

# Capital adequacy and risk management 2018-12

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*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 regulation (EU) No 575/2013 and the Swedish Financial Supervisory Authority's regulations regarding regulatory requirements and capital buffers (2014:12 and amendment provisions).*

## Operations

Ikano Bank AB (publ) conducts banking operations in Sweden, the UK, Norway, Denmark, Finland, Germany, Austria and Poland under the supervision of the Swedish Financial Supervisory Authority. The operations in Denmark, Norway, Finland, the UK, Germany and Poland are operated as branches, while Austria is conducted as cross-border operations.

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. 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 an efficient handling whereby the Bank can offer customers cost-efficient and competitive products.

Lending is offered as unsecured loans and VISA credit cards. 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.

In the Swedish market, the Bank has offered mortgage loans branded "Ikano Bolån" in cooperation with SBAB Bank AB (publ) until 31 August 2018. As previously communicated the coopera-

tion between SBAB and Ikano Bank has ended during the year as SBAB has decided to prioritise sales under its own brand.

## Risks and risk management

In its business operations, the Bank is exposed to several risks such as credit risk, operational risk and business risk, but it must also manage liquidity risk, foreign exchange risk and interest rate risk. The Board of Directors and CEO are ultimately responsible for risk management at Ikano Bank.

Risk management is intended to ensure that the risks do not exceed the risk tolerances set by the Board. The Bank's risks are monitored centrally, but the responsibility for risk management rests primarily with local business units. This means that operating business units own and manage the risk in daily operations. The independent Risk Control Function is responsible for monitoring and evaluating risk management. Reporting is done monthly to the Bank's management and quarterly to the Board of Directors. The Bank's Internal Capital and Liquidity Adequacy Assessment Processes (ICAAP/ILAAP) are updated quarterly and presented to the management and Board of Directors.

For more information on the Bank's risks and organisation for risk management see the Annual Report 2018 note 3 as well as the Governance report.

## 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 including risk appetite and risk tolerance.

The Bank's control organisation comprises three lines of defence with respect to management and control of the company's risks.

The first line of defence is the operating units that are exposed to and manage the risks in daily operations.



The second line of defence is the independent control functions responsible for identifying, quantifying and reporting risks. Compliance is responsible for monitoring the policies and rules determined by the Board of Directors. This function also provides advice and support for the business functions. The independent Risk Control function monitors exposures to Board-approved limits.

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's lending operations consist of the products leasing, factoring, credit cards and unsecured loans. All products are designed for handling of high volumes. The Bank applies scoring models in the assessment of credit risk. During the application process, the risk of default is calculated before credit is granted. The result of the initial application gives a score on a scale reflecting the probability of default. The credit assessment is based on customer information as well as information from credit bureaus. Most of the Bank's scoring models are internally developed but there are also externally developed and generic models, mostly corporate models.

Per 1 January 2018 IFRS 9 Financial Instruments entered into force, replacing IAS 39 Financial Instruments: Accounting and Measurement. The work with implementing IFRS 9 Financial Instruments continued during the year.

Credit impairment provisions are made based on IFRS 9 which unlike IAS 39 builds on a forward-looking model with expected loan losses and credit impairment provisions applied already at the time of origination of the asset.

A key term of impairment regulations is default which for the Bank is defined as those instruments with indications that the borrower is unlikely to fulfil his payment obligations or where those payment obligations are more than 90 days past due. The timing of when an exposure is

declared in default because of days past due differs across Ikano Bank's markets but is never later than 90 days. Following the settlement of payment obligations more than 90 days past due, the instrument is classified as in default a further 90 days before it can be classified as performing if no other deviations are observed.

Financial assets that are subject to the impairment requirement need to be divided into three stages. The credit loss model makes provisions for 12 months expected loan losses for the majority of the portfolio (stage 1) but requires provisions corresponding to the remaining lifetime of financial instruments where a significant increase in the credit risk has occurred since the initial recognition (stage 2) and for credit impaired financial instruments (stage 3), i.e. exposures in default.

