Information about Capital Adequacy and Risk Management 2008 Basel Regulations, Third Pillar

The Swedish Housing Finance Corporation, SBAB

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Risk management

A broad definition of risk is "the volatility in future income that is dependent on changes in the value of assets and liabilities". Risk is a natural element in a business, but entails that some form of uncertainty occurs, and this uncertainty must be managed. For SBAB, risk arises primarily in the lending operations in the form of credit risk, although various types of risks must also be managed in other activities. The difficulties encountered in the credit market in the past year indicate the importance of effective liquidity risk management.

For companies included in the financial corporate Group SBAB (hereinafter referred to as SBAB), risk management entails that, in each individual transaction, SBAB will be able to measure the value generated by the transaction with regard to return and risk, and the level of capital that is optimal in relation to the inherent risk. In concrete terms, this entails that SBAB conducts a recurring discussion focusing on the following questions:

- What are the various risks generated in our operations, and how can we measure these consistently to create comparability?
- How can SBAB organise its risk management and integrate it into business management so that all employees understand the value of correct risk management in the operations?
- Does SBAB have sufficient capital to counter the company's risks?

Risk is an integrated part of all activities conducted by SBAB. Given the company's strategy of generating income primarily by taking credit risks, it is important to know how much risk is actually desirable, both at an aggregated level and in relation to various segments and individual customers. This is called risk appetite and can be defined as "the impact on earnings that a company can accept to support a particular strategy". The sources contributing to risk must be clearly specified.

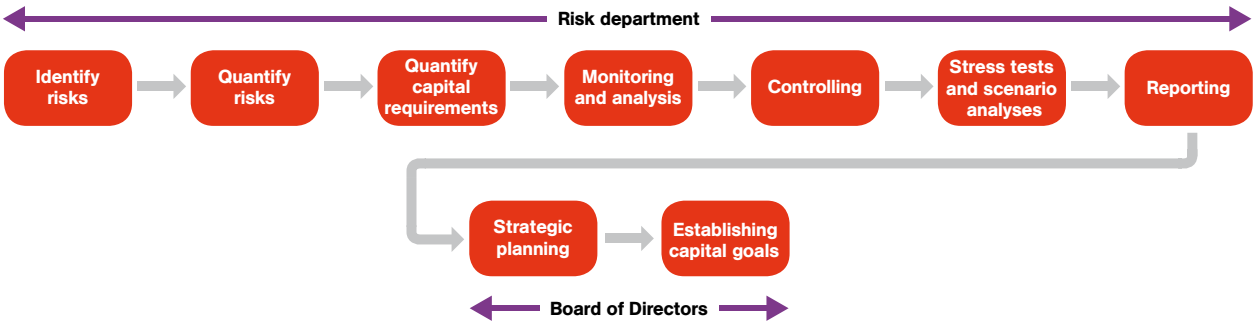
SBAB conducts its operations in three different business areas. Corporate and Retail handle loans, while Finance handles funding and financial risk management. The first two business areas primarily generate credit risk, while the borrowing operations generate several financial risks, of which the interest rate risk can generate some earnings.

To establish the extent of the risk taken by SBAB in its operations, statistical and mathematical models are used both for credit and market risk and to calculate how much capital is required to cover the risks. Schematically, the process can be described as in figure 1.

Initially, the risks generated in the operations are identified. Risks are measured in various models. For business and operational risks, standards based on the business areas' operating expenses and operating income are used. For credit risk, SBAB has developed several statistical rating models depending on the type of counterparty for which a credit rating is required and the existing collateral. Depending on the purpose of the rating, market risk is assessed with a Value at Risk (VaR) model or through a parallel shift of the yield curve.

The next step is to calculate the amount of capital required to cover the risks arising in the operations. Banks and credit institutions now work with a variety of standards for capital requirements, including the minimum capital requirement established by governmental

Figure 1. **SBAB's process for calculating capital requirement**



authorities (used for calculating the capital requirement in accordance with the Basel Committee on Banking Supervision's Pillar I) and the result of the bank or credit institution's own internal models for capital calculations (economic capital models that are the basis for calculating capital requirements in accordance with the Basel Committee's Pillar II). In the calculation of capital requirements in Pillar II, two different types of scenarios are used to include the impacts of a worsened and a probable future state of the market. The results of the assessments of other stakeholders, such as ratings institutions, are also taken into account. Finally, the material is evaluated and then reported to executive management and the Board of Directors for the establishment of capital requirements, taking into consideration future strategic plans.

SBAB uses an advanced method for establishing capital requirements which is based on the company's internally developed models for credit and market risk. The Swedish Financial Supervisory Authority (FI) has reviewed SBAB's method for calculating capital in accordance with the second pillar of the Basel regulations and considers the capital planning to be good.

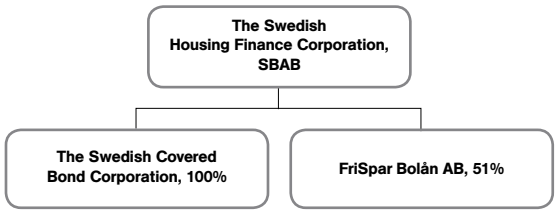
1. The SBAB Group

The information in this document pertains to the financial corporate Group SBAB. The SBAB Group comprises the following three companies:

- The Swedish Housing Finance Corporation, SBAB, (publ), reg. no. 556253-7513 (hereinafter referred to as the Parent Company),
- The wholly owned subsidiary Swedish Covered Bond Corporation (publ), reg. no. 556645-9755 (hereinafter referred to as SCBC),
- The associated company FriSpar Bolån AB, reg. no. 556248-3338 (hereinafter referred to as FriSpar), of which 51% is owned by the Parent Company.

The principal activity of all of these companies is to provide loans for residential properties and shares in tenant-owner associations against collateral in the form of mortgage deeds and tenant-owned property, as well as the funding of office and commercial properties. In 2007, the activities of the Parent Company were expanded to enable private customers to open deposit accounts.

Figure 2. **The SBAB Group**



1.1 Overall aims for risk management

The risk policy determined by the Board of SBAB includes the following overall aims for risk management.

- The aim of SBAB's risk management is to support the company's business operations and rating targets. Risk-taking must be balanced. This will be achieved by ensuring that total risk is kept at a level compatible with SBAB's long-term financial objectives for return, the size of risk capital and the target rating.
- The aim is to identify, control and monitor relevant risks.
- Within the company's different business areas, allocation of capital is to be based on the desired risk level and earnings capacity.
- SBAB's risk management aims to be transparent and thus easily presented for and understood by external parties.

1.2 Risk appetite

SBAB's goal is that the strategy adopted for lending operations will, with respect to management and pricing, consider the risks that arise in the operations and the capital needed to cover these risks. On the basis of the strategy adopted, the Board of the Parent Company establishes the risk that SBAB should be prepared to take (the risk appetite). SBAB's risk appetite is expressed as follows:

- That SBAB will generate a return on equity that is five percentage points higher than the return on five-year government bonds after tax, viewed over a business cycle
- That SBAB's primary capital ratio will not be less than 7%
- The economic capital will not exceed 85% of the available capital

In addition, earnings should be based on credit risk and interest rate risk. Income may not be generated by speculative currency positions.

To monitor the risk outcome in relation to the decided risk appetite, the outcome of selected parameters is reported monthly to executive management and the Board.

1.3 Differences in consolidation basis for subsidiaries

SCBC has been consolidated in the Parent Company at 100% and FriSpar at 51% by means of proportional consolidation. However, when calculating FriSpar's capital adequacy, the proportional method is not used. Instead, the company is consolidated to 100% and a minority holding is reported. This is due to differences in the way Group affiliation is defined in the Act Concerning Capital Adequacy and Large Exposures and FFFS 2007:1, which governs how capital adequacy should be reported, and the International Financial Reporting Standards (IFRS), which regulate the company's accounting.

2. Organisation

2.1 SBAB's risk function

SBAB's risk function (Risk Department) is a department within the finance division that is responsible for analysing and reporting on the overall risks of the SBAB Group in accordance with FI's directives (FFFS 2005:1, Chapter 4). In particular, credit risk, the most significant risk for SBAB, is monitored and analysed.

Credit risk is first monitored in the individual transaction by the credit division, then by the risk department through portfolio management and analysis. The practical management of risks is dealt with by each of the business areas.

The risk department is also responsible for the design, implementation, reliability and monitoring of SBAB's ratings-based systems and for SBAB's internal capital evaluation.

A monthly report on the overall risk scenario is delivered by Risk Department to the Head of Accounts and Risk Department, the CEO and the SBAB Board, together with a description of the trend of economic capital and risk-adjusted return. Continuous reports on current capital adequacy are provided to the CEO, the Board and senior executives at SBAB. In addition, the Board and CEO are provided with a quarterly in-depth analysis of risks.

The Asset and Liability Management Committee (ALCO) handles matters relating to risk and capital planning, which are then addressed by executive management. A quarterly risk report is presented to the company's ALCO, to which is also reported a semi-annual stress test of a downturn scenario and a normal scenario with an in-depth consequence analysis.

