



Information about Capital Adequacy and Risk Management 2011

Basel Regulations, Pillar 3

SBAB Bank AB (publ)

SBAB BANK

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Glossary

Chapter 3. Risk management and risk organisation

Asset and Liability Committee (ALCO) | Body that handles matters relating to risk and capital planning, which are then addressed by Executive Management or the Board of Directors.

Chapter 4. Capital adequacy

Perpetual subordinated debentures | Perpetual subordinated debentures have a maturity that is essentially unlimited, but they can be repurchased if a licence is obtained from the Swedish Financial Supervisory Authority. Perpetual subordinated debentures may be included in the capital base at a maximum of the same amount as the Tier 1 capital.

Capital base | The capital base mainly comprises equity (Tier 1 capital) and subordinated debentures (Tier 2 capital) and acts as a buffer against unexpected losses.

Capital quotient | Capital base divided by minimum capital requirement.

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

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).

Tier 1 capital contribution | The Tier 1 capital contribution generally comprises perpetual subordinated debentures with terms entailing that the Swedish Financial Supervisory Authority has granted permission for them to be included in Tier 1 capital.

Tier 1 capital | Tier 1 capital mainly comprises equity. To be included in Tier 1 capital, it must have been paid in.

Risk-weighted assets in accordance with Basel I | All balance-sheet and off-balance sheet assets 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 in accordance with Basel II | The regulations of Basel II permit the use of the IRB approach, within the framework of Pillar 1, to establish risk-weighted exposure amounts for balance-sheet and off-balance sheet exposures based on SBAB's own models for credit risk, market risk and operational risk. The risk weightings of other exposures are determined on a standardised basis, in appropriate cases based on the counterparty's rating.

Tier 2 capital | Perpetual and time-limited subordinated debentures may be included in the capital base at an amount that does not exceed the Tier 1 capital. If the remaining maturity is less than five years, a settlement of 20% is applied for each of the remaining years.

Time-limited subordinated debentures | Time-limited subordinated debentures may be included in Tier 2 capital at a maximum of 50% of the Tier 1 capital.

Chapter 5. Internal model for calculating capital requirement

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 the company's own assessment of the appropriate size of risk capital. 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 standardised in accordance with Pillar 1. 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.

Capital in accordance with Pillar 1 | Capital in accordance with Pillar 1 refers to the minimum amount of capital that SBAB is to have in accordance with the Capital Adequacy and Large Exposures Act (2006:1371), the Capital Adequacy and Large Exposures Ordinance (2006:1533) and the Swedish Financial Supervisory Authority's Regulatory Code (FFFS 2007:1). On the basis of these regulations, the company has been granted permission to use its own models based on internal data. These provisions also include transitional rules that will probably apply through 2015.

Capital in accordance with Pillar 2 | Capital in accordance with Pillar 2 refers to economic capital which, in combination with capital based on stress tests and capital for further risk, comprises the company's assessment of the appropriate size of risk capital. In accordance with Pillar 2, the capital requirement may not be less than the capital standardised per risk type in accordance with Pillar 1. The intention is for this measurement to comprise the company's minimum capital requirement when the Pillar 1 transitional rules cease to apply.

Internal capital adequacy assessment process (ICAAP) | Process for calculating the minimum amount of capital that the company may have in accordance with the Capital Adequacy and Large Exposures Act (2006:1371), the Capital Adequacy and Large Exposures Ordinance (2006:1533) and the Swedish Financial Supervisory Authority's Regulatory Code FFS 2007:1.

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

Chapter 7. Credit risk in the lending operations

Expected loss (EL) | The calculated expected loss must be covered by earnings from operating activities, while unexpected losses must be covered by the company's equity. EL is arrived at by calculating the risk associated with each individual loan over a long-term period in a statistic model.

EL is measured through the formula $EL = PD * LGD * EAD$. To calculate the EAD for off-balance sheet exposures, the unutilised amount is multiplied by a credit conversion factor (CCF).

Exposure at default (EAD) | Exposure at time of default.

Off-balance sheet item | Commitment, pledged collateral or similar item that is not recognised 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, meaning it is uncertain whether the commitment exists.

Internal ratings-based approach (IRB approach) | The IRB approach is used to calculate the company's statutory capital requirement for credit risk. The foundation IRB approach entails that the institution is only to estimate the parameter PD. In the advanced IRB approach, the institution shall estimate, in addition to PD, one or several of the parameters CCF, LGD and M (maturity).

Credit conversion factor (CCF) | Percentage of an off-balance sheet item that is utilised at the time of a possible future default.

Loan to Value (LTV) | Extent of a loan in relation to the value of pledged collateral, meaning the loan-to-value ratio.

Loss given default (LGD) | Share of loss in the event of default.

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

Chapter 8. Funding

Euro Medium Term Covered Note Programme (EMTCN) | International funding programme for the issuance of covered bonds.

Euro Medium Term Note Programme (EMTN) | International funding programme for medium and long-term funding.

Chapter 9. Credit risk in the finance operations

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

Global Master Repurchase Agreement (GMRA) | International standardised agreement for repos.

International swap and derivatives association (ISDA Master Agreement) | 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.

Residential Mortgage-Backed Securities (RMBS) | Securities with collateral in the form of residential mortgages.

Chapter 11. Liquidity risk

Liquidity Coverage Ratio (LCR) | Liquidity measurement requiring a 30-day stressed liquidity reserve.

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.

Net Stable Funding Ratio (NSFR) | Liquidity measurement of a structural nature, which indicates the stability of the Group's funding by comparing the stability of assets and liabilities.

1. Introduction

In this document, the financial corporate group SBAB presents information about capital adequacy and risk management based on the Swedish Financial Supervisory Authority's Regulatory Code (FFFS 2007:5). This report contains information pursuant to the capital adequacy regulations Pillar 3 and pertains to conditions prevailing on 31 December 2011, unless otherwise specified. This report and the corresponding but more limited periodic information on capital adequacy and liquidity reserves, as well as information on the remuneration system, are published on sbab.se.

The aim of the regulations governing capital adequacy and large exposures is to increase stability in the international banking sector. The regulations are structured under three pillars. Under Pillar 1, the minimum capital requirement for credit risk, market risk and operational risk is calculated on the basis of established regulations. Under Pillar 2, the company determines the capital requirement for measurable risks based on the results of its internal models. The results are supplemented with an assessment of future capital requirements based on the outcome of stress tests and of other risks. Pillar 3 regulates the information that must be disclosed to the market.

The regulations governing capital adequacy and large exposures introduced in 2007 entail that risk in the company's operations must be reflected in the minimum capital requirement. The impact, however, has been limited because the transitional rules that were meant to apply from year-end 2009 were extended and now apply until the date determined by the Government, or the authority to which the Government delegates the right of decision making. The transitional rules, which entail that the minimum capital must not be less than 80% of the capital requirement, measured according to the regulatory framework for Basel 1, which is calculated using standards, are likely to apply until year-end 2015.

A significant difference in the calculation of capital requirements with and without the transitional rules affects the treatment of tenant-owner rights. According to the transitional rules, no reduction of the capital requirement is made for lending to tenant-owner rights. This means that lending against collateral in units of tenant-owner associations is equated with unsecured lending. Lending against mortgage deeds, however, is weighted 50%. If the actual risk is calculated in accordance with previous crashes, the credit risk in lending to tenant-owner rights is lower than for corresponding lending against collateral in the form of, for example, mortgage deeds in properties owned by companies. Equating the credit risk in lending against collateral in the form of tenant-owner rights with unsecured lending may be questioned, also during the transitional period, due to the substantial difference in the evaluation of risk between newer and older regulations. An extension of the regulatory

framework entails a continuation of the imbalance between capital requirements for various types of assets with a similar risk profile.

SBAB's lending primarily involves residential mortgages for the housing sector, which, historically have been characterised by low risk and the underlying collateral stock is of very good quality. This means that the difference between calculating the capital adequacy requirements with and without the transitional rules is considerable according to current regulations, and that the extension of the transitional rules and postponement of the implementation of new capital adequacy regulations have a substantial impact on the calculated minimum capital requirement according to Pillar 1. Accordingly, future decisions concerning transitional rules are highly pertinent to the SBAB since these currently double the minimum capital base and Tier 1 capital requirements.

Much of the substance discussed ahead of Basel II never materialised in the regulatory framework, but was instead deferred to a later date. Since then, the financial and debt crises have led to additional demands for stricter capital adequacy regulations, resulting in the proposal of a new regulatory standardised – Basel III. Basel III proposes higher capital requirements, stricter demands on capital quality, the introduction of a non-risk-based measurement (leverage ratio) and quantitative liquidity requirements. The changes will impose requirements on an increased capital base and higher capital requirements compared with the current regulations. The new regulations will be implemented gradually and the aim is for all of the changes to be introduced by 2019.

In this document, the collective risk in the business is divided into:

- Credit risk
- Market risk
- Liquidity risk
- Refinancing risk
- Operational risk
- Business risk

Other risks, such as reputational risk, strategic risk and political risk, are not addressed in this document since these are not quantified and are only subject to more cursory analysis.

2. Financial corporate group SBAB

The financial corporate group SBAB comprises SBAB Bank AB (publ), the Swedish Covered Bond Corporation and FriSpar Bolån AB. The Swedish Covered Bond Corporation issues covered bonds in the Swedish and international capital markets.

Table 1. Companies included in the financial corporate group SBAB

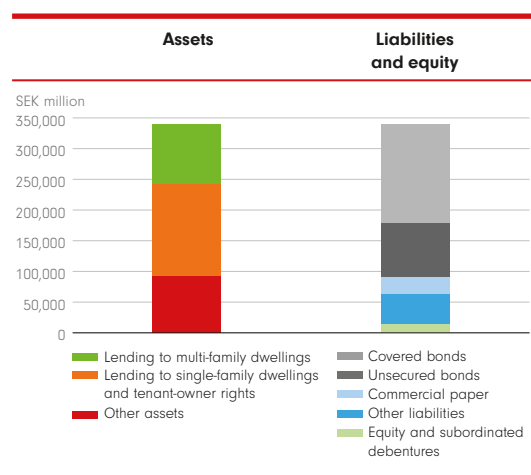
Company	Corp. reg. number	Ownership share	Consolidation method for auditing	Consolidation method for capital adequacy
SBAB Bank AB (publ)	556253-7513	Parent Company	-	-
The Swedish Covered Bond Corporation	556645-9755	100%	Acquisition method	Acquisition method
FriSpar Bolån AB	556248-3338	51%	Proportional consolidation method*	Acquisition method*

* The differences in the selection of method result from various regulations concerning the definition of Group affiliation in the Capital Adequacy and Large Exposures Act and FFFS 2007:1, which govern how capital adequacy should be reported, and the International Financial Reporting Standards (IFRS), which regulate the company's accounting.

The principal activity of all of these companies is to provide mortgage loans for residential properties and tenant-owner rights against collateral in the form of mortgage deeds and units in tenant-owner associations and, to a limited extent, the funding of commercial properties. However, the Swedish Covered Bond Corporation (hereinafter referred to SCBC) does not conduct any proprietary new lending operations.

Instead, it acquires loans from the Parent Company on a regular basis or as needed. The purpose of securing credits is for them to be included, in full or in part, in the cover pool that comprises collateral for holders of SCBC's covered bonds, which are issued in Swedish and international capital markets. SCBC's operations are conducted by employees of the Parent Company.

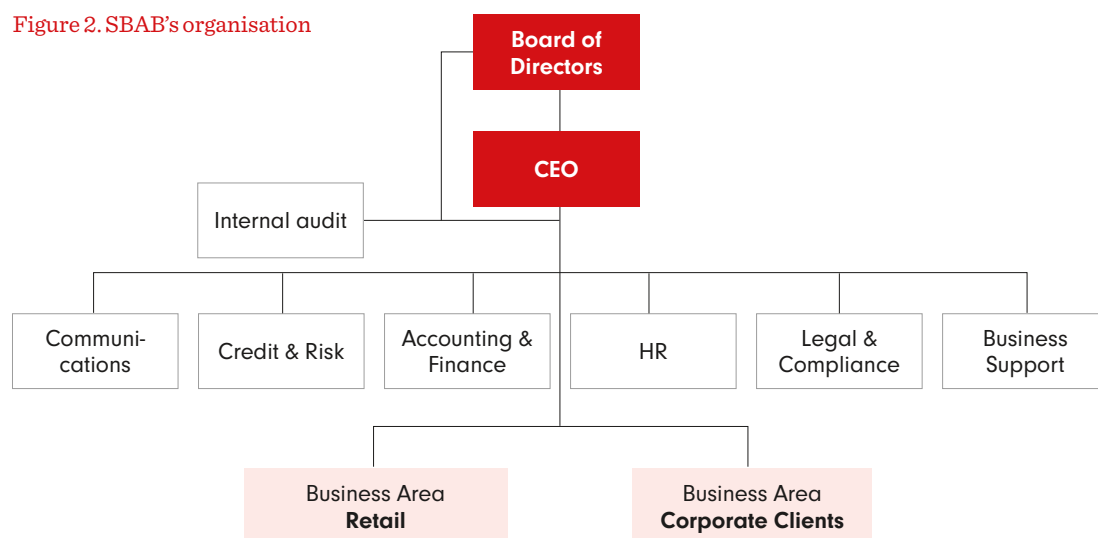
Figure 1. Simplified balance sheet for SBAB



SBAB conducts its operations in two business areas: Corporate Clients and Retail. The Retail business area focuses on deposits from and lending to private individuals and tenant-owner associations. The Corporate Clients business area is active in the property market through deposits from and lending to prop-

erty companies, property funds and municipalities. SBAB's funding is managed by the Accounting and Finance Department. Credit risk is generated primarily in the two business areas, while funding operations give rise mainly to market risk, liquidity risk and counterparty risk.