The Bank's criteria for identification of a significant increase in credit risk are a combination of relative changes and thresholds in probability of default. Ikano Bank has chosen a doubling of probability of default from initial recognition to balance sheet date. Qualitative factors not reflected in the models can, as an exception, also be applied to identify an increase in credit risk for customers within the Corporate segment, for example customer information made available to the Bank through contact with the customer or other stakeholders. In addition, financial instruments past due for more than 30 days are regarded to have had a significant increase in credit risk.

Models for assessing the probability of default and consequently a significant increase in risk are constructed per market and segment based on the Bank's instrument specific information and attributes. To a certain extent external attributes are also used; mainly for the Corporate segment but also for some parts of the Consumer segment. Models to predict the probability of default have been complemented with additional statistical models to calculate expected credit loss. Depending on the stage, expected loss is calculated with either a 12 months or lifetime horizon. For lifetime calculations, models have been based on internal historically available data indicating how portfolios and their risk components have developed. Calculations include also a forward looking component adjusting the model based on the macroeconomic situation in the respective country. Lifetime calculations for credit cards are based on the assumption that losses converge over time and remaining losses can be calculated mathematically. A standard formula to calculate credit losses is: [Probability of default (PD) \* Exposure at default (EAD) \* Loss given default (LGD)].

Exposure at default calculates the future exposure at the time of default considering contractual payments and payments in excess thereof as

well as utilisation of committed unutilised credit limits.

Loss given default calculates the economic loss at the time of default considering expected payments and realisation of collateral or guarantees. In many cases, repurchase agreements within the leasing operations exist in the event of the end customer default as well as guaranteed residual value when a leasing agreement expires. The model also considers potential costs arising in connection with the realisation of collateral and guarantees. Expected payments are modelled based on historical data and contractual payments where these are relevant. Expected cash flows are then discounted to derive expected losses.

The regulatory framework also requires a forward-looking element where macro models have been built for the different markets. Macro variables are collected from official sources and for the Bank include gross domestic product and unemployment. The credit impairment provision is based on three different scenarios, weighted with given probabilities with the most likely scenario assigned a weight of 40 percent and the positive and negative scenarios assigned 30 percent each. The forecast horizon applied to the different scenarios is three years, where after the model regresses to a long term average. The models are based on the Bank's historical data for default or credit losses and for markets without sufficient historical data, time series from official sources have been used as a proxy of defaults. The macroeconomic model affects probability of default and thereby stage assessment, as well as the resulting expected credit loss.

For more information regarding IFRS 9 see Annual Report 2018.

The independent Risk Control function monitors exposures against set limits. The Bank's risk appetite to credit risk is defined based on probability of default and updated annually by the Board. The risk appetite is split into several portfolios and is measured according to the Bank's IFRS 9 models.

The Bank has a diversified loan portfolio in terms of customer, product and geographical market which means that no significant credit risk concentrations exist. No single customer accounts for more than 1 per cent of the loan book.

The table below illustrates the Bank's credit exposure before and after credit risk impairment provisioning, specified as per the internal risk classification (low, medium or high) or an external credit rating depending on the counterparty.

Leasing assets are recognised as tangible fixed assets in the balance sheet. The main groups of leasing objects are office equipment, vehicles and production machinery. Collaterals are solely comprised of residual value guarantees from suppliers of leasing objects recognised as tangible fixed assets. The value of the collateral amounts to SEK 1,425 m as of 31 December 2018 (SEK 1,409 m). No significant changes in the quality of collateral have occurred during the period.

Liquidity and transaction accounts in other banks where the liquidity is handled by the Bank's treasury function are exempt from loan provisions as the credit risk in these positions are assessed as not material. These accounts are classified as loans to credit institutions below.

Accrued interest is reported in the balance sheet item Accrued income and the credit impairment provisions on those are not material.

