Capital adequacy and risk management 2017-12

IKANO BANK

Capital adequacy and risk management

This information refers to Ikano Bank AB (publ) ("Ikano Bank" or the "Bank"), Corporate Identity Number 516406-0922. The document contains information regarding the Bank's capital adequacy and risk management and refers to such information required for the own funds and own funds requirements in accordance with chapter 8, paragraphs 1-7 in the Financial Supervisory Authority's regulations regarding regulatory requirements and capital buffers (2014:12).

Operations

Ikano Bank carries out banking activities subject to a license from the Swedish Financial Supervisory Authority in Sweden, Denmark, Norway, Finland, the UK, Germany, Austria and Poland. The foreign operations are branches of the Swedish operation, with the exception of the Austrian branch, which is conducted as a cross-border operation.

There are three business lines within the Bank: Corporate, Sales Finance and Consumer.

Corporate

Within the Corporate business line, financial solutions for corporate clients in the form of leasing agreements, object financing, invoice purchasing and factoring are offered. These operations are primarily conducted through partner arrangements. In many cases, repurchase agreements are made in the event of the end customer default and guaranteed residual value when the leasing agreement expires. The operations have been focused on a few types of objects for which there is good internal expertise of over-the-counter markets when no repurchase guarantees are available. This business line is represented in Sweden, Denmark, Norway and Finland.

Sales finance

In the business line Sales Finance services for financing and sales support, primarily to retail, are administered and marketed through partners. This business line is represented in all geographic markets. The services offered comprise consumer finance for sales support in the form of store cards and credit cards with Visa and MasterCard, loyalty cards, bonus management and information services for sales support.

The largest partner within Sales Finance is IKEA.

Consumer

The Consumer business line is aimed at private individuals and offers simple, beneficial products and services for savings and loans. The customers carry out part of the application work themselves on the internet or by telephone, which enables efficient and timely handling to offer customers competitive products.

Lending is offered as unsecured loans, mortgage loans and VISA credit cards. Mortgage loans are offered in cooperation with SBAB Bank AB (publ), which means that loans are intermediated to and provided by SBAB under the Bank's "Ikano Bolån" brand. Lending is provided as unsecured loans and card products in Sweden, Denmark, Norway and Germany. Unsecured loans are also offered on the British market. Deposits are offered in the Swedish, Danish, German and British markets and mortgage loan products are only offered in the Swedish market.

As previously communicated the cooperation between SBAB and Ikano Bank will end during 2018. SBAB has decided to prioritise sales under its own brand. This means that Ikano Bank will not continue to offer mortgages provided by SBAB to our customers after 31 August 2018.

Risks and risk management

The Bank is exposed to several risks such as credit risk, operational risk and business risk, but it also has to manage liquidity risk, foreign exchange risk and interest rate risk. Strategic risk and reputation risk are managed within business risk whereas conduct risk and compliance risk are managed within operational risk.

The risk management framework in the Bank aims to ensure that the risks from operating the business do not exceed the risk levels established by the Board. The framework includes limits, tolerance levels and indicators as set by the Board or Managing Director.

The Bank's Board receives quarterly capital adequacy reports, which if necessary can be supplemented with the on-going development of the Bank's risk levels. The Board of Directors concludes that risk management is carried out in a satisfactory manner in relation to the Bank's risk profile and strategy.

Organisation and responsibility

The Board of Directors and the Managing Director are ultimately responsible for risk management at Ikano Bank. To ensure sound risk management, the Board of Directors establishes policies relating to such matters as risk appetite and risk tolerance.

The Bank's organisation for risk management and risk control comprises of three lines of defence. The first line of defence is the business lines that manage the risks in the daily operations.

The second line of defence consists of two functions; the Risk Control function and the Compliance function. Risk Control is responsible for the risk management framework which consists of tools and processes for risk identification, risk quantification and risk reporting as well as the independent monitoring of risk levels in the Bank. Compliance is responsible for the monitoring of bank compliance with rules and regulations. Both second line functions have a regular independent reporting to the Board and Managing Director. These functions also provide advice and support to the business functions.

The third line of defence is the internal audit, which independently audits the first and second lines of defence. Internal audit reports directly to the Board of Directors.

Recovery Planning

Ikano Bank has drawn up a recovery plan and put in place processes around a regular updating of recovery indicators in accordance with the Bank Recovery and Resolution Directive, EBA guidelines and Swedish legislation. The recovery plan is a tool to identify options potentially available to counter extreme crisis scenarios and is an integral part of the Bank's risk and capital management framework.

Credit risk

Credit risk is the Bank's largest risk and is defined as the risk that the counterparty does not fulfil its obligations to the Bank. Credit risk arises in lending operations, the investment of the Bank's operating liquidity and the overnight investment as well as derivatives with positive market values.

The Bank has applied scoring models in the assessment of credit risk of consumers for many years. During the application process, the risk of default is calculated before a credit is granted. The result of the initial application gives a score on a scale reflecting the probability of default. The Bank's models for assessing the probability that customers will default are based on the Basel committee principles for advanced PD and LGD models (Probability of Default, Loss Given Default). The assessment is supplemented with information from credit bureaus before the credit is finally approved. If the risk exceeds the internally accepted maximum risk exposure the credit is denied. In addition to application scoring, Ikano Bank utilises various types of behavioural scoring models.

The Bank has worked with implementing IFRS 9 during the year. IFRS 9 will replace the current IAS 39 regulation by 1 of January 2018.

For more information regarding IFRS 9 see Annual Report 2017.

Leasing and factoring

Credit assessment of corporate credits is performed using internally developed PD models combined with information from external credit bureaus. Limits for larger engagements are decided in local country credit committees and the largest engagements are forwarded to the central credit committee. The established limits on partners and large engagements are monitored continuously during the year.