2.2 Compliance

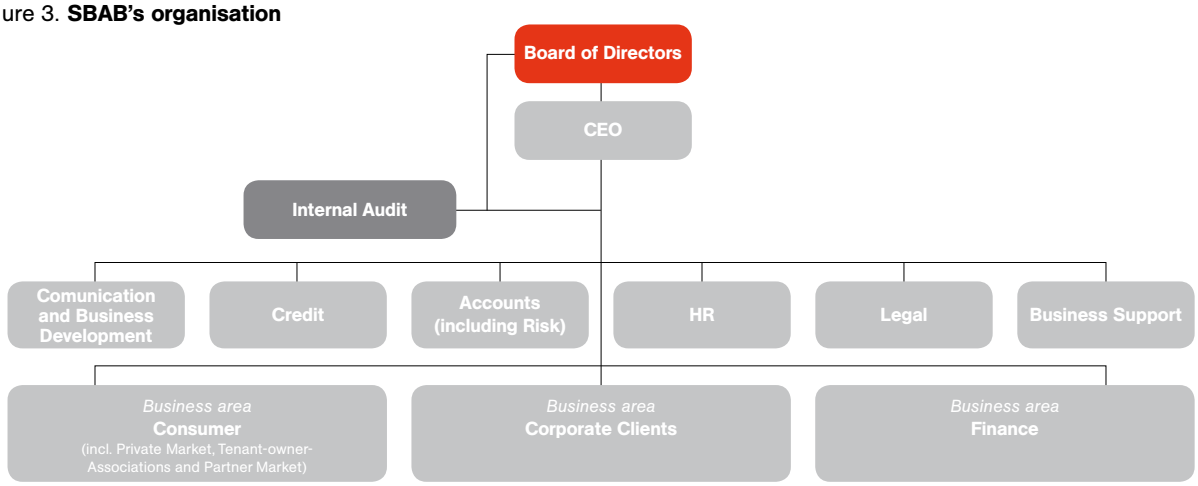
SBAB has a centrally located Compliance Officer in accordance with FI's directives (FFFS 2005:1, Chapter 5). The Compliance Officer's task is to ensure on a comprehensive level that the operations comply with the laws and regulations applicable for financial businesses subject to permits. The Compliance Officer is also responsible for leading and organising the structure required to ensure that controlling functions within the company implement monitoring in their areas of instruction in accordance with a shared model. In addition to continuous reporting to SBAB's chief legal counsel, reporting occurs biannually to the CEO and Board. The annual plan for the compliance function is established by the CEO and chief legal counsel.

2.3 Internal audit

SBAB's internal audit is an internal independent inspection function in accordance with FI's directives (FFFS 2005:1, Chapter 6). The internal audit is organisationally subordinate to the CEO, but it also reports directly to the Board and to the company's Audit Committee, whose responsibilities include reviewing the company's governance, external reporting and internal control.

The principal task of the internal audit is to review and evaluate the internal control of SBAB companies. The auditing occurs in accordance with an audit plan which is prepared annually by the Audit Committee and determined by the Board. The internal audit also periodically reviews the internal ratings-based (IRB) system for credit risk and its use and risk management pertaining to operational risk.

Figure 3. **SBAB's organisation**



3. Internal model for calculating risk capital

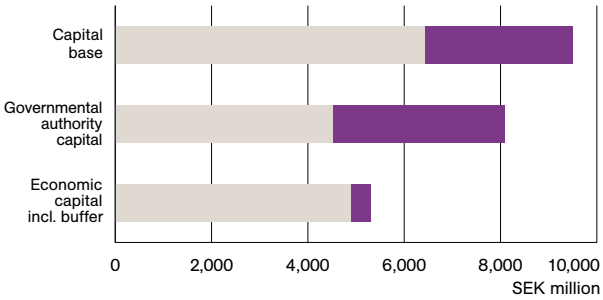
In accordance with the second pillar of the Basel regulations, SBAB's internal capital evaluation should ensure that SBAB has sufficient capital to deal with any financial problems that arise. The Board and executive management are responsible for the internal capital evaluation. In relation to strategic decisions, business planning and changes in the operating environment, SBAB conducts an assessment of how the capital requirement has changed based on risk. SBAB uses a economic capital model as the basis for its assessment of the company's capital requirement within the framework of the capital evaluation process.

3.1 Various standards for capital requirement

Different stakeholders have different criteria for their evaluation of the company's capital requirement. The size of SBAB's capital requirement depends on laws and regulations (the first pillar of the Basel regulations), the company's internal assessment based on decided strategies (the second pillar of the Basel regulations) and the evaluations of rating institutions.

- *Governmental authority capital* (in accordance with Pillar I) pertains to the minimum amount of capital that SBAB may have in accordance with the Capital Adequacy and Large Exposures Act (2006:1371) and FI's Code of Statutes FFFS 2007:1. Based on these regulations, SBAB was granted a permit to use its own models based on its own data.
- *Economic capital* is SBAB's own assessment of the appropriate extent for risk capital. In 2010, in combination with stress tests and potential provisions for further risk, economic capital will replace governmental authority capital as the minimum capital requirement (in accordance with Pillar II). This requirement may not be less than the capital standard in accordance with Pillar I. Economic capital is also based on SBAB's own relatively advanced models in which quantifiable risks are summarised in a single entity. This is also an important component in the company's pricing and financial control.
- *Equity* is the reported capital in SBAB's financial statements. It comprises the capital actually held by the company and, in combination with subordinated loans, this comprises essentially all of SBAB's capital base.
- *The rating agencies'* assessments of the company's capital requirements compared with the capital held by the company comprise one of the foundations in an assessment of financial strength and of SBAB's rating. The company's rating has a direct impact on its borrowing costs.

Table 1. **Capital requirement**



The top bar specifies the size of the entire capital base, of which equity primarily comprises the left portion of the bar and subordinated loans comprise the right portion of the bar.

The middle bar displays the capital requirement in accordance with Pillar I, without transitional provisions in the left portion and with transitional provisions in the right portion.

The lower bar displays the internally calculated capital requirement in accordance with Pillar II, including the buffer attributable to stress tests.

3.2 Internal capital evaluation, Basel committee's second pillar

The business conducted by SBAB affects the extent of the risk taken by the company, which in turn affects the size of the capital required. The size of the capital in turn affects the price of individual transactions for customers. The better the risk can be assessed by the company, the better the size of the capital requirement that is utilised in the transaction can be assessed. In addition, risk-adjusted return can also be assessed.

The quality and utilisation of risk information are essential to SBAB's long-term competitiveness in the market. The purpose of the internal capital evaluation process is to ensure that the company identifies, values, secures and handles the risks to which SBAB is exposed and that SBAB has risk capital that is compatible with the selected risk appetite. The process is revised annually to capture changes in the operating environment that continuously affect the company's performance.

SBAB's evaluation of the extent of the risk capital required to counter the combined risk in the company's operations is based primarily on the calculation of SBAB's economic capital. A qualitative assessment is also made of the risks that are not included in the calculation of economic capital. In addition, SBAB takes into account risk linked to extraordinary events, which is illustrated in conjunction with stress tests. Finally, the risk capital is supplemented with an extra buffer capital. The buffer capital and capital allocation linked to the stress tests, known as surplus capital, is allocated to the business areas based on their share of economic capital. Taken together, the calculated risk capital comprises the capital that is desirable to meet all risks in SBAB's operations.

3.3 Economic capital

Economic capital comprises most of the capital that, according to SBAB's assessment, is required to cover unexpected losses during the coming year. Expected losses are to be covered by earnings from operating activities. The economic capital evaluation takes into account credit risk, market risk, operational risk and commercial risk. Credit risk is the dominant risk in SBAB's operations, as indicated in Table 2. The levels reflect diversification effects, meaning that the risk has been reduced by taking into account the probability that several risks will be realised simultaneously.

To a substantial extent, the economic capital model is based on the result of SBAB's IRB models for quantification of credit risk. Operational risks and commercial risks are calculated using standards based on the business areas' operating income and operating expenses, while market risk is calculated by VaR. In addition to comprising an assessment of the combined capital requirement to counter the risks in the company's operations, the economic capital model is also used to monitor profitability in the company's operations, for economic control and for strategic consideration. Economic capital amounts to 76 percent of available capital (equity).

Figure 4. **Comprehensive process for calculation of economic capital**

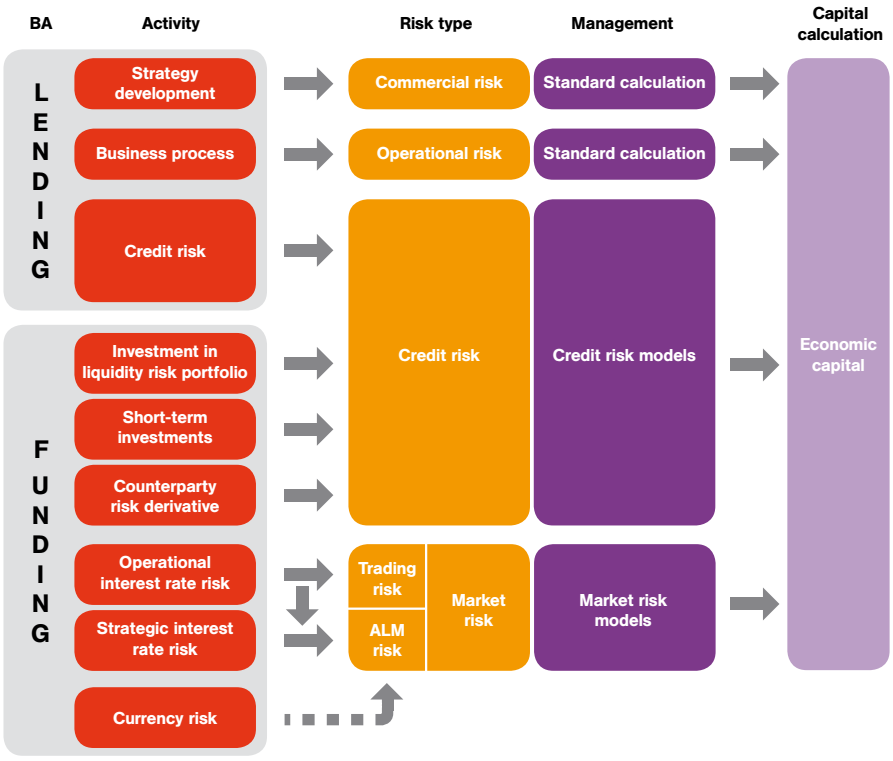


Table 2. **The SBAB Group's economic capital distributed among the four risk types**

SEK million	31 Dec 2008	31 Dec 2007
Economic capital	4,896	3,880
of which,		
Credit risk	71%	84%
Market risk	25%	13%
Commercial risk	3%	4%
Operational risk	1%	1%

3.4 Stress tests

To ensure that the economic capital can also cover unexpected losses in deteriorating economic conditions, stress tests and scenario analyses are conducted on the basis of a number of selected variables. Particular weight is placed on the interest rate trend and market price changes pertaining to properties. Stress tests are based on two main scenarios, a downturn scenario and one based on the current time period, known as a flexible scenario. The latter illustrates the effects of SBAB's future outlook. Although the essential purpose of the tests is to indicate the need for the supply of capital, the effects on the Group's earnings trend are also illustrated. In SBAB's assessment, it is reasonable to set aside SEK 400 million as a capital buffer to meet the risk associated with extraordinary events.

