Landshypotek Bank

Landshypotek Bank Information regarding capital adequacy and risk management 2020

Pillar III

For a richer life in the countryside

Contents

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 figures from the balance sheet and income statement together with the capital and liquidity-related data in the report pertain to the consolidated situation at 31 December 2020 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'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, remuneration policy and diversity goals are included in the bank's 2020 Annual Report.

Accounts of the corporate governance, remuneration policy and diversity goals are presented in the bank's 2020 Annual Report in the corporate governance report and sustainability report respectively.

Refer to the page corporate governance under About Landshypotek on the bank's website www.landshypotek.se

2 About Landshypotek Bank

Landshypotek Bank is a memberowned bank with its main purpose financing ownership and entrepreneurship for farming and forestry, and living in the countryside. The bank also offers homeowner mortgages to the general public.

2.1 A member-owned bank

Landshypotek Bank is a memberowned bank with its main purpose financing ownership and entrepreneurship for farming and forestry, and living in the countryside. The bank has a long history dating back to 1836. In 2020, the bank continued to strengthen its operations in retail residential mortgages. Landshypotek Bank has some 81,000 customers in the farming and forestry sector, mortgage borrowers and savers. The bank is a wholly owned subsidiary of Landshypotek Ekonomisk Förening (the association), which is a financial holding company. 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 2020, the association had about 37,000 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. The bank has no subsidiaries.

2.2 Credit portfolio

The bank's primary operations comprise lending to private individuals secured against collateral in immovable property. The bank's loans to the public totalled SEK 83.0 billion and the exposureweighted loan-to-value (LTV) ratio for lending against collateral in immovable property was 42.9 percent.

In addition to credit granting, the bank collaborates with, among others, Lexly, Dina Försäkringar, DNB and Säkra with the aim of offering its customers a broader range of financial services.

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. A negligible share of lending is at higher LTV ratios and against other forms of collateral, such as EU subsidies. To a lesser extent, guarantees are also offered to customers. 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 around 24 percent. The bank's lending to farming and forestry amounted to SEK 71.5 billion.

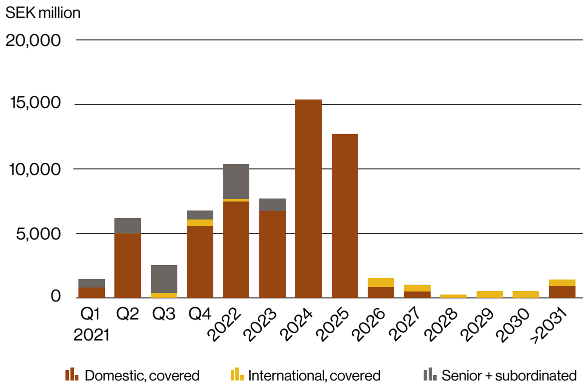
Residential mortgages

Following the bank's entry into a new market, for the bank, by launching home loans against collateral in houses in autumn 2017, the bank continued to clearly profile itself as a mortgage provider in this segment in 2020. 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. The offering does not encompass lending with collateral in tenant-owner apartments. Lending secured against collateral in houses amounted to SEK 11.5 billion at year end. The bank collaborates with Compricer, which acts as a mortgage intermediary, and with Villaägarnas Riksförbund.

2.3 Funding

Landshypotek Bank funds operations primarily through the Swedish capital and money markets, but also to a lesser extent through international funding. No new funding operations outside of the Swedish market have been conducted since 2011. The bank also has a deposit offering, primarily aimed at the bank's members and the general public in Sweden. The bank's funding strategy is to attain an appropriate maturity balance between assets and liabilities. Moreover, the bank has an EMTN programme for domestic and international funding, under which the bank can issue covered, senior and senior non-preferred 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 10 billion, or a corresponding amount in other currencies.

Diagram 1 Maturities of market funding



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

At 72 percent, the covered bonds comprised a majority of the bank's funding at year end. At the same time, senior and subordinated debt (including senior non-preferred) comprised 10 percent of funding. The bank had no certificate-based debt outstanding at year end. Deposits comprised 18 percent of funding at year end.

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 investors. When economically possible, the bank works actively buying back and extending debt to reduce refinancing risks.

Green bond

In November 2020, Landshypotek Bank issued its third green covered bond with underlying properties that conduct sustainable forestry. The properties' forests help bind around 625,000 tonnes of carbon dioxide, while concurrently preserving biodiversity. Investor interest was considerable and the bank raised funding of SEK 2.5 billion through the bond. Altogether, the bank has issued green bonds for a total of SEK 10.75 billion and is the Nordic region's largest issuer of green covered bonds.

Minimum requirement for own funds and eligible liabilities (MREL)

When the Swedish National Debt Office decided in 2017 how Swedish banks and institutions are to be managed in a financial crisis, Landshypotek Bank was deemed a systemically important bank, meaning that were the bank to default in any instance, it would be managed through a resolution procedure.

For the purpose of capitalising the bank in the event of a resolution, the Swedish National Debt Office has assigned an MREL of SEK 6.9 billion or 8.0 percent of the bank's total liabilities and own funds. Furthermore, the bank is to meet the recapitalisation amount requirement pursuant to the liability proportion principle corresponding to SEK 3.2 billion. The bank's MREL eligible liabilities amounted to SEK 10.3 billion to meet the minimum requirement and SEK 3.6 billion to meet the liability proportion principle. In October 2019, the bank completed an initial offering of senior non-preferred (eligible) debt for a nominal amount of SEK 1.0 billion. Following the decision by the Swedish National Debt Office to delay the implementation of the subordination requirement, the bank decided to defer the next issue until 2021. The bank's Board has established that the bank must have a buffer of not less than SEK 300 million in terms of the announced minimum requirement and the liability proportion principle. The bank monitors outcomes on a daily basis and meets the requirement and the limit by a healthy margin.