## Credit risk exposure, gross and net, per risk classification for financial assets, and commitments and undrawn limits

2018

SEK 000

	Stage 1	Stage 2	Stage 3	Total
<b>Financial assets measured at amortised cost according to IFRS 9</b>				
<b>Loans to credit institutions</b>				
AAA	25 975			25 975
AA	960 620			960 620
A	1 070 039			1 070 039
B	94 212			94 212
Credit impairment provisions	-			-
<b>Total carrying amount</b>	<b>2 150 846</b>	<b>-</b>	<b>-</b>	<b>2 150 846</b>
<b>Loans to the public</b>				
Low	20 532 400	486 422	-	21 018 822
Medium	2 118 166	1 720 854	-	3 839 020
High	622 784	1 872 807	795 342	3 290 933
Credit impairment provisions	-111 610	-286 305	-461 737	-859 652
<b>Total carrying amount</b>	<b>23 161 740</b>	<b>3 793 777</b>	<b>333 605</b>	<b>27 289 122</b>
<b>Financial assets measured at fair value according to IFRS 9</b>				
<b>Treasury bills</b>				
AAA	321 659			321 659
AA	960 634			960 634
Credit impairment provisions	-446			-446
<b>Total carrying amount</b>	<b>1 281 847</b>	<b>-</b>	<b>-</b>	<b>1 281 847</b>
<b>Bonds and other interest-bearing securities</b>				
AAA	1 225 649			1 225 649
AA	315 046			315 046
A	671 237			671 237
B	20 002			20 002
Credit impairment provisions	-763			-763
<b>Total carrying amount</b>	<b>2 231 172</b>	<b>-</b>	<b>-</b>	<b>2 231 172</b>
<b>Total gross carrying amount for financial assets measured at amortised cost or fair value through other comprehensive income</b>	<b>28 843 766</b>	<b>4 080 083</b>	<b>795 342</b>	<b>33 719 191</b>
<b>Total credit impairment provisions</b>	<b>-112 819</b>	<b>-286 305</b>	<b>-461 737</b>	<b>-860 861</b>
<b>Total carrying amount</b>	<b>28 730 947</b>	<b>3 793 777</b>	<b>333 605</b>	<b>32 858 329</b>
<b>Leasing objects including trade receivables leasing</b>				
Low	4 925 737	1 077 651	-	6 003 388
Medium	1 581 156	1 242 971	-	2 824 127
High	209 071	1 082 389	390 040	1 681 501
Credit impairment provisions	-14 640	-72 148	-130 856	-217 643
<b>Total carrying amount</b>	<b>6 701 324</b>	<b>3 330 864</b>	<b>259 185</b>	<b>10 291 373</b>
<b>Commitments and undrawn limits</b>				
Low	35 090 552	242 911	-	35 333 463
Medium	2 115 045	849 483	-	2 964 528
High	158 780	403 987	-	562 767
Credit impairment provisions	-13 205	-15 860	-	-29 065
<b>Total commitments and undrawn limits</b>	<b>37 351 171</b>	<b>1 480 522</b>	<b>-</b>	<b>38 831 693</b>

The tables below specifies exposures in the credit portfolio, i.e. Loans to the public and Leasing receivables, before and after credit impairment provisions, broken down by industries etc. Granted but unused credit limits are not included in the exposures.

A loan is classified as non-performing or credit impaired (stage 3) if one or more events have occurred that have an impact on 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 be information about significant financial difficulties.

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 and geography are shown in the following tables.

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

2018 SEK 000	Total exposures	Impairments	Exposure after impairments	Loan losses in the income statement
Households	27 140 238	838 188	26 302 050	-370 302
Trade	2 068 572	25 377	2 043 195	-11 211
Manufacturing industry	1 496 390	28 607	1 467 784	-12 638
Transport and communication	1 277 478	55 649	1 221 828	-24 585
Property and rental activity	1 295 516	21 127	1 274 388	-9 334
Legal, finance and technical industry	735 280	7 922	727 358	-3 500
Building activity	1 454 662	43 600	1 411 062	-19 262
Hotel and restaurant business	1 070 068	27 200	1 042 868	-12 017
Healthcare and social services	394 236	4 256	389 981	-1 880
Art and culture	433 541	6 997	426 544	-3 091
Education	251 497	4 392	247 105	-1 940
Water and waste handling	173 587	620	172 967	-274
Service operations	254 788	4 359	250 429	-1 926
Finance and insurance	98 399	505	97 894	-223
Public administration and defense	80 336	40	80 296	-18
Farming, hunting and forestry	349 721	7 815	341 906	-3 453
Other businesses	83 483	641	82 843	-283
<b>Total</b>	<b>38 657 792</b>	<b>1 077 294</b>	<b>37 580 498</b>	<b>-475 937</b>