Implemented stress tests show that, in the event of a significant economic decline, the greatest changes take place among risk classes in the superior segments, while the poorest segments are not affected to the same extent. This is explained by the fact that more borrowers have ended up representing an increasingly lower credit risk viewed over a ten-year period, due in part to a gradual reduction in interest rates. In a recessionary scenario, it is largely the same customers who move, but in the opposite direction.

3.5 Concentration risk

SBAB primarily concentrates on the property market and is mainly exposed to credit risk. Sufficient capital has been allocated to counter the credit risks that arise from the business operations.

SBAB defines concentration risk as "if the same underlying factor realises the risk" in combination with the fact that the concentration must be regarded as risky. Concentration can also be an expression of risk aversion. Lending concentrated to metropolitan regions is an example of this, as are financial investments concentrated to a few asset types with high credit ratings. In other words, there are examples of concentrations that de facto entail a lower risk. However, the existence of certain concentrations that increase risk cannot be ruled out. These include exposures to certain geographical groupings or to borrowers in the same industry. Large exposures, meaning borrower concentrations, are dealt with on the basis of the SBAB Group's credit directives. The loans concerned are identified, checked and monitored to ensure that they fall within the statutory framework for individual investments.

3.6 The assessment of the Swedish Financial Supervisory Authority (FI)

During the year, FI reviewed SBAB's internal process for capital evaluation. On the basis of this review, FI believes that SBAB is sufficiently capitalised in relation to the risk to which it deems SBAB to be exposed. Furthermore, SBAB is assessed to have satisfactory processes to identify, quantify, handle and report its risks, with the exception of concentration risks. Capital planning is assessed as favourable and the structure pertaining to internal capital evaluation process efforts is satisfactory.

SBAB plans to improve its management of concentration risks by developing a model for such management during 2009.

4. Capital adequacy

4.1 Capital base

The company's capital adequacy is governed by the Capital Adequacy and Large Exposures Act (2006:1371) and FI's Code of Statutes FFFS 2007:1. Regarding calculation of the capital base, the following may be mentioned from the regulations.

Since the rules for capital adequacy (FFFS 2007:1) and for financial reporting (IFRS 31) have different definitions of the concept of subsidiary, SBAB's subsidiary FriSpar Bolån AB is consolidated in its entirety when calculating the capital base, while the proportional method is used in financial reporting.

When calculating primary capital, subordinated loans can be included if certain prerequisites are met in accordance with FFFS 2007:1 Chapter 7, Section 15, and consent has been obtained from FI. SBAB has been granted such consent and has classified SEK 994 million as primary capital (see Table 3).

In accordance with FFFS 2007:1 Chapter 7, Section 13, changes in the value of equity that are attributable to derivative instruments being included in cash flow hedges are excluded and thus do not affect the size of capital. An adjustment of SEK 1 million was made at 31 December 2008. In accordance with FFFS 2007:1 Chapter 7, Section 9, unrealised accumulated changes in the value of loan receivables and accounts receivable that have been classified as saleable financial assets may not affect the size of the capital base except in relation to changes in value that are reported as impairment losses or reversals of impairment losses in profit and loss. An adjustment of SEK 203 million was made at 31 December 2008.

Deductions from primary capital are made for intangible fixed assets in accordance with Chapter 3, Section 2, of the Capital Adequacy Act. In accordance with FFFS 2007:1 Chapter 9, Section 11, the difference between expected loss (EL) and the actual provision is also deducted from primary capital. Remaining amounts are deducted from supplementary capital.

There are no ongoing or anticipated material obstacles nor any legal impediments to a rapid transfer of funds from the capital base other than those that follow from the conditions for the subordinated loan (see Note 31 in the SBAB Group's 2008 Annual Report) or from the general provisions of the Swedish Companies Act (2005:551).

The starting capital required for the Parent Company in accordance with the Banking and Financial Undertakings Act (2004:297) totals SEK 45,650,000. The corresponding capital requirement for the subsidiaries is SEK 44,300,000 for FriSpar and SEK 47,000,000 for SCBC.

4.2 Capital requirement

The regulations implemented in 2007 for capital adequacy and large exposures entail that the low risk in the company's operations is now beginning to be reflected in the minimum capital requirement. However, during a transitional period of three years, the effect will be limited due to transitional provisions. These entail that the minimum capital for 2008 must not be less than 90% of the capital requirement calculated in accordance with the Basel I regulations. For 2009, the corresponding limit is 80%.

Each exposure is allocated to an exposure class, either through the standardised method or the IRB method, when calculating the capital requirement. (Chapter 5, Credit risk, addresses SBAB's allocation of exposure classes and methods for calculating credit risk.) Table 4 shows the individual exposure amounts distributed according to exposure class.

SBAB's capital ratio amounted to 1.17 at 31 December 2008. The calculated minimum capital requirement amounted to SEK 4,518 million, and the supplement in accordance with the transitional provisions amounted to SEK 3,577 million, resulting in a total capital requirement of SEK 8,095 million.

The applicable regulations entail a forthcoming reduction of the minimum capital requirement for SBAB. In the context of the global banking industry's need for capital, further amendments to the regulations is discussed, which entail an increase in the company's minimum capital requirements.

Table 3. **Capital base**

SEK million	Group	
Primary capital	**31 Dec 2008**	31 Dec 2007
Equity	6,637	6,198
Primary capital contribution	994	994
Minority interest	500	467
Total gross primary capital	**8,131**	**7,659**
Less other intangible assets	(48)	(58)
Less deferred tax assets	(24)	(103)
Deduction pursuant to Ch 3, Section 8 of the Capital Adequacy Act	(411)	(346)
Total primary capital net	**7,648**	**7,152**
Supplementary capital		
Perpetual loans	-	722
Time-limited subordinated debentures	2,260	1,260
Deduction pursuant to Ch 3, Section 8 of the Capital Adequacy Act	(410)	(346)
Total supplementary capital	**1,850**	**1,636**
Expanded part of capital base	-	-
Deduction from entire capital base	-	-
Amount for capital base net after deductible items and limit amounts	**9,498**	**8,788**

Table 4. **Capital requirements**

	31 December 2008		31 December 2007	
SEK million	Capital requirements	RWA	Capital requirements	RWA
Credit risk reported in accordance with IRB method				
– corporate exposures	1,577	19,709	1,590	19,869
– retail exposures	672	8,401	392	4,904
Total in accordance with IRB method	**2,249**	**28,110**	**1,982**	**24,773**
Credit risk reported in accordance with standardised method				
– exposures to states and central banks	0	0	0	0
– exposures to municipalities and similar associations	0	0	0	0
– institutional exposures	978	12,233	523	6,538
– corporate exposures	980	12,251	518	6,482
– retail exposures	14	173	18	226
– unregulated items	1	5	0	2
– other items	4	50	8	92
Total in accordance with standardised method	**1,977**	**24,712**	**1,067**	**13,340**
Risks in the trading portfolio	149	1,861	487	6,090
Operational risk	143	1,786	170	2,120
Currency risk	-	-	-	-
Raw material risk	-	-	-	-
Total minimum capital requirements without transition provisions	**4,518**	**56,469**	**3,706**	**46,323**
Supplement during transition period	3,577	44,713	3,675	45,935
Total minimum capital requirements including transition provisions	**8,095**	**101,182**	**7,381**	**92,258**

Table 5. **Capital adequacy**

	Group		Parent Company		FriSpar Bolån		SCBC	
SEK million	31 Dec 2008	31 Dec 2007	31 Dec 2008	31 Dec 2007	31 Dec 2008	31 Dec 2007	31 Dec 2008	31 Dec 2007
Primary capital	7,648	7,152	7,287	7,240	993	940	7,371	4,806
Capital base	9,498	8,788	9,481	9,187	993	940	7,371	4,806
Risk-weighted assets; Basel I	116,105	98,918	31,666	27,901	1,285	11,294	83,369	59,692
Risk-weighted assets; Basel II	101,182	92,258	26,840	25,636	1,024	10,566	73,535	56,027
Primary capital ratio	7.6%	7.6%	27.2%	27.3%	96.9%	8.8%	10.0%	8.5%
Capital adequacy ratio	9.4%	9.4%	35.3%	34.7%	96.9%	8.8%	10.0%	8.5%
Capital ratio	1.17	1.19	4.42	4.48	12.12	1.11	1.25	1.07

