining to income, business turnover, size of credit limit and whether the counterparty is a legal entity or a private individuals.

4.4 Management of credit risk in the credit portfolio

Credit process

The bank's credit policy sets out the frameworks and fundamental principles for granting credit at Landshypotek Bank. All granting of credit at the bank 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. The bank requires collateral to further protect itself against credit losses. This collateral almost exclusively comprises mortgage deeds in immovable property. 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. Credit granting must always be in proportion to the income or cash flows that are to cover loan payments. Credit granting is the result of analysis of the individual customer and/or the limit group to which the customer is linked. The bank's customers are risk classified as described in the Probability of Default (PD) section below. Credit granting at the bank is performed pursuant to a credit mandate matrix approved by the Board, which is governed by parameters such as total credit limit, LTV ratio and PD risk class. All credit decisions are taken in duality, utilising a level structure that complies with the aforementioned credit mandate matrix. The highest decision-making body for day-to-day credit cases is the Board's Credit Committee. As previously stated, the bank grants loans against collateral in immovable property within 75 percent of an internally determined mortgage lending value. In addition, the company offers a smaller amount of lending with higher LTV ratios, short-term loans with EU subsidies as collateral (EU loans) and some guarantees. To reduce the risk of loss, some borrowers need to provide additional collateral, such as sureties and chattel mortgages. District office account managers are assisted in the property valuation process for farms and forest by certified valuers from Landshypotek Ekonomisk Förening's organisation of representatives or other approved external valuers. The valuers ensure that the more complex properties are correctly valued using documented industry experience and a high degree of familiarity with local conditions. A certification process that includes training and written exams ensures the quality of assessments made by

valuers from the network of representatives. Less complex properties are valued in conjunction with credit granting, primarily by internally certified valuers. Houses are almost exclusively valued using a method supplied by UC (UC Bostadsvärdering), but objects that are more complex or more difficult to value require valuation by an authorised estate agent/valuer.

The IRB approach

Internal Ratings Based (IRB) approach

The bank uses the advanced IRB approach for exposures classified by the bank as *Retail – real estate collateral* and the foundation IRB approach for *corporate exposures*.

The bank's IRB approaches are integrated in the credit process through the impact of their risk parameters on pricing, the credit decision procedure, the frequency of credit monitoring and through inclusion in the decision data for credit decisions. In addition, the Board and parts of the Bank Management receive regular reports on the status of the credit portfolio, based on such factors as PD risk classes and expected losses.

Description of the bank's IRB models

Probability of Default (PD)

Landshypotek Bank has two PD models. PD model 1 is used for the risk classification of the bank's customers who are private individuals under the categories: i) Individuals, ii) Micro-enterprises and iii) Small enterprises. Individuals almost exclusively encompasses consumers with salaried employment, no business activities or only very minor business activities. Average sales, over and above salaried income, for private individuals classified as Micro-enterprises or Small enterprises is SEK 1.0 million. PD model 1 includes internal payment history statistics, any financial reporting, time as a customer and a UC model as risk drivers. PD model 2 is used for the risk classification of the bank's customers which are legal entities and private individuals that are categorised as Medium-sized enterprises. For the latter the average sales are

SEK 9.8 million. PD model 2 comprises internal payment history statistics, financial statements, LTV ratios and a UC model as risk drivers.

The PD models are statistical models that are used to estimate the probability of a customer defaulting within one year. In addition to statistical risk classes, it is possible to manually set a PD risk class if the account manager believes the statistical risk class does not accurately reflect the default risk. An upgrade is limited to one risk class step, while downgrades may be carried out without limit to the number of steps. An upgraded risk class is never decided on at a level below the Central Credit Advisory Committee, which is the bank's second highest body for day-to-day credit cases.

PD model 1 allocates exposures to risk classes 1–8 and PD model 2 to A–H. The risk classes 1 and A represent the highest credit quality and risk classes 8 and H comprise credits in default. The bank estimates the PD for each performing risk class for capital adequacy purposes. For this reason, the last seven years of actual data is used as a basis and, in addition, a conservative business cycle adjustment is applied that also takes into account outcomes from the financial crisis years in the early 1990s as well as a margin of conservatism (MoCs). Further stress is applied to the above risk class PD value through a Finansinspektionen formula for the calculation of the regulatory capital requirement. Diagrams 2 and 3 present the allocation of exposure by risk class for the two PD models.

Loss Given Default (LGD)

The bank's LGD model is used for credits in the exposure class *Retail – real estate collateral* with the lien's priority as the risk driver. The assessment of how much of the exposure value in the exposure class that the bank stands to lose in the event of default, is based on internal loss data gathered during the period 1994–2008. Thereafter, the outcome per LGD risk class has been adjusted upward to estimate LGD values under unfavourable conditions. The LGD values are calibrated to correspond to LGD outcomes

Diagram 2 Exposure per PD-risk class, PD-model 1

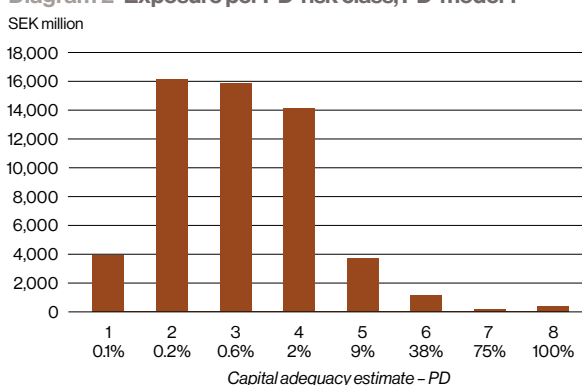


Diagram 3 Exposure per PD-risk class, PD-model 2

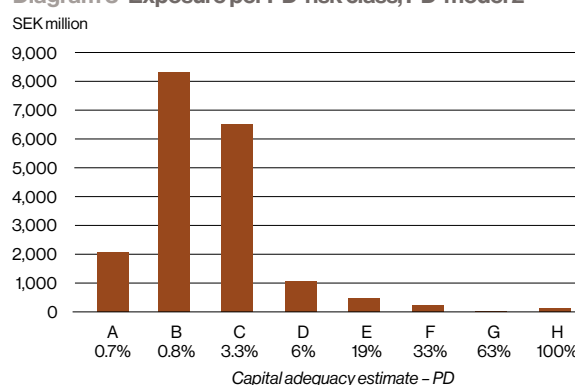
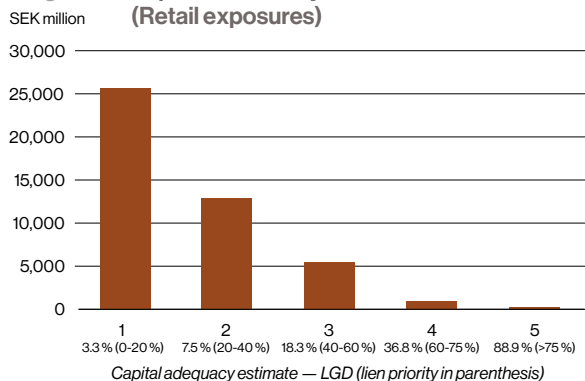