Figure 2. SBAB's organisation



3. Risk management and risk organisation

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 all businesses. For SBAB, risk arises primarily in the lending operations in the form of credit risk, although risks must also be managed in other activities. The recent financial crisis exemplifies the importance of efficient liquidity risk management, and the current debt crisis has turned attention to the management of counter-party risk.

For SBAB, risk management requires that, in each individual transaction, the company is able to measure the value generated by the transaction with regard to risk-adjusted return and the optimal level of capital. Specifically, this means that SBAB engages in continuous discussions concerning the following questions:

- What are the various risks generated in SBAB’s operations, and how can these be measured 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 operations?
- Does SBAB have sufficient capital to offset the company’s risks?

SBAB’s goal is that the strategy adopted for the 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.

3.1 Overall aims for risk management

SBAB’s operations are to be conducted so that the risks are adapted to the risk-bearing capacity. Risk-bearing capacity refers to earnings from operating activities and risk capital. The estimated magnitude of expected losses must be borne by earnings from operating activities, while unexpected losses are to be covered by the capital base or earnings from operating activities. Certain risks, such as liquidity risk, cannot be quantified and compared with risk-bearing capacity in the equivalent manner as credit risk and market risk. In such cases, the cost of reducing risk is weighed against the desired level of risk and the change in risk level attained by a certain measure. SBAB is to expose itself only to risks that are directly attributable to business operations. Such risks primarily encompass the followings types of risks: business risk, credit risk, market risk, liquidity risk, refinancing risk and operational risk.

The Board has decided on the following goals for risk management.

- Overall risk management is to be conducted at a level that at the very least meets the official requirements.
- The collective risk in the operations is to be divided into credit risk, market risk, liquidity risk, refinancing risk, operational risk and business risk. Relevant risks must be identified, measured, regulated and controlled.
- Risk management must support business operations and rating targets.
- Risk-taking must be low, which is achieved by ensuring that the total risk in the company is kept at a level that is compatible with SBAB’s long-term financial objectives for return, the size of risk capital and target rating, as expressed in SBAB’s business plan.
- SBAB’s risk management must be transparent and thus easily presented to and monitored by external parties.
- The estimated capital required to cover unexpected losses during the coming year is to be measured in the form of economic capital.
- SBAB must maintain an appropriate risk management organisation, whereby the distribution of responsibility and the requirements imposed on the various SBAB functions are clear. The organisation must stimulate an open management of risk matters, whereby individual employees are encouraged to take responsibility for the identification and control of risks, and to propose improvements for risk management. SBAB’s risk function is to be responsible for analysing, assessing and reporting SBAB’s collective risks. Identification and management of risks is to be conducted in each business process.

3.2 Risk tolerance

Risk is an integral 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, which is known as risk

tolerance. This can be defined as “the risk that SBAB is willing to accept to achieve the set operational goals within the framework of the long-term strategy.”

The basis for SBAB’s risk tolerance against various risk types is that expected losses for each risk must be covered by earnings from operating activities and unexpected losses must be covered by the company’s capital base or earnings from operating activities. The ability to minimise unwanted risks through an appropriate organisation must also be taken into consideration. The scope of the acceptable risk must be clearly linked to how important the prevailing risk is to SBAB’s business concept and the positive effects anticipated to be achieved in the form of expected revenues, cost savings or reductions in other risk. The balance between risks and risk-bearing capital is reassessed continually.

SBAB divides risks into wanted, necessary, unwanted and risks to which SBAB must not be exposed.

- Wanted risks comprise those directly related to the business concept. The capital base is primarily to be used for unexpected losses caused by such risks. Other risks must be maintained at a level at which both expected and unexpected losses can be covered by earnings from operating activities.
- Necessary risks are those arising from activities that are regarded as a direct prerequisite for being able to implement the business concept efficiently and competitively, whereby a certain level of risk is accepted to achieve these positive effects for the operations within the business concept. The scope of the accepted risk must be clearly motivated by the positive effects that are expected to be achieved in the form of expected revenues, cost savings or reductions in other risks.

- Unwanted risks are those that may well be unavoidable in terms of exposure, but which for various reasons are deemed to be damaging enough to warrant their minimisation, although this could entail significant costs. With a high degree of probability, both expected and unexpected losses must be covered by earnings from operating activities. For the risks for which capital requirements cannot be quantified, the unwanted risk level must be estimated and compared with the cost required to achieve this level.
- Exposure to the risks to which the Board has decided that the Group should not be exposed must be avoided.

SBAB’s risk tolerance is to be expressed in the individual business decisions, in the assessment of overall risk for each risk type and in the consideration between overall risk assumption and assessed capital requirement. As a rule, each business decision changes SBAB’s exposure to various risk types. Accordingly, SBAB’s risk control models should be designed to reflect risk tolerance and each business decision should be based on a healthy balance between the estimated impact on earnings and changes in risk exposure.

The Board establishes the risk that SBAB is prepared to take based on the chosen strategy, earnings from operating activities and risk capital. In this context, the cause of various risks and the size of each risk as a percentage of overall risk should be clear.

SBAB’s risk tolerance is expressed as follows:

- Return on equity must exceed the return on five-year government bonds by five percentage points after tax, viewed over a business cycle (the owner’s return requirement).
- The capital quotient must exceed 1.25 (taking into account the transitional rules).

Figure 3 SBAB’s risk tolerance for total risk exposure



3. Risk management and risk organisation

- The Tier 1 capital ratio must not be less than 7% (taking into account the transitional rules).
- The core Tier 1 capital ratio must exceed 6%.
- Economic capital must not exceed 85% of the capital base.
- The liquidity reserve must be able to handle flows for a minimum of 30 days, Maximum Cumulative Outflow (MCO).
- The tolerance level for operational risk amounts to SEK 7.5 million.

Earnings should be based primarily on credit risk and interest-rate risk.

For 2011, all of these objectives were achieved, except for the owner's return requirement. Return on equity missed the target by 0.9 percentage points. Economic capital corresponded to 37% of the capital base at 31 December 2011. The capital quotient, Tier 1 capital ratio and core Tier 1 capital ratio are presented in Chapter 4. The liquidity reserve could handle flows for 63 days and the result of operational risks was SEK 3.6 million below the tolerance level.

To follow up the results of risk in relation to the approved risk tolerance, the results of the aforementioned parameters are reported to management and the Board on a monthly basis.

3.3 Risk organisation

The Board of Directors has ultimate responsibility for risk management and makes decisions on risk strategy, risk tolerance, risk policy and instructions for managing and measuring risk.

The "Asset and Liability Committee" (ALCO) handles matters relating to risk and capital planning, which are then addressed by executive management or the Board. ALCO presents risk reports on a quarterly basis and stress tests of a "downturn scenario" and a normal scenario, including an in-depth impact assessment, are reported on a six-month basis. The

Chief Executive Officer is the chairman of the ALCO. Other committee members are the managers of each of the business areas, the Chief Financial Officer (CFO), Chief Risk Officer (CRO), the Head of the Risk Unit and the Head of the Market and Liquidity Risk Group.

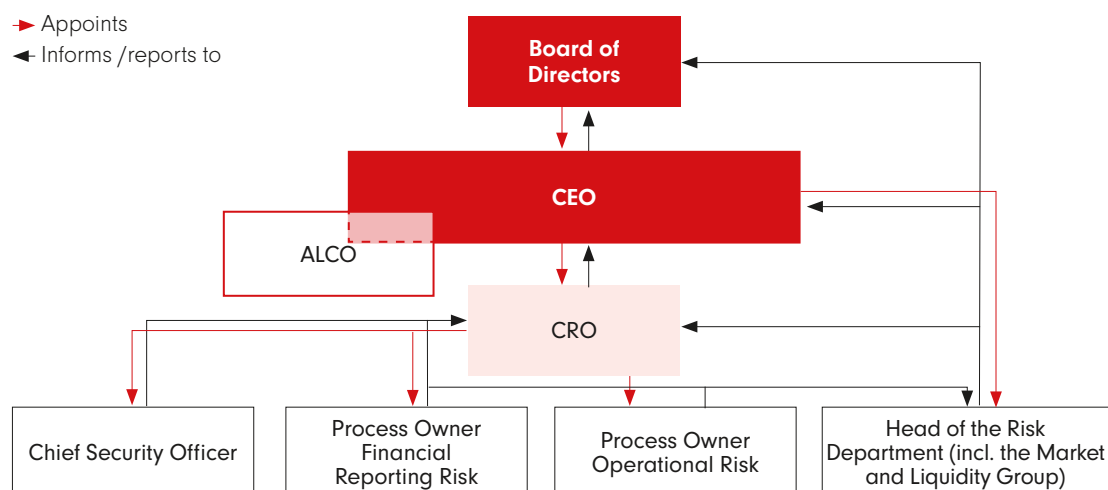
The Head of the Risk Department, who is appointed by the CEO and subordinate to the CRO, has overall responsibility for developing and ensuring that SBAB's risk-taking strategies comply with the Board's intentions and that policies, instructions and processes support relevant follow-ups. The Risk Department analyses and reports SBAB's collective risks to the CEO. The Risk Department is also responsible for the design, implementation, reliability and follow-up of SBAB's risk classification system and for the economic capital model. The individual risks are managed by the particular operation.

The Market and Liquidity Risk Group is a unit within the Risk Department that is responsible for identifying, quantifying and analysing financial risks (market risk, refinancing risk, liquidity risk and counter-party risk). This group monitors current risk levels on a daily basis to ensure that limits in financial operations are not exceeded.

For operational risks and for risks of errors in financial reporting, a special process owner is appointed who is responsible for the risk analysis and reports the outcome of the analysis to the CEO via the Head of the Risk Department. The Head of the Risk Department is responsible for risks in regard to information safety and reports to the CEO and CRO.

A report of the overall risk scenario, combined with the prevailing capital quotient, Tier 1 capital ratio and the Core Tier 1 capital ratio as well as a description from the Accounting and Finance Department of the performance of risk-adjusted returns, is sent the Board, CEO and senior executives at SBAB on a monthly basis. The Board and CEO also receive an in-depth risk analysis on a quarterly basis.

Figure 4. Reporting of risk



4. Capital adequacy

In the wake of the latest financial crisis and concerns over the impact of new, forthcoming crises, more stringent demands are being imposed on capital requirements and on Tier 1 capital contributions for credit institutions. The aim of the new requirements is to build confidence in the institutions' ability to endure new crises. The institutions must prove to rating agencies and the investors who purchase securities from banks, as well as new and existing customers, that they have an adequate capital situation. According to the Basel regulatory framework, without taking the transitional rules into account, SBAB's capital quotient was 2.99.

4.1 Capital requirements

The size of SBAB's capital requirement depends on laws and regulations (Pillar 1 of the Basel regulations), the company's internal assessment based on approved strategies (Pillar 2 of the Basel regulations), the assessments of investors and rating agencies and the evaluations of shareholders and executive management.

Capital in accordance with Pillar 1 refers to the minimum amount of capital that SBAB is to have in accordance with the Capital Adequacy and Large Exposures Act (2006:1371), the Capital Adequacy and Large Exposures Ordinance (2006:1533) and the

Swedish Financial Supervisory Authority's Regulatory Code (FFFS 2007:1). These provisions also include transitional rules that apply through 2015.

4.2 Capital base

SBAB's capital base comprises equity, Tier 1 capital contributions and subordinated debentures. SBAB's capital base amounted to SEK 14,296 million at 31 December 2011.

When calculating Tier 1 capital, subordinated loans can be included if certain prerequisites are met in accordance with Chapter 7, Section 15 of FFFS 2007:1 and consent has been obtained from the Swedish Financial Supervisory Authority. SBAB has been granted such consent and has classified SEK 2,994 million as Tier 1 capital (subordinated debentures SEK 2, 3 and 5 in table 2), of which step-up amounts accounted for SEK 994 million. All capital contributions included in Tier 1 capital were issued before 31 December 2010 and are subject to the transitional rules underlying FFFS 2007:1. Subordinate debentures are subordinated to the Parent Company's other liabilities and the subordinated debentures included in Tier 1 capital are subordinated to other subordinated debentures. During the year, time-limited subordinate debentures were issued in the amount of SEK 1.0 billion. In conjunction with this, a time-limited subordinated debenture loan of SEK 0.5 billion was repaid.