2.4 Deposits

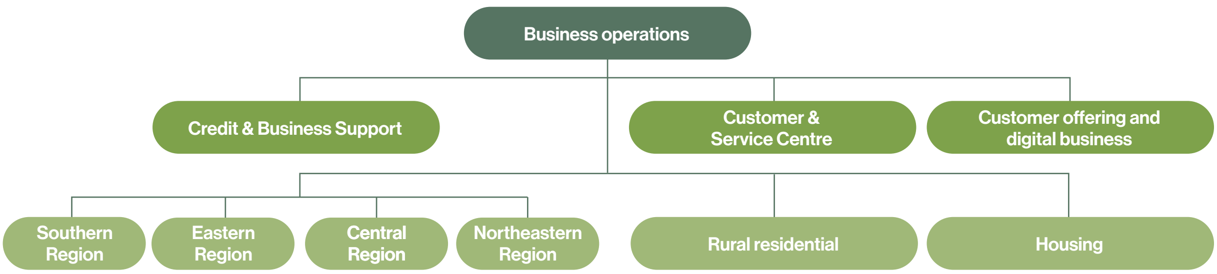
In addition to lending, the bank also has a savings offering to the general public, mainly through digital services. The bank's savings offering encompasses private savings accounts, corporate accounts and forest accounts in which to invest income from forestry. The bank's deposit accounts are encompassed by the deposit insurance in accordance with the decision by the Swedish National Debt Office. At 31 December 2020, deposits totalled SEK 14.7 billion (14.4), representing 18 percent of the bank's funding.

2.5 Organisation

The bank conducts operation through two business areas: one encompassing lending to farming and forestry and the other mortgage lending. The business areas are also responsible for the customer offering and digital business. Loan customers in the farming and forestry sector are processed at local branches as well as digitally and by phone. The bank's branch operations are divided into four geographic regions, see illustration 1.

The bank also divides lending to farming and forestry into three segments, namely: production farming, farming and forestry companies, and living on farms. The bank has 19 offices across Sweden. The account managers in farming and forestry 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 and mortgage customers borrowing for houses are processed centrally from Linköping, to handle these smaller retail customers efficiently and in the same manner through digital channels and by phone. The mortgage advisors are well versed in consumer credit granting and have extensive experience with mortgage loans, all mortgage advisors are licenced by Swedsec. To support all customers, a customer service desk is located in Linköping and a credit and business support unit in the first line. At 31 December 2020, the bank had around 200 employees. The bank is domiciled in Stockholm. Illustration 2 provides an overview of the bank's organisation.

Illustration 1 **The bank's business operations**



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 potential impact of these changes on the bank's customers, collateral and the 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. In addition to enhancing processes, customer offerings and completing comprehensive systems development, the bank continued its goal-oriented efforts to continuously improve the practical implementation of applicable and new regulations in its operations. This applied not least to regulatory frameworks pertaining to governance, risk management and control. In 2020, the bank's Board also kept focus on corporate governance issues, and revised and adopted a number of new 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. Refer to the bank's sustainability report, which is integrated in its 2020 Annual Report, for a description of the bank's sustainability activities and related risks.

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 (defined as seven years), 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

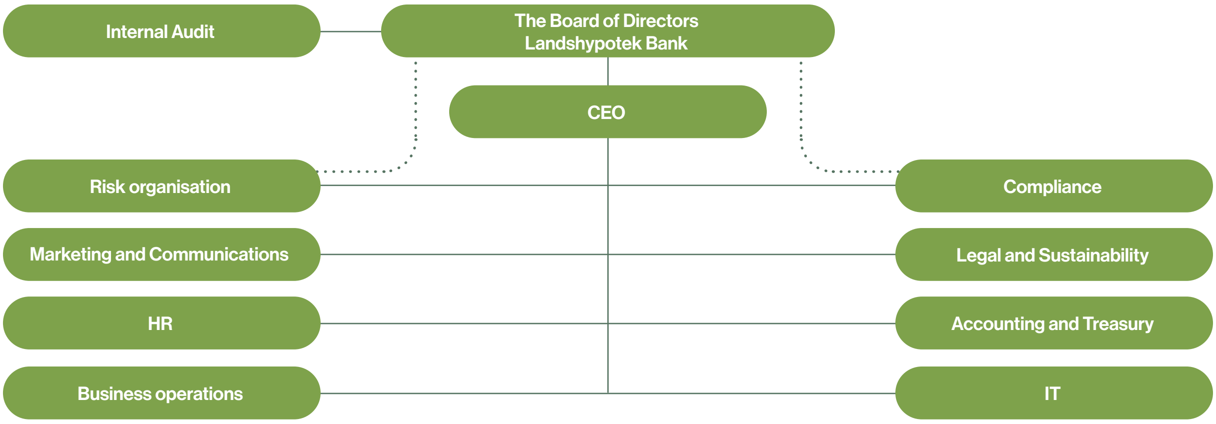
To ensure appropriate risk management – to identify, analyse, rectify, monitor and report risk – and internal control, responsibility is divided between various functions based on the three lines of defence principle. Refer to Illustration 2 for information regarding the bank's overriding organisational structure.