Diagram 4 Exposure value by LGD risk class (Retail exposures)



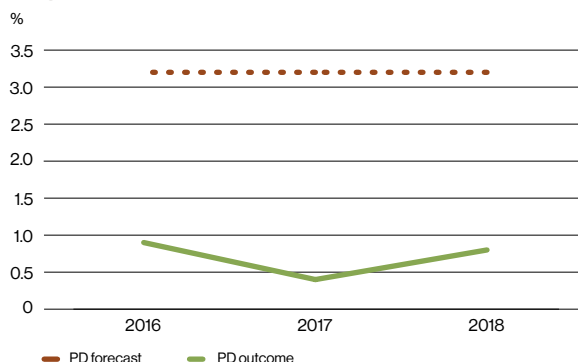
for 1994. Thereafter, an MoC increment has been applied to the LGD values for all LGD risk classes and certain LGD values have been adjusted up further to create a healthy margin between latter years' risk class outcomes and risk class estimates. Loans are allocated to one or several of the five LGD risk classes depending on the lien priority. Diagram 4 presents the allocation of exposure by LGD risk class.

Prescribed LGD values are used for corporate exposures. For collateral in the form of immovable property with an LTV ratio below 71.4 percent, which essentially encompasses all of the bank's corporate exposures, the LGD is 35 percent. The bank's assessment is that this 35 percent constitutes a conservative estimate of the actual risk for the actual exposures. By way of comparison, the bank's LGD model would have given an average LGD of 12 percent for these corporate exposures.

Conversion Factor (CF)

The exposure value is the amount that the counterparty is expected to owe to the bank in the event of a default. For standard loans, exposure value is calculated as the loan

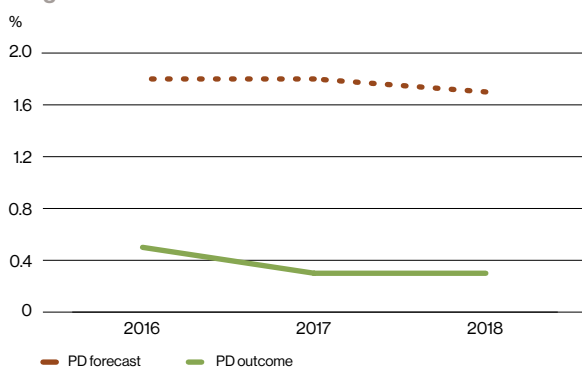
Diagram 6 PD forecast and outcome for PD model 2¹⁾



¹⁾ Counterparty-weighted PD forecast at the start of the year and PD outcome in following years.

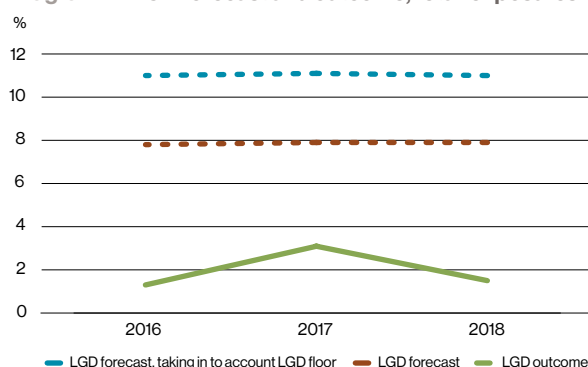
receivable outstanding. For retail exposures within the framework of the bank's *Flexible first lien mortgage loans* where parts of the commitments are off-balance-sheet items, the exposure value is calculated by multiplying the counterparty's credit limit by the bank's internal CF value. This CF is applied on the entire credit ceiling of the flexible first lien mortgage loan and is conservatively set at 107 percent. The exposure value for these flexible first lien mortgage loans totalled SEK 1.3 billion. Exposure values are also calculated for the bank's credit commitments, which are off-balance-sheet. This is carried out for retail exposures by multiplying the amount of the loan commitment by the bank's internal CF value of 92 percent. The exposure value for these loan commitments totalled SEK 1.1 billion. The bank has insufficient outcome data to fully validate and confirm that the CF value of 92 percent is adequate for loan commitments related to the new residential mortgage loans. For this reason, the bank is adding a margin pursuant to Article 3 of the CRR that entails the calculation of capital requirements for residential mortgage loan commitments using a CF of 100 percent.

Diagram 5 PD forecast and outcome for PD model 1¹⁾



¹⁾ Counterparty-weighted PD forecast at the start of the year and PD outcome in following years.

Diagram 7 LGD forecast and outcome, retail exposures¹⁾



¹⁾ Opening estimate at the start of the year and outcome in the following years for retail exposures. Exposure-weighted LGD, the LGD outcome is allocated to the year the default terminated. The current LGD estimate has also been applied for earlier years.

Validation

The bank's internal models and methods used under the IRB approach are validated each year to ensure, inter alia, that the bank adequately estimates credit risk and that the models appropriately grade borrowers and lending according to risk. The analysis results in a validation report, which is presented to and examined by the bank's Balance Sheet and Income Statement Committee.

Forecast and outcome for PD and LGD

PD should represent the long-term average for risk of default and this means that the likelihood of default in a specific year exceeding the forecast is higher for PD than for LGD, where the forecast reflects the expected share of losses, given default under unfavourable economic conditions. Diagrams 5, 6 and 7 show that PD and LGD outcomes have been below forecasts in each of the past three years.

Monitoring of the credit portfolio

Landshypotek Bank's Chief Risk Officer is responsible for preparing and implementing internal governance documents for the credit process and the first line of defence is responsible for ensuring compliance with the internal rules for credit granting. The credit control unit performs regular checks to ensure that operations comply with established regulatory framework and monitoring activities.

All commitments are subject to credit monitoring on a scheduled and ongoing basis. Customers with higher risk levels are monitored more frequently. 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. The credit control unit uses portfolio analysis to identify sectors and segments, where risk has risen, for further assessment.

Management of problem loans

Operations at the bank bear full responsibility for customer relationships, profitability and risks in all customer commitments. When needed, operations is assisted by the central departments with in-depth analyses and with managing problem customers and insolvency cases. The bank's unit for special issues assists with expertise with regard to problem commitments and confirmed insolvency cases.