According to FFFS 2007:1, Chapter 7, Section 9, second paragraph, unrealised accumulated value changes of loan receivables and customer receivables classified as available-for-sale financial assets

Figure 5. Capital and capital requirements according to Pillar 1 and without transitional rules, and in accordance with Pillar 2

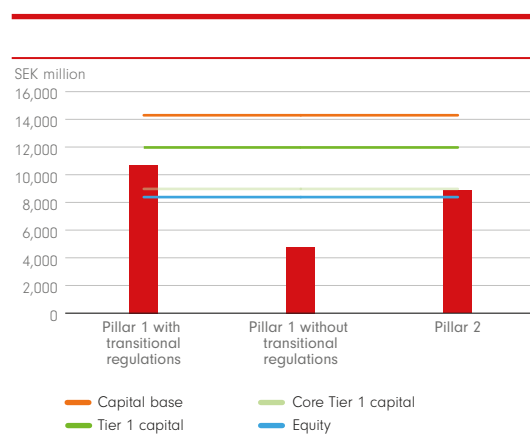


Table 2. Debenture loans

Loan designation	Currency	Nominal amount	Outstanding nominal amount	First possible date for redemption	Interest rate, 31 Dec 2011	Interest rate after first possible date for redemption	Due date	Recognised in capital base SEK million
JPY 1	JPY	10,000	10,000	-	5.23%	5.23%	2015-11-16	456
Debenture SEK 2	SEK	700	700	2016-06-30	5.22%	3 m STIBOR+1.93%	Perpetual	694
Debenture SEK 3	SEK	300	300	2016-06-30	3m STIBOR + 0.93%	3 m STIBOR+1.93%	Perpetual	300
Debenture SEK 4	SEK	1,000	1,000	2013-04-25	7.32%	3 m STIBOR+4.10%	2018-04-25	1,000
Debenture SEK 5	SEK	2,000	2,000	2015-06-08	7.16%	3 m STIBOR+4.50%	Perpetual	2,000
Debenture SEK 6	SEK	1,000	1,000	2016-04-20	6,123%	3 m STIBOR+2.4%	2021-04-21	1,000

4. Capital adequacy

are to be excluded so as not to impact the size of the capital base. Adjustments of SEK 51 million were made as of 31 December 2011. Deductions from Tier 1 capital were made for intangible assets pursuant to Chapter 2, Section 3 of the Capital Adequacy Act. A deduction of half of the difference between the actual reserve and EL (expected loss) may also be made from Tier 1 capital, pursuant to Chapter 9, Section 11 of FFFS 2007:1. The remaining amount reduces Tier 2 capital.

There are no ongoing or anticipated tangible obstacles or legal obstacles to a rapid transfer of funds from the capital base other than those that ensue from the terms for the subordinated debentures (see Note 32 in SBAB Bank's 2011 Annual Report) or what generally arises from the Swedish Companies Act (2005:551).

The starting capital required for the Parent Company in accordance with the Act on Banking and Financing Activities (2004:297) totalled SEK 45.9 million. The corresponding capital requirement for FriSpar Bolån AB (referred to as FriSpar below) was SEK 44.3 million and for SCBC SEK 47.0 million.

Table 3. Capital base

SBAB Bank Group

SEK million	2011	2010
Core Tier 1 capital		
Equity	8,384	8,014
Unrealised changes in value of loan receivables and accounts receivable that were previously classified as available-for-sale assets	51	80
Change in value attributable to derivative instruments included in cash-flow hedges	-	1
Non-controlling interest	706	565
Intangible fixed assets	-38	-34
Half of difference between provisions and anticipated loss for exposures recognised in accordance with IRB	-128	-109
Core Tier 1 capital	8,975	8,517
Tier 1 capital contribution		
Tier 1 capital contribution without redemption incentives ¹⁾	2,000	2,000
Tier 1 capital contribution with redemption incentives ¹⁾	994	994
Tier 1 capital	11,969	11,511
Tier 2 capital		
Perpetual subordinated debentures	-	-
Time-limited subordinated debentures	2,456	2,108
Half of difference between provisions and anticipated loss for exposures recognised in accordance with IRB	-129	-109
Tier 2 capital	2,327	1,999
Expanded part of capital base	-	-
Deduction from entire capital base	-	-
Capital base net after deductible items and limit value	14,296	13,510

¹⁾ Encompassed by the transitional rules to FFFS 2007:1.

4.3 Capital requirements – Pillar 1

When calculating capital requirements, each exposure is allocated to an exposure class, either using the standardised approach or the IRB approach. Table 6 shows the individual exposure amounts distributed by exposure class. SBAB already holds asset-backed securities in the liquidity portfolio in the form of RMBS (residential mortgage-backed securities). These securities, with collateral in residential mortgages, were issued through securitisation, which, in SBAB, were previously reported as corporate exposures according to the standardised approach, but are now reported under the heading "Securitisation position", in accordance with the external rating method in other operations whereby the current ratings from Moody's or Standard & Poor's have been used to calculate the risk weighting. SBAB has no loans that are securitised and neither has it participated in the securitisation of any other institution. SBAB has no due exposures in respect of securitisation, re-securitisation and no securitised rolling exposures. Since the intention is to retain the existing exposures to maturity, no sales were conducted during the year. The purpose of the asset-backed securities is that these will be used as collateral at the Bank of Sweden to secure the Bank's liquidity requirements. (See also Chapter 9.3).

Without taking into account the transitional rules, SBAB's capital quotient at 31 December 2011 was 2.99, the capital adequacy ratio was 23.9%, the Tier 1 capital ratio was 20.0% and the Core Tier 1 capital ratio was 15.0%. Earnings for the period are included in the calculation of the capital base and Tier 1 capital. The figures do not include a dividend to shareholders, which is in line with the Board of Directors' proposal for the appropriation of profits.

Table 4. Positions in securitisation, distributed by risk weight

(SEK million)	RISK WEIGHT		Exposure amount
	7-10%	650%	
Traditional securitisation	8,940	309	9,249
Synthetic securitisation	-	-	-
Total	8,940	309	9,249

Table 5. Positions in securitisation, distributed by country

Country (SEK million)	Exposure
Australia	577
Spain	2,958
United Kingdom	3,832
Italy	32
Holland	1,850
Total	9,249

Table 6. Capital requirements and risk-weighted assets

SBAB Bank Group	2011		2010	
	Capital requirements	RWA	Capital requirements	RWA
SEK million				
Credit risk recognised in accordance with IRB approach				
Corporate exposures	2,491	31,143	2,317	28,962
Retail exposures	894	11,172	838	10,475
Positions in securitisation	229	2,860	-	-
Total exposure recognised in accordance with IRB approach	3,614	45,175	3,155	39,437
Credit risk recognised in accordance with standardised approach				
Exposures to governments and central banks	0	0	0	0
Exposures to municipalities and comparable associations	0	0	0	0
Institutional exposures	514	6,422	178	2,226
Corporate exposures	142	1,781	1,068	13,354
Retail exposures	48	602	17	212
Unregulated items	1	9	1	9
Other items	8	102	6	77
Total exposure in accordance with standardised approach	713	8,916	1,270	15,878
Risks in the commercial portfolio	239	2,981	214	2,673
Operational risk	217	2,713	183	2,290
Currency risk	-	-	-	-
Commodities risk	-	-	-	-
Total minimum capital requirement	4,783	59,785	4,822	60,278
Addition according to transitional rules	5,930	74,125	5,769	72,110
Total capital requirements and RWA according to transitional rules	10,713	133,910	10,591	132,388

Table 7. Capital adequacy

SEK million	SBAB GROUP		PARENT COMPANY		FRISPAR		SCBC	
	2011	2010	2011	2010	2011	2010	2011	2010
Core Tier 1 capital	8,975	8,517	7,432	7,653	1,428	1,142	10,813	10,240
Tier 1 capital	11,969	11,511	10,426	10,647	1,428	1,142	10,813	10,240
Total capital	14,296	13,510	12,819	12,711	1,428	1,142	10,813	10,240
Without transitional rules								
Risk-weighted assets	59,786	60,279	25,159	26,891	910	843	34,654	33,425
Core Tier 1 capital ratio	15.0%	14.1%	29.5%	28.5%	157.0%	135.6%	31.2%	30.6%
Tier 1 capital ratio	20.0%	19.1%	41.4%	39.6%	157.0%	135.6%	31.2%	30.6%
Capital adequacy ratio	23.9%	22.4%	51.0%	47.3%	157.0%	135.6%	31.2%	30.6%
Capital quotient	2.99	2.80	6.37	5.91	19.62	16.95	3.9	3.83
With transitional rules								
Risk-weighted assets	133,917	132,388	27,948	28,876	4,676	4,122	101,241	99,355
Core Tier 1 capital ratio	6.7%	6.4%	26.6%	26.5%	30.5%	27.7%	10.7%	10.3%
Tier 1 capital ratio	8.9%	8.7%	37.3%	36.9%	30.5%	27.7%	10.7%	10.3%
Capital adequacy ratio	10.7%	10.2%	45.9%	44.0%	30.5%	27.7%	10.7%	10.3%
Capital quotient	1.33	1.28	5.73	5.50	3.82	3.46	1.34	1.29

4.4 Capital requirements according to Basel III

The changes that are being discussed in the regulatory framework (Basel III) include an increased capital base and more stringent capital requirements compared with the current regulations. During the year, the proposed regulatory framework for Basel III was further clarified and, in November, the Swedish Government presented a proposed supplement in the calculation of the capital adequacy relations for systemically important banks. The supplement is

to be a maximum 3% as of 2013 and 5% as of 2015. The systemically important banks are the four largest banks: Handelsbanken, Nordea, SEB and Swedbank. At the same time, it was proposed that the increase in the capital requirement should also include additional banks. In addition, it was stated that the current levels of risk weightings for residential mortgage loans would be reviewed.

5. Internal model for calculating capital requirements

In accordance with Pillar 2 of the Basel regulations, the aim of SBAB's internal capital evaluation is to 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 an economic capital model as the basis for its assessment of the company's capital requirement within the framework of the internal capital evaluation process.

5.1 Internal capital evaluation, Pillar 2 of the Basel regulations

The business conducted by SBAB affects the size of the risk taken by the company, which in turn impacts 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 assessment of the size of the capital requirement that is utilised in the individual transaction. The risk-adjusted return can also be assessed for the company when the capital required for the transaction can be calculated.

SBAB's assessment of the capital requirement in accordance with Pillar 2 is based on economic capital, in which capital for concentration risk is included. In combination with capital based on stress tests and capital for further risk, this comprises SBAB's assessment of the appropriate size of risk capital. Under Pillar 2, the capital requirement may not be less than the capital standardised per risk type in accordance with Pillar 1. In such a case, the capital requirement in Pillar 2 is adjusted.

Economic capital is based on SBAB's own relatively advanced models in which quantifiable risks are summarised as a single entity. This is also an important component in the company's pricing and financial control.

When determining the size of risk capital, assessments of investors and rating agencies regarding the company's capital requirements compared with the capital held by the company are also taken into account. The views of rating agencies are reflected in SBAB's rating, which directly impacts the company's funding cost.

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, measures, secures and manages the risks to which SBAB is exposed and that SBAB has risk capital that is compatible with the selected risk tolerance. The process is revised annually to capture changes in the operating environment that continuously affect the company's performance.

5.2 Process for internal calculation of capital requirements

SBAB's process for establishing internally calculated capital requirements is shown in the diagram in Figure 6. First, the risks generated in the operations are identified. The Risk Department is responsible for the quantification of all risks. Various models are used depending on the risk to be measured.

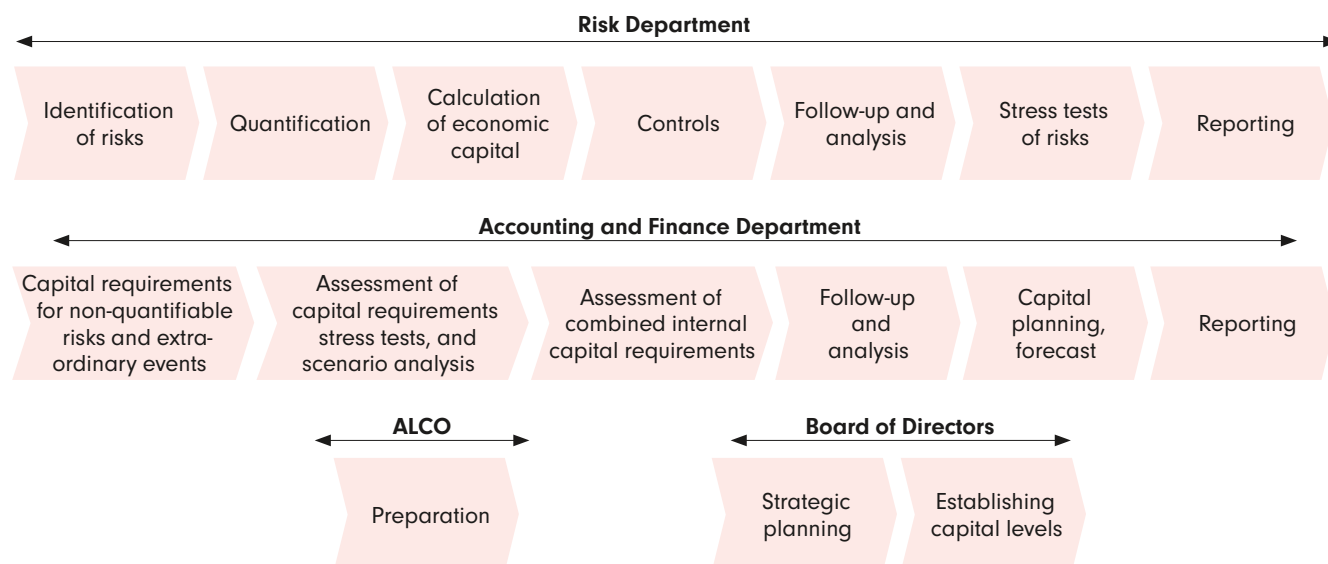
The model for economic capital is used to calculate capital requirements for quantifiable risks. The results are reviewed and analysed. Stress tests of the capital requirements for quantifiable risks are conducted using several scenarios with varying degrees of stress. The results of capital requirements and stress tests are reported to the Accounting and Finance Department.