The model differentiates between functions bearing responsibility for risk and regulatory compliance (first line of defence), functions for monitoring, control, advice and support (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 and that requirements applicable,

Illustration 2 Organisational overview



inter alia, to internal control and risk management encompass all employees.

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, validates the first line's methods and models for risk measurement and control, and supports the first line in interpreting and implementing new regulatory frameworks.

Risk organisation

The risk organisation is tasked with providing advice and support to the CEO and employees, and 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 the risk organisation's 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 Compliance's 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 2020, the bank's internal audit was carried out by Deloitte AB.

Illustration 3 Overview of the bank's policies

Policy
- The Board of Directors' overriding rules that comprise the universe in which we operate as a bank.
- What should the bank do?
- Provide the preconditions to the CEO from the Bank's Board.

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 83.0 billion and all lending takes place in Sweden. Historically, lending mainly encompasses individuals resident in the countryside against collateral in immovable property, primarily agricultural and forest properties. However in 2020, most growth was in lending where security comprised collateral in houses, which grew to slightly more than SEK 11.5 billion (7.0). The credit portfolio has grown by SEK 21.3 billion since 2015, corresponding to average lending growth of 6.1 percent per year. Average lending per bank customer amounted to SEK 1.8 million. The exposureweighted LTV ratio was 42.7 percent for lending related to collateral in agricultural and forest properties and 45 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 83.4 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, while in other cases, salaried income is supplemented with secondary income from business activities, and in still other cases the bank also has customers who only have income from business activities.

As regards the bank's loans to the public, customers are categorised based on data pertaining to income, business turnover, size of credit limit and whether the counterparty is a legal entity or a person in the following categories: i) Individuals, ii) Micro-enterprises, iii) Small enterprises and iv) Medium-sized enterprises.

4.4 Management of credit risk in the credit portfolio

Credit process

Landshypotek Bank's credit policy sets out the frameworks and fundamental principles for granting credit at the 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 an 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 daytoday 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. The office account managers are assisted in the property valuation process for farms and forest by certified valuers from Landshypotek Ekonomisk Förening's (the association) organisation of representatives or other approved external valuers. The valuers ensure that the more complex properties are correctly marked-to-market 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 can also be valued in conjunction with credit granting, 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 an advanced IRB approach for exposures classified by the bank as *Retail – real estate collateral* and a 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 physical entities under the categories: i) Individuals, ii) Micro-enterprises and iii) Small enterprises. Individuals almost exclusively encompasses members of the general public with salaried employment, but who have no 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 those of the bank's customers, both legal entities and non-legal entities, that come under the Medium-sized enterprise category.

For the latter customer group, the average sales are SEK 8.8 million. PD model 2 comprises internal payment history statistics, financial statements, LTV ratios and a UC model as risk drivers.

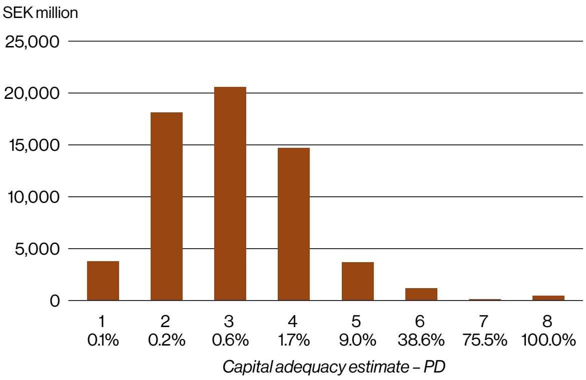
The PD models are statistical models that are used to estimate the probability of a customer defaulting within one year. In addition to statistics-based risk classes, it is possible to manually set a PD risk class if the account manager believes the statistical risk class does not accurately reflect 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 at a level below the Central Credit Advisory Committee, which is the bank's second highest decision-making body for day-to-day credit cases.

PD model 1 categorises exposures under risk classes (1–8) and PD model 2 under 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 nine 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 margins 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 LGD risk class for the two PD models.

Loss Given Default (LGD)

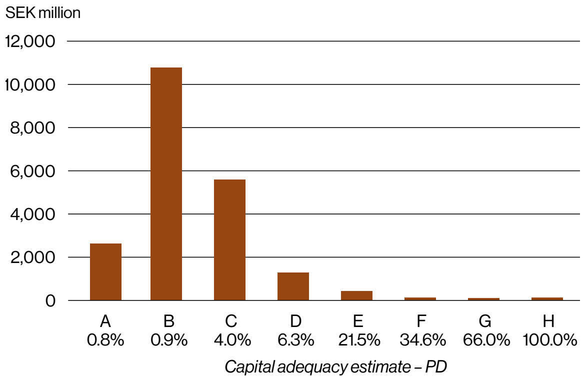
The bank's LGD model is used for credits in the exposure class *Retail – real estate collateral* with the lien's priority as the risk driver. The assessment of how much

Diagram 2 Exposure value per PD risk class, PD model 1[1]



[1] *Customers who are physical entities under the categories: i) Individuals, ii) Micro-enterprises and iii) Small enterprises.*

Diagram 3 Exposure value per PD risk class, PD model 2[1]



[1] *Customers, both legal entities and physical entities, included in the category iv) Medium-sized enterprises.*