The bank's insolvency unit works primarily with defaulting commitments with the aim of discontinuing the loans with a minimal loss for the bank.

4.5 Counterparty risk — credit risk in treasury activities

Landshypotek Bank's counterparty risks comprise the risk of default by counterparties in the bank's funding operations. Counterparty risks arise as a consequence of the bank's management of liquidity, interest-rate and currency risks. Risk tolerance for counterparty risk is generally low.

Table 1 Liquidity portfolio by rating, measured at fair value (SEK thousand)

	Covered bonds	Municipal bonds	Total
AAA	5,774,305	1,934,626	7,708,931
AA+	0	3,329,478	3,329,478
Total	5,774,305	5,264,104	11,038,409

Table 2 Derivative contracts by credit quality step¹⁾, measured at fair value (SEK thousand)

	Positive market value	Exposure amount before credit risk mitigation techniques incl. netting gains and collateral received ^{2) 3)}	Exposure amount after credit risk mitigation techniques incl. netting gains and collateral received ^{2) 3) 4)}
1	582,772	531,169	531,169
2	444,157	627,301	627,301
3	99,172	14,617	14,617
4-6	0	0	0
Total	1,126,101	1,173,087	1,173,087

¹⁾ In accordance with the Commission Implementing Regulation (EU) 2016/1800.

²⁾ Landshypotek Bank received SEK 439,379,000 in cash collateral under derivative contracts.

³⁾ Netting gains amounted to SEK 487,982,000.

⁴⁾ The bank does not use credit risk mitigation techniques.

Table 3 Exposure value, defaulted loans and credit loss allowances by sector (SEK million)

	Exposure value	Of which: defaulted loans	Credit loss allowance
Corporate market			
Gotland	2,694	10	1
Middle Sweden	11,656	155	15
Mälardalen	9,179	20	6
The North	3,898	52	12
Skåne	11,175	64	21
Småland, etc.	7,600	65	9
Västra Götaland	7,861	89	12
Östergötland	11,432	54	3
Retail market			
Rural living — farms	5,118	19	1
Mortgages	3,816	2	0
Total	74,430	529	80

The bank's total counterparty exposure comprises:

- the market value of securities;
- the exposure value of derivative instruments calculated based on the mark-to-market approach stipulated in the CRR; and
- cash deposits.

Counterparty risk may only be undertaken against:

- public bodies that are assigned 0 percent in risk weight for capital adequacy; and
- financial institutions.

New counterparties are approved and limited by the Board and existing limits are reviewed and decided each year. Limits are set for exposure values and tenors. All of Landshypotek Bank's derivative contracts are registered in the cover pool, and the bank has International Swaps and Derivatives Association (ISDA) agreements and unilateral Credit Support Annexes (CSAs) in place for each counterparty, whereby the counterparties provide collateral under certain conditions. Under these agreements, Landshypotek Bank can never be obligated to provide collateral.

The bank has a permission from Finansinspektionen to net derivative exposures with the same counterparty for capital adequacy purposes.

The allocation of the bank's liquidity portfolio and derivative contracts, by rating and credit quality step, are shown in tables 1 and 2 respectively.

4.6 Credit losses

Net credit losses amounted to SEK 8.0 million (12.5) and confirmed losses totalled SEK 41.4 million (22.8) in 2018. Landshypotek Bank implemented its credit loss allowance pursuant to IFRS 9 as of 1 January 2018, which amounted to SEK 83.1 million at 31 December 2018. The credit loss allowance decreased SEK 27.6 million during the year, mainly due to a reduction in stage 3 credit loss allowances. The reduction was due to the termination of problem commitments and low growth in stage 3 exposures. In 2018, the bank dissolved the collective provisions for the wind power portfolio due to the improved industry climate and after individual assessment of all commitments secured against collateral in wind turbines. The exposure value of defaulted loans was SEK 529 million (680). See table 3 for more details about the bank's defaulted loans. The bank continuously develops its work with the credit portfolio. Central units assist operations with in-depth analyses and with managing problem customers and insolvency cases. Credit losses over the past few years pertain to a few isolated customers, where the prerequisites of the individual entrepreneurs proved the deciding factors for the customers' default.

5 Liquidity risk

Landshypotek Bank's appetite for liquidity risk is low and the bank has a liquidity reserve that allows the bank to operate normally even during extended periods of stressed liquidity.

5.1 Definition

Landshypotek Bank defines liquidity risk as follows:

The risk of being unable to discharge its payment obligations at the due date.

5.2 Liquidity risk

Landshypotek Bank's assets almost exclusively comprise loans with collateral in immovable property with LTV ratios below 75 percent of the internally assessed LTV ratio and with long credit periods. The bank is largely dependent on market funding, which on average has shorter tenors thereby giving rise to refinancing risk. To diversify financing and to reduce refinancing risk, the bank offers deposit accounts. However, deposits mean that the bank has a risk of outflows in stressed conditions.

Refer to Table 4 to see a maturity analysis of the bank's financial assets and liabilities.

5.3 Management of liquidity risk

The bank's operations are naturally exposed to liquidity risk and the consequences of a lack of liquidity can be serious. Therefore, the bank's appetite for liquidity risk is low and the management of liquidity risk is of high priority. The bank reduces its liquidity risk by maintaining a liquidity reserve comprised of high-quality securities. This reserve gives the bank the opportunity of bridging temporary strains on liquidity, but also provides the opportunity of procuring funds at times of severe liquidity crises by borrowing against or selling securities in an orderly fashion and reducing the financing need. The main criterion for the selection of assets is that the security is accepted as collateral by the Riksbank, Sweden's central bank.

In order to maintain good payment capacity, the Board has decided that a liquidity reserve should be available that correspond to the forecast, accumulated net cash outflows for the next 180-day period and the outflows of deposits in periods of stress, without any possibility of refinancing. Under this measurement method, the liquidity reserve in the cover pool may only be used to measure outflows from the cover pool. At 31 December 2018, the bank had sufficient funds available to cover all payment obligations for about 242 days under this metric.

In addition to the above set and defined limit, a number of risk metrics are monitored. However, these risk metrics are not limited, but are used either to follow the

status of the liquidity reserve or are governed by legislation or regulations.

The bank also applies ratio limits for the liquidity reserve, based on it covering net outflows over a 33-day significant stress period and in accordance with the LCR requirement specifying a 30-day period. The LCR for the consolidated situation was 357 percent. The requirement is 100 percent, and since the establishment of LCR measurements, the bank has never been below this requirement.

The holdings in the liquidity reserve comprise covered bonds issued by Nordic credit institutions with high credit ratings and bonds issued by Swedish municipalities and county councils, as well as bonds issued by Kommuninvest.