In addition to economic capital, a capital buffer is reserved for non-quantifiable risks and extraordinary events. The outcomes of the stress tests and scenario analyses also give rise to a capital buffer. The collective internally calculated capital requirements are calculated by the Accounting and Finance Department. The results are reviewed and analysed, in the short and long term, in relation to capital planning and forecasts. The combined results of the internal capital assessment are reported to the Asset and Liability Management Committee (ALCO), which prepares the matter prior to it being addressed by the Board. Finally, the Board adopts the process and results of the company's internal capital assessment.

5.3 Economic capital

The capital requirements for credit risk, market risk, operational risk and business risk are quantified in SBAB's model for economic capital. The calculation of capital requirements for credit risk is largely based on the results of the Group's IRB models. Economic capital is defined as the amount of capital needed to ensure solvency over a one-year period, given a predetermined confidence interval. The confidence interval is chosen to reflect the company's target rating. In SBAB's case, the level of confidence is 99.97%, which corresponds to the long-term AA- target rating (under Standard & Poor's ratings scale). When

Figure 6 Process for capital evaluation



calculating economic capital, diversification effects are also taken into account, meaning that risk has been reduced by considering the probability of several risks being realised simultaneously.

Capital requirements for operational risk and business risk are calculated using standards based on the business areas' operating income and operating expenses, while market risk is calculated using Value at Risk (VaR) models. In addition to comprising an assessment of the combined capital requirement to counter the risks in the company's operations, the economic capital is used to monitor profitability in the company's operations, for economic control and for strategic considerations.

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 must be covered by earnings from operating activities. As shown in Table 9, credit risk is the dominant risk in SBAB's operations.

As regards concentration risk, SBAB is assessed to be primarily exposed to credit-risk-related concentration risk in lending and funding operations. The entire capital requirement for concentration risk is included in economic capital for credit risk.

SBAB's capital requirement calculations for credit-risk related concentration risk is based on the method described in the Swedish Financial Supervisory Authority's Memo on Credit Related Concentration Risks (IRB method description) from 31 March 2009 and the Assessment of Capital Requirements for Concentration Risks from 1 October 2009. SBAB

calculates the concentration risk divided into name concentration, industry concentration and sector concentration (geographic concentration). In the calculation made at 31 December 2011, the internally calculated capital requirement for credit-related concentration risk was SEK 878 million.

5.4 Stress tests

Capital planning is based on a basic scenario that reflects the most likely development for operations based on internal forecasts. As a complement, stress tests and scenario analyses are also conducted that cover a three-year period ahead in which the development of the loan portfolio and capital requirements is evaluated during, in part, a recession accompanied by inflation; and, in part, during a scenario corresponding to a financial crisis. Stress tests are conducted on a six-month basis.

The first stressed scenario describes an economic downturn that usually occurs at an interval of 5–7 years. It is assumed, however, that the Riksbank cannot offset the decline by reducing interest rates, which has implications for the housing and property markets. In the second scenario, the Swedish economy suffers from a number of disruptions at the same time. A combination of external and internal factors further aggravates the situation and results in a recession, inflation and bank crisis. It is estimated that such a scenario will occur once over a period of 25–50 years. The scenarios can be described as follows.

Scenario 1

The recovery in Sweden fades during 2011. Low growth in key export markets restrains exports, while rising interest rates (due to higher inflation), dampens the domestic economy. Inflation rises due to high pay agreements, a weaker krona and rising commodity prices, which compels the Riksbank to forcefully use its key interest rate. Long-term interest rates rise when inflation expectations advance. The rise in interest rates puts pressure on house prices, which fall about 10% before stabilising. During 2014, inflation pressure eases, interest rates fall back and the downward pressure on the property market declines.

Scenario 2

The debt crisis in the EMU escalates, Greece (and perhaps other countries) write off their debts, a number of European banks must be recapitalised or nationalised, leading to sharp increases in risk premiums. A combination of declining global demand, a cautious approach by companies and high household debt sparks a fall in GDP, which in terms of magnitude is in line with the downturn during the latest financial crisis, but in terms of duration bears a greater similarity to the crisis of the 1990s. The fall in GDP drags employment and incomes down with it. Inflation falls to about zero and the Riksbank reduces its key rate as far as possible. Prices in the residential and property markets decline despite reductions in interest rates. Overall, single-family dwellings see a fall of 25% before stabilising. The Swedish banking system is infected by the global situation, while Sweden loses its status as a safe haven when government finances deteriorate and the parliamentary situation prevents effective decision-making. 2014 marks the beginning of a laborious recovery.

Table 8. The following macroeconomic parameters will be stressed during the current year and three years ahead

Demand	Prices	Interest rates
GDP growth (real)	Consumer prices	STIBOR, 3 months
Income (real)	Prices of single-family dwellings	Government bond rate, 10 years
Employment	Prices of tenant-owner rights	STIBOR – Treasury bills
Unemployment	Property prices (residential)	Mortgage-backed-bonds
		Government bonds, 5 years
		Government bonds Sweden-Germany, 10 years

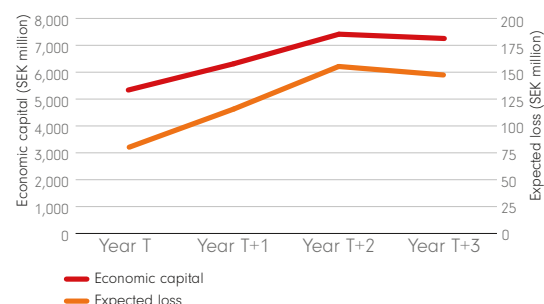
Stress tests are conducted so that the macroeconomic scenario that forms the basis of the stress translates into the effects it has on SBAB's risk models. A change in the credit rating for individual loans is simulated by a change in several of the parameters in SBAB's IRB models. A negative stress on PD variables simulates the deteriorated payment capacity among customers due to such factors as higher interest rates, while the declining market value of underlying collateral results in higher LGD.

SBAB's LGD models are based on loan to value (LTV), which explains why the sharply declining market values in the stress generate a clearly proportional effect on LGD. Some of the variables in the PD models are directly impacted by the macroeconomic variables in a similar manner, while the impact on certain variables has to be deduced.

To evaluate the effect of the stress test, a calculation is made of the change in SBAB's economic capital and expected losses for the loan portfolio resulting from the change in its composition and credit quality. In the sharp economic decline reflected in the stress scenario, both economic capital and anticipated losses increase sharply, albeit from very low levels. In the first year of the stress scenario, economic capital increases by slightly more than SEK 978 million and expected losses increase by nearly SEK 36 million, before rising further in the second year and recovering somewhat in the final year. The increase in both economic capital and anticipated losses is largely due to the simulation of declining market values since they have an impact in both the PD and LGD dimensions.

Figure 7. Result for economic capital and expected loss for Scenario 2

Result for economic capital and expected loss



Based on the results of the stress tests, a buffer of SEK 978 million has been allocated to address the increase in economic capital in the first year of the stressed scenario. The increase in economic capital in the other years is adequately covered by the Group's equity and earnings, which substantially exceed the lowest level corresponding to the minimum capital requirement pursuant to the regulations.

Calculations of internal capital requirements for the various risk types are aggregated and comprise the basis for the collective internally calculated capital requirement, combined with the buffer for stress tests and non-quantifiable risks.

5.5 Extraordinary events

An assessment is also performed of the capital requirements for non-quantifiable risks. Examples of such risks include reputational risk, strategic risk and political risk. SBAB has posted provisions corresponding to 10% of economic capital or SEK 534 million to offset these risks.

Various instruments are valued in the IFRS regulatory framework in line with different valuation principles, which affects operating income. This is due primarily to basis swaps and spreads in the liquidity portfolio. A simplified VaR model is used to calculate the capital requirements for this. At 31 December 2011, the estimated capital requirement was SEK 1,857 million.

Table 9. Internally calculated capital requirements and economic capital by risk type

Risk type SEK million	Economic capital	Adjustment for higher capital requirements per risk type in Pillar 1	Capital requirements based on results of stress tests	Capital requirements for income exposure to spread risk	Capital requirements for other risks	Internally calculated capital requirements
Credit risk	4,858		978			5,836
<i>of which, concentration risk</i>	878					878
Market risk	151	88				239
Business risk	200					200
Operational risk	134	83				217
Other risks				1,857	534	2,391
Total	5,343	171	978	1,857	534	8,883

6. Risk in the remuneration system

To stimulate employees toward efforts to create long-term value creation at SBAB and for its use as a means of control of key overall issues in the company, the Board decided that employees, in addition to fixed monthly remuneration, were to have the potential to receive variable remuneration. The terms and conditions for variable remuneration were decided by the Board to extend for one-year periods. The design of the incentive system varies over time, depending on the priorities set by executive management and the Board, but also depends on various business environment factors such as regulations, guidelines and the competitive situation. Additional information on SBAB's remuneration system is available at sbab.se, including risk analysis for SBAB's remuneration system, remuneration policy and remuneration instructions.

The framework underlying variable remuneration can be found in the remuneration policy and remuneration instructions decided by the Board for the year ahead.

Variable remuneration is based on predetermined and measurable criteria deriving from the business plan. The SBAB Board sets the criteria. The incentive programme for 2011 consisted of a maximum of one month's remuneration and covered all employees with a certain employment period, with the exception of the CEO and other members of corporate management. SBAB proceeded on the basis of the Swedish Financial Supervisory Board's regulations, FFFS 2011:1, that is, persons identified as those who in their work may exercise or influence the risk level at SBAB. This group of employees is covered by special rules regarding the deferment of remuneration. The incentive programme is not backed by any agreement between employees and employers, but is instead a unilaterally decided benefit that means the company, within set frameworks, may at any time amend the terms and conditions underlying remuneration.

The variable remuneration is based primarily on risk-adjusted return. Risk-adjusted remuneration is calculated in line with established methods and models. For 2011, the goals for variable remuneration related to the magnitude of the risk-adjusted return and

deposit volumes. The goals were not achieved and thus no variable remuneration was paid out for 2011.

The total variable remuneration must not limit the company's ability to maintain an adequate capital base. If it had been paid, the total maximum outcome for variable remuneration in 2011 would have amounted to some SEK 17.6 million, which means that the remuneration level would not have limited the company's capacity to maintain an adequate capital base.

During 2011, SBAB paid remuneration totalling SEK 7.4 million within the framework of the 2010 incentive programme. Previously deferred incentive employee remuneration for 2009 and 2010, which was viewed as possibly affecting the company's risk level, totalled SEK 2.0 million and will be paid no earlier than 2013 and 2014, respectively, following indexation in line with the Consumer Price Index. Ahead of payment, a risk adjustment is conducted with the Board deciding – based on information from the Remuneration Committee – as to whether all or part of the deferred remuneration is to be paid, which the Board is at liberty to determine.

The Board has decided not to operate an incentive programme for 2012.

6.1 Agreements on severance pay and pension

As regards pension conditions, notice periods and severance pay for senior executives, SBAB observes the principles stated in the Government's guidelines for senior executives (April 2009). A reciprocal notice period of six months for the CEO during 2011 (up to 20 December 2011) and SBAB applied during 2011. The agreement prescribed that severance pay, if the company terminates the contract and thereby released the CEO from her position, would – in addition to salary during the notice period – provide severance pay corresponding to 18 months' salary without deducting any new salary. The company pays a defined-contribution pension insurance corresponding to 25% of the CEO's pension-based salary, but not after the age of 62. For the head of the Corporate business area and the CFO, Accounting Manager, and Finance Manager, agreements have been reached regarding defined-

contribution pension premiums corresponding to 22% of pensionable salary. There are no other pension agreements that deviate from the general rules of collective agreements in the banking area. In cases involving individual agreements on severance pay, these observe the government's guidelines for State-owned companies. Should notice be served by the company, remuneration amounts to a maximum of two years, including the notice period. In conjunction with employment or income from other business during the two-year period, the latter remuneration is deducted.

The accumulated total amount and the expensed total amount for severance pay and guaranteed variable remuneration pledged during the year was SEK 0.9 million. Severance pay during the year totalled SEK 3.1 million. These payments are attributable to a reorganisation of operations from Karlstad to Stockholm. The figures are not stated specifically in order to avoid publicly disclosing the financial situation of individuals.