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

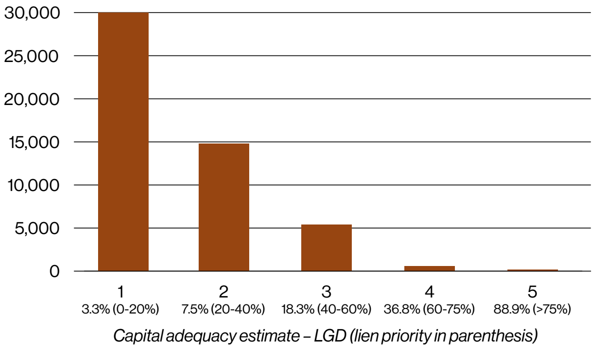
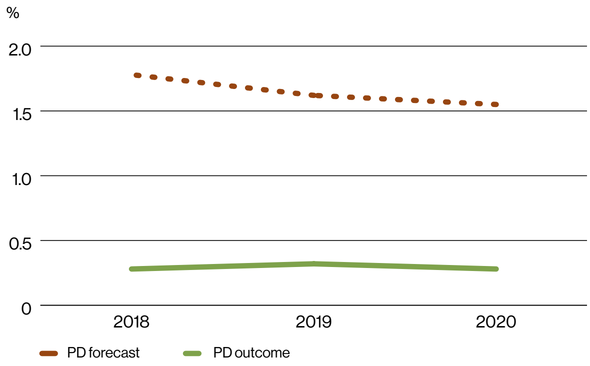


Diagram 5 PD forecast and outcome for PD model 1[1)2)]



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

[2)] *Customers who are physical entities under the categories: i) Individuals, ii) Micro-enterprises and iii) Small enterprises.*

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 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 for retail exposures would have given an average LGD of 10 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 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 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 1.0 billion at 31 December 2020.

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.

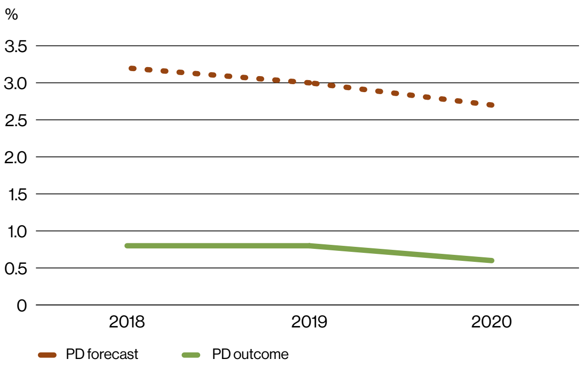
Forecast and outcome for PD and LGD

The PD forecast should represent the long-term average for risk of default, which means that the likelihood of default in a specific year exceeding the forecast is higher for PD than for LGD, where instead 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.

New definition of default

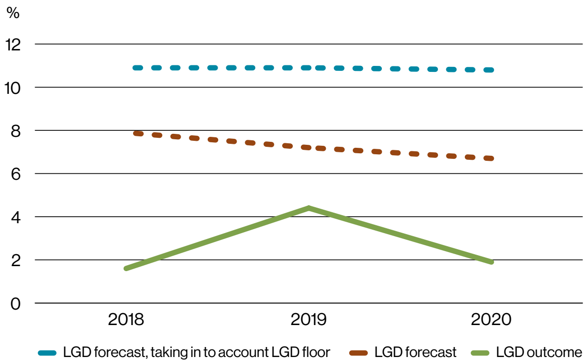
On 15 December 2020, the bank started to register borrowers in default based on a changed definition of default. This was due to new European regulatory requirements aimed at harmonising own-funds calculations for credit risk between banks. A borrower is, inter alia, to be classified as in default if the borrower has a material credit obligation to the bank, which has fallen past due by more than 90 days. A significant credit obligation has already been defined by the bank as not less than SEK 25 million. For the bank, the largest change entailed by the new definition of default is the application of new materiality thresholds. These comprise both absolute and relative minimum materiality thresholds. For retail exposures the new minimum materiality thresholds are SEK 1,000 and 1 percent of the exposure, and for corporate exposures the thresholds are SEK 5,000 and 1 percent of the exposure.

Diagram 6 PD forecast and outcome for PD model 2[1)2)]



[1)] *Counterparty-weighted PD forecast at the start of the year and PD outcome in following years.*
[2)] *Customers, both legal entities and physical entities, included in the category iv) Medium-sized enterprises.*

Diagram 7 LGD forecast and outcome, retail exposures[1)]



[1)] *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.*

The actual data reported for PD, LGD and CF in this report is based on the definition of default that has been used, in other words, for 2020 the bank has applied its previous definition of default from 1 January to 14 December and the new definition of default from 15 December to 31 December. The impact of the implementation of the new definition of default in operations on the bank's capital situation was only marginal. However, the new definition of default could lead to an improvement in the capital situation in conjunction with its implementation in the models in about one year's time. This is due to the expectation that the bank's default rate will decline and that the bank will only calculate internal estimates of PD for corporate exposures.

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 industryspecific 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 credits

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 Credit and Business support unit 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 Credit losses

Net credit losses amounted to recoveries of SEK 13.0 million (recovery: 3.1) in 2020 and confirmed losses totalled SEK 24.0 million (11.0). Landshypotek Bank credit loss allowance pursuant to IFRS 9 amounted to SEK 41.2 million (78.8) at 31 December 2020. The credit loss allowance decreased SEK 37.6 million during the year, mainly as a result of fewer stage 3 provisions. The exposure value of defaulted loans decreased and amounted to SEK 583 million (637) at the same time as the decrease in stage 3 provisions amounted to SEK 25.1 million. 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.

4.6 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.

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 stage, are shown in tables 1 and 2 respectively.