Counterparty risk

The credit risk that occurs in trading with financial instruments is called counterparty risk. This is the risk that the counterparty in a financial transaction may be unable to fulfil their payment obligations or deliver the securities in accordance with what has been agreed upon. Exposure per counterparty group is limited through limits and rating requirements.

Operational risk

Operational risk is the risk of direct or indirect loss resulting from inadequate or defective internal processes, procedures and systems, management errors or external events and factors. This definition includes legal risk, conduct risk and compliance risk but not strategic risk or reputational risk.

Ikano Bank, as an Internet bank, is strongly dependent on IT systems and telephony. Follow-up of incidents and improvements in accessibility are priority areas. The Bank has an incident reporting system where incidents are reported and monitored. Risks are analysed continuously and policies, guidelines and procedure descriptions are available to prevent and limit damages due to operational risks.

Risk Control coordinates the work with operational risk but the respective managers in each business operation are responsible for operational risk. Annual risk reviews are carried out by the management for the different operations, where the greatest risks are measured and managed in an action plan. New products, partners and IT systems undergo a risk assessment that includes operational risk. The goal is to ensure efficient processes and minimise operational risks so that the Bank's customers and other stakeholders are ensured that Ikano Bank has a high level of security and accessibility.

The Bank's risk appetite in regard to operational risks is defined based on three different criteria:

1. The Bank's contingency plan - Business Continuity Planning, shall be updated and tested,

2. All new products must go through the NPAC and

3. Areas where the Bank's Operational Risk Assessment has identified a potential risk that may result in costs exceeding SEK 2 m for the Bank. In this case, the action plan shall be set in motion and be completed within 12 months.

All criteria are to be followed up.

Market risk

Market risk is the risk of decreases in profits or market values due to adverse market fluctuations in interest rates and currencies. Market risk is managed by the Bank's Treasury function. The Bank does not trade on its own behalf or on behalf of clients with derivatives or financial instruments. Therefore, the Bank has no capital requirement in accordance with the regulations for trading. Securities are held solely in order to maintain sufficient liquidity in accordance with the liquidity regulations. Derivatives are traded in order to minimise positions in business balances arising in the deposit and lending operations for customers.

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or future cash flows from the Bank's assets will fluctuate because of changes in currency rates. For Ikano Bank, currency exposure arises in the context of net investment in foreign operations as well as the payment flows in loans and investments in foreign currency and borrowing in foreign currency. The majority of the Bank's cash flows in all currencies are managed in a common cash pool. Net exposures are managed centrally by the Treasury function and are mainly mitigated by currency derivatives.

A sensitivity analysis shows that an increase in the exchange rate by 10 percent reduces the overall net exposure by SEK -9.8 m.

In the Bank's income statement, exchange rate results with SEK -8.6 m (-2.1) are included in Net gains and losses on financial transactions.

The Bank's risk appetite for currency risk is defined in terms of total outstanding exposure in all currencies.

Interest risk

Interest rate risk is the risk that the fair value or future cash flows from a financial instrument will fluctuate because of changes in market interest rates. Interest rate risk arises when lending and borrowing are not optimally matched.

In accordance with the Bank's steering documents, interest rate risk must be minimised so that any possible effect on the result is limited. The Bank's risk tolerance to interest rate risk is defined as profit and loss impact at 200 basis point shifts of all yield curves. This amount shall not exceed 3.5 percent of the Bank's own funds.

The Bank limits (hedges) the interest rate risk for fixed interest deposits by entering into interest rate swap agreements whereby the Bank receives a fixed interest rate and pays a variable interest rate. For these fair value hedges, the Bank applies hedge accounting. During the year, the change in fair value of the hedged items (fixed interest deposits), with regard to the hedged risk, amounted to SEK 0.5 m (8.2) and on hedging instruments (derivatives) to SEK -0.5 m (-8.2). The reported net amount of SEK 0 m is consequently the year's reported inefficiency.

The Bank applies cash flow hedge for certain deposits at variable interest rates as the hedged risk is the uncertainty in future interest cash flows.

For hedging, interest rate swaps are used. Swaps are measured at fair value in the balance sheet. In the income statement the accrued and paid interest are reported as interest expense and other changes in the value of the interest rate swap are recognized in other comprehensive income and accumulated in the fair value reserve in equity to the extent that the cash flow hedge has been effective until the hedged item affects profit or loss. All the ineffectiveness of the hedge is recognized in the income statement item Net gains and losses on financial transactions and amounted in 2017 to SEK 1.2 m.

The Bank also limits the interest rate risk separately for the investments and the borrowing portfolio managed by the Treasury function. Such measurements result in an indirect limitation of volume and fixed interest periods on the Bank's interest-bearing investments and total net exposure. The Bank also hedges the interest rate risk in a lending portfolio with fixed interest. Hedge accounting is not applied to this.

The Bank's deposits and lending are primarily short-term with a maturity period no longer than three months. The fixed interest periods for both the Bank's assets and liabilities in the balance sheet and for non-balance sheet items are shown in the table below.

A sensitivity analysis shows that a change of one percentage point in the market rate of interest increases/reduces the net interest income for the next 12-month period by SEK 36.5 m (30.1), given the interest-bearing assets and liabilities that exist on the closing date. A parallel increase of one percentage point in the interest rate curve would have an effect on equity after tax of SEK -11.7 m 6and SEK 12.4 m with a parallel decrease of the interest rate curve.

As of 31 December 2017, the Bank had interest rate swaps with a contract value of SEK 2.5 bn (2.9). The swaps' net fair value as of 31 December 2017 totalled SEK -4.7 m (-6.2) consisting of assets of SEK 1.6 m (14.0) and liabilities of SEK 6.3 m (20.2).