The market value of the liquidity reserve was SEK 11 billion, of which 36 percent comprised supplemental collateral in the pool for covered bonds. 57 percent of the liquidity reserve comprised securities with a AAA rating. No security had a rating below AA+.

5.4 Stress tests

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

- a stop in the borrowing market, no new deposits are available;
- lower market values of the investments in the liquidity reserve;
- customers stop paying interest and repaying their loans;
- full utilisation of customers' flexible loans in the first month; and
- withdrawals from deposits.

The stress tests carried out by the bank have indicated a healthy payment capacity even if several different events that have a negative effect on liquidity were to occur simultaneously. At 31 December 2018, the bank was able to meet its payment obligations for about 192 days when stress was applied to all parameters. Withdrawals from deposits is the single scenario that has the most significant negative impact on liquidity. In such a scenario, the fact that the bank's deposit products are covered by the national deposit insurance comprises a risk-mitigating factor. The bank believes that the current payment capacity is satisfactory and corresponds well to the bank's low appetite for liquidity risk.

Table 4 Maturity analysis for financial assets and liabilities (SEK thousand)

	<3 months	3–12 months	1–3 years	3–5 years	>5 years	Total
Financial assets						
Loans to credit institutions	539,948	0	0	0	0	539,948
Loans to the public	49,699,804	9,857,007	9,805,418	3,237,646	437,197	73,037,073
Bonds and other interest-bearing securities	224,748	2,506,620	5,954,403	2,471,727	0	11,157,497
Derivatives	46,071	1,585,623	1,662,027	553,648	3,192,030	7,039,399
Total	50,510,570	13,949,250	17,421,849	6,263,021	3,629,227	91,773,917
Financial liabilities						
Liabilities to credit institutions	954,103	0	0	0	0	954,103
Borrowing/deposits from the public	14,149,540	0	0	0	0	14,149,540
Debt securities issued	1,858,972	10,564,652	28,297,523	14,619,840	9,710,999	65,051,986
Derivatives	22,495	1,619,304	1,446,920	335,526	2,727,721	6,151,965
Subordinated liabilities	6,864	23,887	1,253,658	0	0	1,284,409
Other liabilities	0	0	0	0	0	0
Total	16,991,974	12,207,842	30,998,101	14,955,366	12,438,720	87,592,003
Contracted cash flows	33,518,596	1,741,408	-13,576,253	-8,692,345	-8,809,493	4,181,914

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, which reflects what would happen if operations were to cease as of 31 December 2018. The calculation of future rates of interest is based on forward rates plus any credit spreads.

5.5 Encumbered assets

Landshypotek Bank's lending is largely financed through covered bonds. This provides the bank with a relatively high degree of encumbrance. At 31 December 2018, the bank's encumbrance ratio, that is the ratio of encumbered assets to total assets pursuant to Article 100 in

the CRR, was 80 percent, with the assets in the cover pool for issuing covered bonds representing the source of encumbrance. A total of SEK 69 billion of the bank's assets were encumbered at 31 December 2018. Refer to Table 5 for more information about the bank's encumbered assets.

Table 5 Disclosures, encumbered assets, consolidated situation (SEK million)

	Carrying amount of encumbered assets	Carrying amount of unencumbered assets
Bonds and other interest-bearing securities	0	11,038
Other assets	68,596	5,756
Total	68,596	16,795
	Fair value of pledged collateral received or own issued interest-bearing securities	Fair value of collateral received or own issued interest-bearing securities that can be encumbered
Bonds and other interest-bearing securities	0	0
Other collateral received	0	0
Total	0	0
	Matching liabilities, contingent liabilities or securities lent	Assets encumbered, collateral received and own interest-bearing securities issues excluding covered bonds and asset-backed securities
Total	51,764	68,596

6 Market risk

Landshypotek Bank does not set any prices and conducts no trading operations, which mean the bank's market risk is low.

6.1 Definition

Landshypotek Bank is exposed to market risk in the form of interest-rate risk, currency risk, credit-spread risk and basis-spread risk, which are defined as follows:

- Interest-rate risk — *The risk that the market value of discounted future inflows and outflows will develop negatively as a result of changes in interest rates.*
- Currency risk — *The risk of losses on borrowed, lent or invested capital when exchange rates fluctuate.*
- Credit-spread risk — *The risk of decreased market values as a consequence of widened spreads for risk-free interest for assets measured at fair value.*
- Basis-spread risk — *The risk of decreased market values for derivatives entered into on borrowing in foreign currencies that cannot be compensated with a corresponding change in the market value of the issued debt instrument.*

6.2 Market risk

Interest-rate risk arises in the bank's core operations and is attributable to differences in tenors between assets and liabilities. Currency risk arises in the bank's international funding when there is a change in exchange rates. Credit-spread risk arises in the bank's management of liquidity risk when the credit ratings for the assets comprising the liquidity reserve change. Basis-spread risk arises as a consequence of the reduction of the first two risks through the use of derivatives.

6.3 Management of market risk

The financial risk policy regulates how market risks are to be measured and reported and sets the framework for the bank's appetite for market risks. The bank's Treasury unit manages the bank's market risks. Derivative instruments are used to efficiently reduce the effects of changes in the interest-rate and currency markets on the bank's assets, liabilities and earnings.

Interest-rate risks

Interest-rate risk arises when fixed-interest terms for assets and liabilities are mismatched and is measured, inter alia, as the changes in the market values that occur from a one-percentage-point parallel shift in the interest-rate curve. The total risk is measured daily and

limited, and divided into different time slots. Measurement excludes customer margins and uses equity as financing for customers' loans outstanding, with an average tenor of about two to three years. The Treasury unit also has a smaller deviation mandate of +/- SEK 10 million for the practical management of the interest-rate risk. At year end, the interest-rate risk was SEK 1.7 million according to this metric. With a fixed-interest period of zero for equity, the interest-rate risk in the banking book was negative SEK 68.6 million. The bank utilises interest-rate swaps as a tool for managing interest-rate risks.

Refer to Table 6 to see the fixed-interest terms for the bank's interest-bearing assets and liabilities.

Currency risks

The bank has no appetite for currency risks. The currency risk that arises when raising funds in currencies other than SEK is hedged by taking all of the cash flows in the external currency and reflecting them in the derivative contracts used to hedge currency and interest-rate risk. In nominal amounts, the bank's financing in foreign currency amounted to SEK 5.2 billion.