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

	Group		
	Covered bonds	Municipal bonds	Total
AAA	4,947	2,053	7,000
AA+		2,658	2,658
Total	**4,947**	**4,711**	**9,658**

Table 2 Derivative contracts by credit quality step [1], measured at fair value (SEK million)

	Group		
Group	Positive market value [2]	Exposure amount before credit risk mitigation techniques incl. netting gains, collateral received and any future exposure [3] [4]	Exposure amount after credit risk mitigation techniques incl. netting gains, collateral received and any future exposure [3] [4]
1	665	695	695
2	512	624	624
3	–	13	13
4–6	–	–	–
Total	**1,177**	**1,332**	**1,332**

[1] *In accordance with the Commission Implementing Regulation (EU) 2016/1800.*
[2] *Positive market values pertain to the net of market value and accrued interest per derivative.*
[3] *Landshypotek Bank received SEK 559 million in cash collateral under derivative contracts.*
[4] *Netting gains amounted to SEK 274 million.*

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 for which risk can be mitigated by the bank holding a liquidity buffer. Refer to Table 3 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

Table 3 **Maturity analysis for financial assets and liabilities (SEK million)**

	Group					
	<3 months	3–12 months	1–3 years	3–5 years	>5 years	Total
Financial assets						
Eligible treasury bills	383	348	2,643	1,477	0	4,851
Loans to credit institutions	483					483
Loans to the public	51,636	9,660	16,532	5,824	297	83,950
Bonds and other interest-bearing securities	565	990	2,306	1,261		5,122
Derivatives	61	984	746	303	2,907	5,002
Total	**53,128**	**11,982**	**22,228**	**8,865**	**3,204**	**99,408**
Liabilities						
Liabilities to credit institutions	5,842					5,842
Borrowing/deposits from the public	14,672					14,672
Granted credit facilities	399					399
Debt securities issued	509	11,740	21,496	24,689	8,717	67,151
Derivatives	27	907	369	77	2,536	3,916
Subordinated liabilities	8	1,208	0	0	0	1,216
Other liabilities	19	256	23			0
Total	**21,478**	**14,111**	**21,889**	**24,765**	**11,252**	**93,495**
Contracted cash flows	**31,651**	**-2,129**	**339**	**-15,900**	**-8,048**	**5,913**

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. Loans to the public are reported until the next date for loan renewal, when the customer can redeem the loan if the customer so desires. Interest-rate derivatives are settled on a net basis, while currency interest-rate derivatives are settled on a gross basis, which is reflected in the above table. This entails that contracted amounts on maturity are only included for currency interest-rate derivatives. All flows are stated net for interest-rate derivatives.

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 at the least corresponds 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. This limit applies both for the covered operations and for the bank in general. For this reason, a separate reserve is registered in the cover pool, for the purpose of covering outflows from the covered bonds for next 180-day period. At 31 December 2020, the bank had sufficient funds available to cover all payment obligations for about 299 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 229 percent. The LCR requirement is 100 percent, and since the establishment of LCR measurements, the bank has never been below this requirement.

The net stable funding ratio (NSFR) was introduced as a regulatory requirement in 2021 with the aim of limiting the proportion of short-term funding. A ratio of not less than 100 percent is required to meet the NSFR and at 31 December, the ratio was 112 percent.

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 regions, as well as bonds issued by Kommuninvest.
The market value of the liquidity reserve was SEK 9.7 billion, of which 43 percent comprised supplemental

collateral in the pool for covered bonds. 74 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 possible if unlikely market conditions. Examples of stressed scenarios that are tested include:

- a stop in the borrowing market and 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
- substantial withdrawals from deposits with immediate effect (day 1)

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 2020, the bank was able to meet its payment obligations for about 23 days when stress was applied to all parameters simultaneously. 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.

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 2020, the bank's encumbrance ratio, that is the ratio of encumbered assets to total assets pursuant to Article 100 in the CRR, was 68 percent, with the assets in the cover pool for issuing covered bonds representing the source of encumbrance. A total of SEK 65 billion of the bank's assets were encumbered at 31 December 2020.

Refer to Table 4 for more information about the bank's encumbered assets.

Table 4 Disclosures, encumbered assets, consolidated situation (SEK million)

	Carrying amount of encumbered assets	Carrying amount of unencumbered assets
Bonds and other interest-bearing securities	0	9,659
Other assets	65,059	20,517
Total	**65,059**	**30,176**

	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	**57,703**	**65,059**

6 Market risk

Landshypotek Bank does not set any prices and conducts no trading operations, which means 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 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 non-interest-based credit 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 negative SEK 9.3 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 140 million. The bank utilises interest-rate swaps as a tool for managing interest-rate risks.

Refer to Table 5 to see the fixed-interest terms for the bank's interest-bearing assets and liabilities.

In addition to daily interest-rate risk measurement, the interest-rate risk is also measured pursuant to Finansinspektionen's memorandum (FI-REF 14-14414) "Pillar II method for assessment of additional capital requirements for market risks in other operations," where stress is applied to economic value according to six predetermined scenarios for interest-rate movements. For these measurements, the bank applies the same methods for calculating future cash flows as with the daily measurements.

Refer to Table 6 for the outcome of the interest-rate risk measurements.

The bank also measures earnings at risk pursuant to Finansinspektionen's memorandum (FI-REF 14-14414) "Pillar II method for assessment of additional capital requirements for market risks in other operations," whereby the effect of interest-rate movements are measured for three different balance sheet development scenarios (constant, run-off and dynamic). On measurement, stress is applied amounting to 200 basis points with a floor of negative 1.0 percent.

Refer to Table 7 for the outcome of the earnings at risk measurements.