Interest rate exposure – fixed interest periods for assets and liabilities

2017 SEK m	Not longer than 3 months	Longer than 3 months, but not longer than 6 months	Longer than 6 months, but not longer than 1 year	Longer than 1 year, but not longer than 5 years	Longer than 5 years	No interest	Total	Remaining average fixed interest term
Assets								
Cash and balances with central banks	7	-	-	-	-	0	**7**	0.1 years
Treasury bills	968	-	-	205	-	-	**1 173**	0.4 years
Loans to credit institutions	1 765	-	-	2	-	47	**1 814**	0.1 years
Loans to the public	17 298	2 122	4 096	4 201	74	8	**27 799**	0.6 years
Leasing receivables	8 052	191	251	950	88	193	**9 724**	0.4 years
Bonds and other interest-bearing securities	1 303	151	52	598	-	-	**2 104**	0.9 years
Other assets	62	2	-	-	-	1 398	**1 462**	0.0 years
Total assets	**29 454**	**2 466**	**4 398**	**5 955**	**163**	**1 646**	**44 082**	
Liabilities and equity								
Liabilities to credit institutions	2 082	422	0	-	-	-	**2 504**	0.2 years
Deposits from the public	19 345	901	1 589	2 679	-	1 103	**25 617**	0.4 years
Issued securities	5 285	940	400	200	-	-	**6 825**	0.3 years
Other liabilities	52	2	1	-	-	2 494	**2 548**	0.1 years
Subordinated liabilities	388	431	-	-	-	-	**820**	0.3 years
Equity and untaxed reserves	-	-	-	-	-	5 768	**5 768**	0.0 years
Total liabilities and equity	**27 153**	**2 695**	**1 989**	**2 879**	**-**	**9 365**	**44 082**	
Total difference	**2 302**	**-230**	**2 409**	**3 076**	**163**	**-7 720**	**-**	
Interest rate derivates, long positions 1)	469	2 065	-	-	-	-	**2 534**	
Interest rate derivates, short positions 1)	49	344	590	1 550	-	-	**2 534**	

1) Nominal values

Liquidity risk

Ikano Bank defines liquidity risk as the risk of being unable to make payment when due, without significantly increasing the costs, or ultimately, not being able to meet payment obligations to any degree. The definition is also linked to the risk of being unable to receive renewed financing on maturity, so-called refinancing risk.

The matching of assets and liabilities, both in terms of maturity and volume, along with a good access to multiple funding sources forms the basis of the Bank's liquidity and financing strategy. The liquidity level must always be sufficient; this means there should always be a liquidity reserve and the Bank should always be able to fulfil its payment commitments and be in a position to strengthen liquidity without delay when necessary. The Bank's management and control of liquidity risks are centralised and the liquidity risk is reflected in the Bank's internal pricing.

The Bank's liquidity management and liquidity risks are handled by the Bank's central Treasury function in close cooperation with the local business units. The management of liquidity risk is controlled by the independent Risk Control function. The Bank's Board of Directors and management receive continuous reporting regarding the liquidity positions and development of liquidity.

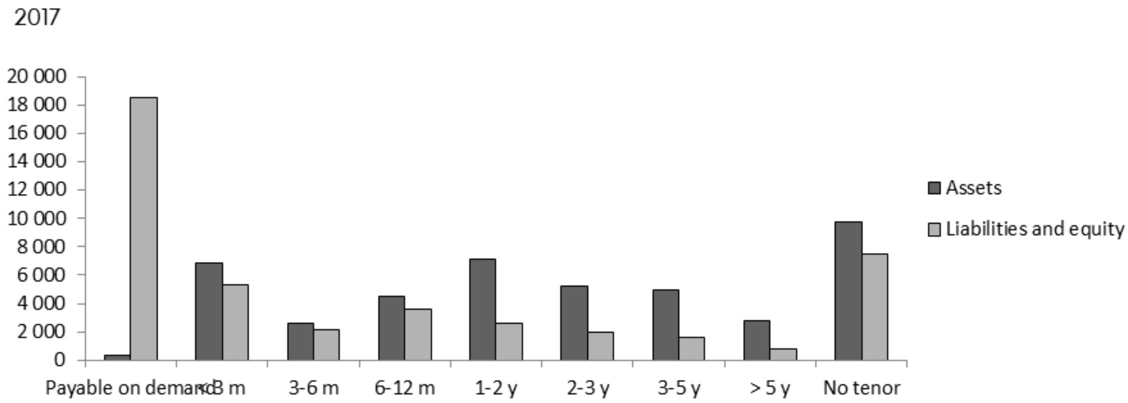
The liquidity risk is managed through effective liquidity planning, application of limits, measurement and analysis. Control and monitoring is conducted against the Bank's liquidity limits specified in the Bank's steering documents. Liquidity planning is a significant component of the liquidity management, and forecasts are drawn up regularly in order to manage and control the Bank's total liquidity. Future cash requirements are monitored daily, as is the limit for minimum intra-day liquidity.

The Bank carries out regular stress tests on liquidity in order to increase its preparedness and assess the ability of the Bank to meet its payment obligations under conditions deviating from normal conditions. The analyses are based on the Bank's risk tolerance, and include both company-specific and market-wide issues with varying degrees of stress and duration. Examples of events analysed include large withdrawals of deposits by the public, as well as market financing ceasing to be available. The Bank has a contingency funding plan containing action plans in the event of disruptions and if the supply of liquidity is limited. The contingency funding plan is used if three or more of the Bank's defined internal risk indicators signal a heightened risk.

