SBAB Bank AB (publ)

CAPITAL ADEQUACY AND RISK MANAGEMENT 2012

Basel Regulations, Pillar 3



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Glossary

Chapter 1: Introduction

The European Parliament and Council's directive on authority to conduct operations in credit institutions and on the supervision of credit institutions and securities companies – CRD IV | New forthcoming common European regulations on risk management and capital adequacy. Together with the CRR, this is what is known as Basel III.

The European Parliament and Council's recommendation on supervisory requirements for credit institutions and securities companies – CRR | New forthcoming common European regulations on risk management and capital adequacy. Together with the CRD IV, this is what is known as Basel III.

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

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 regulations that will probably apply until Basel III is introduced. **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 regulations 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 FFFS 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 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.

Exposure At Default (EAD) | Exposure at time of default. To calculate the EAD for off-balance sheet exposures, the unutilised amount is multiplied by a credit conversion factor (CCF).

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 method) | 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 is to 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 issuance of covered bonds.

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

Chapter 9. Credit risk in the funding 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 repurchases. 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 netting 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 risk measurement that measures the relationship between liquid reserves and a 30-day net outflow in a stressed scenario.

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 risk measurement of a structural nature, which indicates the stability of the Group's funding in relation to assets.

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1. Introduction

In this report, the SBAB financial group 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 2012, 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's website, 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 is required to continuously have capital in an amount, type and distribution that is sufficient to cover the risks to which they are or will become exposed. 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 have been 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, now apply through yearend 2013 unless the forthcoming European regulatory framework CRR/CRD IV (Basel III) is enacted prior to that and an alternative is thereby stipulated. According to the transitional regulations, lending for tenant-owner rights is equated with unsecured lending in contrast to what applies under Basel II and Basel III, in which the lower risk has been taken into account.

Much of the substance discussed ahead of Basel II never materialised in the regulatory framework, but was instead deferred to a later date. Subsequently, the financial and debt crises have led to additional demands for stricter capital adequacy regulations, resulting in proposals for new regulatory standards – CRR and CRD IV. Basel III proposes higher capital requirements, stricter demands on capital quality, the introduction of a non-risk-based measure (leverage ratio) and quantitative liquidity requirements. The changes will impose requirements for an increased capital base and higher capital requirements compared with the current regulations. Within the framework of these regulations, Swedish authorities have announced a request for additional national requirements. 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 The risk that the counterparty is unable to fulfil its payment obligations.
- Concentration risk Exposures concentrated to certain types of borrowers, regions or industries.
- Market risk The risk of a decline in profitability due to unfavourable market fluctuations.
- Liquidity risk The risk that the company is unable to meet its payment obligations on the date of maturity without the related cost increasing significantly.
- Operational risk The risk of losses due to inappropriate or unsuccessful internal processes, human error, incorrect systems or external events, including legal risk.
- Business risk The risk of declining income due to deteriorating competitive conditions or an incorrect strategy or decision. Margin risk, which arises when the repricing periods applying to interest-rate margins for lending and funding differ, is also included in business risk.

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

2. SBAB Financial group

The SBAB financial group 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 SBAB financial group

Company	Corp. reg. number	Ownership share	Consolidation method for for auditing	Consolidation method for capital adequacy
The Swedish Housing Finance Corporation, SBAB	556253-7513	Parent Company	-	-
The Swedish Covered Bond Corporation	556645-9755	100%	Acquisition method	Acquisition method
FriSpar Bolån AB	556248-3338	51%	Proportional	Acquisition method*
			consolidation 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. The Parent Company also conducts lending operations and, to a limited extent, the funding of commercial properties and unsecured lending.

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.



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During the year, SBAB conducted 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. During 2013, there are plans for expanding the operations through sales of fund units. The Corporate Clients business area is active in the property market through deposits from and lending to property companies, property funds and municipalities. SBAB's funding is managed by the Treasury, within the Accounting and Finance Department. The operations are mainly exposed to credit risk, market risk and liquidity risk.

In view of SBAB's strategic orientation of focusing on and assigning priority to the development of a new consumer bank, the Board of Directors has decided to restructure the Corporate Clients business area to facilitate a future divestment of this operation. Among other consequences, this has led to a slimming of Corporate Clients' lending portfolio, with priority assigned to a limited segment comprising major property companies.



¹⁾ In addition to reporting to the CEO, Compliance reports to the Board of Directors

²⁾ SBAB's function for independent risk management within the Credit and Risk Department reports to the Board of Directors in addition to the CEO.

The Heads of: Business Development, Accounting & Finance, Retail Market, Tenant-owner Associations Market, Collaboration Market, Legal, Communications & HR, Credit & Risk, are included in SBAB's executive management.

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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 component of all businesses and all risks that arise must be managed. SBAB is mainly exposed to credit risk in its lending operations. The recent financial and debt crises have called attention to, for example, the importance of effective management of liquidity and counterparty risk.

For SBAB, risk management requires that, in each individual lending 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. The aim of the strategy adopted for the lending operations, with respect to management and pricing, is to consider the risks that arise in the operations and the capital needed to cover these risks.

Specifically, this means that SBAB engages in continuous discussions concerning the following questions:

- What various risks are generated in the operations?
- How can these be measured to create comparability?
- Does SBAB have sufficient capital to offset the company's risks?

3.1 Overall aims for risk management risk

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. In cases where risks cannot be quantified and compared with risk-bearing capacity in the same manner as, for example, credit risk and market risk, the costs incurred for reducing the risk are weighed against the desired risk level and the change in risk level achieved through a particular measure.

SBAB is to consciously expose itself only to risks that are directly attributable to or are regarded as necessary for the business operations. Such risks primarily encompass business risk, credit risk, market risk, liquidity risk and operational risk. The Board of Directors has decided on the following goals for risk management:

- Risk management must support the business operations and rating targets.
- The level of risk-taking must be low. This is to be achieved by ensuring that the total risk is kept at a level that is compatible with financial objectives for return, the size of risk capital and the target rating, as expressed in SBAB's business plan.
- Collective risk management is to be pursued at a level that, at a minimum, fulfils the requirements of authorities.
- Risk management is to be transparent and easily presented to and understood by the company's external stakeholders.

- The capital assessed to cover unexpected losses in the next few years must be measured in the form of economic capital.
- The collective risk in the operations is to be divided into credit risk, market risk, liquidity risk, operational risk and business risk.
- 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. Risk management 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 define 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 in relation to 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 re-assessed continuously. 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 of Directors has decided that the Group is not to 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 the 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 of Directors establishes the risk that SBAB is prepared to take based on the chosen strategy, earn-

ings from operating activities and risk capital. SBAB's income is to mainly derive from credit risk. The cause of various risks and the magnitude of each risk as a percentage of overall risk should be clear. During 2012, SBAB was subject to the following quantitative targets and limitations that were connected to risk tolerance at a total level:

Table 2. Targets for risk tolerance

	Target		Outco	ome	Difference	
	2012	2011	2012	2011	2012	2011
Return on equity (owner's return requirement) ¹⁾	7.4%	8.0%	7.3%	7.1%	-0.1%	-0.9%
Core Tier 1 capital ratio ²⁾	≥ 6.0%	≥ 6.0%	6.9%	6.7%	0.9%	0.7%
Tier 1 capital ratio ²⁾	≥ 7.0%	≥ 7.0%	9.1%	8.9%	2.1%	1.9%
Capital adequacy ration ²⁾	≥ 10.0%	≥ 10.0%	11.5%	10.7%	1.5%	0.7%
Period during which MCO ³⁾ is to cover liquidity reserve	≥ 30 days	≥ 30 days	83 days	60 days4)	53 days	30 days
Tolerance level for operational risk – total	20.0 SEK million	7.5 SEK million	0.4 SEK million	3.9 SEK million	19.6 SEK million	3.6 SEK million
Tolerance level for operational risk - individual incidents	5.0 SEK million	-	0.1 SEK million	-	4.9 SEK million	-

1) Yield on five-year Government bonds plus five percentage points after tax over a business cycle

2) Calculated in accordance with transitional rules

3) Maximum cumulative outflow

4) Adjusted to facilitate increased comparability since RMBS was not included in the calculation of the liquidity reserve in 2012

In December 2012, SBAB's Board of Directors resolved on the new risk-tolerance targets that are to apply in 2013. These are based on the three main categories of financial solvency, liquidity risk and compliance. The category, financial solvency, encompasses the risks for which SBAB must retain capital, while liquidity risk encompasses the risks impacting SBAB's prerequisites for successful financing and cash management. Compliance, the third main category, encompasses the regulations and ethical standards with which SBAB must comply to be able to pursue its operations. Each category is divided into subgroups with specific objectives for which the outcome is followed up on and reported.