Credit-spread risk and basis-spread risk

Credit-spread risk arises as a consequence of the bank reducing its liquidity risk by holding a liquidity reserve of liquid bonds. Credit-spread risk is created by movements in credit spreads for the assets that comprise the liquidity reserve. The bank has hedged value changes related to the interest-rate conditions that impact the underlying assets, but value changes related to market perceptions of credit risk have not been hedged. The bank measures these changes in value and it is this portion of the total changes in asset value that impacts the income statement and balance sheet. The bank limits credit-spread risk by setting maturity limits on individual holdings and by only buying securities with high credit ratings, which reduces credit-spread volatility. Moreover, the bank has a limit of 2.5 years for the average tenor in the liquidity portfolio to further reduce the risk of undesirable earnings impacts.

Basis-spread risk arises for the bank when the currency and interest-rate risk from borrowing in a currency other than SEK, is reduced through derivatives. The hedging of cross-currency interest-rate swaps means that the bank's foreign currency payments are swapped for payments in SEK, thus allowing the bank to hedge currency and interest-rate risk in foreign currencies even though concurrent basis-spread risk arises. Earnings

effects arise when changes in the market values of cross-currency interest-rate swaps are not matched by corresponding market value changes in the issued debt. Basis spreads have been volatile in recent years and can contribute to relatively substantial impacts on earnings. Due to increased volatility in basis spreads, the bank has

chosen not to take up any funding in foreign currencies since 2011. However, if the bank does not terminate the derivatives, the net earnings impact on expiry would be zero, but derivatives can impact the earnings of individual interim periods or calendar years.

Table 6 Fixed-interest terms for the Group's interest-bearing assets and liabilities (SEK thousand)

	<3 months	3–12 months	1–3 years	3–5 years	>5 years	Total
Assets						
Loans to credit institutions	539,948	0	0	0	0	539,948
Loans to the public	49,413,083	9,594,840	9,462,080	3,142,041	389,931	72,001,976
Bonds and other interest-bearing securities	5,988,000	150,000	3,725,000	960,000	0	10,823,000
Derivatives	25,630,780	1,678,378	7,208,673	12,413,403	4,744,032	51,675,266
Total assets	81,571,812	11,423,219	20,395,753	16,515,445	5,133,963	135,040,190
Liabilities						
Liabilities to credit institutions	954,103	0	0	0	0	954,103
Deposits from the public	14,149,540	0	0	0	0	14,149,540
Debt securities issued	30,692,000	3,378,378	8,605,950	12,613,403	4,946,754	60,236,486
Derivatives	34,966,430	4,269,000	10,075,000	2,060,000	505,000	51,875,430
Subordinated liabilities	1,200,000	0	0	0	0	1,200,000
Other liabilities	0	0	0	0	0	0
Total liabilities	81,962,073	7,647,378	18,680,950	14,673,403	5,451,754	128,415,559
Net	-390,261	3,775,840	1,714,802	1,842,041	-317,791	6,624,632
Interest-rate sensitivity, net	627	-2,945	-29,010	-62,415	25,095	-68,647
Cumulative interest-rate sensitivity	627	-2,317	-31,327	-93,742	-68,647	

The above table differs from the maturity analysis, which includes all contracted flows, that is, nominal amounts plus contracted interest payments. The table shows nominal amounts for derivatives. Nominal amounts for inflows from derivatives are shown on the asset side and nominal amounts for outflows on the liability side. The amounts have been allocated according to the dates when interest is reset. This differs from the maturity analysis, which includes all contracted flows, that is, nominal amounts plus contracted interest payments.

7 Operational risk

Operational risk at Landshypotek Bank is low, which is a result of the bank's business focus.

7.1 Definition

Landshypotek Bank defines operational risk as:

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

7.2 Operational risk

Landshypotek Bank has a low appetite for operational risk. The bank does not conduct operations in areas that generally generate the largest operating losses for banks. The bank conducts no trading operations or operations related to payment services, nor does it conduct any debit card operations, and conducts relatively uncomplicated operations for a bank.

However, a certain degree of operational risk exists in all operations and the bank breaks operational risk down into the following areas:

- Business and process risk
- Personnel risk
- IT and information security
- External risk

A total of 103 incidents were reported in 2018, and the losses caused by these amounted to SEK 807,000.

7.3 Management of operational risk

The management of operational risk is primarily described in the bank's operational risk policy and risk policy.

The risk policy describes the appetite for operational losses due to incidents and the operational risk policy governs the identification, management and reporting of risks. The operations bear responsibility for operational risk and incidents, and all employees are obligated to act to reduce the risk of operational losses. The bank's risk organisation has a supporting and controlling role in the work with operational risks.

Landshypotek Bank uses a system for incident management and risk analysis, whereby risks and incidents are linked to processes deemed significant for the bank. Identified risks are assessed based on probability and consequence, meaning how likely it is that the risk will materialise and the effect materialisation of the risk will have on the operations. As a complement to the risk analysis, the bank has identified risk indicators that individually or collectively can indicate changes in operational risk levels. The results of the bank's risk mapping, compilation of incidents, risk indicators and proposed actions are presented to the CEO and the Board and the implementation of action plans is followed up. The main purpose of these efforts is, as far as possible, to identify operational risks in the significant processes and to take actions to ensure these risks do not materialise. The incident reporting and the risk mapping are also used as supporting data for the annual internal capital adequacy assessment.

The bank has an established process for significant changes, known as the New Product Approval Process (NPAP). The process aims to ensure the bank is ready to manage new products, services and other significant changes prior to their implementation or launch. Key components in this process comprise the involvement of relevant departments at the bank, transparent discussion of the risks that could arise from the changes and well-documented decisions.

The bank's business continuity management identifies the critical parts of operations with the aim of creating robustness in these areas even in the case of extraordinary events that may be difficult to foresee. Should incident and business continuity management prove inadequate for handling an extraordinary situation, the bank's crisis management processes are activated.

The bank has a decentralised and local network of risk and compliance officers, who are tasked with serving as a link between the bank's control functions and its operations, consulting on the preparation of new policies, assisting with the implementation of new regulatory frameworks and participating in new training initiatives.

8 Capital adequacy and capital requirements

Landshypotek Bank strives to maintain a level of capitalisation that secures the bank's survival even under unforeseen circumstances.