7. Credit risk in lending operations

SBAB conducts customer-oriented credit operations in which guiding principles such as professionalism, simplicity and quality create the conditions for favourable profitability and long-term customer relations. This means that the credit operations are to be characterised by high credit quality, efficient decision-making processes, respect for and understanding of the customer's situation, straightforward conduct, language and procedures, balanced risk-taking in the portfolio and in each individual transaction, and risk-based pricing.

7.1 Credit risk in the lending portfolio

Credit risk is the single largest risk in SBAB and accounts for 90% of the risk-weighted assets according to Pillar 1. Credit risk is defined as the risk of loss due to the customer or counterparty's inability to make interest payments and loan repayment 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 individual transactions is first monitored by the business area, then by the credit department. Credit risk is then monitored through portfolio management by the Risk Department, which is also responsible for analysing credit risk. Each business area deals with the practical management of credit risk.

Credit risk in lending operations is restricted by limits determined for the customer or customer group. The credit risk is also managed in the credit granting process by analysing the potential borrowers' ability to make their interest and amortisation payments. 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 comfortably exceeds today's levels. Furthermore, risk classification

based on the IRB approach is used in the analysis of the credit risk for new and existing customers in the loan portfolios.

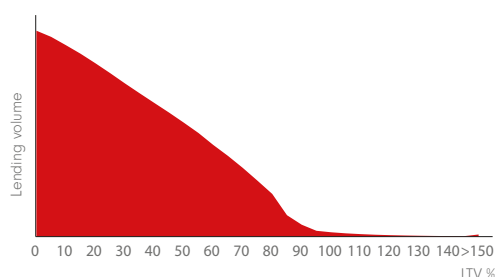
Large exposures, meaning those amounting to 10% or more of the capital base, are managed based on the credit directives, finance directives and external regulations. All exposures exceeding 2% of the capital base are identified and analysed for the purpose of deciding whether they fall within the framework of large exposures in relation to a group of customers with internal association.

The granting of credit requires the provision of adequate collateral, which can be provided in the form of real property or a unit in a tenant-owner association. Adequate collateral usually means mortgage deeds in a property or a tenant-owner right of 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 retail customers and C1–C4 for corporate customers. In other cases, a loan-to-value ratio of 75% applies. SBAB grants small unsecured loans to residential mortgage borrowers in the household segment.

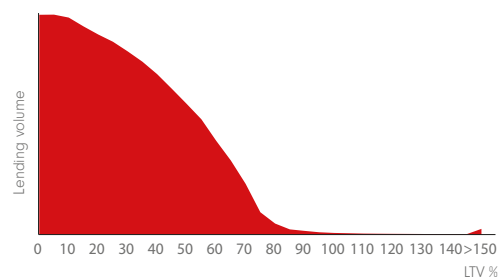
In addition to collateral in real property or a unit in a tenant-owner association, it is possible to grant credit against, for example, collateral in the form of a state credit guarantee, a municipal guarantee, securities, bank guarantees and deposits in a Swedish

Figures 8 and 9. Loan-to-value (LTV) ratio for the retail and corporates markets

Retail market¹⁾



Corporate market¹⁾



¹⁾ The retail market refers to lending to consumers for single-family dwellings, holiday homes and tenant-owner rights. The corporate market refers to all other lending to the public. Among other implications, this means that a private individual with a loan for a multi-family dwelling is viewed as a corporate customer.

bank. To a limited extent, equities corresponding to up to 85% of the market value of the underlying property can be approved as collateral. SBAB does not hold any collateral that has been taken over to protect a receivable.

Lending to the public accounts for 73% of SBAB's total assets. Figures 8 and 9 describe loan to value (LTV) for loans for which collateral consists of mortgage deeds on a unit in a tenant-owner association. Figure 8 shows the retail market portfolio¹⁾ and Figure 9 shows the corporate market portfolio. The figures cover 96% of total lending to the public. Since 85% of lending has collateral in mortgage deeds or in units in tenant-owner association, within 60% of LTV and 92% within 70% of LTV, while 96% of borrowers are categorised in risk classes 1–4, the credit quality is viewed as being very favourable.

The information in this chapter dates from 31 December 2011, but differs in the following respects from the information presented in the 2011 Annual Report:

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

7.2 Risk classification system

For each individual exposure to corporate or retail customers with tenant-owner rights or residential property as collateral, as is the case for 96% of SBAB's total lending, the credit risk is assessed using the Group's credit risk models. For other types of exposures, the standardised approach is used for measurement of credit risk. For cases in which external ratings are used, the lowest rating from Moody's or Standard & Poor's is selected. In credit risk models, an assessment

is made of the probability of default¹⁾, and share of loss, as well as the proportion of loan promises utilised in the event of default. On the basis of these parameters, together with exposure at default (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, of which the eighth class comprises customers in default. The trend for customers in high-risk classes is monitored thoroughly and, when necessary, exposure is managed actively by credit monitoring personnel.

The IRB models are used throughout SBAB's operations for tasks such as granting of credit, pricing, portfolio analysis and performance monitoring per business area.

The models produced are validated annually by the Risk Department and, whenever required, the models are recalibrated. All deviations from the quantitatively calculated risk class are analysed.

A systematic qualitative assessment in accordance with the rules and regulations for loans, based on a number of questions, complements the quantitative assessment process for the customer's risk class in the corporate market for customer segments for which current financial accounts are available (see Figure 10). For other customer segments in the corporate market, 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.

¹⁾ An exposure is deemed 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 the agreed interest or amortisation.

Figure 10. SBAB's internal ratings based process for corporate clients



7.3 Risk classification method

In conjunction with capital adequacy and risk classification, exposures are categorised in exposure classes.

The IRB approach is applied for corporate exposures with collateral in real property, while in the case of retail exposures¹⁾, the advanced IRB method, with collateral in residential property or a unit in a tenant owner association, is applied.

For central government, institutional, corporate and other exposures for which collateral other than a mortgage deed or tenant owner right has been received, the standardised approach 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. Table 6, capital requirements and risk-weighted assets, shows the distribution of capital requirements by exposure classes and risk-weighted assets.

With regard to exposures that are assessed using the IRB approach, SBAB has opted to use a scoring method for risk classification of counterparties in the PD dimension. The data on which the scoring models are based was obtained from both internal and external sources. Internal data consists of customer information, loan information, default outcomes and internal payment records. Data obtained externally includes financial accounts, external payment records, property data, and macroeconomic data. PD estimates for corporate exposures are based on data originating in December 1996. PD estimates for retail exposures are based on data originating in September 2001. Table 10 shows the distinction between retail exposures and corporate exposures.

Table 10. Loan portfolios and exposure classes for which the IRB method is applied

Portfolio	Property	Exposure class	PD-model
Consumers	Single-family dwellings and holiday homes Tenant-owner rights	Retail exposure	Retail
Corporate	Private properties Tenant-owner associations Commercial property	Corporate exposure	Corporate

¹⁾ The term "household exposures" refers to loans to private individuals for the financing of the purchase of single-family dwellings, holiday homes and tenant-owner rights when the loan does not pertain to rental operations. The term "corporate exposures" refers to legal entities and private individuals, which pertain to multi-family dwellings or loans for the rental of residential property.

For off-balance sheet retail exposures, SBAB uses in-house estimates of the credit conversion factor (CCF). Two different scoring methods are used to estimate the probability that the exposure will end up on SBAB's balance sheet. The choice of model depends on how far the particular loan matter has progressed in SBAB's credit approval system. The estimated probability is used to allocate each exposure to one of eight CCF risk classes. The CCF estimate, including the safety margin, is calculated as the 99-percentile of the average approval frequencies per monthly observation point in the particular CCF classes.

7.4 Swedish Financial Supervisory Authority

The Swedish Financial Supervisory Authority's decision from March 2007 permits SBAB to use the IRB approach 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 approach for credit risk,
- a time-limited approval to apply the standardised approach for credit risk for portfolios of insignificant size, and
- the right to apply the standardised approach to all institutional exposures.

All PD and CCF models for household credits were reassessed during 2010 and 2011. The Swedish Financial Supervisory Authority concluded that the scope of the changes in the POD model for tenant-owner associations, property companies and in the CCF models for household credits was such that a new licence was required. Testing of the models was conducted during 2011 and a licence to use the models was granted in December 2011. The models will be applied during 2012. In December, a license was also received to use the basic internal ratings approach for lending against collateral in mortgage deeds in properties other than residential facilities, along with an extended licence to apply the standardised approach for credit risk for portfolios of insignificant size through 31 December 2014.

7.5 Exposure amounts by exposure class

Without taking credit risk protection into account, the total amount for all credit risk exposures was SEK 328,444 million (see Table 11). Corporate exposures comprised only 33% of total exposures for which the

7. Credit risk in lending operations

IRB approach is used, but due to the higher average risk weighting, the exposures account for 69% of the total capital requirement when the IRB approach is applied.

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, was SEK 265,578 million, of which 58% comprised retail exposures. Loan promises and other credit-related commitments totalled SEK 33,552 million which, after the credit conversion factor was taken into account, amounted to SEK 4,816 million.

Risk-weighted assets for credit exposures amounted to SEK 54,091 million, of which SEK 45,175 million was recognised in accordance with the IRB approach and SEK 8,916 million according to the standardised

approach. The average risk weighting for exposures recognised in accordance with the IRB approach was 17.4%, while the weighting for exposures recognised in accordance with the standardised approach was 22.1%. Average PD per counterparty for IRB exposures amounted to 0.97% for corporate exposures and 0.69% for retail exposures. LGD indicates how large the loss will be in the event of default. The exposure-weighted LGD for corporate exposures was 31.4% and exposure-weighted LGD for retail exposures was 10.0%. The exposure-weighted amount for LGD is controlled by the limitation rule, which entails a lowest total level for LGD of 10% for exposures covered by the advanced IRB approach, for which collateral consists of a tenant-owner right, a mortgage in a residential property or the site leasehold on such a property.

Table 11. Exposure amount per exposure class for credit-risk exposures

SEK million	Exposure	Of which, off balance- sheet items before CCF	Exposure after CCF ¹⁾	Of which, off balance- sheet items after CCF	Average value of exposures in lending portfolio ²⁾	RWA	Capital require- ment	Average risk weight	Pro- vision	Expected Loss	Average PD per counter party	Exposure- weighted LGD
Credit risk recognised in accordance with IRB approach												
Corporate exposures	96,088	609	90,900	609	89,735	31,144	2,491	34.3%	50	276	0.97%	31.4%
Retail exposures	188,236	32,943	159,127	4,207	152,872	11,172	894	7.0%	204	236	0.69%	10.0%
Of which,												
Single-family dwellings and holiday homes	111,775	14,166	99,086	1,850	95,884	6,286	503	6.3%	95	131	0.64%	9.9%
Tenant-owner rights	76,461	18,777	60,041	2,357	56,988	4,886	391	8.1%	109	105	0.77%	11.9%
Positions in securitisation	9,249	–	9,249	–	–	2,860	229	29.2%	–	–		
Total credit risk in accordance with IRB approach	293,573	33,552	259,276	4,816	242,607	45,176	3,614	17.4%	254	512		
Credit risk recognised in accordance with the standardised approach												
Exposures to states and central banks	83	–	83	–	–	0	0	0.0%				
Exposures to municipalities and similar associations	424	–	5,985	18	8,311	0	0	0.0%				
Institutional exposures	30,906	–	30,906	487	5,957	6,422	514	20.8%				
Corporate exposures	1,956	–	1,956	370	8,331	1,781	142	91.0%				
Retail exposures	1,362	–	1,358	695	369	602	48	44.3%				
Unregulated items	0	–	7	–	3	9	1	142.8%				
Other items	140	–	140	–	–	102	8	72.8%				
Total credit risk in accordance with standardised approach	34,871	–	40,435	1,570	22,971	8,916	713	22.1%				
Total	328,444	33,552	299,711	6,386	265,578	54,092	4,327	18.0%				

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 exposures have been excluded.

7.6 Geographical distribution of exposure amounts

The SBAB Group's portfolio is mainly secured by housing in the Stockholm area (48%) and the Öresund region (24%). Only 3% of the underlying collateral derives from economically weak regions (see Table 12).

Sweden is divided as follows:

- Greater Stockholm: Stockholm's labour market region according to Statistics Sweden (SCB) (2004).
- Greater Gothenburg: Gothenburg's labour market region according to SCB (2004).
- 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 ¹⁾.
- Weak regions: Municipalities with very weak or negative growth according to analyses by SBAB ²⁾.
- Other regions: Municipalities that are not allocated to any other category.

¹⁾ This analysis is based on statistics from Statistics Sweden (SCB), including short and long-term population growth, the proportion of the population that is older than 64 years of age, average income and the vacancy rate in public housing, and on the local knowledge of SBAB analysts.

7.7 Exposure amounts distributed according to the next stipulated term of expiry ²⁾

A large proportion (55%) of the portfolio has less than one year left until the next stipulated term of expiry. The group with a remaining term of between one and five years accounts for 43% of the outstanding loans (see Table 13).