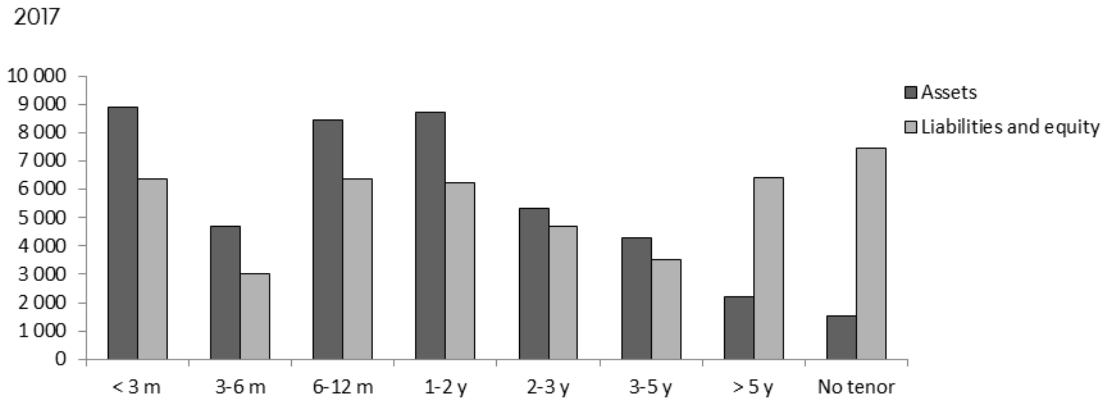
Measurement and monitoring of the balance sheet structure and liquidity exposure with respect to the remaining maturity of assets and liabilities are carried out continuously. Both contractual maturity and behavioural-modelled maturity are analysed.

The first graph below shows the Bank's maturity exposure based on the reported cash flow's contractual remaining maturity as of 31 December 2017. Deposits from the public are comprised of both fixed term and non-fixed term deposits. Total deposits from the public are reported in the column "on demand" since the counterparty always has an option to choose when repayment should take place. Analyses of the behavioural cash flows show however that the deposits constitute a long-term stable source of financing, which implies that the maturity distribution of deposits from the public is, in practice, distributed over several time intervals which are shown in the second graph below.

Liquidity risk exposure, recognised cash flows – remaining contractual term of recovery



Liquidity risk exposure, recognised cash flows – remaining expected time of recovery



Ikano Bank offers a variety of card products where a majority implies that the customer receives a credit. The unused portion of customer credits and loan commitments are reported within items loan promises and unused credit limits. Customer behaviour is monitored carefully as it affects the liquidity risk and history shows that this item is at a stable level, i.e. customers' utilization rate follows a stable pattern.

The Bank performs monthly stress tests of increased outflow of deposits from the public and increased utilization in customers' unused credit.

In addition to committed and uncommitted credit facilities a liquidity reserve is maintained to be able to handle potential changes in the customer's expected behaviour also during periods of liquidity stress.

The Bank's risk appetite is defined by two different measures of liquidity: The survival horizon is defined as the length of time the Bank can survive without cash inflow in a stressed scenario in regard to both bank-specific situations and the financial markets in general. The model is conservative as it assumes that the Bank will continue to engage in lending activities and to repay funding according to contractual maturity combined with stress assumptions regarding deposit outflow and the customers use of credits limits. The Bank's risk tolerance is to be able to operate more than two months without seeking external financing. The second measure is the Bank's liquidity coverage ratio, which shall exceed 100 percent. The measure show how the Bank's high quality liquid assets relate to the net cash outflow during a 30-day period of stress.

Liquidity portfolio and liquidity reserve

Ikano Bank's liquidity is managed within the framework of the Bank's liquidity portfolio. The liquidity portfolio consists of deposits with banks, short-term lending to credit institutions and also investments in liquid interest-bearing securities, which can be sold and converted into cash on short notice. The composition and size of the Bank's liquidity portfolio and the liquidity reserve is regulated in steering documents established by the Bank's Board of Directors.

The liquidity portfolio is divided into three categories: liquidity reserve, intra-day liquidity and operational liquidity.

The Bank's liquidity reserve, in accordance with the steering documents, shall always total at least 10 percent of deposits from the public. In addition to the liquidity reserve, the Bank shall maintain an intra-day liquidity of at least 4 percent of deposits from the public. Therefore, in accordance with this policy, the liquidity portfolio shall always total at least 14 percent of deposits from the public.

The liquidity reserve, along with other operating liquidity, is invested in interest-bearing securities in the Bank's markets. Steering documents define what quality level the securities that are included in the Bank's liquidity reserve shall have. Intra-day liquidity manages the Bank's daily payment commitments. The liquidity in this portfolio is to be available within one day, and is to consist of funds in bank accounts, investments available the next banking day (overnight) and bank overdraft facilities, granted in writing.

The liquidity reserve is to constitute a separate reserve of high-quality liquid assets, which are to be quickly convertible in case of market stress situations that affect the Bank's financing options. The liquidity reserve is invested in interest-bearing securities with a high credit rating on the Swedish market. The assets are to be available for realisation and conversion into cash at short notice. Unused bank overdraft facilities are not included in the liquidity portfolio.

The Bank's operational liquidity is managed in the operational liquidity portfolio. The assets in the portfolio consist of interest-bearing securities on the Swedish market. Investments in this portfolio are to have a minimum rating of BBB+ (rating according to Standard and Poor's).

The Bank's liquidity reserve is based on the Financial Supervisory Authority's current regulations on liquidity risk and asset classification in the European Commission's delegated act for the liquidity coverage requirement.

The Financial Supervisory Authority, in its regulations regarding the handling of liquidity risks, FFFS 2010:7, has included a definition of liquidity reserve. This definition coincides with the Bank's definition, with the exception of cash and deposits with credit institutions, which are not part of the Bank's liquidity reserve. According to the Financial Supervisory Authority's definition, the liquidity reserve totals SEK 4.2 bn. These assets are of a high quality, liquid in private markets and eligible as collateral with the Swedish Central Bank.