8.1 Own funds

The consolidated situation's own funds primarily comprise member contributions, other contributed equity, retained earnings, other Tier 1 capital and dated subordinated term loans (Tier 2 capital). Own funds for the consolidated situation amounted to SEK 6.2 billion, of which SEK 4.7 billion comprised CET1 capital. The members of Landshypotek Ekonomisk Förening are obliged to contribute capital to the cooperative association in an amount corresponding to 4 percent of the respective member's capital debt to the bank. Members who have repaid their loans and ceased to be members are normally repaid their contributions around three years after ending their membership. However, the repayment of member contributions requires the approval of the Board of the cooperative association. Moreover, the repayment of member contributions requires advance permission from Finansinspektionen as does the inclusion of newly paid-up member contributions as CET1 capital. When calculating CET1 capital for capital adequacy purposes, deductions are made from *CET1 capital before regulatory adjustments*, for regulatory adjustments (deductions), for additional value adjustments, intangible assets, deferred tax assets dependent on future profitability and the IRB deduction. Other Tier 1 capital for the consolidated situation was SEK 0.6 billion and comprised the bank's perpetual subordinated loans, which from an accounting perspective are recognised as equity. Tier 2 capital amounted to SEK 0.9 billion. Refer to Table 7 and Table 8 for further information about the items composing own funds.

8.2 Capital requirements and the combined buffer requirements

Capital requirement

Landshypotek Bank bases calculation of the capital requirement on the rules (Pillar I) as found, inter alia, in the CRR and in FFFS 2014:12. The bank estimates the capital requirement for credit risk, operational risk and credit valuation adjustment (CVA) risk. Moreover, the bank calculates capital requirements pursuant to articles 3 and 458 of the CRR. Article 3 relates to credit risk and comprises an addition for model risk pertaining to loan commitments for mortgages, which is described in more detail in Section 4.4. Article 458 also relates to credit risk and requires a risk-weight floor of 25 percent for banks

that use an advanced IRB approach for the exposure class, *Retail – real estate collateral*. This risk-weight floor has applied previously, but impacted the capital requirement within the Pillar II framework. Following Finansinspektionen's decision, the risk-weight floor was moved to Pillar I from 31 December 2018. The move has a material impact on the bank's capital ratios, which is described in more detail in Section 8.3. However, the change does not affect the internally assessed capital requirement, since the movement of the risk-weight floor only entails reallocation of the capital requirement from Pillar II to Pillar I. Article 458 is applied by Finansinspektionen with the aim of mitigating macroprudential and systemic risks in the form of property bubbles. Finansinspektionen has previously stated that the portion of the risk-weight floor that applies up to 15 percent is due to the authority's assessment that the banks' IRB approaches do not fully capture the risk entailed in these exposures if their average risk weights are below 15 percent. Furthermore, Finansinspektionen states that the portion of the risk-weight floor that pertains to average risk weights between 15 and 25 percent is to take into consideration the broader systemic risks that could arise from Swedish mortgages in the form of households, in conjunction with falling property prices or increased interest rates in combination with an economic downturn, dramatically decreasing their consumption in such a manner that it impacts credit quality in other sectors to which the credit institutions are exposed. Despite the bank's credit portfolio essentially comprising only lending against collateral in agricultural and forest properties, it is covered by the credit portfolio definition that Finansinspektionen has decided will encompass the "risk-weight floor for Swedish mortgages."

The bank uses the IRB approach to cover the capital adequacy requirements for more than 99 percent of the total exposure value in the credit portfolio and uses the advanced IRB approach for the exposure class *Retail – real estate collateral* and the foundation IRB approach for *Corporates*. For capital adequacy purposes, the standardised approach is used for other credit risk, including counterparty risk and CVA risk, and the basic indicator approach is applied for operational risks.

Combined buffer requirement

In addition to the capital requirement, under the Capital Buffers Act and FFFS 2014:12, the bank must have adequate CET1 capital to meet the combined buffer

requirement, which in the bank's case comprises the sum of a capital conservation buffer and a countercyclical buffer of 2.5 and 2.0 percent, respectively, of the total risk exposure amount. In accordance with the decision by Finansinspektionen, the countercyclical buffer will be

raised to 2.5 percent from 19 September 2019. However, the combined buffer requirement differs from capital requirements, since not meeting it is possible on a temporary basis.

Table 7 Capital adequacy analysis (SEK thousand)

	Consolidated situation
CET1 capital: Instruments and reserves	
Member contributions	1,729,349
Other contributed equity	1,797,796
Tier 1 capital instruments	700,000
Reserves	-5,589
Actuarial changes	-23,985
Retained earnings	1,604,633
Net profit for the year ¹⁾	310,086
Equity in the balance sheet	6,112,290
Deductions related to the consolidated situation and other foreseeable costs	-118,787
Deductions for Tier 1 capital instruments classified as equity	-700,000
CET1 capital before regulatory adjustments ²⁾	5,293,503
CET1 capital: regulatory adjustments	
Further value adjustments	-11,038
Intangible assets	-143,497
Deferred tax assets that rely on future profitability	-2,635
Fair value reserves related to gains or losses on cash-flow hedges	0
IRB deductions	-440,272
Defined-benefit pension plans	0
Total regulatory adjustments to CET1 capital	-597,442
CET1 capital	4,696,062
Additional Tier 1 capital: instruments	
Tier 1 capital instruments	0
of which: classified as equity under applicable accounting standards	0
Qualifying Tier 1 capital included in consolidated additional Tier 1 capital issued by subsidiaries and held by third parties	567,186
Tier 1 capital (CET1 capital and other Tier 1 capital)	5,263,248
Tier 2 capital: instruments and provisions	
Capital instruments and subordinated loans eligible as Tier 2 capital	0
Positive amounts resulting from the calculation of expected loss amounts (IRB)	0
Qualifying own funds instruments included in consolidated Tier 2 capital issued by subsidiaries and held by third parties	934,598
Tier 2 capital before regulatory adjustments	934,598
Tier 2 capital: regulatory adjustments	
Total regulatory adjustments to Tier 2 capital	0
Tier 2 capital	934,598
Own funds (Tier 1 capital + Tier 2 capital)	6,197,846
Total risk exposure amount	33,664,443
Capital ratios and buffers	
Own funds requirement	2,693,155
CET1 capital ratio (%)	13.9
Tier 1 capital ratio (%)	15.6
Total capital ratio (%)	18.4
Institution-specific CET1 capital requirement including buffer requirements (%)	9.0
of which: capital conservation buffer requirement (%)	2.5
of which: countercyclical buffer requirement (%)	2.0
CET1 capital available to meet buffers (%) ³⁾	9.4

¹⁾ A decision by Finansinspektionen in February 2018 gave Landshypotek Bank AB approval, subject to specific terms and conditions in the decision, for using the interim or full-year surplus in own-funds calculations for the institute and also for its consolidated situation.

²⁾ This item differs from equity under IFRS in that the proposed dividend's contribution to equity is excluded.

³⁾ Calculated as "the bank's CET1 capital less CET 1 used to cover the CET1 capital requirement and less any other CET1 items used to cover the tier 1 capital requirement and/or total own funds requirements divided by the total risk exposure amount."