5. Credit risk

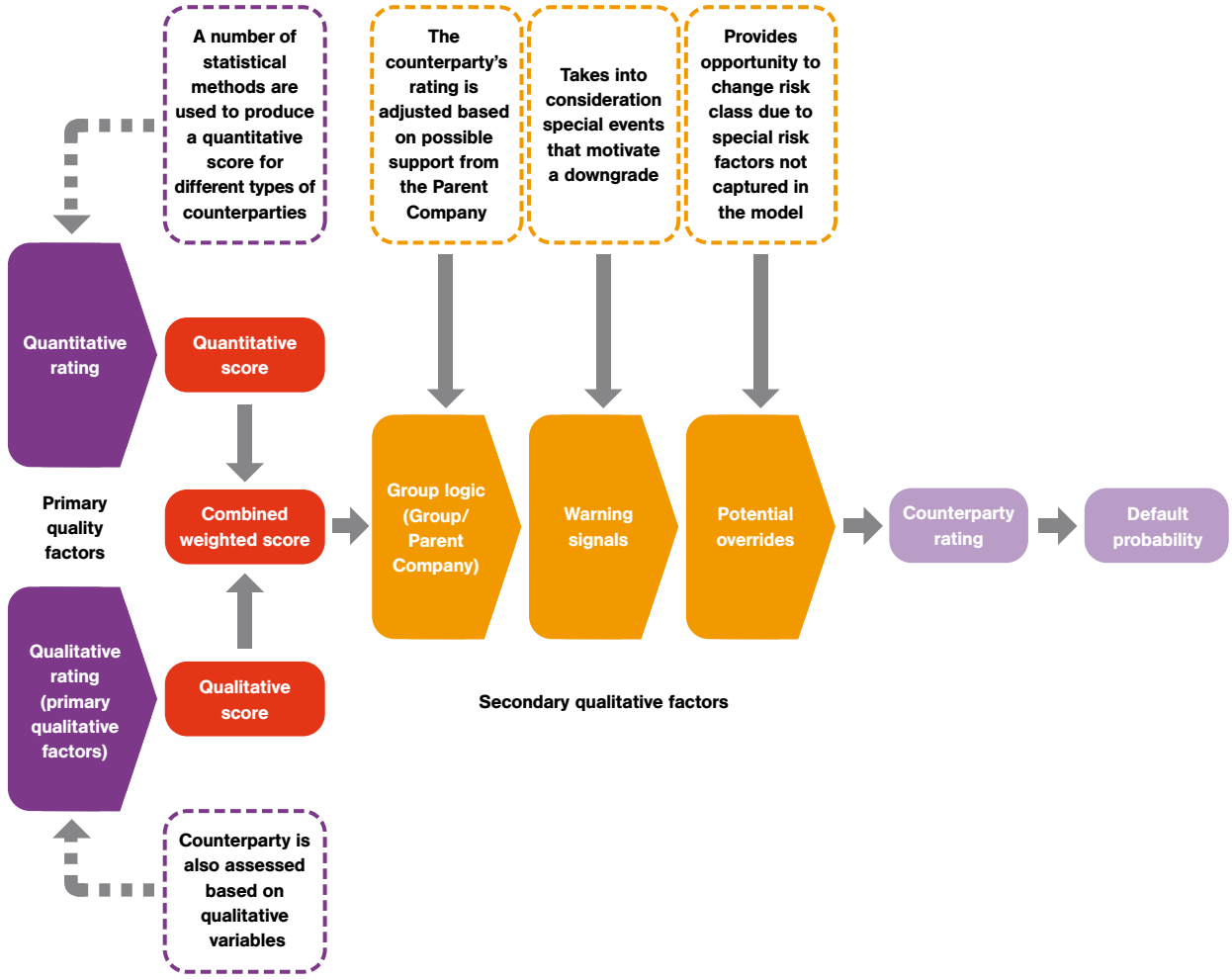
5.1 Risk classification system

Of SBAB's total lending, 81% comprises corporate or retail exposures with tenant-owned apartments or residential property as collateral. The credit risk for each of these exposures is assessed in the Group's credit risk models. The standardised method is used for quantification of credit risk for other types of exposures (see Table 7). For the cases in which external ratings were used, the lowest rating from either Moody's or Standard & Poor's was selected. In the credit risk models, an assessment is made of the probability of default[1)], loss given default and the proportion of the loan promises that will be utilised in the event of default. On the basis of these parameters, together with EAD, customers can be ranked according to credit risk and the expected and unexpected loss can be estimated. After assessment, the exposure is referred to one of eight risk classes for corporate and retail loans respectively, where the eighth class consists of customers in default. Customers in high risk classes are monitored thoroughly and, when necessary, the exposure is managed actively by credit monitoring personnel in the credit division.

The expected credit loss (EL) is measured using the formula EL = PD*LGD*EAD. In order to calculate EAD for off-balance-sheet exposures, the unutilized amount is multiplied by a credit conversion factor (CCF).

[1)] *An exposure is considered to be in default if the claim is more than 60 days past due or if it has been assessed that the customer will probably not pay agreed interest or amortisation.*

Figure 5. **SBAB's internal rating process for corporate clients**



- PD (probability of default) comprises the probability of default for a customer
- LGD (loss given default) states the extent of the loss in the event of default
- EAD (exposure at default) measures the expected exposure in the event of default
- CCF (credit conversion factor) constitutes the proportion of an off-balance sheet item which is utilised at the point in time of a possible future default.

IRB models are used throughout SBAB's operations for tasks such as granting of credit, pricing, portfolio analysis and performance monitoring. The models produced are validated annually by the risk department, and all deviations from the quantitatively calculated risk class are analysed. For Corporate customers, the current year's validation shows, inter alia, an increased concentration of customers in the best risk classes, which indicates that the risk differentiation is not optimal. To counteract the increasing concentration, the models will be adjusted during 2009.

A more rigorous process, in which qualitative factors complement the quantitative assessment process of the customers' risk classes, is used in the business area Corporate Clients for customer segments for which current financial accounts are available. This entails greater uniformity in the assessment and facilitates handling of supporting documentation. For other customer segments in the business area Corporate Clients, credit analysts add their assessment of risk class and an explanatory statement to the supporting material for assessment of risk class in the decision-processing system.

5.2 Risk classification method for exposure classes

For the purpose of capital adequacy and risk classification, exposures are categorised in exposure classes.

The IRB method is applied for corporate exposures for housing where a mortgage deed has been received as collateral and for retail exposures. For central government, institutional and corporate exposures that do not pertain to residential properties or for which collateral other than a mortgage deed or tenant-owned apartment has been received, the standardised method is applied. The portion of the loan for which a municipality or guarantee from the Swedish National Housing Credit Guarantee Board (BKN) has provided collateral is attributed to central government exposure. The distribution of exposure classes and capital requirement is shown in Chapter 4.2, Capital requirements.

- Retail exposures refer to loans to private individuals for funding of single-family dwellings, tenant-owned apartments and holiday homes to the extent that the loan does not relate to letting activity.
- Corporate exposures refer to loans to legal entities and private individuals for multi-family dwellings or loans for letting of housing.

With regards to exposures that are assessed using the IRB method, SBAB has opted to use a scoring method for risk classification of counterparties in the PD dimension. The statistical method used to estimate the probability of default is logistic regression. This statistical method was chosen based on the part that is to be analysed, meaning default, and on the basis of the existing available data. In its choice of method, SBAB also considered the method's ability to generate reliable predictions so that future default can be anticipated.

The available data on which the scoring models are based was obtained from both internal and external sources. Internal data consists of loan information, default outcomes and internal payment records. Data obtained externally includes financial accounts, external payment records, property data, and municipal and parish data. PD estimates for corporate exposures are based on data originating in December 1996, and PD estimates for household exposures are based on data originating in September 2001. The distinction drawn between retail exposures and corporate exposures is shown in Table 6.

For off-balance retail exposures, SBAB has developed its own estimates of the credit conversion factor (CCF). Two different methods were used to calculate CCF, depending on where each individual loan was located in the

Table 6. **Loan portfolios and exposure classes for which the IRB method is applied**

Portfolio	Property	Exposure class	PD model
Retail	Single-family dwellings and holiday homes, Tenant-owned apartments	Retail exposures	Retail
Corporate	Private properties, Tenant-owner associations	Corporate exposures	Corporate

SBAB credit-granting process. For a large proportion of the off-balance household exposures, a scoring method was used to estimate the probability that the exposure would end up on SBAB's balance sheet. For the exposures not covered by the scoring method, SBAB estimated this probability based on the location of the individual loan in the credit-granting process and on whether the counterparty was an existing SBAB customer. The estimated probability was used to allocate each exposure into one of eight CCF risk classes. The CCF estimate for each risk class is then calculated as the realised average proportion of total off-balance exposures that leads to a commitment by SBAB. To avoid underestimation, safety margins were added.

In terms of borrowing, the SBAB Group has a limited number of counterparties, and these are mainly institutions. All counterparties are to be approved and limited in a specific order before transactions may be carried out.

5.3 Swedish Financial Supervisory Authority (FI)

FI's decision in March 2007 allows SBAB to use the IRB method to calculate risk-weighted exposure amounts for credit risk. At the same time, SBAB was granted:

- the right to calculate exposure amounts in relation to the Swedish government, the Riksbank and Swedish municipalities in accordance with the standardised method for credit risk,
- a time-limited permit to apply the standardised method for credit risk for portfolios of insignificant size and
- the right to apply the standardised method to all central government and institutional exposures.

In 2008, SBAB applied for a permit to use its own estimates for LGD and CCF for corporate loans and loans to tenant-owner associations for collateral in the form of mortgage deeds. Until such a permit is obtained, the foundation IRB method will be applied.

6. Information about the loan portfolio

Credit risk is defined as the risk of loss due to the customer or counterparty's inability to make interest payments and amortisation or otherwise fulfil the loan agreement. Credit risk arises in conjunction with loans and loan promises, and also in connection with impairment of the value of pledged assets entailing that these no longer cover the Group's receivables.

Credit risk in lending operations is restricted by limits decided upon for the customer or customer group. The credit risk is also managed in the credit granting process, where potential borrowers' ability to make their interest payments is analysed. For example, new retail loans are granted only to borrowers who are expected to be able to pay interest and amortisation in an interest-rate situation that exceeds current levels by a comfortable margin. Furthermore, risk classification based on the internal ratings-based method is used in the analysis of the credit risk for new and existing customers in the loan portfolios.

In order to grant credit, adequate collateral is required, which can be provided in the form of real estate or a tenant-owned apartment. Adequate collateral usually means mortgage deeds in a property or a tenant-owned apartment up to 75%-85% of the market value. The 85% ratio applies provided that collateral can be obtained with priority right and that the customer has risk class R1-R4 for consumers and C1-C4 for corporate customers. In other cases, a loan-to-value ratio of 75% applies. If collateral was complemented with credit insurance, it was possible in 2008 to provide loans to private customers at up to 95% of market value. This remains possible in 2009, but the credit insurance requirement has been replaced by a requirement for "Låneskydd Trygg" [1)], and the loan amount exceeding 85% of market value must be amortised over a maximum of 10 years (previously 15 years). In addition to the above collateral, it is possible to grant credit for, inter alia, collateral in the form of a state credit guarantee, a municipal guarantee, securities, bank guarantees and deposits in a Swedish bank. To a limited extent, equities corresponding to up to 85% of the market value in the underlying property can be approved as collateral. SBAB does not hold any collateral which has been taken over to protect a claim.

The information in this section dates from 31 December 2008, but differs in the following respects from the information presented in the 2008 Annual Report:

1. Exposure amounts including accrued interest are reported instead of the capital receivable.
2. FriSpar's loan portfolio is included at 100%.