The liquidity portfolio totalled SEK 5.1 bn as of 31 December 2017, which constitutes 20 percent of deposits from the public. It includes the liquidity reserve in accordance with the above and other interest-bearing securities with a value of SEK 0.8 bn. None of the assets are being utilised as collateral and no non-performing assets exist. The assets are measured at market value.

In addition to the liquidity portfolio, the Bank has access to committed credit facilities of SEK 3.0 bn.

At year-end, the Bank's liquidity coverage ratio (LCR) totalled 229 percent. This measure shows how the Bank's high quality liquid assets are related to net outflows over a thirty-day period under stressed conditions. A statutory limit for the liquidity coverage ratio of 80 percent applies since 1 January 2017, with an increasing phasing to 100 percent on 1 January 2018. For a healthy and stable liquidity management, the Bank has already decided to hold a LCR of over 100 percent.

Encumbered assets

Information on the Bank's encumbered assets can be found in the Bank's Annual Report and its website www.ikanobank.se – Additional information Pillar 3.

Summary of the liquidity reserve

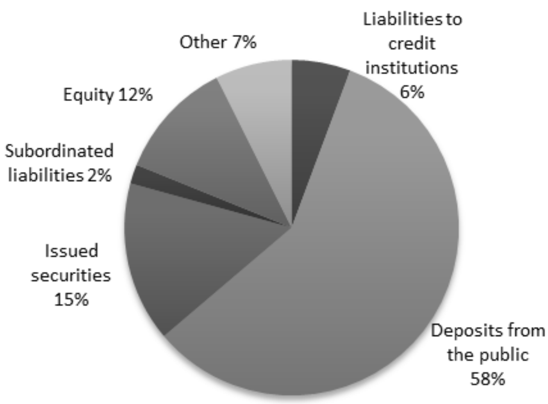
SEK 000	2017
Cash and balances in central banks and other banks	1 780 779
Securities issued by public entities	1 172 947
Securities issued by financial companies	149
Other secured bonds	1 123 514
Liquidity reserve (according to definition in FFFS 2010:7)	**4 226 207**
Other operating liquidity invested in securities	831 499
Total liquidity portfolio	**5 057 706**
Other liquidity-creating measures	
Unused committed credit facilities	2 954 402

Sources of funding

The aim of the long-term funding plan is a diversified funding which takes into account the spread of risk and funding costs.

Summary of sources of funding

SEK 000	2017
Liabilities to credit institutions	2 503 967
Deposits from the public	25 616 729
Issued securities	6 824 779
Subordinated liabilities	819 680
Equity	5 070 310
Other	3 246 632
Total	**44 082 098**



Other information

SEK 000	2017
Total assets	44 082 098
Loans to the public	27 798 753
Deposits from the public	25 616 729
Ratio deposits/total assets	58%
Ratio liquidity portfolio/deposits	20%

Capital management and capital adequacy

Below, information is provided regarding own funds and own funds requirements in accordance with among others regulation (EU) No 575/2013 regarding prudential requirements and capital buffers (2014:12).

The capital requirements regulations help to strengthen resilience against financial losses and thereby protect the Bank's customers. The regulations state that the Bank's own funds shall cover the minimum statutory own funds requirements, which for Ikano Bank include the requirements for credit risks, CVA risks, operational risks and foreign exchange risks. In addition, the own funds requirements include further identified risks in the operation in accordance with the Bank's internal capital adequacy assessment process and the requirements stipulated by the Board of Directors, also referred to as Pillar 2 requirements and statutory requirements for capital buffers.

To ensure that the own funds of Ikano Bank are adequate, the internal capital adequacy assessment (ICAAP/ILAAP) is performed. This process is a tool used by the Board of Directors to assess the need for changes in the own funds requirement in the event of changed circumstances. This might involve strategic commercial decisions or events in the market impacting the operations and their development. The Bank performs stress tests and scenario analyses to assess the need for further capital. The risk control function is responsible for monitoring the process of the Bank's capital planning. This is done annually and is integrated with the Bank's budget and strategic planning. The plan is monitored continuously and a comprehensive risk analysis is conducted annually to ensure that risks are properly assessed and reflect the Bank's true risk profile and capital needs. The capital requirements according to the capital adequacy assessment process are reported regularly to the SFSA. The capital requirement of the ICAAP in addition to Pillar 1 requirements for 31 December 2017 totalled SEK 980 m.

Ikano Bank has quantified tolerance levels for the CET 1 ratio and total capital ratio above regulatory requirements. The margins represent buffers adapted to the Bank's risk profile in order to cover identified risks based on probability and financial impact. To meet the anticipated expansion of loans, maintain strategic freedom of action and also handle external changes, the Board of Directors has also expressed target levels for the Bank's capital ratios as part of the risk appetite framework.

As of 31 December 2017, the Bank had own funds of SEK 6.0 bn (5.8) compared with the statutory own funds requirement for Pillar 1-risk of SEK 2.9 bn (2.8). The total capital ratio was 16.5 percent with a Tier 1 capital ratio of 14.3 percent. Consequently, the Bank has a good capital adequacy that meets both statutory and internal requirements. The Bank's common equity Tier 1 capital amounted to SEK 5.2 bn. After a statutory minimum for common equity Tier 1 capital has been allocated to cover 75 percent of the total own funds requirement calculated in accordance with Pillar 1, a further SEK 3.0 bn remain available as common equity Tier 1 capital.