Table 8 Subordinated loans Landshypotek Bank

Name of loan	Currency	Nominal amount, SEK thousand	Nominal amount outstanding, SEK thousand	First possible redemption date	Interest rate	Interest rate after first possible redemption date	Due date
AT1SUB	SEK	700,000	700,000	29 Mar 2022	3M Stibor + 4.4%	3M Stibor + 4.4%	Perpetual
EMTN67	SEK	1,200,000	1,200,000	25 May 2021	3M Stibor + 2.7%	3M Stibor + 2.7%	25 May 2026

Table 9 Own funds requirement by risk, approach and exposure class, consolidated situation (SEK thousand)

	Exposure value	Risk exposure amount	Own funds requirement	Average risk weight
Credit risk – IRB approach	74,231,219	25,317,610	2,025,409	34%
Retail – real estate collateral	45,165,912	6,409,183	512,735	14%
Corporates	29,005,804	18,848,924	1,507,914	65%
Other non-credit-obligation assets	59,504	59,504	4,760	100%
Credit risk – Standardised approach	13,109,929	1,259,684	100,775	10%
Central governments or central banks	16,678	0	0	0%
Regional governments or local authorities	5,267,855	0	0	0%
Institutions	1,756,180	546,061	43,685	31%
Corporates	12,009	12,009	961	100%
Retail	39,937	27,798	2,224	70%
Secured by mortgage liens on immovable property	205,154	91,447	7,316	45%
Exposures in default	843	1,243	99	147%
Covered bonds	5,811,272	581,127	46,490	10%
Operational risk – Basic indicator approach		1,447,606	115,808	
Credit valuation adjustment risk – Standardised approach	1,057,527	754,092	60,327	71%
Additional risk exposure amounts under Article 3 CRR		3,154	252	
Additional stricter prudential requirements based on Article 458 CRR		4,882,295	390,584	
Total	88,398,675	33,664,443	2,693,155	

New IRB permissions

In autumn 2017 and spring 2018 respectively, the bank received permission from Finansinspektionen for:

- A new definition of retail and corporate exposures, which has led to the bank's largest customers, who conduct operations as a sole trader, being moved from the retail exposure class to the corporate exposure class.
- To use the foundation IRB approach for corporate exposures.
- A change in the advanced IRB approach for retail exposures.
- A broadening of the application area for the IRB approach to also include lending to legal entities (SEK 2.9 billion in exposure value).

In conjunction with the implementation of the change, the bank also started to use the IRB approach for capital adequacy purposes regarding homeowner mortgages. Since 30 June 2018, the bank has covered the capital adequacy requirements using the new permissions, which has led to an increase in the capital requirement under Pillar I. Since the bank has prepared previously for this increase under Pillar II, the internally assessed capital requirement was unaffected.

Capital adequacy and buffer requirements under Basel III are shown in Table 7. The regulatory capital requirement is divided into risk category, measurement method and exposure class and presented in Table 9.

8.3 Capital ratios

The total capital ratio for the consolidated situation amounted to 18.4 percent (43.8) and the CET1 capital ratio was 13.9 percent (31.7) (16.3 percent excluding the risk-weight floor in Pillar I).

Own funds decreased SEK 0.6 billion to SEK 6.2 billion, primarily as a result of:

i) the consolidated situation, following a clarification from the EBA, being assessed as being encompassed by the rules limiting how large a proportion of the bank's issued Tier 1 capital and T2 capital instruments may be included in own funds and Tier 1 capital respectively for the consolidated situation.

ii) the IRB deduction in *CET1 capital before regulatory adjustments* has risen due to the new IRB permissions described in Section 8.2 and below. The regulatory capital requirement increased SEK 1.4 billion to SEK 2.7 billion, primarily as a result of:

A) The bank, with the new IRB permission described in Section 8.2, now applying a foundation IRB approach for corporate exposures, which in the named order of significance increased capital requirements by:

- a) The assigned average LGD of 35 percent is used, which entails a more than 100 percent increase in the average LGDs previously used for these exposures.

Table 10 Leverage ratio (SEK thousand)

	Consolidated situation
Balance Sheet according to the accounting standards	85,932,414
Adjustment for assets not included in the consolidated situation	0
Adjustment for differences between carrying amounts and leverage exposure — derivatives	-364,920
Collateral adjustments — derivatives	0
Adjustment for differences between carrying amounts and leverage exposure — repos and bond loans	0
Assets recognised off the balance sheet, gross (before adjustments for conversion factors)	2,094,410
Deductions from off-balance-sheet assets or application of conversion factors	1,650,966
Assets recognised off the balance sheet, net	443,444
Other adjustments	-540,069
Assets used to calculate the leverage ratio	85,470,869
Capital used to calculate the leverage ratio	
Tier 1 capital	5,263,248
Leverage ratio	
Leverage ratio calculated using Tier 1 capital	6.2%

b) Higher weighting for downturn years in the bank's PD estimates¹⁾.

c) The application of higher margins of conservatism (MoCs) in the bank's PD estimates.¹⁾

d) Changed method for cyclical PD adjustments, which means the portfolio PD for performing credits is less dependent on the business cycle and thus is more constant over time.

B) The risk-weight floor of 25 percent is also described in Section 8.2. A considerable portion of the bank's exposure value pertains to the exposure class *Retail – real estate collateral* (61 percent) and since the bank's average risk weight, excluding the risk-weight floor, for this portfolio (14 percent) is significantly lower than 25 percent, this results in a considerable increase in the capital requirement.

The bank's CET1 capital to cover the combined buffer requirement and Pillar II requirements corresponded to 9.4 percent of the total risk exposure amount. Refer also to Section 8.4 for a report on the bank's internally assessed capital requirement.

8.4 Internally assessed capital requirement

Within the framework for Pillar II under Basel III, the institute is also responsible for describing and assessing the capital requirement for other material risks not covered by the aforementioned capital and buffer requirements mentioned in Section 8.2. In 2018, the bank's assessment was that within the Pillar II framework the bank had a capital requirement for credit risk, market risk, rating risk and pension risk.

1) The bank has taken into account Finansinspektionen's memorandum (FI-Ref. 15-13020) regarding the number of downturn years for long-term default rates and the EBA's guidelines (EBA/GL/2017/16), which apply from 2021, regarding MoCs in PD estimates.

Among other actions, the bank has prepared under the Pillar II framework in 2018 for the increased capital requirement that will arise as a consequence of the previously mentioned changes that the bank has received permission to use from Finansinspektionen, and which are described in more detail in Section 8.2. The difference that arose following the implementation of the permission in 2018 is only a reallocation between Pillar I and Pillar II. The reallocation was in the form of an increase in the capital requirement and the IRB deduction from *CET1 capital before regulatory adjustments*, while the Pillar II capital requirement is reduced. In other words, the difference between the internally assessed capital requirement and own funds is not impacted. The internal assessment takes into account the capital requirement, the combined buffer requirement and the Pillar II capital requirement. The internally assessed capital requirement for the consolidated situation was SEK 4.8 billion (5.3). The capital requirement should be compared with own funds of SEK 6.2 billion (6.8).