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 another 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 3.5 billion. The bank has not taken up any funding in foreign currencies since 2011.

Credit-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

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 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. 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 5 Fixed-interest terms for the Group's interest-bearing assets and liabilities (SEK million)

	Group					
	<3 months	3–12 months	1–3 years	3–5 years	>5 years	Total
Assets						
Eligible treasury bills	2,856	325	550	400	0	4,131
Loans to credit institutions	483					483
Loans to the public	51,306	9,334	16,086	5,700	256	82,682
Bonds and other interest-bearing securities	1,004	1,000	2,950	500	0	5,454
Derivatives	30,396	740	12,611	300	500	44,547
Total assets	**86,045**	**11,399**	**32,197**	**6,900**	**756**	**137,297**
Liabilities						
Liabilities to credit institutions	5,842					5,842
Borrowing/deposits from the public	14,672					14,672
Debt securities issued	38,450	1,240	12,811	7,000	4,471	63,971
Derivatives	17,957	8,975	16,010	1,660	0	44,602
Subordinated liabilities	1,200					1,200
Other liabilities	0					0
Total liabilities	**78,122**	**10,215**	**28,821**	**8,660**	**4,471**	**130,288**
Net	**7,923**	**1,184**	**3,376**	**-1,760**	**-3,714**	**7,009**
Interest-rate sensitivity, net	-9	-8	-51	-69	-3	-140
Cumulative interest-rate sensitivity	-9	-17	-68	-137	-140	

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.

Table 6
Change in economic value after interest rate stress (SEK million)

Interest rate stress scenario	Change in economic value
Parallel shock up	-35
Parallel shock down	22
Steepener shock	5
Flattener shock	-15
Short rates shock up	-28
Short rates shock down	15
Long rates shock up	-25
Long rates shock down	14

Table 7
Earnings at risk during interest rate stress (SEK million)

Balance Sheet	Interest rate decrease	Interest rate increase
Constant	-66	16
Run-off	-65	36
Dynamic	-76	46

7 Operational risk

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

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 from a historic perspective 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 44 incidents were reported in 2020, and the losses caused by these amounted to SEK 0.1 million.

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 bank's operational losses are not permitted to materially impact the bank's strategy or goals, which means that the total losses resulting from operational risk may not exceed 5 percent of the bank's budgeted annual profit before credit losses. The bank's guidelines for operational risk as decided by the CEO contain limits for operational risk that comprise earlier warning signals within the framework of the bank's appetite. The bank has limits for the following areas:

- Losses arising from materialised operating losses;
- Downtime for digital customer interfaces;
- Vulnerability of the bank's IT structure; and
- Training of personnel in IT security.

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.

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, perpetual subordinated loans (other Tier 1 capital) and dated subordinated term loans (Tier 2 capital). Own funds for the consolidated situation amounted to SEK 6.3 billion, of which SEK 5.1 billion comprised CET1 capital. During the year, CET1 capital increased SEK 0.3 billion, primarily as a result of new member contributions, profit for the year and the reduction in the own funds deduction for intangible assets. The was the result of new regulations entailing that software assets, which are classified as intangible assets, are permitted to be written down over three years in own funds, which is more beneficial than the previous rules that entailed deducting the entire balance-sheet line item intangible assets from own funds. Other Tier 1 capital decreased SEK 0.1 billion during the year to SEK 0.4 billion and T2 capital decreased SEK 0.2 billion to SEK 0.8 billion. The reduction in other Tier 1 capital and T2 capital was due to the consolidated situation being subject to provisions that limit how large a share of externally issued additional Tier 1 capital and T2 capital instruments in Landshypotek Bank may be included in own funds for the consolidated situation, which is impacted, inter alia, by the size of the bank's surplus capital. This increased significantly in the year, primarily as a result of a lowered combined buffer requirement and new rules that reduced the capital requirement for SMEs entering force. The nominal amount was SEK 0.7 billion for other Tier 1 capital and SEK 1.2 billion for T2 capital. For further information, refer to section 8.2.

Refer to Table 8 for more detailed information about the bank's own funds. 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. When calculating the CET1 capital for capital adequacy purposes, deductions are made for regulatory adjustments (value adjustments, intangible assets, deferred tax assets dependent on future profitability and the IRB deduction).

Table 8 **Capital adequacy analysis (SEK million)**

	Consolidated situation[1] 31 Dec 2020
CET1 capital: Instruments and reserves	
Member contributions	1,833
Share capital	–
Other contributed equity	1,798
Tier 1 capital instruments	700
Reserves	-18
Actuarial changes	-17
Retained earnings	1,913
Net profit for the year[2]	323
Equity in the balance sheet	**6,532**
Deductions related to the consolidated situation and other foreseeable costs[3]	-122
Deductions for Tier 1 capital instruments classified as equity	-700
CET1 capital before regulatory adjustments	**5,710**
CET1 capital: regulatory adjustments	
Further value adjustments	-10
Intangible assets	-58
Deferred tax assets that rely on future profitability	0
IRB deductions[4]	-519
Total regulatory adjustments to CET1 capital	**-587**
CET1 capital	**5,123**
Additional Tier 1 capital: instruments	
Tier 1 capital instruments	–
of which: classified as equity under applicable accounting standards	–
Qualifying Tier I capital included in consolidated additional Tier 1 capital issued by subsidiaries and held by third parties	440
Tier 1 capital (CET1 capital + Tier 1 capital)	**5,563**
Tier 2 capital: instruments and provisions	
Capital instruments and subordinated loans eligible as Tier 2 capital	–
Positive amounts resulting from the calculation of expected loss amounts (IRB)	–
Qualifying own funds instruments included in consolidated Tier 2 capital issued by subsidiaries and held by third parties	772
Tier 2 capital before regulatory adjustments	**772**
Tier 2 capital: regulatory adjustments	
Total regulatory adjustments to Tier 2 capital	**0**
Tier 2 capital	**772**
Own funds (Tier 1 capital + Tier 2 capital)	**6,335**
Total risk exposure amount	**33,701**
Capital ratios and buffers	
Own funds requirement	**2,696**
CET1 capital ratio (%)	15.2
Tier 1 capital ratio (%)	16.5
Total capital ratio (%)	18.8
Institution-specific CET1 capital requirement including buffer requirements (%)	7.0
of which: capital conservation buffer requirement (%)	2.5
of which: countercyclical buffer requirement (%)	0.0
CET1 capital available to meet buffers (%)[5]	10.5