6.1 Total amount of all exposures during the period

SBAB uses the IRB method for corporate and retail exposures with collateral in a residential property or a tenant-owned apartment. Without taking credit risk protection into account, the total amount for all credit risk exposures was SEK 257,612 million at 31 December 2008. Corporate exposures comprised only 34% of total exposures for which the IRB method is used after outflow and inflow, but because the average risk weight is substantial, the exposures have a relatively considerable weight in the capital adequacy calculation.

The average exposure amount, calculated on the basis of the exposure amount in the loan portfolios at the end of each month in the past year, amounted to SEK 180,831 million, of which 54% comprised retail exposures. SBAB issued loan promises and other credit-related commitments totalling to SEK 24,802 million which, after the credit conversion factor was taken into account, amounted to SEK 4,826 million.

LGD states how large the loss will be in the event of default. The exposure-weighted LGD for single-family dwellings and holiday homes was 9.37% and exposure-weighted LGD for tenant-owned apartments 14.95%. While the exposure-weighted LGD for single-family dwellings was relatively constant compared with the preceding year, the average risk weight for tenant-owned apartments increased somewhat, indicating that there is a minor difference in LGD between the two segments (see Table 7). The exposure-weighted amount for LGD is controlled by the limitation rule, which means a lowest total level for LGD of 10% for exposures covered by the advanced IRB method assuming that collateral consists of a tenant-owned apartment, a mortgage in a residential property or the site leasehold of such a property.

[1)] *Unemployment and sickness insurance with no life insurance component.*

Table 7. **Total exposures without credit risk coverage and average value per exposure class**

SEK million	Exposure	Of which off-balance sheet items (before CFF)	Exposure after outflow and inflow respectively[1]	Of which off-balance sheet items (after CFF)	Average value of exposures in lending portfolio[2]	RWA	Capital requirement	Average risk weight	Provision	Expected loss	Average PD	Exposure-weighted LGD
Credit risk reported in accordance with IRB method												
of which												
– Corporate exposures	60,716	1,354	53,761	1,084	49,648	19,709	1,577	36.7%	88	278	1.62%	31.24%
– Retail exposures	141,416	23,448	102,511	3,741	96,941	8,401	672	8.2%	114	187	0.71%	10.48%
– of which single-family dwellings and holiday homes	*93,074*	*11,738*	*82,228*	*1,552*	*79,980*	*5,398*	*432*	*6.6%*	*75*	*115*	*0.68%*	*9.37%*
– of which tenant-owned apartments	*48,342*	*11,710*	*20,283*	*2,189*	*16,961*	*3,003*	*240*	*14.6%*	*39*	*72*	*0.78%*	*14.95%*
Total credit risk in accordance with IRB method	**202,132**	**24,802**	**156,272**	**4,825**	**146,589**	**28,110**	**2,249**	**18.0%**	**202**	**465**		
Credit risk reported in accordance with standardised method												
of which												
– exposures to states and central banks	325	-	325	-	-	0	0	0.0%				
– exposures to municipalities and similar associations	684	-	8,038	-	8,936	0	0	0.0%				
– institutional exposures	18,541	-	37,079	-	18,175	12,232	978	33.0%				
– corporate exposures	30,755	-	30,755	1	6,852	12,251	980	17.3%				
– retail exposures	231	-	231	0	276	173	14	75.0%				
– unregulated items	4,846	-	5	-	3	5	1	100.0%				
– other items	98	-	98	-	-	50	4	57.8%				
Total credit risk in accordance with standardised method	**55,480**	**-**	**76,531**	**1**	**34,242**	**24,711**	**1,977**	**21.2%**				
Total	**257,612**	**24,802**	**232,803**	**4,826**	**180,831**	**52,821**	**4,226**	**19.4%**				

[1] For exposures after inflows and outflows, adjustments have been made of amounts to be recognised and covered by capital in an exposure class other than the original one.
[2] Off-balance sheet items have been excluded.

6.2 Exposure amounts distributed by geographical distribution

The SBAB Group's portfolio is mainly secured by housing in the Stockholm area (43%) and the Öresund region (24%). Only 4% of the underlying collateral derives from weak regions (see Table 8).

The SBAB Group's division of Sweden comprises:

- *Greater Stockholm:* Stockholm's labour market region according to Statistics Sweden (SCB) (2004).
- *Greater Gothenburg:* Gothenburg's labour market region according to SCB (2004).
- *The Öresund Region:* Labour market regions in Malmö and Helsingborg according to SCB (2004).
- *University and growth regions:* Municipalities with universities and municipalities with especially buoyant growth according to analyses by SBAB [2].
- *Weak regions:* Municipalities with very weak or negative growth according to analyses by SBAB [2].
- *Other regions:* Municipalities that are not allocated to any category.

6.3 Exposure amounts distributed according to the next stipulated term of expiry [3]

A large proportion (55%) of the portfolio has less than 1 year left until the next stipulated term of expiry. The group with a remaining term of between 1 and 5 years accounts for 40% of the outstanding loans (see Table 9).

6.4 Exposure amounts distributed by type of property

The largest exposure amounts derive from lending to single-family dwellings (44%), tenant-owned apartments (20%) and tenant-owner associations (19%). Lending to commercial premises and municipalities accounts for a minority (3%) of the loan portfolio (see Table 10).

[2] This analysis is based on SCB statistics including growth in the short and long term, the proportion of the population that is older than 64 years, average income and the vacancy rate in public housing, and on the local knowledge of SBAB analysts.

[3] The stipulated term of expiry refers to the day for confirmation of the conditions that are to apply for the loan during the coming new term. These conditions are to be supported by the terms of the original loan agreement.

Table 8. **Geographical distribution of exposure amounts**

SEK million	Greater Stockholm	Greater Gothenburg	Öresund region	University and Growth regions	Weak regions	Other regions
IRB-exposures						
IRB Retail exposures	42,464	8,225	30,370	6,022	3,737	7,952
IRB Corporate exposuresg	17,670	5,133	11,159	7,997	2,013	8,705
Standardised exposures						
Standardised Corporate exposures	4,120	289	1,363	923	382	546
Standardised Retail exposures	148	21	33	14	7	8
Standardised Municipal exposures	1,660	724	634	506	2,040	2,473
Standardised Institutional exposures	14,521	1,489	1,835	472	22	198
Standardised Unregulated exposures	2	0	2	0	0	0
Total	**80,585**	**15,881**	**45,396**	**15,934**	**8,201**	**19,882**

Table 9. **Exposure amounts distributed by next stipulated term of expiry**

SEK million	< 1 year	1 - 5 years	> 5 years
IRB exposures			
IRB Retail exposures	57,049	36,840	4,881
IRB Corporate exposures	25,047	23,509	4,120
Standard exposures			
Standard Corporate exposures	4,187	3,409	28
Standard Retail exposures	208	20	3
Standard Municipal exposures	3,716	4,025	296
Standard Institutional exposures	11,384	6,659	496
Standard Unregulated exposures	4	1	0
Total	**101,595**	**74,463**	**9,824**

6.5 Past due exposures and exposures with impairment requirements

Past due exposure refers to total claims where any part is more than five days past due. SBAB has chosen not to take into account claims that are past due by five days or less so that the result of the analysis is not distorted when payments are delayed because the payment date coincided with a public holiday.

Exposures with impairment requirements refer to doubtful exposures whereby individual provisions have been posted for commitments relating to corporate loans or retail loans, meaning that in SBAB's assessment, future payments are exposed to risk and that the collateral does not cover the amount of the claim.

The selection of provisions comprises all corporate customers where there is objective evidence of impairment and individual private customers where special reasons for impairment exist. All exposures in risk class C8 are reviewed monthly and assessed for risk. The size of the individual provision is assessed by comparing the agreed payment flow from the customer with the expected future payment capacity, whereby an analysis of the property's cash flow is included as an important parameter in combination with a valuation of the underlying collateral.

Table 10. **Exposure amounts distributed by type of property**

SEK million	Single-family dwellings and holiday homes	Tenant-owned apartments	Tenant-owner associations	Private multi-family dwellings	Municipal multi-family dwellings	Commercial properties
IRB exposures						
IRB Retail exposures	80,676	18,094	-	-	-	-
IRB Corporate exposures	22	2	33,067	19,257	328	-
Standardised exposures						
Standardised Corporate exposures	0	-	43	1,283	2	6,295
Standardised Retail exposures	149	82	-	-	-	-
Standardised Municipal exposures	660	-	1,965	665	4,738	9
Standardised Institutional exposures	-	18,538	-	-	-	-
Standardised Unregulated exposures	4	0	0	-	-	-
Total	**81,511**	**36,716**	**35,075**	**21,205**	**5,068**	**6,304**

Table 11. **Exposures with past due amounts and with individual provisions**

SEK million	Total exposure amount in the lending portfolio	Exposure amount for overdue exposures	Exposures with individual provisions		Total exposure amount in the lending portfolio after individual provisions
			Exposure amount	Individual provision	
Single-family dwellings and holiday homes	81,512	577	12	10	81,502
Tenant-owned apartments	36,717	270	7	5	36,712
Tenant-owner associations	35,076	145	106	68	35,008
Private multi-family dwellings	21,204	28	15	12	21,192
Municipal multi-family dwellings	5,069	24	-	-	5,069
Commercial properties	6,304	-	-	-	6,304
Total	**185,882**	**1,044**	**140**	**95**	**185,787**

Table 12. **Geographical distribution of exposures with past due amounts and with individual provisions**

SEK million	Total exposure amount in the lending portfolio	Exposure amount for overdue exposures	Exposures with individual provisions		Total exposure amount in the lending portfolio after individual provisions
			Exposure amount	Individual provision	
Greater Stockholm	80,586	465	25	12	80,573
Greater Gothenburg	15,882	96	7	7	15,875
Öresund region	45,396	276	6	6	45,391
University and growth regions	15,936	81	15	12	15,924
Weak regions	8,200	61	12	9	8,191
Other regions	19,882	66	75	49	19,833
Total	**185,882**	**1,045**	**140**	**95**	**185,787**

Customers in risk class R8 are covered by the individual provision in special cases after individual assessment. The individual provision amounts to 9% of the total exposure amount for past due exposures (compare Table 11).