3.3 The three lines of defence

To define the division of responsibilities between the operations, Risk Control and Compliance, as well as the Internal Audit, SBAB applies the division of roles and responsibilities resulting from the principle of the three lines of defence:

- The first line of defence pertains to all risk management activities performed by line management and line staff. The operations exposed to the risk also own the risk, which entails that the daily management of risks is to occur as part of the operations.
- The second line of defence pertains to the Risk Control and Compliance functions. These functions establish the principles and framework for risk management. Risk Control is to ensure that risk awareness and acceptance are sufficient to be able to manage risks on a daily basis. Risk Control is also to have a supportive role and is to work to ensure that the operations have the procedures, systems and tools required for maintaining day-to-day management of risks and that enable the operations to thereby comply with applicable laws and regulations in the sphere of responsibility of risk control. Compliance

Figure 4. The three lines of defence



The three lines of defence

is to ensure that the operations comply with laws and regulations while supporting the operations in its sphere of responsibility.

• The third line of defence pertains to the Internal Audit, which regularly performs independent checks of the management of and systems for internal controls.

3.4 Risk organisation

The Board of Directors has ultimate responsibility for assessing and monitoring the risks arising in the operations and for deciding on the risk policies, capital policy and risk tolerance, as well as instructions for managing and measuring risk in the following areas:

- Credit instructions for lending The instructions are established by the Board of Directors, which thereby regulates the authority to make credit and limit decisions at various levels in SBAB. Loans and credit limits exceeding SEK 250 million are to be decided by the Board of Directors' Credit Committee.
- Finance directive for funding operations The Board of Directors determines the limits for the management of financial risks. The Board of Directors has delegated responsibility for certain issues to SBAB's Risk and Capital Committee (formerly the Finance Committee).

The newly formed Risk and Capital Committee is the Board of Directors' body for preparing issues for resolution by the Board of Directors in respect of SBAB's funding operations, risks and capital. The committee comprises three Board Members and the CEO. (For more information regarding the Board of Directors' committee, see the Corporate Governance Report in SBAB's Annual Report.)

ALCO, the Asset and Liability Committee, was reorganised in 2012. The Committee handles matters relating to risk and capital planning, which are to be addressed by Executive Management. The CFO is the Chairman of the ALCO. Other committee members include senior executives from the Credit and Risk Department, and the Finance and Treasury department.

The CRO is responsible for SBAB's for assessment and monitoring risk. Risk Control is SBAB's central body for ongoing risk management. The Head of Risk Control is appointed by the CEO and is organisationally subordinate to the CRO.

Risk Control's responsibilities' include:

- Overall responsibility for developing risk-taking strategies and for ensuring that SBAB's strategies for assuming risk are implemented in accordance with the Board of Directors' intention, and that policies and processes facilitate relevant follow-up.
- Identifying, measuring, analysing and reporting risk exposure to the Board of Directors and CEO.
- Providing the Board of Directors and the CEO with a tangible and comprehensive overview of all risks in the institution.
- Participating in the production of the institution's risk

strategy and in all material risk management decisions.

- Having sufficient authority to influence strategic risk management decisions and being able to contact the Board of Directors directly.
- The design, implementation, reliability and follow-up of SBAB's risk classification system and for the economic capital model.

Risk Control monitors current risk levels on a daily basis and ensures that limits in financial operations are not exceeded.

Special function managers have been appointed for managing operational risk and new-product approval processes. Although the financial reporting risk is basically an operational risk, it is assessed and measured in a special process when the risk can be attributed to financial statements.

The Chief Security officer Is responible for managing the sececurity policies and for maintaining a coordinated cecurity plan. These functions are organisationally subordinate to the CRO and report the outcome of analyses to the CEO via the risk reports compiled by Risk Control.

A monthly report on the overall risk scenario, capital adequacy ratios and the economic capital trend is presented by Risk Control to the Board of Directors, the CEO and Executive Management. The Board of Directors and the CEO are also provided with a more in-depth description of risks on a quarterly basis. In addition, a daily report from the Market and Liquidity Risk Team on current risk levels in relation to granted limits is presented to the CEO, CFO and CRO.

SBAB's Board and management are thereby provided with a relevant overview of the Group's risk exposure on a continuous basis. Risk Control's work and reporting also provide a foundation for the Group's strategic planning and form the basis for determining SBAB's capital goals.



During 2012, Anti-money Laundering, "AML", was transferred to the compliance function.

4. Capital adequacy

In the wake of the latest financial crisis and the current debt crisis, in addition to concerns over the impact of new, forthcoming crises, more stringent capital requirements and greater demands are being imposed on what is to qualify for inclusion as Tier 1 capital contributions. 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.

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 made by the owner, the Board of Directors 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 regulations that will probably apply until Basel III is introduced. Taking into account the transitional regulations, SBAB's capital quotient at 31 December 2012 was 1.44 and the core Tier 1 capital ratio was 6.9%.



Figure 6. Capital and capital requirements according to Pillar 1 and without transitional rules, and in accordance with Pillar 2

4.2 Capital base

SBAB's capital base comprises equity, Tier 1 capital contributions and subordinated debentures. SBAB's capital base amounted to SEK 15,526 million at 31 December 2012. The figures do not include a dividend to shareholders, which is in line with the Board of Directors' proposal for the appropriation of profits. Earnings for the period are included in the calculation of the capital base and Tier 1 capital.

When calculating Tier 1 capital, subordinated loans may 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 1, 2 and 4 in table 3), 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 2012, a new time-limited subordinated debenture was issued in two tranches totalling SEK 1 billion.

Table 3. Debenture loans

(Million)

			Outstanding	First possi-		Interest rate after		
	Cur-	Nominal	nominal	ble date for	Interest rate,	first possible date		Recognised in
Loan designation	rency	amount	amount	redemption	31 Dec 2012	for redemption	Due date	capital base
JPY 1	JPY	10,000	10,000	-	5.23%	5.23%	16 Nov 2015	300
Debenture SEK 1	SEK	700	700	30 Jun 2016	5.22%	3 m stibor+1.93%	Perpetual	694
Debenture SEK 2	SEK	300	300	30 Jun 2016	3m stibor + 0.93%	3 m stibor+1.93%	Perpetual	300
Debenture SEK 3	SEK	1,000	1,000	25 Apr 2013	7.32%	3 m stibor+4.10%	25 Apr 2018	1,000
Debenture SEK 4	SEK	2,000	2,000	8 Jun 2015	7.16%	3 m stibor+4.50%	Perpetual	2,000
Debenture SEK 5	SEK	1,000	1,000	20 Apr 2016	6.12%	3 m stibor+2.40%	20 Apr 2021	1,000
Debenture SEK 6	SEK	800	800	16 Nov 2017	3 m stibor+2.65%	3 m stibor+2.65%	16 Nov 2022	800
Debenture SEK 7	SEK	200	200	16 Nov 2017	4.18%	3 m stibor+2.65%	16 Nov 2022	200

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 are to be excluded so as not to impact the size of the capital base. Adjustments of SEK 37 million have been made as of 31 December 2012. 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) must 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 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 (refer to Note 32 in SBAB Bank's 2012 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 was SEK 44.3 million for FriSpar Bolån AB (referred to as FriSpar below) and SEK 47.0 million for SCBC.