[1] *The consolidated situation encompasses Landshypotek Ekonomisk Förening and the Landshypotek Bank AB Group.*

[2] *A decision by Finansinspektionen granted Landshypotek Bank a permit, subject to specific terms and conditions, for using the interim or full-year surplus in own-funds calculations for Landshypotek Bank AB and also for its consolidated situation.*

[3] *The item pertains to expected value transfers in the form of dividends to members in the consolidated situation and Group contributions to the Parent Association of Landshypotek Bank AB.*

[4] *Deductions arising from expected credit losses exceeding the outstanding provisions for credit losses (negative amounts resulting from the calculation of expected loss amounts).*

[5] *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 9 **Own funds instruments Landshypotek Bank**[1]

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
AT1 SUB	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

[1] *Refer to the page Capital Instruments under Investor Relations on the bank's website.*

8.2 Capital requirements and the combined buffer requirements

Regulatory capital requirement

Landshypotek Bank bases calculation of the regulatory capital requirement on the rules (Pillar I) as found, mainly, in the CRR and in FFFS 2014:12. The bank estimates the regulatory capital requirement for credit risk, operational risk and credit valuation adjustment (CVA) risk. In addition, the bank calculates capital requirements pursuant to Article 458 of the CRR. This capital requirement also relates to credit risk and entails application of a risk-weight floor of 25 percent for the exposure class Retail – real estate collateral for banks that have a permit use an IRB approach for calculating the capital requirement for the exposure class. Article 458 is applied by Finansinspektionen with the aim of mitigating macroprudential and systemic risks in the form of property bubbles. The risk-weight floor has been introduced due to the assessment of Finansinspektionen that, following an extended period of low credit losses, a risk exists that banks' IRB models do not ensure that banks' maintain adequate capital to cover exposures to Swedish mortgages.

Despite the bank's credit portfolio largely 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." For capital adequacy purposes, the credit portfolio is more than 99 percent covered by the IRB approach. The bank 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 counter-party risk and CVA risk, and the basic indicator approach is applied for operational risks.

During the year, new rules extending the so-called SME discount entered force, which reduced the capital requirement for lending to SMEs. Mainly attributable

Table 10 **Own funds requirement by risk, approach and exposure class (SEK million)**

	Consolidated situation 31 Dec 2020			
	Exposure value[1]	Risk exposure amount[2]	Own funds requirement[3]	Average risk weight[4]
Credit risk – IRB approach	**83,822**	**23,956**	**1,916**	**29%**
Retail – real estate collateral	50,942	6,527	522	13%
Corporates	32,747	17,296	1,384	53%
Other non-credit-obligation assets	133	133	11	100%
Credit risk – Standardised approach	**11,876**	**1,218**	**97**	**10%**
Central governments or central banks	19	–	–	0%
Regional governments or local authorities	4,720	–	–	0%
Institutions	1,913	587	47	31%
Corporates	14	14	1	100%
Retail	26	18	1	70%
Secured by mortgage liens on immovable property	221	100	8	45%
Exposures in default	2	3	0	150%
Covered bonds	4,962	496	40	10%
Operational risk – Basic indicator approach		**1,554**	**124**	
Credit valuation adjustment risk – Standardised approach	**1,222**	**764**	**61**	**63%**
Additional stricter prudential requirem. based on Article 458 CRR		**6,208**	**497**	
Total	**96,920**	**33,701**	**2,696**	

[1] *Exposure value calculated in accordance with the CRR. In certain cases, instead of exposure value, the abbreviation EAD (Exposure at default) and the term exposure amount were used in the bank's previous reports.*
[2] *After application of the relevant risk weights. Risk weights for the IRB approach are based on internal risk classification and internal historical data while risk weights as prescribed in the CRR are applied for the standardised approach.*
[3] *Calculated by multiplying the risk exposure amount by 8 percent. Does not include any buffer requirements.*
[4] *Calculated by dividing the risk exposure amount by the exposure value for the respective risk/exposure class.*

to the above, the capital requirement under Pillar I decreased SEK 0.1 million to SEK 2.7 million despite increased lending in the year.

Combined buffer requirement

In addition to the regulatory 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 capital conservation buffer and the countercyclical buffer. Over the year, the bank's combined buffer requirement decreased from 5.0 percent to 2.5 percent of the total risk exposure amount. This was a result of Finansinspektionen lowering the countercyclical buffer requirement from 2.5 percent to zero percent. The reason Finansinspektionen lowered the countercyclical buffer requirement was to ensure a well-functioning credit supply during the economic downturn in the wake of the Covid-19 pandemic. However, the combined buffer requirement differs from other regulatory capital requirements, since not meeting it is allowed on a temporary basis.