6.6 Past due exposures and exposures with impairment requirements according to geographic distribution

In total, individual provisions amount to 0.05% of the total exposure amount (see Table 12). “Other locations” accounts for the largest share of individual provisions in relation to geographic region (0.2%).

6.7 Exposures per risk class in the PD dimension

The quality of the portfolio is favourable. A total of 96% of the corporate exposures and 94% of the household exposures in the balance sheet derive from the four best risk classes (C1-C4, Corporate exposures and R1-R4, Retail exposures, respectively (see figures 6-9).

Figure 6. **IRB Corporate - exposure per risk class**

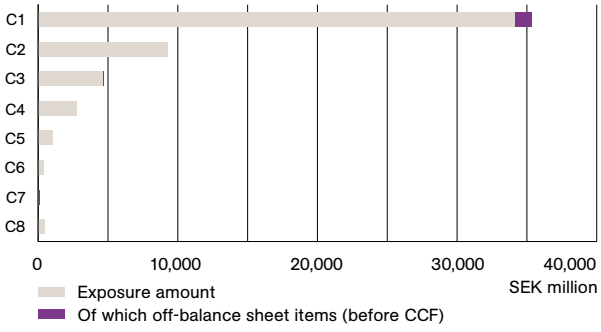


Figure 7. **IRB Retail - exposure per risk class**

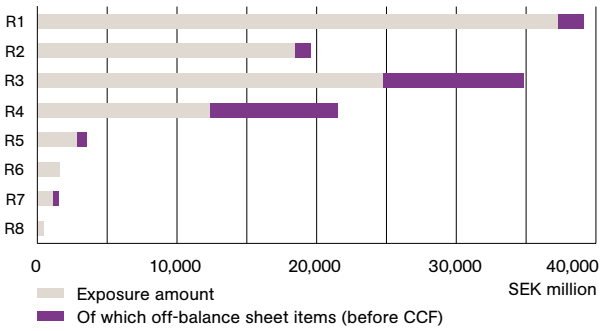


Figure 8. **IRB Retail - Single-family dwelling/holiday home - exposure per risk class**

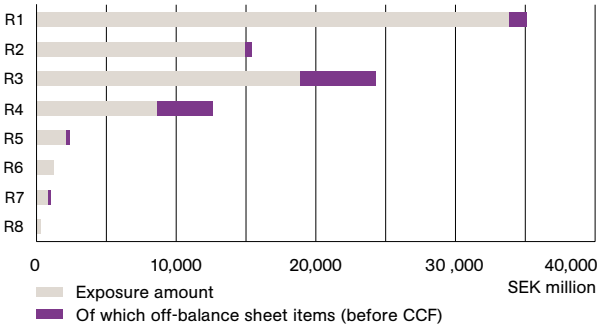
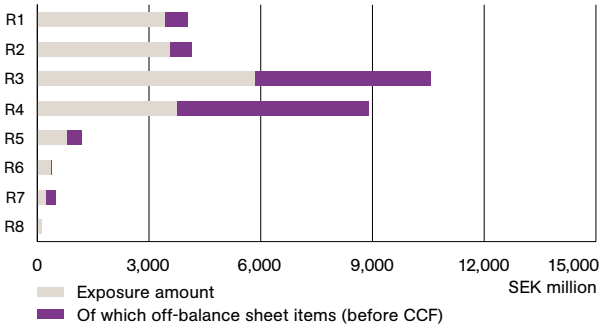


Figure 9. **IRB Retail - Tenant-owned apartments - exposure per risk class**



6.8 Realised outcome in the PD and LGD dimensions

Table 13 displays the PD estimate as of 31 December 2008 and the PD outcome in 2008. The estimated outcome for the corporate model significantly exceeds the actual outcome, which indicates that, in the prevailing economic conditions, the PD models overestimate the risk of default. The number of default outcomes estimated by the model is much closer to the number of actual outcomes for household exposures than it is for corporate exposures.

The exposure-weighted amount for LGD is controlled by the abovementioned limitation rule, which entails that the lowest total level for LGD is 10% for exposures covered by the advanced IRB method and where collateral comprises a tenant-owned apartment, a mortgage in a residential property or the site leasehold of such a property.

Table 13. **Realised outcome in the PD and LGD dimesions**

Default outcomes	PD estimate	Realised outcomes [1]	LGD estimate	Realised outcomes [2]
Corporate exposures	1.6%	0.5%		
Retail exposures	0.7%	0.5%	10.5%[3]	1.1%[3]

[1] *The results are exposure-weighted.*

[2] *An exposure is considered to be in default if the claim is more than 60 days past due or if the assessment has been made that the customer will probably not pay agreed interest or amortisation.*

[3] *Realised outcome has been calculated on default loans where the default was concluded during the year.*

6.9 Comparison of expected loss and outcome

In a comparison between expected loss (EL) according to the IRB method (foundation and advanced) and actual outcome for established losses during 2007 and 2008 (see Table 14), it can be noted that EL decreased for corporate loans, while the opposite trend applies for retail loans. The market values for properties in the corporate segment were updated, which primarily entails that LGD decreased at the same time as a positive migration in the PD dimension took place. For the retail portfolio, the opposite trend can be observed, although not to the same extent. Realised outcome was substantially lower than the outcome estimated by the models, which indicates that the models overestimated the size of expected loss in the prevailing state of the economy.

The relatively minor established losses that arose during 2008 occurred partly in cases where borrowers failed to pay interest and amortisation and partly in cases where the market value of the collateral provided was less than the value of SBAB's receivable.

For the corporate market, unregulated claims older than 60 days declined compared with the preceding year. This is reflected in the change in the amount of the provision. An increased credit risk can be noted for borrowers whose loans pertained to single-family dwellings and tenant-owned apartments, which led to an increase in the individual provision for this group.

Table 14. **Comparison of expected loss between outcome and model** [1)]

SEK million Exposure class	EL-IRB/IRB Basic 31 Dec 2007	EL-IRB/IRB Basic 31 Dec 2006	EL-IRB/IRB Advanced 31 Dec 2007	EL-IRB/IRB Advanced 31 Dec 2006	Realised outcome 2008	Realised outcome 2007
Corporate exposures	240.2	311.5	145.9	176.4	0.3	3.6
Retail exposures	69.0	55.5	69.0	55.5	7.0	3.2
– *of which single-family dwellings and holiday homes*	*51.6*	*37.8*	*51.6*	*37.8*	*4.7*	*2.7*
– *of which tenant-owned apartments*	*17.4*	*17.7*	*17.4*	*17.7*	*2.3*	*0.5*
Total	**309.2**	**367.0**	**214.9**	**231.9**	**7.3**	**6.8**

[1)] *Expected loss (EL) has been calculated for those loan receivables existing at the end of 2006 and 2007. In Table 14, the expected loss is compared with the realized outcome of confirmed losses during the realized outcome years of 2007 and 2008, respectively.*

6.10 Credit risk coverage

The guarantee from the Swedish National Housing Credit Guarantee Board (BKN) is utilised to reduce the capital requirement. The receivable of SEK 715 million covered by the credit insurance from BKN was weighted by 0% in the calculation of capital adequacy. Approximately SEK 6.7 billion of the lending was to Swedish municipalities or was secured by a municipal guarantee. When calculating capital adequacy, this lending was weighted at 0%. In addition, the Parent Company and SCBC have previously had joint credit insurance from Genworth Financial Mortgage Insurance Limited (Genworth) that was not used in the calculation of capital adequacy. The credit insurance covers the portion of the loan amount that exceeds 85% of the value of pledged collateral. The total insured loan amount is SEK 2.2 billion. The insurance agreement was terminated as of 1 January 2009 and cannot be utilised for new loans. For existing loans, however, the insurance applies as before. Genworth has rating A (Standard & Poor's) and Aa3 (Moody's). In addition, the credit loss guarantees of SEK 1.4 billion from business partners were not utilised in the calculation of capital adequacy.

7. Liquidity risk

Liquidity risk means the risk of SBAB encountering difficulties in meeting payment obligations associated with financial liabilities. There has been a strong focus on liquidity risk management in the entire bank sector since credit turbulence broke out in the latter half of 2007. SBAB's liquidity risk management is based on the following principles:

1. Broad and diversified borrowing
Because SBAB has maintained an active presence in the international capital market since 1989, its brand is well-established. Borrowing takes place on a global basis with both short-term and long-term loans. Moreover, since 2006 the SBAB Group has had access to the covered bond market through its subsidiary, SCBC.

2. Conservative matching of assets and liabilities
SBAB applies strict regulations as to how assets and liabilities are to be matched. As a rule, capital maturity for funding the lending must be at least as long as that for the lending itself.

3. Liquidity reserve with immediately available liquidity
At 31 December 2008, SBAB had the following reserves of immediately available liquidity:

- SEK 4 billion loan facility at the Swedish National Debt Office
- SEK 4.6 billion in bank facilities
- SEK 31.8 billion in liquid securities

4. Liquidity reserves
When calculating the value of reserves, SBAB applies the valuation deductions issued by the Riksbank, in accordance with the Riksbank's Guidelines for Collateral Management in the Riksbank's regulatory framework for RIX and monetary policy instruments.

For calculation of the issue capacity of covered bonds, SBAB measures the quantity of qualified assets that are not already taken into use for strategic covering of outstanding debt in SCBC. In addition, a valuation deduction is added corresponding to SCBC's minimum possible extent of excess collateral.

5. A liquid balance sheet
SBAB's assets consist primarily of lending against collateral in property. SCBC was established in 2006 with the purpose of issuing covered bonds, which has also resulted in increased liquidity in SBAB's balance sheet.

6. Continuous monitoring of liquidity risks
The size of SBAB's liquidity reserves and the liquidity of the balance sheet are key factors in SBAB's management of liquidity risk. By coordinating lending with liquidity risk management, concentrations of large borrowing maturities are avoided.

7.1 Liquidity risk measurements

SBAB measures and stress-tests liquidity risk by totalling the maximum conceivable need for liquidity for every day during the coming 365 days. This measure of liquidity risk is referred to as Maximum Cumulative Outflow (MCO) and is limited. The MCO calculations are based on a crisis scenario in which all loans are extended on maturity, meaning that no liquidity is added through loan redemption and that no funding is available. In this way, the maximum need for liquidity can be identified for every given future period, and the necessary liquidity reserve can be established based on these calculations.