Table 4. Capital base		
SEK million	2012	2011
Core Tier 1 capital		
Equity	8,761	8,384
Unrealised changes in value of loan receivables and accounts receivable that were previously classified as available-for-sale assets	37	51
Non-controlling interest	731	706
Intangible fixed assets	-122	-38
Deferred tax assets	-36	-
Half of difference between provisions and anticipated loss for exposures recognised in accordance with IRB	-69	-128
Core Tier 1 capital	9,302	8,975
Tier 1 capital contribution		
Tier 1 capital contribution without redemption incentives*	2,000	2,000
Tier 1 capital contribution with redemption incentives*	994	994
Tier 1 capital	12,296	11,969
Tier 2 capital		
Perpetual subordinated debentures	-	-
Time-limited subordinated debentures	3,300	2,456
Half of difference between provisions and anticipated loss for exposures recognised in accordance with IRB	-70	-129
Tier 2 capital	3,230	2,327
Expanded part of capital base	-	-
Deduction from entire capital base	-	=
Capital base net after deductible items and limit value	15,526	14,296

* Encompassed by the transitional rules to FFFS 2007:1

4.3 Capital requirements

When calculating capital requirements, each exposure is allocated to an exposure class, either using the standardised approach or the IRB approach. Table 5 shows the individual exposure amounts distributed by exposure class.

Table 5. Capital requirements and risk-weighted assets

	2012		2011	
	Capital		Capital	
2012 2013 Capital million Capital requirements Capital requirements if it risk recognised in accordance with IRB approach borate exposures 2,173 27,160 2,491 il exposures 908 11,355 894 1000 ions in securitisation 423 5,292 229 I exposure recognised in accordance with IRB approach bost is securitisation 3,504 43,807 3,614 stir risk recognised in accordance with standardised approach bost is governments and central banks 0 0 0 stures to governments and central banks 0 0 0 0 utional exposures 387 4,837 514 orate exposures 169 2,117 142 il exposures 76 946 48 rigulated items 1 7 1 usures to funds 12 150 - ritems 9 112 8 I exposure in accordance with standardised approach 654 8 169 713 s in the commercial portfolio <	RWA			
Credit risk recognised in accordance with IRB approach				
Corporate exposures	2,173	27,160	2,491	31,143
Retail exposures	908	11,355	894	11,172
Positions in securitisation	423	5,292	229	2,860
Total exposure recognised in accordance with IRB approach	3,504	43,807	3,614	45,175
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	387	4,837	514	6,422
Corporate exposures	169	2,117	142	1,781
Retail exposures	76	946	48	602
Unregulated items	1	7	1	9
Exposures to funds	12	150	-	-
Other items	9	112	8	102
Total exposure in accordance with standardised approach	654	8 169	713	8,916
Risks in the commercial portfolio	162	2,026	239	2,981
Operational risk	211	2,636	217	2,713
Currency risk	-	-	-	-
Commodities risk	-	-	-	-
Total minimum capital requirements and RWA	4,531	56,638	4,783	59,785
Addition according to transitional rules	6,279	78,486	5,930	74,125
Total capital requirements and RWA according to transitional rules	10,810	135,124	10,713	133,910

Table 6. Capital adequacy

	SBAB Group		Parent C	Parent Company		FriSpar		SCBC	
SEK million	2012	2011	2012	2011	2012	2011	2012	2011	
Core Tier 1 capital	9,302	8,975	7,920	7,432	1,489	1,428	10,724	10,813	
Tier 1 capital	12,296	11,969	10,914	10,426	1,489	1,428	10,724	10,813	
Total capital	15,526	14,296	14,179	12,819	1,489	1,428	10,724	10,813	
Without transitional rules									
Risk-weighted assets	56,638	59,786	26,688	25,159	260	910	31,903	34,654	
Core Tier 1 capital ratio	16.4%	15.0%	29.7%	29.5%	573.8%	157.0%	33.6%	31.2%	
Tier 1 capital ratio	21.7%	20.0%	40.9%	41.4%	573.8%	157.0%	33.6%	31.2%	
Capital adequacy ratio	27.4%	23.9%	53.1%	51.0%	573.8%	157.0%	33.6%	31.2%	
Capital quotient	3.43	2.99	6.64	6.37	71.72	19.62	4.2	3.9	
With transitional rules									
Risk-weighted assets	135,124	133,917	30,719	27,948	710	4,676	103,714	101,241	
Core Tier 1 capital ratio	6.9%	6.7%	25.8%	26.6%	209.7%	30.5%	10.3%	10.7%	
Tier 1 capital ratio	9.1%	8.9%	35.5%	37.3%	209.7%	30.5%	10.3%	10.7%	
Capital adequacy ratio	11.5%	10.7%	46.2%	45.9%	209.7%	30.5%	10.3%	10.7%	
Capital quotient	1.44	1.33	5.77	5.73	26.21	3.82	1.29	1.34	

4.4 Securitised assets

SBAB holds securitised assets in the liquidity portfolio in the form of residential mortgage-backed securities (RMBS). These RMBSs in which SBAB has invested are recognised under the heading "securitisation positions" in respect of capital adequacy and as "loans and receivables" in the financial statements. The purpose of the securitised assets was that they would be included in the bank's liquidity reserve and thus secure the bank's liquidity requirements by being used as collateral in repo transactions in the market or with the Riksbank.

However, since the liquidity value of the securitised assets has declined drastically since they were acquired, they are no longer included in internal liquidity measurements or in other assessments of the suitable magnitude of the liquidity reserve. Capital requirements are calculated according to the external ratings-based approach, whereby the worst current rating from Moody's or Standard & Poor's has been used to calculate the risk weight.

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. No new purchases are planned. Since an RMBS transaction only had a rating from Standard & Poor's and this was rescinded because Standard & Poor's did not receive sufficient information of satisfactory quality in respect of the loans granted from one of the four banks behind the RMBS transaction, SBAB lacked a credit rating for this transaction. Accordingly, it was decided to sell this asset, thus resulting in a loss of SEK 20 million. No additional sales are currently planned.

Table 7. Positions in securitisation, distributed by country, rating and risk weight¹⁾

SEK million	AAA	AA	Α	BBB	BB	В	
Country	7%	8%	10%-20%	35%-100%	250%-650%	1,250%	Total exposure
Australia	427						427
Spain		35	1,002	894	310	274	2,515
United Kingdom			949				949
The Netherlands	928						928
Total	1,355	35	1,952	894	310	274	4,819

1) The worst rating in accordance with Standard & Poor's rating scale (Moody's rating was translated into Standard & Poor's)

4.5 Capital requirements according to Basel III

The changes that are being discussed in the forthcoming 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. In addition to the forthcoming Basel III regulations, Swedish authorities have proposed a national risk-weight floor of 15% in Pillar 2 for residential mortgages to Swedish retail customers. Increased capital requirements are proposed for banks regarded as key to the system. In Sweden, the supplement is to initially be 3% and thereafter 5%. The key system banks are the four largest banks: Handelsbanken, Nordea, SEB and Swedbank. The requirement for additional capital could eventually encompass more banks.

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 of Directors 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 (ICAAP).

5.1 Internal capital assessment, 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 SBAB, 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.

Pillar 2 of the Basel II regulations imposes the requirement that the banks' management and assessment of risks must be satisfactory to ensure that the banks can fulfil their obligations. In order to fulfil this requirement, the banks must have methods that enable them to continuously evaluate and uphold capital in an amount, type and distribution that is sufficient to cover the risks to which they are or will become exposed. This is called the internal capital adequacy assessment process (ICAAP).

SBAB's assessment of the capital requirement in accordance with Pillar 2 is based on economic capital. 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. The capital requirement for any type of risk may not be less than the capital ratio stipulated in 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. Economic capital is also an important component in 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

As part of SBAB's process for establishing internally calculated capital requirements, the risks generated in the operations are identified initially. Risk Control 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 the quantifiable risks. The results are reviewed and analysed. SBAB uses stress tests to assess the possible impact of the recession on the capital requirement.

In addition to economic capital, capital buffers are reserved for capital requirements caused by profit volatility, non-quantifiable risks and extraordinary events. The internal capital requirement is calculated on the basis of economic capital, buffers for stress tests and scenario analyses, as well as profit volatility and non-quantifiable risks. 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 Board of Directors and the CEO. Finally, the Board of Directors adopts the process and results of the company's internal capital assessment.