Capital buffers

The combined buffer requirement for Ikano Bank consists of the capital conservation buffer and the countercyclical capital buffer. According to the law (2014:966) regarding capital buffers, the capital conservation buffer shall consist of a common equity Tier 1 capital equivalent to 2.5 percent of the Bank's total risk exposure amounts. For Ikano Bank, the capital conservation buffer totals SEK 913 m and is covered well by the available common equity Tier 1 capital. The countercyclical buffer is determined by multiplying the total risk exposure amount with the weighted average of the countercyclical buffer rates applicable in those countries where the relevant credit exposures of the institution are located. The institution-specific countercyclical buffer for the Bank has been determined at 1.01% or SEK 368 m after weighting the applicable geographic requirements, which for the Bank means Sweden and Norway. Ikano Bank's combined buffer requirement is SEK 1,281 m.

For further information on the countercyclical capital buffer, see the Bank's website www.ikanobank.se - Additional information Pillar 3.

Summary of own funds, risk exposure amount and own funds requirements

SEK 000	2017
Tier 1 capital	5 211 615
Tier 2 capital	819 680
Own funds	**6 031 295**
Total risk exposure amount	**36 515 692**
Total own funds requirements	**2 921 255**
Total Capital ratio	**16.6%**
Tier 1 Capital ratio	**14.3%**
Common equity Tier 1 ratio	**14.3%**
Available common equity Tier 1 Capital	**3 020 673**
Available common equity Tier 1 Capital in relation to Total risk exposure amount	**8.3%**
Capital conservation buffer	912 892
Counter-cyclical capital buffer	367 680
Combined buffer requirement	**1 280 572**

Own funds

The Bank's own funds totalled SEK 6.0 bn whereof SEK 5.2 bn is Tier 1 capital and SEK 0.8 bn is Tier 2 capital. Of the Bank's Tier 1 capital, all components have characteristics to be qualified as core Tier 1 capital. The different components of the core Tier 1 capital are share capital, statutory reserves, fund for development expenses, fund for fair value (excluding the cash flow reserve), retained earnings, untaxed reserves (78 percent thereof) and the year's audited result. Share capital consists of 10 004 shares with a quota value of SEK 7 896. The reserve fund is counted as part of the restricted capital that cannot be distributed to shareholders. The fund for fair value consists of a translation reserve that arises upon consolidation of the Bank's foreign branches and the fair value reserve arising from unrealised fair value adjustments on the Bank's financial assets available for sale. Retained profit and loss consists of the Bank's accumulated earnings and a capital contribution by the shareholders in connection with the acquisition of the UK operation. The Bank's untaxed reserves consist of accelerated depreciation on tangible assets, 78 percent of these are included in Tier 1 capital.

Deductions from the core Tier 1 capital were made for intangible assets. The Bank's intangible assets consist of capitalised expenditures for internally generated and acquired software and IT systems. Cumulative value of the effective portion of cash flow hedging instruments that are recognized in fund for fair value amounting to SEK 8 m is not included in the Bank's own funds.

The Bank's deferred tax assets that rely on future profitability are exempted from deductions from the own funds until the 31 December 2017 as they in total do not exceed 10 percent of core Tier 1 items. At 31 December 2017, the Bank has no deferred tax receivables that rely on future profitability.

Below is a specification of Ikano Bank's own funds as of 31 December 2017.

For standardised settlement of equity instruments and capital, see the Bank's website www.ikanobank.se – Additional information Pillar 3. The Bank's balance sheet is described in the Bank's Annual Report for 2017.

Specification of own funds

SEK 000	2017
Own funds	
Tier 1 capital	
Equity reported in the balance sheet	**5 070 310**
Share capital	78 994
Statutory reserve	193 655
Fund for development expenses	243 021
Fund for fair value	166 137
Retained earnings	4 104 642
Net result for the year	283 861
Untaxed reserves (78% of which)	544 562
Less:	
Intangible assets	-394 813
Cash flow hedge	-8 444
Total Tier 1 Capital	**5 211 616**
Total Common Equity Tier 1 Capital	**5 211 616**
Tier 2 capital	
Subordinated liabilities	819 680
Total Tier 2 Capital	**819 680**
Total own funds	**6 031 295**

Risk exposure amount and own funds requirements

In calculating the risk exposure amounts for credit risk in accordance with pillar 1, the Bank uses the standardised approach, which includes seventeen exposure classes with defined, weighted risks. The risk exposure amount for credit risk is SEK 28.7 bn, which results in an own funds requirement of SEK 2.3 bn.

The Bank uses Standard and Poor's rating for the calculation of the own funds requirement for Bonds and other interest-bearing securities.

The risk exposure amount for operational risks is calculated in accordance with the basic indicator approach, which means that the risk-exposure amount constitutes 15 percent of the average operating income for the three previous financial years. The Bank's risk exposure amount for operational risk is SEK 4.8 bn, resulting in an own funds requirement of SEK 387 m.

The risk exposure amount for foreign exchange risk covers all items on and off the balance sheet measured at the current market value and converted to Swedish kronor in accordance with the closing rate. Eight percent of the total net position in foreign currency is calculated to constitute capital requirements for the majority of the exposures.

The Bank's risk exposure amount for foreign exchange risk is SEK 2.9 bn, with an own funds requirement of SEK 236 m.

The Bank's risk exposure amount for CVA risk is SEK 8.6 m, giving an own funds requirement of SEK 0.7 m.