In addition, SCBC has issuing capacity in the form of qualified assets for covered bonds that have not yet been taken into use. This comprises an additional reserve that is not included in the calculation of MCO.

The principal liquidity risk measures for SBAB are:

- how long the company can cope without raising new loans
- how long the company can cope if it can only issue covered bonds [1)]

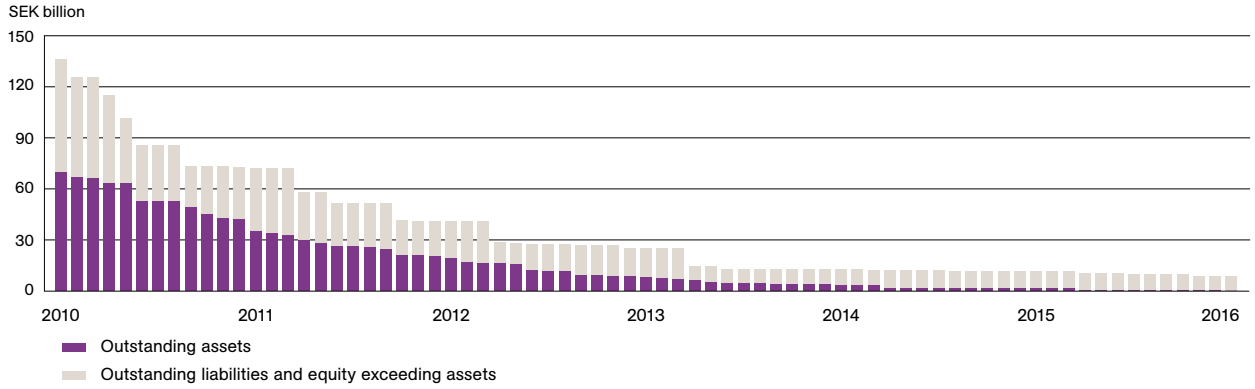
7.2 Liquidity situation in 2008

In the strained market that prevailed in 2008, SBAB adopted a conservative approach to liquidity risk management and planned to increase the average MCO. In 2008, the liquidity reserve corresponded to an average of 87 days MCO.

At 31 December 2008, the size of SBAB's liquidity reserve corresponded to 105 days MCO. The volume of the qualified total collateral entails that SBAB need not rely on non-covered funding in 2009. During 2008, SBAB's

[1)] *This latter measurement is limited by the amount of qualified collateral for covered bonds in SBAB's balance sheet. See also the Annual Report for SCBC.*

Figure 10. **Future surplus liquidity, one year and forward, Group**



Assets and liabilities plus equity from one year and onward at 31 December 2008. The graph shows that SBAB has longer liabilities and equity than assets and therefore does not lack future funding for existing assets.

liquidity reserve was never less than the equivalent of 30 days' future liquidity requirements, including maturities of large benchmark bonds.

7.3 Information about the liquidity portfolio

SBAB's liquidity portfolio is a liquidity reserve which is intended to manage liquidity and funding risks. At 31 December 2008, the portfolio amounted to SEK 31.5 billion. The assets are classified as Loan receivables and account receivables (residential mortgage-backed securities (RMBS)), SEK 23.1 billion and Securities valued at fair value through profit and loss (covered bonds, government bonds and securities guaranteed by government), SEK 8.4 billion.

SBAB's liquidity portfolio comprises three asset classes:

- European covered bonds
- European and Australian RMBS, i.e. securities with collateral in the form of residential mortgage portfolios.
- Securities issued by or guaranteed by states

The holdings in the liquidity portfolio are long term. A total of 98% of the portfolio comprises securities with only the highest rating, Aaa, from Moody's, or AAA from Standard & Poor's, except for two covered bonds that have the rating AAA/Aa3 and AAA/A1, respectively. SBAB's liquidity portfolio does not have and has never had any exposure to the United States, to US assets or to home loans not classed as prime. The expected average maturity for the assets in the liquidity portfolio is 3.9 years. Derivative contracts have been entered into to manage interest-rate risk and currency risk. The bonds in the portfolio can be pledged at the Riksbank or the European Central Bank.

In accordance with the decision of the European Commission and FI's assessment, SBAB decided to reclassify assets in the RMBS portfolio from the category Available-for-sale financial assets to the category Loan receivables and accounts receivable. This reclassification was made at 1 July 2008 at a fair value of SEK 21.7 billion.

The reclassification of assets in the RMBS portfolio as Loan receivables and accounts receivable entails that the assets are to be reported at their accrued acquisition value and that credit risk assessment will take place in accordance with the same principles used in the risk assessment of SBAB's credit portfolio. All exposures in the RMBS portfolio are ranked according to LTV (loan to value ratio) and age (date originated) in three different groups. For all exposures in the groups with the greatest uncertainty (particularly RMBS secured with Spanish and English residential mortgages respectively), information on actual and expected cash flow and any change in LTV was updated. For the countries with the most doubtful exposures, information was obtained on the trend for such essential macrovariables as available income, unemployment and the trend in interest expense. Updated and obtained information was then analysed by the credit division. No need for a provision was deemed to exist.

8. Funding risk

SBAB endeavours to achieve an overall matching in maturity periods for tied-up capital between liabilities and assets. The funding risk is an expression of deviations from this matching. SBAB's calculation of funding risk is based on all contracted capital amounts with a remaining maturity of over one year, which thus supplements SBAB's use of the liquidity risk model, which covers the interval up to one year. In the funding risk model, equity is calculated as having the same maturity as SBAB's longest lending assets. The funding risk is calculated as the extent of any future liquidity deficit.

In the prevailing financial crisis, SBAB has selected a more conservative funding risk management method than previously. Forthcoming defaults are prefunded and the share of short-term lending has been reduced.

9. Counterparty risk

In financial activities, counterparty risk arises through derivative transactions. SBAB uses derivatives to eliminate interest rate and currency risks associated with lending and borrowing at fixed interest rates.

In accordance with the financial directives established by SBAB's Board of Directors, the Group's credit risk limit is to be established by SBAB's Finance Committee for all counterparties in financial activities (i.e. borrowers and financial counterparties) with the exception of the Swedish state and companies in the SBAB Group, for which no limits on the exposure are applied. The exposure amount for the counterparty risk is calculated in accordance with the Market Valuation Method and the Agreement on net calculation of derivative contracts.

The credit risk limit can be established for a maximum period of one year before a new consideration must take place. Decisions on credit limits made by the Finance Committee are to be reported to the Board at the immediately following board meeting.

The Capital Adequacy and Large Exposures Act (2006:1371) limits large individual exposures to a maximum of 25% of the capital base. Individual limits for investment and counterparty exposure (excluding money market limits) may, as a main rule, amount to a maximum of 15% of the capital base. Certain Nordic counterparties are exempted from these rules; for such counterparties, the maximum limit can amount to the equivalent of 20% of the capital base. Current ratings for individual counterparties, as issued by Moody's or Standard & Poor's, constitute an additional restriction on the establishment of individual credit risk limits. The higher the counterparty's rating class, the greater the exposure that may be permitted in relation to SBAB's capital base.

In order to reduce the potential counterparty risk in derivative transactions involving non-standardised derivative instruments that are not cleared by approved clearing organisations in accordance with FI's capital adequacy directives (FFFS 2007:1), standard agreements for netting in bankruptcy (ISDA Master Agreements or similar agreements, and when appropriate, annexed collateral arrangements known as Credit Support Annexes or CSA's) must have been entered into between the SBAB company in question (the Parent Company or SCBC) and the counterparty. When SCBC enters into a derivative agreement, an annexed CSA must always be created. The ISDA Master Agreement entails, inter alia, that netting is regulated in the event of bankruptcy. A CSA means that the parties have agreed in advance to transfer assets if the exposure exceeds a certain threshold amount. The threshold amount and the lowest amount to be transferred to or from the counterparty can vary depending on the parties' ratings. Tables 15 and 16 provide an overview of the distribution of individual derivative instrument transactions and market value by various maturities and ratings, respectively.

9.1. Money market investments

SBAB has separate limits for money market investments, i.e. investments that extend over a maximum of one week forward. Individual money market limits may not exceed SEK 500 million or 5.75% of the capital base.

Table 15. **Derivative instruments for the SBAB Group**

31 December 2008 SEK million	Total nominal amount	Positive market value	Negative market value
< 1 year Interest rate swaps	50,792	618	633
> 1 year Interest rate swaps	177,058	6,089	4,762
< 1 year Interest rate and currency swaps	34,727	4,666	1,115
> 1 year Interest rate and currency swaps	58,380	8,963	1,032
< 1 year Share-related derivative contracts	129	5	1
> 1 year Share-related derivative contracts	0	0	0
> 1 year Credit derivatives	18,042	308	0
Total	**339,128**	**20,649**	**7,543**

Table 16. **Derivative instruments distributed by rating for the SBAB Group**

31 December 2008 SEK million	Net market value	Positive market value	Negative market value
AAA	244	271	27
AA+	(29)	173	201
AA	0	0	0
AA–	5,765	10,693	4,928
A+	7,269	8,418	1,148
A	(202)	994	1,197
A–	59	100	42
Total	**13,106**	**20,649**	**7,543**
Collateral			**9,634**
Netting gains[1)]			**6,497**

[1)] *Netting gains means the total of the estimated reduction in exposure per counterparty, which arises in cases where positive market values (receivables) can be reduced against negative market values (liabilities).*

10. Operational risk

SBAB uses the standardised method to measure and handle operational risk. This method entails that the capital requirement is based on 12%, 15% and 18% respectively of the average operating income of the business areas. This method includes requirements for documentation, processes and structure such as:

- Established controlling documents
- Processes for managing operational risks
- Emergency plans and continuity plans
- Documented risk management
- Internal reporting structure
- Method of distributing operating income to business areas

Capital requirements for operational risk are shown in Table 4. FI has reviewed SBAB's method for measuring and managing operational risk. The method complies with the provisions of FI's directives, and FI considers it reliable.