Figure 7. Process for intern	nal capital evaluation				
1. Quantification of risks	2. Quantification and assessment of other risks (capital buffers)	3. Assessment of combined internal capital requirements	4. Capital base (compared with capital policy and plan)	5. Operational governance Allocation of capital	6. Reporting
 Credit risk Concentration risk Market risk Operational Risk Business risk 	 Stress test Profit volatility Other risks and extraordinary events 	 Comparison of economic capital and minimum capital requirements in accordance with Pillar 1 Aggregation of capital require- ments for the various risks 	 Total equity Tier 1 capital contribution Tier 2 capital 	 Risk-adjusted profitability Segment analysis and capital costs Return on allocated capital 	 Fulfilment of cap targets and com- bined internal co tal requirements Internal reporting (monthly CEO newsletter) External reporting (Swedish Financi Supervisory Auth ity and quarterly interim reports, Pillar 3 annually)

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 Standardised & Poor's ratings scale). When 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 a Value at Risk (VaR) model. 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.

5.3.1 Concentration risk

Concentration risk arises when exposures are concentrated to certain types of borrowers, regions or industries. SBAB Bank is considered to be exposed to credit-risk related concentration risk in its lending and finance operations. The entire capital requirement for concentration risk is included in the 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 single-name concentration, industry concentration and geographic concentration. Upon calculation at 31 December 2012, the internally calculated capital requirement for concentration risk amounted to SEK 575 million, of which SEK 504 million pertained to credit risk in the lending operations and SEK 71 million to credit risk in the funding operations. Concentration risk related to finance operations increased SEK 15 million while concentration risk related to lending operations declined SEK 318 million compared with the preceding year-end. The decrease was due to SBAB currently measuring concentration as a part of the total lending portfolio, in contrast to the past when it was measured as a part of the portfolio of corporate exposures.

5.4 Stress tests

Capital planning is founded on a basic scenario that reflects the most probable operational development in accordance with internal forecasts. Complementing this, stress tests and scenario analyses are performed, whereby the development of the loan portfolio and capital requirements during a serious economic downturn is evaluated. When performing the tests, events and economic conditions that could give rise to an unfavourable impact on the institution's loan-portfolio exposures and that are not reflected in the anticipated scenario are also taken into account.

5.4.1 Stress test method

SBAB uses a number of statistical models to forecast credit risk. The common factor for the models is that they are built around one or more explanatory variables that are specifically adapted to the kind of exposure and risk dimension (PD or LGD) for which the model is intended to be used. A change in one or more of these explanatory variables results in a change in the forecast credit risk. This in turn affects the risk class to which an exposure is allocated. In the stress tests, this relationship is utilised by simulating changes in the underlying model variables. The starting point for this simulation is an assumed macroeconomic scenario. In the stress test, a scenario that expresses an unfavourable economic trend will result in a migration towards worse risk classes, which in turn entails higher economic capital and larger anticipated losses. A scenario that reflects an economic recovery will consequently result in the opposite effect. A simplified illustration of the process is provided below.

The stress test is conducted for the portfolio at that specific time. Then, this portfolio is subjected to stress

over a three-year time horizon. The macroeconomic scenario that forms the basis of the stress test is also assumed to have a direct effect in SBAB's risk models and on the composition of the population. This means that the model variables are expected to change without any time shift.

The components included in SBAB's model for stress tests comprise:

- Determination of a macroeconomic scenario for the stress test
- Translation of the macroeconomic scenario to the model variables
- Assumptions regarding new lending and loan redemption
- Calculation of expected losses and economic capital In the current internal capital evaluation process, the portfolio's total volume is assumed to remain constant over the three years included in the stress test, which means that no assumption is made regarding new sales or loan redemption. This appears intuitively reasonable given the stressed scenario that is applied. Historically, SBAB has applied the model based on various scenarios and with various assumptions, primarily depending on the purpose of the analysis.

5.4.2 Macroeconomic scenario

The stress tests can be used in a number of conceivable approaches and methods. In general, these involve an assumption regarding a future scenario, either hypothetical or based on historical outcome. The stress tests presented in the current internal capital evaluation process are based on a hypothetical scenario whereby the development of the parameters is based on a subjective interpretation of economic theory and empirical analysis. The scenario describes a sharp economic decline.

Figure 8. Schematic process for the calculation of economic capital in stress testing Macroeconomicscenario
Explanatory
Risk forecast (PD & LGD)
Risk class
Economic capital

Scenario

Interest rates rise when financial concern in the surrounding world spreads to Sweden, thus leading to rises in both government bond rates and risk premiums. A declining GDP and rising interest rates have negative implications on housing and property markets. This scenario typically occurs every 20-25 years. The Swedish recovery ends abruptly at the end of 2012. Declining demand in key export countries leads to a drop in exports while uncertainty and wariness among both households and companies dampen domestic demand. GDP declines by a total of nearly 6% (in 2008-2009, it was 7.5%) until the end of 2013. Sweden is infected by the European financial unrest and loses a part of its status as a safe haven. In conjunction with this, both government bond rates and risk premiums rise despite a reduction of the key interest rate by the Riksbank. Prices of single-family homes drop by around 15% in the second half of 2012 and in 2013 before stabilising. Prices of tenant-owners' rights and property also drop. In 2014, the unease lessens, the economy recovers, interest rates drop somewhat and the property market turns upward.

Table 8. The following parameters are subjected to stress in the current and next three years

Demand	Prices	Interest rates		
GDP growth (real)	Consumer prices	Residential mortgages, 3 month		
Disposable household income (nominal)	Single-family home prices	STIBOR, 3 month		
Employment	Prices of tenant owners' rights	Government bond rate, 10 year		
Unemployment	Residential property prices	STIBOR-Treasury discount not		
		Housing bonds- Government bonds, 5 year		
		Government bonds Sweden-Germany, 10 year		

For a number of variables in the models, there is a natural connection between the value the variable is expected to take on and the development of one or more of the macroeconomic parameters. In these cases, the variable value could consequently be recalculated directly based on the change in the underlying macro-parameters.

In general, all model variables are expected to be affected to some extent, except the variables that are not deemed to be correlated to economic conditions.

Since a macroeconomic scenario cannot be directly translated to the effect that it has on certain PD variables, historical correlations are used instead. Examples of such model variables are the number of reminders and claims. For these variables, the effect has instead been estimated based on the historical correlation in relation to the interest rate.

LGD is subjected to stress according to the same methodology as PD. Since SBAB's LGD models are built around the loan-to-value ratio, changes in the market value of property have a direct impact on LGD.

5.4.3 Expected loss and economic capital

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 996 million and expected losses by SEK 41 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.

Based on the results of the stress tests, a buffer of SEK 996 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 remaining 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.





5.5 Capital requirement due to profit volatility

Due to the structure of the accounting regulations, whereby different parts of the balance sheet are measured differently, valuation effects arise that affect operating profit and thereby the capital base without constituting a real market risk. This primarily affects basis swap spreads and mortgage and government bond spreads in SBAB's liquidity portfolio, which largely comprises SBAB's liquidity reserve.

According to IFRS, the assets in the liquidity portfolio are measured at market value (excluding RMBSs, which are classified as loans and accounts receivable). The interest-rate swaps connected to these assets are also measured at market value. However, the funding that finances these assets is not to be measured at market value. Basis swaps are also measured at fair value while the loans to which the basis swaps are linked are not fully measured at market value. This means that the basis risk on the basis swaps and the credit spread on the assets lack counter-items in profit and loss. This has the effect that operating profit, and thereby the capital base, varies in a manner that does match the actual risk to which the portfolio is exposed. To simulate how much this can conceivably affect the capital base, a simplified value at risk (VaR) model has been used. The model is based on a holding period of one year and a confidence level of 99.97%.

The capital adequacy requirement is estimated at SEK 2,465 million for basis swap spreads, SEK 372 million for mortgage spreads and SEK 513 million for government spreads. By estimating general correlations based on weighted curves for prices for the respective types of exposure, the capital adequacy requirement has been calculated at SEK 2,080 million.

5.6 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 reserved an amount corresponding to 10% of economic capital or SEK 560 million to offset these risks.

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

Risk type	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	5,070		996			6,066
of which, concentration risk	575					575
Market risk	156	5	,			161
Business risk	129					129
Operational risk	243					243
Other risks				2,080	560	2,640
Total	5,598	5	996	2,080	560	9,239

6. Risk in remuneration systems

SBAB is to have a remuneration system that is both compatible with and promotes effective risk management and does not encourage undue risk-taking. Remuneration is to promote SBAB's long-term interests. Further information on remuneration systems is available in SBAB's annual report and on the website sbab.se.