Specification of risk exposure amounts and own funds requirements

SEK 000	2017 Risk exposure amount	2017 Own funds requirements
Credit risk according to the standardised approach		
Exposures to states and central banks	32 571	2 606
Exposures to regional government and local authorities	10 632	851
Exposures to public sector entities	26	2
Institutional exposure	416 933	33 355
Corporate exposure	1 833 137	146 651
Retail exposure	24 884 944	1 990 796
Equity exposure	32 207	2 577
Past due items	773 689	61 895
Covered bond exposure	113 016	9 041
Other items	620 241	49 619
Total credit risk	**28 717 396**	**2 297 392**
Operational risk according to the basic indicator approach	**4 840 640**	**387 251**
Foreign exchange risk according to the standardised approach	**2 949 096**	**235 928**
CVA risk according to the standardised approach	**8 559**	**685**
Total	**36 515 692**	**2 921 255**

Leverage ratio

The leverage ratio is a measure that provides an alternative to the risk-based capital requirement. The aim is that there should be a clear and simple measure of capital strength. The measurement shows capital as a percentage of asset size, without the actual risk level of the assets being taken into consideration. To this date there is no legal minimum level of the Leverage ratio. The EU commission has proposed a Leverage ratio of 3 percent to be introduced in connection with the proposed revised Capital Requirements Regulation.

The leverage ratio is calculated using the Tier 1 capital as a percentage of total assets. For the Bank, the leverage ratio per 31 December 2017 is 10.9 percent (10.5) and thus well above the proposed binding measure.

Specification of the Leverage ratio

SEK 000	2017-12-31
Derivatives	126 092
Undrawn credit facilities	3 804 636
Other off-balance sheet items	452 904
Other assets	43 623 449
Total exposure value	**48 007 081**
Tier 1 capital	**5 211 615**
Leverage ratio	**10,9%**

Information regarding credit risk

Total exposure to credit risk and own fund requirements by exposure class and average exposure amounts for the period are shown below. The period's average exposure amounts are based on estimates of exposures for each quarter during the period.

Total exposures refer to exposures in the balance sheet after provisions for loan losses and unused credit limits and other commitments. The exposure class past due items are according to capital adequacy regulations items overdue more than 90 days or specifically impaired receivables.

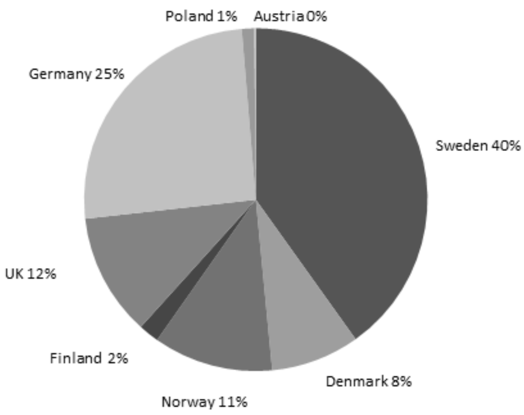
Breakdown of total exposures for credit risk shown by class of exposure

2017 SEK m	Total exposure	Own fund requirement	Average exposure amount
Government and central banks	1 205	3	1 141
Local government and comparable associations	1 607	1	1 737
Public sector entities	15	0	124
Institutional exposure	2 043	33	2 062
Corporate exposure	2 308	147	2 504
Retail exposure	73 484	1 991	72 316
Past due items	700	62	774
Covered bond exposure	1 130	9	1 205
Equity exposure	32	3	30
Other items	620	50	587
Total	**83 144**	**2 297**	**82 480**

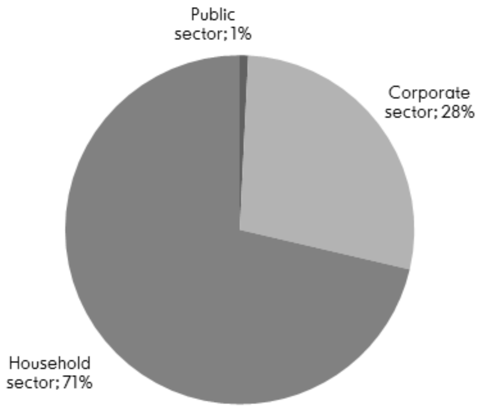
Geographical breakdown of risk exposure amount for credit risk and specific credit risk adjustment

2017-12-31 SEK 000	Sweden	Denmark	Norway	UK	Finland	Germany	Poland	Austria
Exposures to Central governments or central banks	-	-	-	-	-	32 571	-	-
Exposures to Regional governments or local authorities	-	-	10 632	-	-	-	-	-
Exposures to public sector entities	-	-	-	-	-	26	-	-
Exposures to Institutions	305 831	13 373	2 408	29 883	141	11 028	54 269	0
Corporate exposure	987 666	579 089	177 199	0	89 184	0	0	0
Specific credit risk adjustment deducted above	-	*4 103*	-	-	-	-	-	-
Retail exposure	9 871 690	3 083 434	2 074 042	4 456 861	583 223	4 356 883	391 096	67 715
Specific credit risk adjustment deducted above	*98 197*	*50 128*	*65 403*	*66 103*	*4 800*	*77 044*	*4 788*	*490*
Past due items	267 005	206 937	156 593	20 652	28 351	82 836	3 277	8 037
Equity exposure	32 207	-	-	-	-	-	-	-
Covered bond exposure	79 828	1 519	31 669	-	-	-	-	-
Other item	466 080	25 214	82 260	22 287	23 712	688	-	-
Total Risk Exposure Amount for Credit risk	**12 010 306**	**3 909 566**	**2 534 803**	**4 529 683**	**724 611**	**4 484 032**	**448 643**	**75 753**
Exposures to small and medium sized companies								
Corporate exposure	94 114	70 320	12 089	-	-	-	-	-
Retail exposure	1 700 343	1 007 503	508 273	-	163 637	-	-	-