Table 13 Exposure amounts distributed by the next stipulated term of expiry

SEK million	< 1 year	1–5 years	> 5 years	Total
IRB exposures				
Retail exposures	101,567	51,188	2,165	154,920
Corporate exposures	32,903	54,803	2,585	90,291
Standardised exposures				
Corporate exposures	2,960	3,685	68	6,713
Retail exposures	843	180	16	1,039
Municipal exposures	261	163	–	424
Unregulated exposures	18	32	0	50
Total	138,552	110,051	4,834	253,437

²⁾ 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 12. Geographical distribution of exposure amounts

SEK million	Greater Stockholm	Greater Gothenburg	Öresund region	University and growth regions	Weak regions	Other regions	Total
IRB exposures							
Retail exposures	77,995	11,163	45,077	7,219	3,674	9,792	154,920
Corporate exposures	40,817	10,579	15,285	10,594	2,616	10,400	90,291
Standardised exposures							
Corporate exposures	2,136	724	491	922	841	1,599	6,713
Retail exposures	487	81	95	68	174	134	1,039
Municipal exposures	181	–	–	–	84	159	424
Unregulated exposures	4	0	32	12	1	1	50
Total	121,620	22,547	60,980	18,815	7,390	22,085	253,437

Table 14. Exposure amounts distributed by type of property

SEK million	Single-family dwellings and holiday homes	Tenant-owner rights	Tenant-owner associations	Private multi-family dwellings	Municipal multi-family dwellings	Commercial properties	Unsecured	Total
IRB exposures								
Retail exposures	97,237	57,683	–	–	–	–	–	154,920
Corporate exposures	38	7	51,217	28,547	2,952	7,530	–	90,291
Standardised exposures								
Corporate exposures	0	–	2,259	640	2,759	1,055	–	6,713
Retail exposures	484	125	–	–	–	–	430	1,039
Municipal exposures	–	–	–	–	424	–	–	424
Unregulated exposures	5	1	31	12	–	–	1	50
Total	97,764	57,816	53,507	29,199	6,135	8,585	431	253,437

7.8 Exposure amounts distributed by type of property

The largest amounts of exposure derive from lending for single-family dwellings and holiday homes (39%), tenant-owner rights (23%) and tenant-owner associations (21%). Lending to municipal and commercial properties accounts for a smaller proportion (2% and 3%, respectively) of the loan portfolio (see Table 14). Unsecured loans account for less than 1% of the total exposure amount.

7.9 Past due exposures and exposures subject to impairment requirements

Past due exposures refer to total claims where any part is more than five days past due. SBAB has elected to use this method so that the result of the analysis is not distorted when payments are delayed because the payment date coincided with a public holiday. Exposures subject to 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 the collateral does not cover the amount of the claim.

The selection used for 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. Customers in risk class R8 are covered by the individual provision, in special cases after individual assessment. The individual provision amounted to 4.1% of the total exposure amount for past due exposures (refer to Table 15).

7.10 Geographical distribution of past due exposures and exposures subject to impairment requirements

Individual provisions accounted for a total of 0.02% of the total exposure amount (see Table 16). "Other regions" accounted for the largest share (0.11%) of individual provisions in relation to the total exposure amount.

Table 15. Exposures with past due amounts and individual provisions

SEK million	Total exposure amount in the loan portfolio	Exposure amounts with past due receivables	Exposure amounts for exposures with individual provisions	Individual provisions	Total exposure amount in the loan portfolio after individual provisions
Single-family dwellings and holiday homes	97,764	621	5	5	97,759
Tenant-owner rights	57,816	294	17	13	57,803
Tenant-owner associations	53,507	58	44	24	53,483
Private multi-family dwellings	29,199	299	17	10	29,189
Municipal multi-family dwellings	6,135	-	-	-	6,135
Commercial properties	8,585	1	-	-	8,585
Without collateral	431	2	-	-	431
Total	253,437	1,275	83	52	253,385

Table 16. Geographical distribution of exposures with past due amounts and individual provisions

SEK million	Total exposure amount in the loan portfolio	Exposure amounts with past due receivables	Exposure amounts for exposures with individual provisions	Individual provisions	Total exposure amount in the loan portfolio after individual provisions
Greater Stockholm	121,620	686	29	16	121,604
Greater Gothenburg	22,547	63	5	5	22,542
Öresund region	60,980	302	3	2	60,978
University and growth regions	18,815	57	5	3	18,812
Weak regions	7,390	39	1	1	7,389
Other regions	22,085	128	40	25	22,060
Total	253,437	1,275	83	52	253,385

7.11 Exposures per risk class in the PD dimension

The quality of the portfolio is favourable. A total of 97% of corporate exposures and 90% of retail exposures in the balance sheet derives from the four best risk classes C1–C4 (corporate exposures) and R1–R4, Retail (retail exposures), see Figures 11–14.

7.12 Realised outcome in the PD and LGD dimensions

Table 17 shows the PD and LGD estimate as of 31 December 2010 and the outcome for 2011. The estimated outcome for the corporate model significantly exceeded the actual outcome, which indicates that, in the prevailing economic conditions, the PD models overestimate the risk of default. In the case of retail exposure, the model's estimated default outcome is much closer to real outcomes than in the case of corporate exposures.

The exposure-weighted amount for LGD is controlled by the above-mentioned limitation rule, which entails that the lowest total level for LGD is 10% for exposures covered by the advanced IRB approach and where collateral comprises a tenant-owner right, a mortgage in a residential property or the site leasehold on such a property.

Table 17. Realised outcome in the PD and LGD dimension

Exposure Class	PD estimate	Realised outcome ¹⁾	LGD estimate	Realised outcome ²⁾
Corporate exposures	1.3%	0.2%		
Retail exposures	0.7%	0.6%	10.7% ³⁾	1.4% ³⁾

¹⁾ 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 the agreed interest or amortisation.

²⁾ Realised outcome has been calculated on loans in default where the default was concluded during the year.

³⁾ The results are exposure-weighted.

Figures 11–14. Exposures per risk class in the PD dimension

Figure 11. Corporate exposures, according to IRB, per PD class

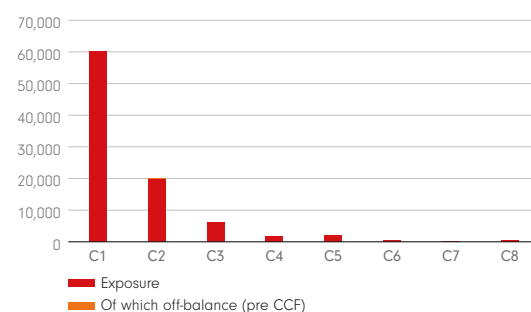


Figure 12. Retail exposures, according to IRB, per PD class

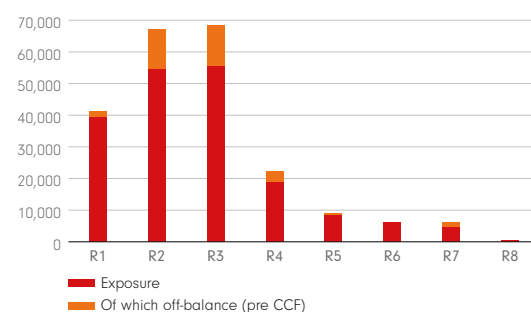


Figure 13. Retail exposures, according to IRB, against collateral in single-family dwellings and holiday homes per PD class

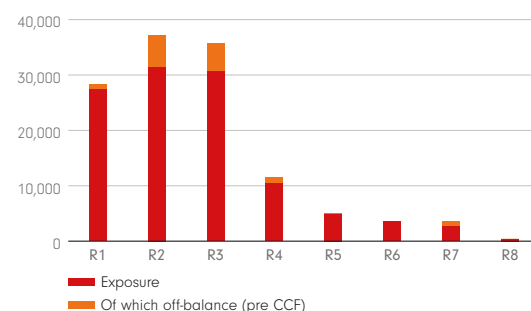
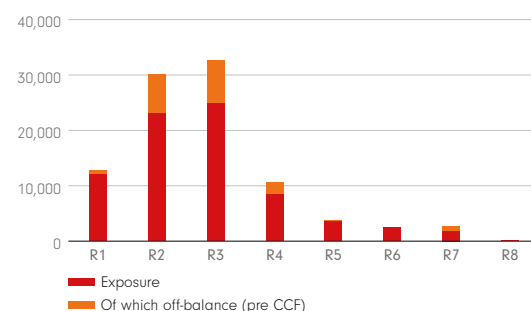


Figure 14. Retail exposures, according to IRB, against collateral in tenant-owner rights per PD class



7.13 Comparison of expected loss and outcome

In a comparison of expected loss (EL) according to the internal IRB approach during the comparative period (see Table 18), it can be noted that EL increased for corporate loans, while declining for both sub-groups in the case of retail exposures. For corporate loans, the increase in EL was due mainly to a larger loan portfolio. For retail exposure, the decrease was due to the risk falling more than the increase in the loan portfolio.

The actual outcome was significantly below the estimated outcome of the models, which suggests the models overestimated the magnitude of EL in the current economic conditions. The relatively small confirmed losses emerging during the year were due, in part, to the lender not managing his interest payments and amortizations and, in part, because the market value of pledged collateral was less than the value of SBAB's receivable.

7.14 Credit risk protection

A guarantee from the Swedish National Housing Credit Guarantee Board (BKN) is utilised to reduce the capital requirement. The receivable of SEK 415 million covered by credit insurance from BKN was weighted by 0% in the calculation of the capital quotient. Approximately SEK 5.6 billion of the lending was to Swedish municipalities or was secured by a municipal guarantee. When calculating the capital quotient, this lending was weighted at 0%. SBAB has also received loan loss guarantees totalling SEK 205 million from business partners, although these were not utilised in the calculation of the capital quotient.

In addition, the Parent Company and SCBC previously had joint credit insurance from Genworth Financial Mortgage Insurance Limited (Genworth) that was also not used in the calculation of the capital quotient. The credit insurance covers the portion of the loan amount that exceeds 85% of the value of pledged collateral. The total insured loan amount was SEK 635 million. 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 a rating of BBB (Standard & Poor's) and Baa3 (Moody's).

Table 18. Comparison of expected loss between outcome and model, and individual provision ¹⁾

Exposure Class	EL, IRB/IRB foundation 31 Dec 2010	EL, IRB/IRB foundation 31 Dec 2009	EL, IRB/IRB advanced 31 Dec 2010	EL, IRB/IRB advanced 31 Dec 2009	Realised outcome 2011	Realised outcome 2010	Individual provision 31 Dec 2011	Individual provision 31 Dec 2010
Corporate exposures	328	290			17	1	3	59
Retail exposures			189	203	14	24	49	15
Of which, single-family dwellings and holiday homes			105	108	6	13	49	3
Of which, tenant- owner rights			84	95	8	11	-	12
Total	328	290	189	203	31	25	52	74

¹⁾ EL was calculated for the loan receivables existing at the end of 2009 and 2010.

Table 18 shows a comparison of EL with the actual outcome of confirmed losses during 2010 and 2011.

8. Funding

The SBAB Group's operations are financed primarily through funding in the capital and money markets. Funding takes place, in part, through the Parent Company SBAB Bank AB (publ) and, in part, through SCBC, with funding in SCBC occurring through the issuance of covered bonds. The company's funding operations use Swedish and international funding programmes. Funding takes place in public markets and is supplemented by private placements. Funding is mainly targeted at major institutional investors. While international funding is primarily aimed at European investors, the SBAB Group also attracts investors in the US and Australia, as well as Japan and other areas of Asia.

8.1 Medium and long-term funding

Unsecured funding

SBAB has a regular programme for medium and long-term funding, the Euro Medium Term Note Programme (EMTN programme), which is used both for Swedish and international funding. The EMTN programme has a framework limit of EUR 13 billion. The programme grants investors the right to demand premature repayment of a bond should the Swedish Government no longer have the right to exercise at least 51% of the voting rights for the shares in the company. This right is subject to the condition that the Swedish Government has not previously guaranteed SBAB's obligations under the bonds, in which case the right to premature repayment expires. In all other cases, the terms of the EMTN programme match market practice for similar programmes and entitle investors to premature repayment of the bonds if, for example, SBAB fails to pay the interest or capital amount on time, if SBAB breaks other terms of the programme (with consideration given to certain healing periods) or if SBAB enters into bankruptcy or liquidation. Under the EMTN programme, SBAB can choose between various types of interest rate structures, including floating and fixed rates, and issue bonds in several currencies and denominations. Under the terms of the EMTN programme, SBAB can issue both non-subordinated loans and dated or perpetual subordinated loans, which with the Swedish Financial Supervisory Authority's permission may qualify as Tier 1 or Tier 2 capital.

SBAB has a Japanese Shelf Registration in place, under which SBAB has the potential to issue bonds on the Japanese market. Like the EMTN programme, the bondholder is entitled to premature repayment of a bond if the Swedish Government ceases to exercise at least 51% of the voting for shares in the company. This right is subject to the condition that the Swedish Government has not previously guaranteed SBAB's obligations under the bonds, in which case the right to premature repayment expires.