6.1 Risk in remuneration systems

The Annual General Meeting decides on the overall principles for remuneration and other employment benefits for senior executives (the managers who members of SBAB's executive management).

The Board of Directors decides on:

- Remuneration policy, remuneration instructions and risk analysis pertaining to remuneration systems and control documents on remuneration matters.
- Remuneration and other employment benefits for executive management (the Heads of Internal Audit, Risk Control and Compliance).
- Measures to follow up the application of SBAB's control documents regarding remuneration issues.

The Board of Directors has appointed a Remuneration Committee comprising three Board members appointed by the Board of Directors. The Remuneration Committee prepares matters regarding remuneration that are to be decided on by the Board of Directors and makes an independent assessment of SBAB's control documents regarding remuneration issues and remuneration systems. The Board of Directors must ensure that appropriate control functions in SBAB participate in the independent assessment. The Board of Directors decides on the mission description for the Remuneration Committee. The meetings of the Remuneration Committee are reported back to the Board of Directors through the minutes prepared from the Remuneration Committee's meetings. The Board of Directors is to annually evaluate and follow up how SBAB has complied with the principles for the remuneration of senior executives that have been decided on by the Annual General Meeting and the remuneration structures and remuneration levels in SBAB.

SBAB currently has no variable remuneration. However, in the period 2009-2011, employees had the opportunity to receive variable remuneration. Since the incentive programmes of those years, funds have been withheld concerning specially regulated personnel (as per FFFS 2011:1). Deferred remuneration from 2009 will be paid no earlier than 2013 and the corresponding for 2010 no earlier than 2014. Since the 2011 incentive programme did not provide an outcome, there are no deferred incentive payments for 2011.

For variable remuneration whose payment has been deferred, SBAB may decide that this be forfeited in part or in full if it subsequently turns out that the employee, profit centre or SBAB did not meet the earnings criteria or if the Board of Directors decides that variable remuneration is not to be paid for another reason. SBAB's financial situation is to be taken into account for decisions regarding payment of variable remuneration.

6.2 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). In 2012, the CEO and SBAB's were subject to a mutual period of notice of six months. With respect to severance pay, the agreement stipulates that if the company gives notice terminating the agreement and the CEO leaves his/her position, the company – is to in addition to salary during the period of notice – pay severance pay corresponding to 18 monthly salaries subject to deduction of new salary.

The company pays a defined-contribution pension insurance corresponding to 30% of the CEO's pension-based salary, but not after the age of 65. An agreement has been entered into with the Head of the Corporate Business Area concerning a defined-contribution plan corresponding to 25% of pensionable salary. An agreement has been entered into with the CFO, CRO, Head of Communications and Head of Compliance concerning a defined-contribution plan 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. Deductions will be made from the remuneration should new employment or income from another activity be received during the two-year period.

The accumulated total amount plus the total expensed amount for severance pay and guaranteed variable remuneration pledged during the year was SEK 2.0 million (0.9). Disbursed severance pay during the year amounted to SEK 2.5 million (3.1). This was attributable to a few individual agreements and the number of people affected is not stated here to avoid disclosing the financial situation of individual employees.

7. Credit risk in the 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 92% of the risk-weighted assets according to Pillar 1 (without taking transitional regulations into account). Credit risk is defined as the risk of loss due to the customer or counterparty's inability to pay interest and make loan repayments 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 arising when granting new loans is first monitored by the business area, then by the credit department. Credit risk is then monitored through portfolio management by Risk Control, which is also responsible for analysing credit risk. Each business operation 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 first lien 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 also grants small unsecured loans to borrowers in the retail 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 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 77% of SBAB's total assets. Figures 10 and 11 describe loan to value (LTV) for loans for which collateral consists of mortgage deeds on a unit in a tenant-owner association. Figure 10 shows retail exposures¹⁾ and Figure 11 shows corporate exposures. The figures cover 97% of total lending to the public. Since 76% of lending has collateral in mortgage deeds or in units in tenant-owner association, within 50% of LTV and 95% within 75% of LTV, while 93% of borrowers are categorised in risk classes 1-4, the credit quality is viewed as being very favourable.

1) The term "retail exposures" refers to loans to private individuals for financing single-family dwellings, holiday homes and tenant-owner rights insofar as it does not involve rental operations. The term "exposures to corporates" refers to loans to legal entities and private individuals pertaining to multi-family dwellings or loans for the rental of residential properties.

Figure 10 and 11. Loan to value (LTV) för privatmarknad och företagsmarknad

Segment	Under 50% LTV	Under 75% LTV	Under 100% LTV	Exposure weighted average LTV
Corporate	81%	99%	100%	59%
Retail	73%	93%	99%	69%
Total	76%	95%	99%	65%
Corporate	Retail			
Lending volumes	Lending v	volumes		
0 10 20 30 40 50 60 70 80 90 100 110 120	130 140>150 0 1	0 20 30 40 50 6	50 70 80 90 100 7	110 120 130 140 >150

The information that follows in this chapter dates from 31 December 2012, but differs in the following respects from the information presented in the 2012 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 97% 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 default²⁾, 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 Risk Control and, whenever required, they are recalibrated. All deviations from the quantitatively calculated risk class are analysed.

For those customer segments within corporate exposures for which current financial statements are available, the quantitative assessment process is supplemented with a systematic qualitative assessment in accordance with SBAB's rules and regulations, based on a number of questions (see Figure 12). For other customer segments involving corporate lending, 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.

2) An exposure is regarded as in default if the receivable is more than 60 days past due (for receivables exceeding SEK 1,000) or if the assessment has been made that the customer will probably not be able to pay agreed interest amounts or cover repayments of the principal.





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 exposures, the advanced IRB approach, 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 a unit in tenant-owner associations has been received, the standardised approach is applied. The portion of loans for which a municipality or the Swedish National Housing Credit Guarantee Board (currently a part of the Swedish Board of Housing Building and Planning) has issued a guarantee is referred to central government and municipal exposures and is recognised in accordance with the standardised approach. Table 5, 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 from September 2001 and onwards. 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
	Private properties		
Corporate	Tenant-owner properties	Corporate exposure	Corporate
	Commercial properties		
Consumers	Single-family dwellings and holiday homes	Retail exposure	Retail
	Tenant-owner rights		

For off-balance sheet retail exposures, SBAB uses inhouse 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 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 CFF classes.

- The internal ratings-based approach (IRB approach) is used to calculate risk-weighted exposure for credit risk if security is obtained in the form of real property or share in tenant-owner associations.
- The total exposure amount to the Swedish Government, the Swedish Central Bank, Swedish municipalities, institutional exposures and portfolios of insignificant size are calculated using the standardised approach for credit risks.

In 2012, SBAB applied for permission to manage tenant-owner associations with sales of less than EUR 50 million and 100% collateral in residential property in the retail exposure class, for which SBAB has an IRB permit. In February 2013, permission was obtained to change the definition of retail exposures and to use the internal approach for calculating LGD for exposure to tenant-owner associations.

7.4 Exposure amounts by exposure class

In contrast to other tables in this section, Table 11 shows all credit-risk exposures both in and outside the lending portfolio. Without taking credit risk protection into account, the total amount for all credit risk exposures was SEK 323,897 million.

Credit risk protection used for IRB exposures consist of government and municipal guarantees. Loans backed by collateral in the form of a unit in a tenant-owner association or mortgage deeds account for the entire amount for IRB exposures. Residential properties that constitute collateral are first valued at the lending occasion and subsequently at least every third year. Commercial properties are measured annually. Credit risk protection used for the standardised approach pertains to collateral in Swedish government paper.

Although SBAB has also obtained credit-loss guarantees of SEK 226 SEK million from business partners, these are not used when calculating capital adequacy ratios. In addition, the Parent Company and SCBC have jointly taken up credit insurance with Genworth Financial Mortgage Insurance Limited (Genworth), which is also not used when calculating capital adequacy. The credit insurance covers that part of the principal that exceeds 85% of the value of collateral pledged. The insured principal amounted to SEK 444 million at 31 December 2012. The insurance policy has been cancelled effective 1 January 2009 and cannot be utilised for new loans. However, the policy continues to apply as before for loans that were covered by the insurance from the start. Genworth has a rating of BBB- (Standard & Poor's).