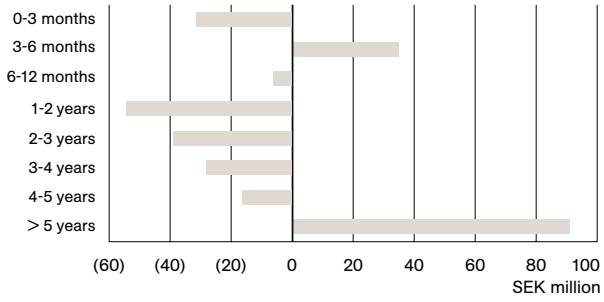
11. Interest rate risk for positions not included in the trading portfolio

SBAB measures the interest rate risk in two categories: operating interest rate risk and strategic interest rate risk. The risks are measured daily and add up to SBAB's total interest rate risk exposure. The exposure is quantified by calculating the impact of a parallel shift in SBAB's yield curve by +1 percentage point on net present value at a given point in time. The calculation takes into account contracted transaction flows in lending, the liabilities register and derivatives.

Operating interest rate risk arises in the SBAB Group's current lending and borrowing activity. The exposure corresponds to the net of the interest rate risk associated with, on the one hand, the total of external lending and investments that is funded by external borrowing and, on the other, the total of external borrowing and derivative instruments. SBAB's operating interest rate risk is calculated for each currency and then summarised. The interest rate risk is handled daily in real time and arises in the SBAB portfolios to which capital and interest rate flows have been grouped, depending on maturity and type of borrowing instrument. The risk is measured in all portfolios and aggregated in conjunction with reporting. Using swap contracts, SBAB reduces the operating interest rate risk in the longer lending maturity periods to the corresponding three-month Stockholm Interbank Offered Rate (STIBOR).

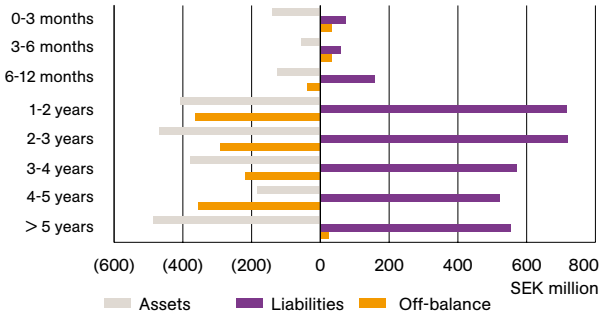
The strategic interest rate risk is the reinvestment risk that arises when SBAB's equity and flow is invested. The flow arises because interest payments in lending and borrowing have different payment frequencies. SBAB's equity is primarily to be used to fund lending operations. The benchmark value for investment of equity is defined as a series of durations with even fixed-interest maturities every year from 1 to 10 years. The interest rate risk associated with equity is the interest rate risk that deviates from the benchmark. The Board establishes the benchmark, which is to be reviewed at least once annually. See Figures 11 to 13 for positions that are not included in the trading portfolios.

Figure 11. **Interest rate risk in a parallel shift of the yield curve by +1 percentage point**



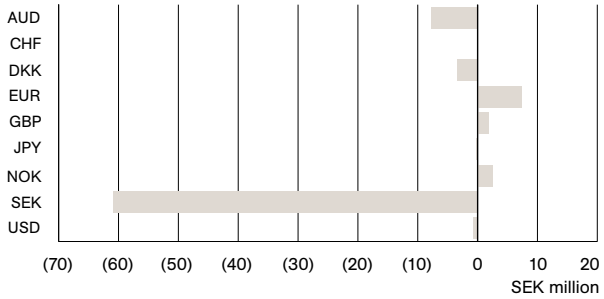
Interest rate risk distributed by time buckets in a parallel shift of the yield curve by +1 percentage point. Total: negative SEK 50.0 million. 31 December 2008

Figure 12. **Interest rate risk for assets, liabilities and off-balance instruments in connection with a parallel shift of the yield curve by +1 percentage point**



Interest rate risk distributed by time buckets, assets, liabilities and off-balance sheet instruments in a parallel shift of the yield curve by +1 percentage point. Total: negative SEK 50.0 million. 31 December 2008

Figure 13. **Interest rate risk distributed by currencies in connection with a parallel shift of the yield curve by +1 percentage point**



Interest rate risk distributed by currencies in a parallel shift of the yield curve by +1 percentage point. Total: negative SEK 50.0 million. 31 December 2008

12. Risks associated with trading portfolios

The trading portfolios comprise two groups of positions: a pure trading portfolio and investments in SBAB's liquidity portfolio.

The liquidity portfolio has a minimised interest rate risk. The risk in the portfolio is attributable to the credit risk.

SBAB manages interest rate, currency, credit and liquidity risks associated with the trading portfolios as an integrated part of the balance sheet in conjunction with the other operations. The risks are limited in accordance with the financial directives. This means that, for the management of interest rate risk, the entire balance sheet is set to market value, even if the other operations are managed using another accounting method. The interest rate risk in the trading portfolios is included as a part of the total limit of the operating interest rate risk, which has been delegated to The Treasury Department. Credit risks in the form of issue and counterparty risks in the trading portfolios are regulated by credit risk limits. A special framework for credit risks applies for the liquidity portfolio.

13. Glossary

Chapter 2. **Organisation**

Asset and liability management committee (ALCO) • The ALCO handles matters relating to risk and capital planning, which are then addressed to executive management.

Chapter 3. **Internal model for calculating risk capital**

Asset-Liability Management (ALM) • ALM handles the risk that arises in conjunction with the matching of assets and liabilities in SBAB's balance sheet.

Economic capital • Economic capital is SBAB's own assessment of the appropriate extent for risk capital. In 2010, in combination with stress tests and potential provisions for further risk, economic capital will replace governmental authority capital as the minimum capital requirement. This requirement may not be less than the capital standard in accordance with Pillar I. Economic capital is also based on SBAB's own relatively advanced models in which all quantifiable risks are summarised in a single entity. This is also an important component in the company's pricing and financial control.

Governmental authority capital • Governmental authority capital (in accordance with Pillar I) pertains to the minimum amount of capital that SBAB may have in accordance with the Capital Adequacy and Large Exposures Act (2006:1371) and FI's Code of Statutes FFFS 2007:1. Based on these regulations, SBAB was granted a permit to use its own models based on its own data to measure risk.

Internal capital adequacy assessment process (ICAAP) • Process for internal capital valuation.

Value at Risk (VaR) • Measure of the maximum anticipated loss at a given level of security and over a defined time period.

Chapter 4. **Capital adequacy**

Capital base • The capital base is comprised mainly of equity (primary capital) and subordinated loans (supplementary capital) and acts as a buffer against unexpected losses.

Capital adequacy ratio • Capital base divided by risk-weighted assets.

Capital ratio • Capital base divided by minimum capital requirement.

Fixed-term subordinated loans • Fixed-term subordinated loans may be included in supplementary capital to a maximum of 50% of the primary capital.

Minimum capital requirement • The lowest amount that the company is permitted to have as its capital base in accordance with the Capital Adequacy and Large Exposures Act (2006:1371).

Primary capital • Primary capital is comprised mainly of equity. To be included in primary capital, it has to been paid.

Primary capital surplus • The primary capital surplus comprises perpetual subordinated loans with terms entailing that FI has granted permission for them to be included in primary capital. The primary capital surplus may comprise a maximum of 30% of primary capital. The portion exceeding 30% is included in supplementary capital.

Perpetual subordinated loans • Perpetual subordinated loans have a maturity period that is essentially unlimited, but they can be repurchased if a permit is obtained from FI. Perpetual subordinated loans may be included in the capital base to a maximum of the same amount as the primary capital.

Risk weighted assets, Basel I • All balance-sheet and off-balance-sheet items are weighted according to risk. Under the regulations of Basel I, this is performed on a standardised basis. Assets are divided into categories based on risk, whereby they are multiplied by a number of pre-established risk weightings, primarily 0%, 20%, 50% and 100% of the nominal amount.

Risk weighted assets, Basel II • The regulations of Basel II permit the use of the IRB method, within the framework of Pillar I, to establish risk-weighted exposure amounts for balance-sheet and off-balance-sheet exposures based on in-house developed models for credit risk, market risk and operating risk. The risk weightings of other exposures are determined on a standardised basis, in appropriate cases based on the counterparty's rating.

Supplementary capital • Perpetual and fixed-term subordinated loans may be included in the capital base to an amount that does not exceed primary capital. If the remaining maturity period is less than five years, a settlement of 20% is applied for each of the remaining years.

Chapter 5. **Credit risk**

Credit conversion factor (CCF) • Proportion of an off-balance sheet item which is utilised at the point in time of a possible future default. Expressed as a percentage.

Expected loss (EL) • The calculated expected loss should be covered by earnings from operating activities, while unexpected losses should be covered by the company's equity. EL is arrived at by calculating the risk associated with each individual loan over a period of one year.

Exposure at default (EAD) • Exposure at time of default

IRB method • Internal ratings-based method.

Loss given default (LGD) • Share of loss in the event of default for a possible future default

Off-balance sheet item • Commitment, pledged collateral or similar item that is not reported in the balance sheet because it is unlikely that it will be necessary to realise or utilise it, or because, due to its extent, it cannot be calculated with sufficient reliability. Off-balance sheet items may also comprise potential commitments, i.e. it is uncertain whether the commitment exists.

Probability of default (PD) • Probability of default of a customer or counterparty within a year

Chapter 7. **Liquidity risk**

Loan to Value (LTV) • Extent of a loan in relation to the value of pledged collateral

Maximum cumulative outflow (MCO) • MCO is a measurement of liquidity risk entailing the maximum conceivable need for liquidity for every day during the coming 365 days.

Residential mortgage-backed securities (RMBS) Securities with collateral in the form of residential mortgages

Chapter 9. **Counterparty risk**

Credit Support Annex (CSA) • Supplement to the ISDA agreement that regulates the provision of collateral in connection with a derivative transaction.

The International Swaps and Derivatives Association (ISDA) • Framework agreement that regulates the rights and obligations between the parties to a derivative transaction, primarily the offsetting of debt in the event of bankruptcy.

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