Secured funding

The subsidiary SCBC has three funding programmes for issuance of covered bonds: a Swedish covered mortgage bond programme with no fixed limit, an international Euro Medium Term Covered Note Programme (EMTCN programme) with a limit of EUR 10 billion and an Australian Covered Bond Issuance Programme with a limit of AUD 4 billion. The terms of these programmes for the issuance of covered bonds are in line with market practice for similar programmes and entail, for example, that investors are not entitled to premature repayment of the bonds. The terms also stipulate that SCBC can choose between various types of interest rate structures, including floating and fixed rates, and issue bonds through these two programmes in several currencies and denominations.

8.2 Short-term funding

SBAB manages its short-term funding primarily through three commercial paper programmes:

- A Swedish commercial paper programme with a limit of SEK 25 billion.
- A European commercial paper programme with a limit of EUR 3 billion.
- A US commercial paper programme with a limit of USD 4 billion.

The terms of these commercial paper programmes are in line with market practice for similar programmes and include limited opportunities for an investor to demand premature repayment. Issuances are performed through issuing institutions, and through these three programmes, SBAB is able to issue commercial papers in several currencies and denominations both in the Swedish and the international market. The commercial papers mainly comprises “discount papers,” meaning that it does not have floating or fixed coupon rates, but rather is issued in an amount that is less than the nominal amount, and when it matures, the nominal amount is repaid.

8.3 Funding strategy

The size of the funding portfolio is adjusted based on the volume of the outstanding loans and the composition of the assets, taking into consideration such factors as liquidity risk. Funding is also continuously adapted to meet the new liquidity rules included in Basel III.

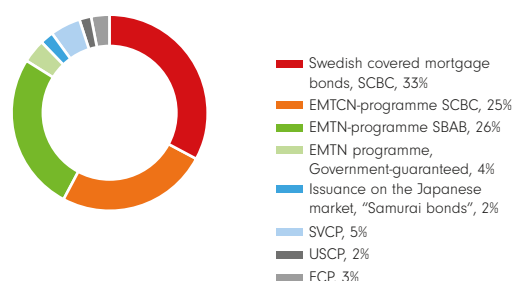
Funding must be well diversified. SBAB’s long-term goal is for approximately half of the funding to comprise securities issued in Sweden and the remainder securities issued outside Sweden. The portfolio must have an effective distribution between secured and unsecured funding with evenly distributed maturity dates, meaning that there should be no periods with large concentrations of debt maturities. The portfolio must also comprise funding in several currencies with a diversified investor base. Funding is to take place through several leading banks and through public and private placements. Interest-rate risk and currency risk associated with funding are managed through the use of derivatives, primarily interest-rate swaps and currency swaps.

Short-term funding under SBAB’s commercial paper programme must be adjusted to market conditions but always constitute a limited share of the portfolio. SBAB’s assets are to be used efficiently through secured funding. Secured funding is primarily utilised for protracted durations. The funding mix between SCBC and SBAB must be well balanced, taking into account the companies’ ratings and total long-term funding cost.

Both SBAB and SCBC must have an active market presence, with favourable and frequent relations with investors in each investor segment.

Figure 15. Funding sources and distribution by currency for issued securities

Funding sources, securities issued by SBAB
Debt outstanding at 31 Dec 2011: SEK 277 billion



Distribution by currency, securities issued by SBAB
Debt outstanding at 31 Dec 2011: SEK 277 billion



9. Credit risk in the finance operations

In the finance operations, credit risk arises, in part, in the form of counterparty risks for the derivative contracts entered into by SBAB to manage its financial risks and, in part, as a result of investments in the liquidity portfolio and investment of surplus liquidity.

In accordance with the finance directive established by the Board of Directors, the credit-risk limit is established by SBAB's Finance Committee for all counterparties in the finance operations (meaning debtors and financial counterparties), with the exception of the Government of Sweden and companies included in the SBAB Group, for which no limits are placed on exposure. The exposure amount for the counterparty risk is calculated through market valuation and observes the standard set in the Bank's ISDA Agreements.

The credit-risk limit may be established for a period of no longer than one year, following which a new assessment must be conducted. Decisions on the credit-risk limit which are taken by the Finance Committee must be reported to the Parent Company's Board of Directors at the following Board meeting.

The Swedish Capital Adequacy and Large Exposures Act (2006:1371) restricts 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, not exceed 15% of the capital base. Certain Nordic counterparties are exempt 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.

9.1 Counterparty risk

Counterparty risk is the risk that SBAB's financial counterparties cannot meet their commitments pursuant to the completed derivatives contract, and such risk consists primarily of exposures to leading banks. Exposure is primarily covered through collateral agreements in which the counterparty provides collateral in an effort to reduce exposure.

To limit the potential counterparty risk associated with derivative transactions involving non-standardised derivative instruments that are not cleared by clearing organisations approved by the Swedish Financial Supervisory Authority (in accordance with

FFFS 2007:1), a framework agreement must have been concluded with the counterparty. This ISDA Master Agreement, or similar agreements, have in particular cases been supplemented with associated collateral agreements, known as Credit Support Annexes (CSAs). When SCBC enters into derivative agreements, it must always sign an associated CSA. The ISDA Master Agreement entails, among other things, 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 minimum transfer amount to or from the counterparty can vary depending on the parties' ratings. Tables 19 and 20 provide an overview of the distribution of the market value of individual derivative transactions by various maturities and ratings, respectively.

To limit the counterparty risk associated with repo transactions, GMRA's (Global Master Repurchase Agreements) are used. These agreements control aspects such as the transfer of collateral to or from the counterparty.

Reconciliation with the counterparty is conducted daily or weekly with each derivatives counterparty with whom a collateral agreement has been signed, and collateral is moved to offset exposure. In all cases, the posted or accepted collateral takes the form of cash with a transfer of title, meaning that the party receiving the collateral is entitled to use it in his operations.

In the case of most collateral agreements concluded by the Parent Company, the threshold amount and the minimum transfer amount are regulated by the parties' rating; the worse the rating that a party has, the lower are these amounts. A decline in SBAB's credit rating by three notches, as of 31 December 2011, would have resulted in the need for extra collateral of SEK 27.6 million.

9.2 Money market investments

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

9.3 Liquidity portfolio

SBAB's liquidity portfolio consists mainly of liquid interest-bearing securities with a high rating, with the purpose of reducing the company's liquidity risk. The exposure is limited by asset class and country and must have the highest rating on the acquisition date. Moreover, the exposure is an integral part of the overall credit risk utilisation for each issuer/counterparty. In this context, holdings of covered bonds are assigned a weight of 10%.

The holdings in the portfolio are long term and at 31 December 2011 amounted to SEK 48.9 billion with an average duration of 3.0 years. At the same date, 91% of the portfolio's value had a rating of Aaa from Moody's, or of AAA from Standard & Poor's. The various asset classes in the portfolio are:

- Securities issued by or guaranteed by Central Governments
- Securities issued by Supranational and Sovereign Agencies (SSAs)
- Securities issued by Public Sector Entities (PSEs)
- European Covered Bonds
- European and Australian Residential Mortgage-Backed Securities (RMBS).

Portfolio holdings are either classified as "Securities at fair value through profit and loss" or "Loans and receivables".

Securities at fair value through profit and loss

- Securities issued by Central Governments, SEK 5.9 billion.
- Securities guaranteed by Central Government, SEK 2.6 billion.
- Securities issued by Supranational and Sovereign Agencies (SSAs), SEK 0.6 billion.

- Securities issued by Public Sector Entities (PSEs), SEK 2.4 billion.
- European Covered Bonds, SEK 27.7 billion.

Loans and receivables:

- Residential Mortgage-Backed Securities, SEK 9.7 billion.

Loans and receivables are reported at their accrued book value. Credit risk assessment is conducted on the basis of assessed future cash flows and the market value of the collateral. All exposures in the RMBS portfolio are ranked according to loan to value (LTV) and age (date originated) in three risk classes. Two new models are used for the calculation of credit risk in the RMBS portfolio. The first is based on factors such as arrears statistics and credit support per transaction. Using this model, all transactions in the RMBS portfolio have been analysed. The second model is based on information such as actual and expected cash flow, underlying borrower statistics and macro-variables. This model has been used for a few carefully selected transactions with an assessed elevated risk. The model assesses the magnitude of a possible deficit for each separate transaction and whether this deficit will affect the holder of AAA tranches in the form of forthcoming losses or whether any deficit will be covered by subordinated securities and statutory reserves. Overall, the models show that the portfolio is not subject to any provision requirements.

Table 21. Net credit exposure for derivative instruments

SEK million	
Positive gross market value of contracts	17,424
- Nettings gains	12,874
= Current offset credit exposure	4,550
- Collateral held	4,468
= Net credit exposure to derivatives	82

Table 19. Derivative instruments

SEK million	Total nominal value	Positive market values	Negative market values
<1 year, interest-rate related	100,244	624	-685
>1 year, interest-rate related	325,286	8,215	-6,377
<1 year, currency related	58,574	4,254	-2,618
>1 year, currency related	112,553	4,332	-4,328
Total	596,656	17,424	-14,009

Table 20. Derivative instruments distributed by rating

SEK million	Net market value	Positive market values	Negative market values
AA -	1,135	5,430	-4,295
A +	1,126	2,522	-1,396
A	1,154	9,472	-8,318
Total	3,416	17,424	-14,009
Collateral			3,241
Nettings gains			12,918

10. Market risk

Market risk is the risk that unfavourable market fluctuations could negatively affect the earnings. SBAB is characterised by low risk-taking, and the Board decides ultimately on methods for risk measurement and establishing limits. Market risk is monitored at the Group level and, through daily reporting, the Risk unit monitors current risk levels and compliance with limits.

Interest-rate risk arises primarily when the interest-rate structure between the company's funding and lending, or Asset and Liability Management risk (ALM risk), is not fully matched. Currency risk refers to the risk of changes in the SEK exchange rate in relation to other currencies leading to deteriorating profitability. Basis swap risk is a term for the risk that arises when funding in a foreign currency is swapped for a different term to maturity than the term to maturity in the underlying lending.

10.1 Interest-rate risk

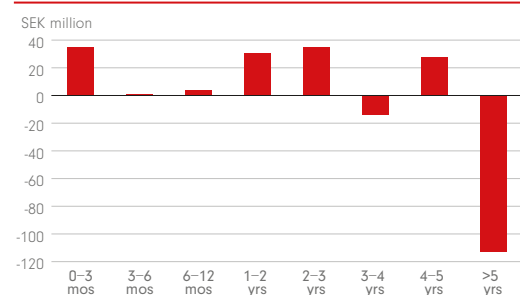
The main principle for SBAB's Asset and Liabilities Management is to utilise direct funding and derivative instruments to limit exposure, and to create added value through active management within the limits set by the Board.

Interest-rate risk is quantified, in part, through a parallel shift in SBAB's yield curve by one percentage point, and, in part, through a model that simulates a large number of non-parallel shifts in the yield curve – referred to as curve risk – as well as through VaR. The calculation takes into account all contractual transaction flows affecting lending, funding and derivatives. The parallel shift measure and the curve risk are used in limit setting and limit monitoring, while VaR is part of the model for economic capital.

The limits on interest-rate risk set by the Board consist of an operational and a strategic component. The risks are measured daily and add up to SBAB's total interest-rate risk exposure.

Figure 16. Interest-rate risk for positions not included in the trading book in the event of a parallel shift in the yield curve by +1 percentage point.

Interest-rate risk in the event of a parallel shift in the yield curve by +1 percentage point.

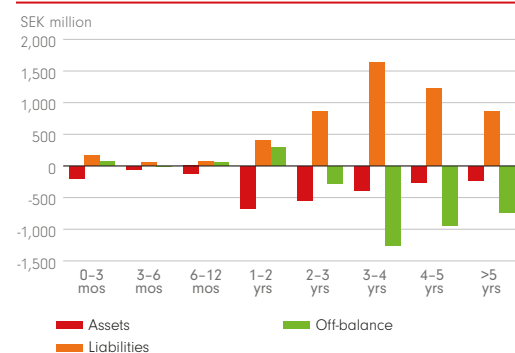


Operational interest-rate risk arises in the SBAB Group's current lending and funding activities, including deposit operations. The operational interest-rate risk is limited to 1% of SBAB's capital base in the event of a parallel shift in the yield curve by one percentage point. On 31 December 2011, operational interest-rate risk exposure was a negative SEK 28.3 million compared with the limit of \pm SEK 139 million, as set by the Board. The interest-rate risk for positions not included in the trading portfolio totalled SEK 7.8 million.

Curve risk is quantified through a model in which the short end of the yield curve is varied upwards (downwards) by 0.5 percentage points and the long downwards (upwards) by 0.5 percentage points. A large number of turning points for the short and long end of the yield curve are tested and the curve risk is defined as the least favourable of these scenarios. Curve risk for the operational part is limited at 1% of SBAB's capital base. On 31 December 2011, curve risk totalled SEK 70.1 million compared with the limit of SEK 139 million.

Figure 17. Interest-rate risk for positions not included in the trading book for assets, liabilities and off balance-sheet instruments in the event of a parallel shift in the yield curve by +1 percentage point.

Interest-rate risk for assets, liabilities and off balance-sheet instruments in the event of a parallel shift in the yield curve by +1 percentage point.