Corporate exposures comprised only 32% of total exposures for which the IRB approach is used, but due to the higher average risk weighting, the exposures account for 71% 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 249,059 million, of which 64% comprised retail exposures. Loan promises and other credit-related commitments totalled SEK 36 784 million which, after the credit conversion factor was taken into account, amounted to SEK 5,619 million.

Risk-weighted assets for credit exposures amounted to SEK 51,976 million, of which SEK 43,807 million was recognised in accordance with the IRB approach and SEK 8,169 million according to the standardised approach. The average risk weighting for exposures recognised in accordance with the IRB approach was 16.8%, while the weighting for exposures recognised in accordance with the standardised approach was 27.2%. Average PD per counterparty for IRB exposures amounted to 0.75% for corporate exposures and 0.62% for retail exposures. LGD indicates how large the loss will be in the event of default. The exposure-weighted LGD for corporate exposures was 31.1% 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 retail 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

Total	323,897	5,500	39,427	291,092	6,628	256,210	256,575	51,976	4,158	17.9%				
Iotal credit risk in accordance with standardised approach	27,495	1,292	2,643	30,063	1,009	-	7,516	8,169	654	27.2%				
Other items	234	-	-	234	-	-	-	112	9	48.0%				
Unregulated items	150	-	-	150	-	-	-	150	12	100.0%				
Retail exposures	5	-	-	5	-	-	5	7	1	133.3%				
Corporate exposures	2,115	-	1,059	1,262	212	-	898	946	76	75.0%				
Institutional exposures	2,904	-	1,584	2,117	797	-	1,475	2,117	169	100.0%				
Exposures to municipalities and similar associations	19,927	1,292	-	18,635	-	-	-	4,837	387	26.0%				
Exposures to states and central banks	217	-	-	4,425	-	-	5,139	0	0	0.0%				
Credit risk recognised in ac- cordance with the standardised approach	1,943	-	-	3,235	-	-	-	0	0	0.0%				
Total credit risk in accordance														
Positions in securitisation	296,402	4,208	36,784	261,029	5,619	256,210	249,059	43,807	3,504	16.8%	262	400		
, Tenant-owner rights	4,819	-	-	4,819	-	-	, _	5,292	423	109.8%	-	-		
Single-family dwellings and holiday homes	82,620	-	20,906	64,462	2,748	64,462	59,701	4,521	361	7.0%	89	84	0.63%	10.4%
Of which,	115,464	306	14,867	102,152	1,860	102,152	98,867	6,834	547	6.7%	116	139	0.61%	10.0%
Retail exposures	198,084	306	35,773	166,614	4,608	166,614	158,568	11,355	908	6.8%	205	223	0.62%	10.0%
Corporate exposures	93,499	3,902	1,011	89,596	1,011	89,596	90,491	27,160	2,173	30.3%	57	177	0.75%	31.1%
Credit risk recognised in ac- cordance with IRB approach														
SEK million	Exposure	Securities that reduce capital require- ments in the form of guaran- tees and financial securities	Of which, off- balance sheet items before CCF	Exposure after CCF ¹⁾	Of which, off- balance sheet items after CCF	Exposure covered by credit-risk protection in the form of properties	Average value of exposures in lending portfolio ²	RWA	Capital require- ment	Average risk weight	Provision	Expected Loss	Average PD per counter- party	Exposure- weighted LGD

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.

When the term exposure is used in the section of this chapter that follows, it refers to exposure after outflows or inflows.

7.5 Exposure amounts by geographical region

The SBAB Group's portfolio is mainly secured by housing in the Stockholm area (49%) and the Öresund region (24%). Only 3% of the underlying collateral derives from economically weak regions (see Table 12). Sweden is divided as follows:

- Great Stockholm: Stockholm's labour market region according to Statistics Sweden (SCB) (2004).
- Greater Gothenburg: Gothenburg's labour market region according to SCB (2004).
- The Öresund region: Labour market regions in Malmö and Helsingborg according to SCB (2004).
- University and growth regions: Municipalities with universities and municipalities with especially buoyant growth according to analyses by SBAB3.
- Weak regions: Municipalities with very weak or negative growth according to analyses by SBAB³).
- Other regions: Municipalities that are not allocated to any other category.

3) The analysis is based in part on statistics from SCB, such as short and long-term population growth, the proportion of the population older than 64 years, average income and the vacancy rate in public utility housing, and in part on the local knowledge of SBAB's analysts.

Table 12. Geographical distribution of exposure amounts

	Greater	Greater	Öresund	University and	Weak	Other	
SEK million	Stockholm	Gothenburg	region	growth regions	regions	regions	Total
IRB exposures							
Corporate exposures	81,723	11,455	47,518	7,433	3,645	10,231	162,005
Retail exposures	41,710	11,418	13,957	8,722	2,482	10,296	88,585
Standardised exposures							
Corporate exposures	692	53	76	421	2	77	1,321
Retail exposures	667	94	125	64	35	72	1,057
Municipal exposures	1,389	216	339	217	852	1,412	4,425
Unregulated exposures	4	-	1	-	-	0	5
Total	126,185	23,236	62,016	16,857	7,016	22,088	257,398

7.6 Exposure amounts according to the next stipulated term of expiry¹⁾

A large proportion (53%) of the portfolio has less than one year left until the next stipulated term of expiry. The proportion with a remaining term of between one and five years accounts for 46% of the outstanding exposure (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				
Exposures to corporates	30,218	56,498	1,869	88,585
Retail exposures	101,456	58,769	1,780	162,005
Standardised exposures				
Exposures to corporates	887	430	3	1,320
Retail exposures	1,043	13	1	1,057
Municipal exposures	2,182	2,216	27	4,425
Past-due exposures	6	-	-	6
Totalt	135,792	117,926	3,680	257,398

¹⁾ The stipulated date of expiry is defined as the day for establishing the conditions that are to apply for loans during the forthcoming contractual period. The terms must be supported by the stipulations of the original loan agreement.

7.7 Exposure amounts by type of property

In the distribution of the lending portfolio by type of property, lending for single-family dwellings and holiday homes accounts for 39%, tenant-owner rights for 24% and tenant-owner associations for 22%. Lending to municipal and commercial properties accounts for only a smaller proportion (2% and 3%, respectively). Unsecured loans account for less than 1% of the total exposure amount (refer to Table 14).

Table 14. Exposure amounts distributed by type of property

SEK million	Single- family dwellings and holi- day homes	Tenant- owner rights	Tenant- owner associations	Private multi-family dwellings	Municipal multi-family dwellings	Commercial properties	Unsecured	Total
IRB exposures								
Corporate exposures	32	6	53,126	26,121	2,901	6,400	-	88,586
Retail exposures	100,291	61,714	-	-	-	-	-	162,005
Standardised exposures								
Corporate exposures	0	-	366	201	5	748	-	1,320
Retail exposures	133	167	-	-	-	-	756	1,056
Municipal exposures	306	-	1,915	279	1,901	24	-	4,425
Unregulated exposures	1	1	-	-	-	-	4	6
Total	100,763	61,888	55,407	26,601	4,807	7,172	760	257,398

7.8 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 5.0% of the total exposure amount for past due exposures (refer to Table 15).

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 indi- vidual provisions	Individual provisions	fotal exposure amount in the loan port- folio after individual provisions
Single-family dwellings and holiday homes	100,764	734	9	7	100,757
Tenant-owner rights	61,887	310	18	15	61,872
Tenant-owner associations	55,407	42	-	-	55,407
Private multi-family dwellings	26,601	19	42	34	26,567
Municipal multi-family dwellings	4,807	-	-	-	4,807
Commercial properties	7,172	1	-	-	7,172
Without collateral	760	7	-	-	760
Total	257,398	1,113	69	56	257,342

7.9 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 (0.05%) of individual provisions in relation to the total exposure amount.