Capital adequacy and buffer requirements under Basel III are shown in Table 8. The regulatory capital requirement is divided into risk category, measurement method and exposure class and presented in Table 10.

8.3 Capital ratios

The total capital ratio for the consolidated situation amounted to 18.8 percent (18.42) and the CET1 capital ratio was 15.2 percent (13.9) (18.6 percent excluding the risk-weight floor in Pillar I).

The improvement in the CET1 capital ratio was due to improved own funds and a lower regulatory capital requirement, whereas the improvement in the total capital ratio was limited by the reduction in other Tier 1 capital and T2 capital in the consolidated situation. For further information, refer to section 8.1.

Table 11 **Capital requirement (SEK million)**

	Consolidated situation
Internally assessed capital requirement [1]	
Pillar I capital requirement	2,696
Percentage of total risk exposure amount	8.0
Pillar II capital requirement	544
Percentage of total risk exposure amount	1.6
Combined buffer requirement	843
Percentage of total risk exposure amount	2.5
Total capital requirement	**4,082**
Percentage of total risk exposure amount	**12.1**
Own funds (Tier 1 capital + Tier 2 capital)	**6,335**
Percentage of total risk exposure amount	**18.8**
Capital requirement as assessed by Finansinspektionen [2]	
Pillar I capital requirement	2,696
Percentage of total risk exposure amount	8.0
Pillar II capital requirement	648
Percentage of total risk exposure amount	1.9
Combined buffer requirement	843
Percentage of total risk exposure amount	2.5
Total capital requirement	**4,187**
Percentage of total risk exposure amount	**12.4**
Own funds (Tier 1 capital + Tier 2 capital)	**6,335**
Percentage of total risk exposure amount	**18.8**

[1] *Pertains to Pillar I capital requirements pursuant to the Capital Requirements Regulation (EU) No 575/2013, Pillar II capital requirements according to the bank's (ICAAP 2020) and the combined buffer requirement pursuant to the Capital Buffers Act (2014:966).*

[2] *Pertains to Pillar I capital requirements pursuant to the Capital Requirements Regulation (EU) No 575/2013, Pillar II capital requirements according to Finansinspektionen's (SREP 2019) and the combined buffer requirement pursuant to the Capital Buffers Act (2014:966).*

The bank's CET1 capital to cover the combined buffer requirement and Pillar II requirements corresponded to 10.5 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 2020, the bank's assessment was that within the Pillar II framework the bank had a capital requirement for credit risk, market risk and pension risk. 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 4.1 billion (5.0). During the year, the capital requirement has reduced significantly, largely due to the lower countercyclical buffer requirement. However, Landshypotek's assessment is that the buffer requirement will be raised in the mid-term and the bank has therefore raised its internal capital targets to prepare for a future increase in the countercyclical buffer requirement. The capital requirement should be compared with own funds of SEK 6.3 billion (6.3), see Table 11.

8.5 Leverage ratio

From 2015, a leverage ratio must be calculated and reported externally by the bank. The metric will become a mandatory capital requirement of 3 percent under the CRR in the second quarter of 2021. The bank's leverage ratio amounted to 5.9 percent (6.1) at year end, refer to Table 12 for further information about the leverage ratio.

Table 12 **Leverage ratio (SEK million)**

	Consolidated situation
Balance Sheet according to the accounting standards	95,235
Adjustment for assets not included in the consolidated situation	–
Adjustment for differences between carrying amounts and leverage exposure – derivatives	-392
Collateral adjustments – derivatives	–
Adjustment for differences between carrying amounts and leverage exposure – repos and bond loans	–
Assets recognised off the balance sheet, gross (before adjustments for conversion factors)	*2,105*
Deductions from off-balance-sheet assets or application of conversion factors	*1,662*
Assets recognised off the balance sheet, net	443
Other adjustments	-480
Assets used to calculate the leverage ratio	**94,806**
Capital used to calculate the leverage ratio	–
Tier 1 capital	5,563
Leverage ratio	–
Leverage ratio calculated using Tier 1 capital	5.9%

9 Definitions and explanations

Agricultural and forest properties	Agricultural units.
The Association	Landshypotek Ekonomisk Förening
Basel III	In Sweden, the Basel III agreement was implemented through the direct impact of the EU CRR and the Swedish implementation of CRD, 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 conversion factor used in the calculation of the exposure value for certain off-balance-sheet exposures. In the bank's case, the CF is applied for the product, first lien mortgage loans.
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.
Consolidated situation	The consolidated situation encompasses Landshypotek Ekonomisk Förening and Landshypotek Bank.
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.
CRD	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: • It is deemed unlikely that the counterparty will pay its credit obligations in full to the bank without the bank having to take measures to realise collateral. • Any of the counterparty's significant credit obligations to the bank falling past due by more than 90 days. • The counterparty no longer meets any of the above criteria but remains in default quarantine.
EMTN programme	The Euro Medium Term Note programme is an international borrowing programme for issuing covered bonds, senior debt (including senior non-preferred) 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 a multiplier (for example, a conversion factor).
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 deductions	Deductions arising from expected credit losses exceeding (ECLs) 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.
NSFR	Net stable funding ratio, is a metric for liquidity risk, whereby liabilities and assets are assigned different quotients depending on, inter alia, quality and tenor.
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).
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	Billion Swedish krona.
SEK thousand	Thousand Swedish krona.
SEK million	Million Swedish krona.
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