8.5 Leverage ratio

From 2015, a leverage ratio must be calculated and disclosed externally by the bank. As yet, the metric does not give rise to any mandatory capital requirement. The design of the metric and the calibration of requirements is being evaluated by the regulators and a mandatory leverage ratio requirement could, according to the EU regulation (Capital Requirements Regulation (CRR) II) referred by the European Commission from November 2016, be implemented at the earliest in 2019. The proposal means that banks will have to maintain a leverage ratio of not less than 3 percent.

The bank's leverage ratio amounted to 6.2 percent (6.7), refer to Table 10 for further information about the leverage ratio. The deterioration in the leverage ratio mainly pertained to the higher IRB deduction mentioned in Section 8.3, which also had a negative impact on the capital used to calculate the leverage ratio (Tier 1 capital).

9 Definitions and explanations

Advanced IRB approach	An IRB approach with own estimates of loss given default (LGD) values and conversion factors.
Agricultural and forest properties	Agricultural units
Basel III	In Sweden, the Basel III agreement was implemented through the direct impact of the EU CRR and the Swedish implementation of CRD IV, which was implemented through Finansinspektionen's regulations and general guidelines as well as through Swedish legislation.
Basic indicator approach	An approach for calculating the capital requirement for operational risk.
Capital Buffers Act	The Capital Buffers Act (2014:966).
Capital Requirements Regulation (CRR)	Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
CET1 capital	A subcomponent of own funds and primarily comprises equity. Deductions are made for dividends generated, the IRB deduction and intangible assets.
CET1 capital ratio	CET1 capital in relation to the total risk exposure amounts.
CF	The multiplier (conversion factor) used in the calculation of the exposure value for loan commitments and other off-balance-sheet exposures.
Combined buffer requirement	For Landshypotek Bank, this comprises the sum of the CET1 capital requirement, which pursuant to the Capital Buffers Act follows from the capital conservation buffer and the institution-specific countercyclical capital buffer.
Commission Implementing Regulation (EU) No 1423/2013	Commission Implementing Regulation (EU) No. 1423/2013 laying down the implementation of technical standards with regard to disclosure of own funds requirements for institutions.
Consolidated situation	The consolidated situation encompasses Landshypotek Ekonomisk Förening and the Landshypotek Bank Group.
CRD IV	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.
Credit portfolio	Lending to the public in accordance with the balance sheet.
Default	Exposure to a specific counterparty is deemed to be in default if any of the following criteria are met: <ul style="list-style-type: none"> • It is deemed unlikely that the customer will pay its credit obligations in full to the bank without the bank having to take measures to realise collateral. • Any of the customer's significant credit obligations to the bank falling past due by more than 90 days.
EMTN programme	The Euro Medium Term Note programme is an international borrowing programme for issuing covered bonds, senior debt and dated subordinated loans in both SEK and other currencies.
Exposure value	For assets in the balance sheet, this is the recognised value, but for off-balance-sheet items, the obligation is multiplied by the CF.
Exposure-weighted	The weighted-average exposure value.
FFFS 2014:12	Finansinspektionen's (the Swedish Financial Supervisory Authority) regulations regarding prudential requirements and capital buffers, FFFS 2014:12.
Foundation IRB approach	An IRB approach with prescribed LGD values and conversion factors.
Houses	A house.
Internally assessed capital requirement	Comprises the risks covered by the calculation of the capital requirement (Pillar I), the combined buffer requirement and the risks arising in the bank's ICAAP (Pillar II).
IRB deduction	Deductions arising from expected credit losses exceeding the outstanding provisions for credit losses (negative amounts resulting from the calculation of expected loss amounts).

Landshypotek Bank or the bank	Landshypotek Bank AB (publ).
LCR	The liquidity coverage ratio, is a measure of liquidity risk, whereby net cash outflows over a 30-day significant stress period are shown in relation to how much liquidity the bank has.
LGD	Loss given default.
LGD floor	The average exposure-weighted LGD value is steered by a limitation rule that entails a floor for the total LGD level of 10 percent for all retail exposures against collateral in residential properties and 15 percent for all retail exposures with collateral in commercial properties.
Limit group	A group of customers with an internal economic ties of such a nature that financial issues one customer can infect another. Limit groups can also comprise customers with no credit limits.
Loan commitment	Committed, but undisbursed credits.
Loan-to-value (LTV) ratio	The long-term sustainable value of the collateral being loaned against with the bank is never permitted to exceed the market value.
Mortgages on immovable property	The bank accepts mortgage deeds on various types of immovable property as collateral, but almost exclusively agricultural and forest properties, and houses.
MTN programme	The Medium Term Note programme is a borrowing programme for issuing covered bonds denominated in SEK or EUR.
Other Tier 1 capital	A subcomponent of own funds, which comprises perpetual subordinated loans after deductions (regulatory adjustments) pursuant to the CRR.
Own funds	Own funds comprise the total of Tier 1 capital and Tier 2 capital.
Own funds requirement	This means that institutions subject to the CRR must have a CET1 capital ratio of not less than 4.5 percent, a Tier 1 capital ratio of not less than 6 percent and a total capital ratio of not less than 8 percent (own funds requirements). This means that the capital for the respective ratios must amount to the specified percentage of the total risk exposure amount.
PD	The probability of a borrower defaulting within one year (probability of default).
Private individual	Includes both consumers and sole traders with personal liability.
Risk exposure amount	The risk-weight for each risk exposure multiplied by the exposure value is the risk exposure amount (REA).
Risk weight	A metric that describes the risk level of an exposure under the CRR. Calculated by dividing the risk exposure amount by the exposure value for the respective risk exposure.
SEK billion	Billions of Swedish kronor.
SEK million	Millions of Swedish kronor.
SEK thousand	Thousands of Swedish kronor.
Standardised Approach	A method for calculating credit risks, which is based on standardised risk weights. The standardised approach can also be applied for CVA risk.
Tier 1 capital	The sum of CET1 capital and other Tier 1 capital.
Tier 2 capital	A subcomponent of own funds, which comprises dated subordinated loans after deductions (regulatory adjustments) pursuant to the CRR.
Total capital ratio	Total own funds in relation to the total risk exposure amount.
Total credit limit	The total of the credit limits for the borrowers included in a limit group.



Landshypotek Bank