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	Fotal exposure amount in the loan port- folio after individual provisions
Greater Stockholm	126,185	490	40	34	126,151
Greater Gothenburg	23,236	95	5	5	23,231
Öresund region	62,016	343	5	4	62,012
University and growth regions	16,858	46	1	1	16,857
Weak regions	7,015	45	2	2	7,013
Other regions	22,088	94	16	10	22,078
Total	257,398	1,113	69	56	257,342

7.10 Exposures per risk class in the PD dimension

The quality of the portfolio is favourable. A total of 97% of corporate exposures and 89% 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 13–16.

Figurer 13-16. Exposures per risk class in the PD-dimension



Figure 14. Retail exposures, according to IRB, per PD class



Figure 15. Retail exposures, according to IRB, against collateral in single-family dwellings and holiday homes per PD class



Figure 16. Retail exposures, according to IRB, against collateral in tenant-owner rights per PD class



7.11 Realised outcome in the PD and LGD dimensions

Table 17 shows the PD and LGD estimate as of 31 December 2011 and the outcome for 2012. The estimated outcome for the corporate exposures 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. 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 unit in tenant-owner associations, a mortgage in a residential property or the site leasehold on such a property.

Table 17. Realised outcome in the PD and LGD dimension

		Realised		
Exposure Class	PD estimate	outcome ¹⁾	LGD estimate	outcome ²⁾
Corporate exposures	1.0%	0.4%		
Retail exposures	0.7%	0.6%	10.7% ³⁾	3.3%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.

7.12 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 decreased for corporate loans, while increasing for both sub-groups in the case of retail exposures. The changes are mainly due to a decrease and an increase, respectively, in the loan portfolios. 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 amortisations and, in part, because the market value of pledged collateral was less than the value of SBAB's receivable.

Table 18. Comparison of expected loss between outcome and model, and individual provision¹⁾

SEK million	EL, IRB/IRB foundation 31 Dec 2011	EL, IRB/IRB foundation 31 Dec 2010	EL, IRB/IRB advanced 31 Dec 2011	EL, IRB/IRB advanced 31 Dec 2010	Realised outcome 2012	Realised outcome 2011	Individual provision 31 Dec 2012	Individual provision 31 Dec 2011
Exposure Class								
Corporate exposures	275	328	-	-	0	17	6	3
Retail exposures	-	-	229	189	33	14	21	49
Of which, single-family dwel- lings and holiday homes	-	-	133	105	23	6	7	49
Of which, tenant-owner rights	-	-	96	84	10	8	14	-
Total	275	328	229	189	33	31	27	52

1) Expected loss (EL) has been calculated for the loan receivables that existed at the end of 2010 and 2011, respectively. In Table 18, the expected loss is compared with the actual outcome for confirmed loan losses during the outcome years of 2011 and 2011, respectively.

8. Funding

The SBAB Group's operations are funded 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

Senior unsecured funding

SBAB has a regular programme for medium and longterm 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 can 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 rights 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 issuing covered bonds: a Swedish covered 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 three 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 match 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 paper," meaning that it does not have floating or fixed coupon rates, but is issued in an amount that is less than the nominal amount, and when it falls due, 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. 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 transactions 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 the Parent Company must be well balanced, taking into account the companies' ratings and total long-term funding cost.

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

Figure 17. Funding sources and distribution by currency for issued securities

Funding sources, securities issued by SBAB Bank Group Debt outstanding at 31 Dec 2012: SEK 254 billion



- Swedish covered mortgage bonds, SCBC, 36%
- EMTCN-programme SCBC, 28% EMTN-programme SBAB, 24%
- Issuance on the Japanese market, "Samurai bonds", 2%
- SVCP, 4%
- USCP. 4%
- ECP. 2%

Distribution by currency, securities issued by SBAB Bank Group Debt outstanding at 31 Dec 2012: SEK 254 billion



9. Credit risk in the treasury operations

In the treasury operations, credit risk arises, in part, in the form of counterparty credit 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 Credit Committee for all counterparties in treasury 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 credit risk is generally calculated on the basis of market value and observes the standard set in the Bank's agreements on netting of derivative contracts.

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 that are taken by the Credit Committee must be reported to the Parent Company's Board of Directors at the following Board meeting.

The 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 exempted from these rules; for such counterparties, the maximum limit can amount to the equivalent of 20% of the capital base. Current ratings for individual counterparties, as issued by Moody's or Standard & Poor's, constitute an additional restriction on the establishment of individual credit risk limits. The higher the counterparty's rating, the larger the exposure that may be permitted in relation to SBAB's capital base.

9.1 Counterparty credit risk

Counterparty credit risk is the risk that SBAB's financial counterparties cannot meet their commitments pursuant to the completed derivatives and repo contracts, 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, has in particular cases been supplemented with associated collateral agreements, known as Credit Support Annexes (CSAs). When SCBC enters into derivative agreements, it must always draft an associated CSA. The ISDA Master Agreement entails, inter alia, that netting is regulated in the event of bankruptcy. A CSA means that the parties have agreed in advance to transfer assets if the exposure exceeds a certain "threshold amount". The threshold amount and the minimum amount to be transferred 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 instrument transactions by various maturities and ratings, respectively.

To limit the counterparty credit risk associated with repo transactions, GMRAs (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 are to be conducted daily or weekly with each derivatives counterparty with whom a collateral agreement has been signed, and collateral is moved over to even out exposure. Wherever applicable, the posted and received collateral takes the form of cash under a transfer of title, which entitles the party that receives the collateral to use it in its operations. In the case of most collateral agreements concluded by the Parent Company and SCBC, 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 rating by three notches, as of 31 December 2012, would have resulted in the need for extra collateral of SEK 102.4 million.

9.2 Money market investments

SBAB has separate limits for money market 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 mainly consists of liquid interest-bearing securities with a high rating and its purpose is to reduce the company's liquidity risk. Holdings in securities are limited by asset class and by country, respectively, and must have the highest rating upon acquisition. Moreover, the securities holder is an integral part of the overall credit risk utilisation for each issuer/ counterparty.

In this context, holdings of covered bonds are assigned a weighting of 10%. The holdings in the portfolio are long term and at 31 December 2012 amounted to SEK 44.0 billion with an average duration of 3.6 years. At the same date, 93% of the portfolio's value had a rating of Aaa from Moody's or 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 mortgagebacked securities (RMBS).

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

Securities measured at fair value through profit or loss:

- Securities issued or guaranteed by central governments, SEK 12.5 billion
- Securities guaranteed by central governments, SEK 4.1 billion
- Securities issued by Supranational and Sovereign Agencies (SSAs), SEK 1.6 billion.
- Securities issued by public sector entities (PSEs), SEK 3.7 billion.
- European covered bonds, SEK 17.6 billion.

Loans and receivables:

Residential Mortgage-Backed Securities 4,4 mdkr.

Loans and receivables are stated above at their market 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 then ranked according to loan to value (LTV) and age (date originated) in three risk classes. Two 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 holdings 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 holdings 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 19. Derivative instruments

SEK million	Total nominal value	Positive market values	Negative market values
< 1 year, interest-rate related	198,525	6 ,059	-5,299
> 1 year, interest-rate related	472,297	14,605	-11,956
< 1 year, currency related	60,892	1,251	-1,771
> 1 year, currency related	113,327	3,649	-8,046
Total	845,041	25,564	-27,072

Table 20. Derivative instruments distributed by rating

		Positive	Negative
SEK million	Net market value	market values	market values
AA-	-434	5,709	-6,143
A+	569	4,923	-4,354
A	-224	2,743	-2,967
A-	399	3,666	-3,267
Total	311	17,042	-16,731
Collateral			-1,128
Nettings gains			10,189

Table 21. Net credit exposure for derivative instruments

SEK million	
Positive gross market value of contracts	17,042
– Nettings gains	-13,950
= Current offset credit exposure	3,092
- Collateral held	-1,289
= Net credit exposure to derivatives	1,803

10. Market risk

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

Interest-rate risk arises primarily when the interest-rate structure between funding and lending is not fully matched. Currency risk refers to the risk that changes in the SEK's exchange rate in relation to other currencies will result in deteriorating profitability. Basis swap risk is a term for the risk that arises when funding in a foreign currency is swapped for a different period to maturity than the period to maturity in the underlying lending.