The strategic interest-rate risk is the reinvestment risk that arises when SBAB's equity and "flow" are invested in fixed-income lending. The flow arises when interest payments for lending and funding have different payment frequencies. SBAB's equity and flow are to be used primarily to fund lending operations. The benchmark for the investment of equity is set by the Board and is defined as a series of fixed-interest maturities with uniform maturity every year from one to six years. The interest-rate risk in equity is defined as the deviation from this benchmark. The flow is invested with an average maturity corresponding to the lending portfolio's average maturity. The strategic interest-rate risk is limited to +/- SEK 20 million. On 31 December 2011, the strategic interest-rate risk totalled SEK 2.0 million.

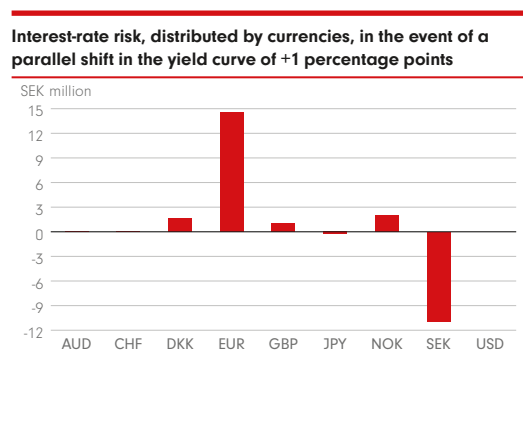
The interest-rate risk is also quantified by measuring Value at Risk, VaR. The VaR model used is a parametric model with risk factors based on an assumption of normally distributed standard deviations, calculated with variance/covariance matrices for the risk factors included. A unilateral 99.97% confidence interval and a holding period of one year are used.

10.2 Interest-rate risk for positions included in the trading book

The trading book predominantly comprises investments in SBAB's liquidity portfolio¹⁾. The liquidity portfolio is subject to a minimised interest-rate risk. The risk in the liquidity portfolio primarily derives from credit risk.

Interest-rate risk in the trading book at SBAB is managed as an integral part of the balance sheet, together with other operations, and the risk is limited in accordance with the finance directive. Interest-rate risk in the trading book is included as part of the limit for operational interest-rate risks delegated to the Finance Department.

Figure 18. Interest-rate risk for positions not included in the trading book, distributed by currencies, with a parallel shift in the yield curve of +1 percentage points



¹⁾ SBAB's liquidity portfolio, excluding RMBS, is included in the trading book.

10.3 Currency risk

As the main rule, SBAB should not be exposed to exchange-rate fluctuations. Accordingly, funding in international currency must be hedged or invested in matching currencies. Investments are currency hedged through funding in the corresponding currency or by entering into currency swap contracts. Since certain currency risks can arise because interest-rate cash-flows are not completely matched, a limited deviation from the main rule may be accepted.

The currency risk, excluding the liquidity portfolio, is calculated as the effect on the present value of all contractual liquid flows given a change in the exchange rate of ± 10 percentage points per corresponding exchange rate. Currency exposure at 31 December 2011 was SEK 4.2 million. Total currency exposure may not exceed the equivalent of SEK 10 million.

The liquidity portfolio is also hedged through funding in the corresponding currency or through currency swap contracts. Calculated per currency, the portfolio is to be hedged to between 99.5% and 100.5%.

Currency options may only be used for the purpose of hedging, and no open exposures are permitted.

10.4 Basis-swap risk

Basis-swap risk arises when funding in a foreign currency is swapped on a different term to maturity than the term to maturity in the underlying lending. The main rule is that all funding in foreign currency is to be swapped to SEK with matching maturities. The risk consists of deviations from the main rule. The risk is calculated as the effect on the present value, relative to full matching, of a parallel shift of the basis swap curve from a currency to SEK by ± 0.25 percentage points. The maximum permissible risk is SEK 50 million. The basis-swap risk at 31 December 2011 was SEK 648,000.

10.5 Risks in the trading book

The trading book predominantly comprises investments in SBAB's liquidity portfolio. The liquidity portfolio is subject to a minimised interest-rate risk. The risk in the liquidity portfolio primarily derives from credit risk. Interest-rate, credit and liquidity risks in the trading book are managed within SBAB as an integral part of the balance sheet along with other operations and the risks are limited in accordance with the finance directive. Interest-rate risk in the trading book is part of the limit for operational interest-rate risks delegated to the Finance and Treasury Department. Credit risks in the form of issuer and counterparty risks in the trading portfolio are regulated by credit risk limits, which are set by SBAB's Finance Committee.

11. Liquidity risk

Liquidity risk is defined as the risk that SBAB will not be able to meet its payment obligations on the date of maturity without the related cost increasing significantly.

The overall purpose of SBAB's liquidity strategy is to ensure SBAB's survival in terms of liquidity in the short term and that the company can effectively meet its payment obligations. Key features of the strategy are a proactive and continuous liquidity planning, active liability management and the size, content and management of SBAB's liquidity reserves.

SBAB has long identified the importance of well-functioning and proactive liquidity-risk management. The company's liquidity-risk management is based on the following principles:

Broad and diversified funding

Because SBAB has maintained an active presence in the international capital market since 1989, its brand is well established. Funding takes place on a global basis on short-term, mid-term and long-term. Moreover, through SCBC, SBAB has access to the covered bond market in Sweden and internationally.

Liquidity reserves

To ensure access to funding in times when the normal sources of funding do not function, SBAB has a liquidity portfolio. In calculating the reserve value of the securities in the liquidity portfolio, SBAB applies the haircuts 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. The reserve value of the liquidity portfolio is referred to as the liquidity reserve.

The portfolio comprises liquid securities with high ratings, with assets eligible for repos with the Riksbank or another central bank accounting for 86% of the portfolio value.

At 31 December 2011, SBAB's reserves consisted of SEK 1.5 billion in bank facilities and SEK 48.9 billion in liquid securities. The liquidity reserve is divided into a strategic, long-term component, which is valued at SEK 38.6 billion (after the Riksbank's haircuts) and a temporary component used to even out major debt maturity. In addition to the reserves above, SBAB had a lending facility at the Swedish National Debt Office during 2011 of SEK 1.0 billion, which matured on 31 December 2011. Moreover, unutilised capacity for issuance of covered bonds constitutes an additional liquidity reserve.

SBAB's liquidity portfolio consists of liquid interest-bearing securities with a high rating, which are an integral part of the Group's liquidity management. Holdings of securities are limited in terms of risk class and country, and must have the highest rating upon acquisition. In addition to these group limits, limits have also been set for individual issuers.

A liquid balance sheet

SBAB's assets consist primarily of lending against collateral in property and tenant-owner rights. SCBC was established in 2006 for the purpose of issuing covered bonds, which has also resulted in increased liquidity in SBAB's balance sheet.

Table 22. Liquidity reserve

SEK million	DISTRIBUTION BY CURRENCY				
	2011-12-31	SEK	EUR	USD	Other
Liquidity reserve					
Securities issued or guaranteed by central government, central banks or multinational development banks	9,080	2,411	6,043	351	275
Securities issued or guaranteed by municipalities or PSEs	2,378	2,236	–	142	–
Covered bonds	27,733	15,762	11,139	210	622
Securities issued by finance companies (excl. covered bonds)	9,700	–	8,468	652	580
Total liquidity portfolio	48,891	20,409	25,650	1,355	1,477
Bank and lending facilities	1,484	–	–	1,484	–
Total liquidity reserve	50,375	20,409	25,650	2,839	1,477
Distribution by currency		40%	51%	6%	3%

Continuous monitoring of the liquidity risk

Active debt management, the liquidity of the balance sheet and the size of SBAB's liquidity reserves are key factors in SBAB's liquidity risk management. By viewing funding activities as a natural part both of operations and strategic planning of liquidity risk, concentrations of excessively large funding maturities are avoided. Another important part of the continuous liquidity risk management is constantly monitoring and testing the practical liquidity value of the liquidity portfolio on the secondary market.

Contingency plan

SBAB has a contingency plan for the management of liquidity crises. The contingency plan contains a clear delegation of responsibility for the personnel concerned, as well as instructions as to how the company can rectify potential liquidity deficits.

The plan stipulates suitable actions to handle the implications of various types of crisis scenarios and contains definitions of events that cause and escalate the contingency plan. The contingency plan must be regularly tested and updated based, for example, on the results of stress tests.

11.1 Liquidity-risk measurements

SBAB measures and stress-tests its 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.

11.2 New regulations for liquidity risk

In the wake of the financial crisis, a major international review and extensive efforts were launched to assess the regulations for the management of the liquidity risks of banks and credit institutions. The objective of the new regulations, which are still being formulated, is to increase the resilience of banks to serious disruptions in the capital market and to achieve larger harmonisation in the view of liquidity risk at international level.

In order to set minimum levels for the liquidity of banks, the new regulations focus on two key ratios or standard measurements called the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). LCR aims to ensure the maintenance of an adequate

amount of unutilised liquid assets that, when necessary, can be converted to funds to cover a 30-day forecast liquidity requirement, while NSFR aims to indicate how stable the Group's funding is by comparing the stability of assets and liabilities.

Since 1 July 2011, LCR is reported each month by SBAB for observation by the Swedish Financial Supervisory Authority.

11.3 Stress tests for liquidity risk

A model has been developed for stress testing of liquidity risk in order to fulfil internal requirements with regard to the analysis of liquidity risk and risk management preparedness. The stress tests were designed in line with the Swedish Financial Supervisory Authority's regulations on liquidity management, which impose general requirements on stress tests (FFFS 2010:7). The developed models analyse SBAB's capacity to meet its capital requirements in various market scenarios and to assess the effect of protracted stress on an estimated maturity profile. The scenarios have been designed to match SBAB's specific risk profile and cover both company-specific and market-related problems. The scenarios are divided into various stages that capture an increased degree of stress intensity in order to show how a crisis can continuously worsen.

The scenarios simulated in the stress tests include:

- The 2008/2009 financial crisis – stress of funding operations, whereby the funding programme closes at different stages.
- Rating-related stress with a gradually declining rating for SBAB and SCBC.
- Falling property market prices – various levels of falling prices, which reduce LTV, thus lowering the share of funding that can be conducted via SCBC.

The stress tests are under continuous development and the assumptions underlying the various scenarios are evaluated regularly. The stress tests are conducted and reported quarterly, with results being assessed against SBAB's established risk tolerance and used to adapt strategies and guidelines.

11.4 The liquidity status in 2011

Over the course of 2011, the liquidity reserve averaged 121 days MCO. At 31 December 2011, the reserve corresponded to 77 days MCO. During 2011, SBAB's liquidity reserve was never less than the equivalent of 48 days' future liquidity requirements.

12. Refinancing risk

SBAB has the objective of maintaining diversified funding. The refinancing risk is a measure of the deviation between the structure of assets and liabilities.

SBAB's calculation of refinancing risk is based on all contractual capital amounts with a remaining maturity exceeding one year. The calculation thus supplements SBAB's use of the liquidity risk model, which covers the interval up to one year. In the refinancing risk model, equity is assigned a maturity corresponding to SBAB's longest lending assets.

SBAB has adopted a more conservative approach to the management of funding. For example, a larger portion of coming maturities has been pre-funded

and the portion of short-term funding as a portion of total funding is maintained at a low level. SBAB works proactively to even out the debt maturities while extending the duration of the debt. Monitoring of upcoming maturities, repurchases, replacements and pre-funding constitutes a key element of practical management efforts aimed at reducing the risk. Refinancing risk is calculated in part as the total of maturing funding within 90-day periods relative to total funding volume.

13. Operational risk

Operational risk means the risk of losses due to inappropriate or unsuccessful internal processes, human error, faulty systems or external events. The definition includes legal risk.

SBAB uses a model to manage operational risk. The model is based on self-evaluation of operational risks and risks associated with financial reporting in existing processes and on monitoring and incident reporting. The results of the self-evaluation are reported annually and any incidents that occur are reported on a monthly basis to the Board of Directors, CEO and senior executives.

SBAB uses the standardised approach to assess capital requirements for operational risk. This approach entails that the capital requirement is based on 12%, 15% and 18% of the average operating income of the business area's for the past three years (in line with

the definition according to FFFS 2007:1). The method includes requirements in terms of documentation, processes and structures such as:

- Established control documents
- Documented risk management
- Internal reporting structure
- Processes for managing operational risks
- Contingency and continuity plans
- Methods for distributing operating income among the business areas

Table 6 shows the capital requirements for operational risk.

14. Business risk

Business risk is defined as the risk of declining earnings due to more difficult competitive conditions, strategic mistakes or erroneous decisions.

Business risk also includes margin risk that arises when the interest margin for assets and liabilities has different fixed-rate periods. SBAB is subjected to margin risks, primarily as a result of customers' ability to redeem their loans in advance as opposed to fixed periods for capital market funding, but also due to the difference in actual capital maturity for lending in relation to funding and deposits.

Business risk is allocated to two main groups: new business and existing business. New business is usually relatively similar to the business SBAB already

has. Changes in the form of new products or new markets may only constitute a small part of SBAB's activities and must be implemented at such a pace that SBAB does not substantially jeopardise and is most likely avoids pressure on its capital base.

Business risk is managed in conjunction with business planning work. The capital requirement for business risk is quantified in the calculation of economic capital using a standardised approach based on the business areas' operating expenses.