Geographical breakdown of total exposure



Credit portfolio distributed by sector



Total remaining contractual term of exposures shown by class of exposure

2017 SEK m	On demand	<3 months	3-12 months	1-5 years	> 5 years	No tenor
Government and central banks	567	278	11	349	0	-
Local government and comparable	351	129	170	947	5	5
Public sector entities	15	0	-	-	-	-
Institutional exposure	347	1 492	44	10	0	149
Corporate exposure	-	870	405	998	35	-
Household exposure	37 163	5 752	6 122	13 721	2 733	7 992
Past due items	-	55	105	266	60	214
Covered bond exposure	-	-	154	976	-	-
Equity exposure	-	-	-	-	-	32
Other items	-	-	-	-	-	620
Total credit risks	**38 442**	**8 577**	**7 011**	**17 267**	**2 834**	**9 014**

Exposures in the credit portfolio before and after impairment and loan losses shown by industry

2017 SEK 000	Total exposures	Impairments	Exposure after impairments	Loan losses in the income statement
Households	27 661 482	887 883	26 773 599	-485 910
Trade	2 045 656	17 560	2 028 095	-9 610
Manufacturing industry	1 488 941	13 184	1 475 757	-7 215
Transport and communication	1 283 020	14 352	1 268 669	-7 854
Property and rental activity	1 253 795	10 151	1 243 645	-5 555
Legal, finance and technical industry	758 870	13 435	745 435	-7 353
Building activity	1 197 532	22 897	1 174 635	-12 531
Hotel and restaurant business	864 024	20 087	843 937	-10 993
Healthcare and social services	349 529	6 989	342 540	-3 825
Art and culture	417 823	2 729	415 094	-1 493
Education	214 704	1 728	212 976	-946
Water and waste handeling	245 627	1 901	243 726	-1 041
Service operations	220 995	1 572	219 423	-860
Finance and insurance	114 532	266	114 267	-145
Public administration and defense	78 670	0	78 670	0
Farming, hunting and forestry	282 285	263	282 022	-144
Other businesses	60 791	207	60 584	-114
Total	**38 538 278**	**1 015 204**	**37 523 075**	**-555 588**

The table above specifies exposures in the credit portfolio, i.e. Loans to the public and Leasing receivables, before and after impairment, broken down by industry. Granted but unused credit limit is not included in the exposures.

An exposure requiring impairment is regarded as a non-performing loan according to the definition given in the Annual Report. In the Annual Report, a loan is classified as non-performing if one or more events have occurred impacting the estimated future cash flows from the asset or group of assets. Payments more than 45–90 days overdue, depending on the product and market, are generally considered by the Bank as objective evidence that a loan is non-performing. Other objective evidence may consist of information of considerable financial difficulties. The Bank evaluates whether a need for impairment exists for non-performing loans and whether a loan loss must be recognised on an individual basis for each loan due and for substantial individual loans. When no need for impairment can be identified for loans evaluated in relation to the need for impairment on an individual basis, an additional assessment is carried out along with other loans with similar credit risk properties to investigate whether a need for impairment exists at portfolio level. An assessment to establish portfolio impairment is carried out using statistical models which calculate the probability that a debt in the different portfolios will not be settled in accordance with the original contract.

The recognised value of assets after impairment is calculated as the present value of the future cash flows discounted by the effective interest rate applicable when the asset was initially recognised. Short-term assets are not discounted. Impairment is charged to profit and loss.

Unsettled receivables refers to receivables which are due for payment and which are not included in non-performing loans. These receivables are included in the additional assessment in which impairment is made at portfolio level. Non-performing loans and unsettled receivables by sector are shown in the following tables.

Non-performing loans divided by sector and geography

SEK 000	2017
- household sector	**926 090**
Sweden	182 983
Denmark	87 354
Norway	185 820
United Kingdom	164 812
Finland	15 228
Germany	283 049
Poland	6 846
- corporate sector	**412 794**
Sweden	157 890
Denmark	180 014
Norway	55 443
United Kingdom	-
Finland	17 810
Germany	1 637
Poland	-
- public sector	**0**
Sweden	**-**
Denmark	0
Norway	-
United Kingdom	-
Finland	-
Netherlands	-
Germany	-
Poland	-
Total	**1 338 884**

Unsettled receivables, not included in non-performing loans, divided by sector and geography

SEK 000	2017
- household sector	**586 480**
Sweden	208 820
Denmark	29 098
Norway	85 319
United Kingdom	96 756
Finland	11 029
Germany	130 273
Poland	25 186
- corporate sector	**739 474**
Sweden	246 099
Denmark	239 614
Norway	197 702
United Kingdom	-
Finland	53 382
Germany	2 677
Poland	-
Total	**1 350 726**

Exposure in the credit portfolio divided by sectors

SEK 000	2017
Loan recivables, gross	
- household sector	27 661 482
- corporate sector	10 584 040
- public sector	292 756
Total	**38 538 278**
Less:	
Specific impairment for individually assessed significant	**118 784**
- household sector	14 921
- corporate sector	103 863
- public sector	0
Impairment for collectively assessed homogenous	**896 421**
- household sector	872 962
- corporate sector	23 434
- public sector	25
Loan receivables, net reported value	
- household sector	26 773 599
- corporate sector	10 456 743
- public sector	292 731
Total	**37 523 075**

Unsettled receivables, not included in non-performing loans, divided by sector and geography

2017 SEK 000	Specific credit risk adjustments for individually assessed loan receivables	Specific credit risk adjustments for collectively assessed homogenous groups of loan receivables	Total
Opening balance 1 Jan 2016	111 950	925 823	1 037 773
Reversed impairment no longer required for loan losses	34 909	261 920	296 829
Reversal of previous impairment for loan losses recognised in the annual accounts as determined loan losses	2 559	-	2 559
Impairment for the year for loan losses	-10 541	-310 737	-321 278
Exchange rate differences	-678	-	-678
Closing balance 31 Dec 2017	**138 200**	**877 006**	**1 015 206**