10.1 Interest-rate risk

The main principle for SBAB's interest-rate risk management is to utilise direct funding and derivative instruments to limit interest-rate risk exposure.

Interest-rate risk is quantified, in part, through a parallel shift in the 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 Value at Risk, VaR. The calculation takes into account all contractual cash flows affecting lending, funding and derivatives. The parallel shift measure and the curve risk are used for limiting, while VaR is part of the model for economic capital.

The interest-rate risk limits established by the Board of Directors are divided into two categories – operational

and strategic. The risks are measured on a daily basis and add up to SBAB's total interest-rate risk exposure. 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 2012, operational interest-rate risk exposure was a negative SEK 39.8 million compared with the limit of \pm SEK 139 million set by the Board. The interest-rate risk for positions not included in the trading book totalled SEK 7.8 million.

Curve risk is quantified through a model in which the short end of the yield curve is varied upward



The interest-rate risk by period, in the event of a parallel shift in the yield curve by +1 percentage point amounted to SEK 18.0 million at 31 December 2012.





The interest-rate risk, by period, in the event of a parallel shift in the yield curve by +1 percentage point divided by assets, liabilities and the off-balance amount was SEK 18.0 million at 31 December 2012.

(downward) by 0.5 percentage points and the long downward (upward) by 0.5 percentage points. A large number of breakpoints 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 portfolio is limited to 1% of SBAB's capital base. At 31 December 2012, the curve risk corresponded to SEK 38.9 million, compared with the limit of SEK 139 million. 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 because the frequency of interest payments from lending and funding varies. 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 associated with equity is defined as the deviation from this benchmark. The flow is invested at an average maturity corresponding to the average maturity of the lending portfolio. The strategic interest-rate risk is limited to +/- SEK 20 million. On 31 December 2012, the strategic interest-rate risk corresponded to SEK 15.5 million.

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

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 portfolio 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 Treasury Department.

10.3 Currency risk

As the main rule, SBAB is not to be exposed to exchange-rate fluctuations. Funding in international currency is to 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 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 contracted liquid flows given a change in the exchange rate of \pm 10% per corresponding exchange rate. Currency exposure at 31 December 2012 was SEK 2.3 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%. There are no currency options in the portfolio.

10.4 Basis-swap risk

Basis-swap risk arises when lending in a foreign currency is swapped to SEK on a different period to maturity than the period 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. Basis swap risk comprises any 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 \pm 0.25 percentage points. The risk may not exceed SEK 50 million. The basis-swap risk at 31 December 2012 was SEK 523 thousand.

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

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 portfolio 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 instruction. Interest-rate risk in the trading book is included as part of the limit on operational interest-rate risk that has been delegated to the finance and treasury department. Credit risks in the form of issuer and counterparty risk in the trading book are governed by credit risk limits set by SBAB's Credit Committee.

Figure 19. 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



At 31 December 2012, the interest-rate risk, distributed by currencies, in the event of a parallel shift in the yield curve of +1 percentage point amounted to SEK 18.0 million.

11. Liquidity risk

Liquidity risk is defined as the risk that SBAB will not be able to meet its payment obligations in conjunction with due dates 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 debt management and the size, content and management of SBAB's liquidity reserves. SBAB has long understood the importance of well-functioning and proactive liquidity-risk management, which 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. Short-term, mid-term and long-term funding takes place on a global basis. Through SCBC, SBAB also has access to the covered bond market in Sweden and internationally.

Liquidity reserves

To ensure access to funds in times when the normal sources of funding do not function, SBAB has a liquidity portfolio. In calculating the provision value of the securities in the liquidity portfolio, SBAB applies the valuation deductions established 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 90% of the portfolio value.

At 31 December 2012, SBAB's reserves consisted of SEK 44.0 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 valuation deductions) and a temporary component used to even out major debt maturity. Moreover, unutilised capacity for the issuance of covered bonds constitutes a very liquid reserve.

SBAB's liquidity portfolios consist 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 in conjunction with acquisition. In addition to these group limits, limits have also been set for individual issuers.

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	December	Distribution by currency			
	2012	SEK	EUR	USD	Other
Securities issued or guaranteed by central government, central banks or multinational development banks	18,233	4,989	11,435	1,007	802
Securities issued or guaranteed by municipalities or PSEs	3,724	3,295	-	429	-
Covered bonds issued by others	17,617	12,538	4,745	334	0
Securities issued by finance companies (excl. covered bonds)	4,391	0	4,047	103	241
Total liquidity portfolio	43,965	20,822	20,227	1,873	1,043
Distribution by currency		48%	46%	4%	2%

SBAB's liquidity portfolio primarily comprises liquid, interest-bearing securities with a high rating and is an integrated part of the Group's liquidity risk management. Holdings in securities are limited by asset class and by country, respectively, and must have the highest rating upon acquisition. In addition to these collective

limits, limits for individual issuers may also be set. RMBS are recognised in the table above at market value, in accordance with the Swedish Bankers Association's template for the disclosure of a bank's liquidity reserve. These assets are excluded from the calculation of internal and regulatory liquidity measurements.

Continuous monitoring of 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 feature both of operations and strategic planning of liquidity risk, concentrations of excessively large funding maturities are avoided. Another important part of the ongoing liquidity risk management is the continuous monitoring and testing of the practical liquidity value of the liquidity portfolio in 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 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 assumed to be extended on maturity, meaning that no liquidity is added through loan redemption and that no funding is available. Accordingly, the maximum need for liquidity can be identified for every given future period, and the necessary liquidity reserve can be established.

11.2 New provisions 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 a more harmonised approach to liquidity risk at the 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 that the company maintains an adequate amount of unutilised cash and cash equivalents that, when necessary, can be converted to liquid 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.

As of 1 January 2013, SBAB becomes subject to FFFS 2012:6, the regulations formulated by the Swedish Financial Supervisory Authority, which constitute a Swedish version of LCR. The regulations stipulate that the institutions covered by them must, at every point in time, have an LCR amounting to at least 100%, both at the consolidated currency level and for EUR and USD isolated.

11.3 Stress tests for liquidity risk

SBAB has a model for stress testing liquidity aimed at internal requirements for analytical and contingency management of liquidity risk. The stress tests have been designed in line with the Swedish Financial Supervisory Authority's stipulations on liquidity management, which impose general requirements on stress tests (FFFS 2010:7). The developed models analyse SBAB's capacity to meet the need for capital 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 idiosyncratic and market-related stress. The scenarios are divided into various stages that capture an increased degree of stess in order to show how a crisis can continuously worsen.

The scenarios simulated by the stress tests include:

- The 2008/2009 financial crisis stress in the funding operations, with funding programmes closing at various 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 covered bonds.
- Stress of liquidity in the liquidity reserve.

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

11.4 Liquidity situation in 2012

During 2012, the definition of the liquidity reserve that is used in governing measurements was changed so that holdings of RMBSs are no longer included in the reserve. However, shorter-term investments of surplus liquidity that usually arises in connection with prefunding of major debt maturities are included. At 31 December 2012, the reserve corresponded to 83 days MCO, according to the new definition. During 2012, SBAB's liquidity reserve was never less than the equivalent of 45 days' future liquidity requirements.

11.5 Structural liquidity risk

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

SBAB has adopted a conservative approach to the management of funding. A larger share of future maturities is being pre-funded and the share of total funding attributable to short-term funding is being 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 constitute key elements of the practical management efforts aimed at reducing the risk. The structural liquidity risk is calculated as the total of maturing funding of 30 day periods, relative to the liquidity reserve.

12. 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.

The model for managing operational risks is based on self-evaluation of operational risks and risks associated with financial reporting as well as on monitoring and registering incident reporting. The self-evaluation process encompasses identification of risks in all units, measurement of identified risks and management of significant risks. The results of the self-evaluation are reported annually and any incidents that occur are reported on a monthly basis to the Board, the CEO and senior executives. For more details concerning the management of risks associated with the financial statements, refer to the Corporate Governance Report in SBAB's annual report, the section on Internal Control of Financial Reporting.

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 business area's average operating income 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 plans and continuity plans
- Method for allocating operating income among business areas

Capital requirements for operational risk are presented in Table 5, Capital requirements and risk-weighted assets.

13. 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 its profit level and with great probability 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 method based on the business areas' operating expenses.

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