## Exposures in the credit portfolio after impairments divided by sectors

SEK 000	2018
<b>Loan receivables, gross</b>	
- household sector	27 140 238
- corporate sector	11 349 847
- public sector	167 707
<b>Total</b>	<b>38 657 792</b>
Of which:	
<b>Non performing loans</b>	<b>1 185 391</b>
- household sector	761 403
- corporate sector	423 988
- public sector	-
Less:	
<b>Specific impairment for individually assessed loans</b>	<b>1 077 296</b>
- household sector	838 188
- corporate sector	237 588
- public sector	1 520
<b>Specific impairment for collectively assessed homogenous groups of loans</b>	-
- household sector	-
- corporate sector	-
- public sector	-
<b>Loan receivables, net reported value</b>	
- household sector	26 302 050
- corporate sector	11 112 259
- public sector	166 187
<b>Total</b>	<b>37 580 496</b>

## Non-performing loans divided by sector and geography

SEK 000	2018
<b>- household sector</b>	<b>761 402 590</b>
Sweden	256 988 611
Denmark	164 445 964
Norway	84 507 351
United Kingdom	167 758 815
Finland	22 195 558
Germany	58 837 408
Poland	6 668 883
<b>- corporate sector</b>	<b>423 988 110</b>
Sweden	225 083 373
Denmark	46 186 095
Norway	91 489 074
United Kingdom	-
Finland	59 487 067
Germany	1 742 501
Poland	-
<b>- public sector</b>	<b>-</b>
Sweden	-
Denmark	-
Norway	-
United Kingdom	-
Finland	-
Germany	-
Poland	-
<b>Total</b>	<b>1 185 390 699</b>

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

SEK 000	2018
<b>- household sector</b>	<b>1 581 427 728</b>
Sweden	646 418 751
Denmark	439 758 313
Norway	197 907 905
United Kingdom	103 408 339
Finland	54 811 004
Germany	120 685 454
Poland	18 437 962
<b>- corporate sector</b>	<b>151 968 402</b>
Sweden	59 844 421
Denmark	41 743 888
Norway	3 936 278
United Kingdom	17 310 185
Finland	13 772 741
Germany	14 188 734
Poland	1 172 155
<b>Total</b>	<b>1 733 396 130</b>

## 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

Ikano Bank defines operational risk as 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, but excludes strategic risk and reputational risk.

Ikano Bank, as an Internet bank, is strongly dependent on IT systems and technical infrastructure. Follow-up of incidents and improvements in accessibility are prioritised areas. The Bank has an incident reporting system where incidents are reported and monitored. Risks are analysed continuously and policies, guidelines and process instructions are available to prevent and mitigate losses caused by operational risks.

The Risk Control Function is responsible for creating the risk framework and supporting in coordination of the work with operational risk but the respective businesses are responsible for managing operational risk. Annual risk reviews are carried out by management for the different business units, to ensure that risks are measured, managed and documented with action plans. New products, partners and IT systems undergo a risk assessment that includes operational risk (the New Product Approval Process NPAP). 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 for operational risk is defined based on a number of different criteria. All criteria are monitored and reported on by the independent Risk Control Function.

## 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 25 m.

In the Bank's income statement, exchange rate results with SEK -0.6 m (-8.6) 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 rate 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 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 2018 to SEK -9.9 m. Per 31 December 2018 no fair value hedges exist.

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 off-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 36.3 m (36.5), 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 -15.1 m and SEK 16.0 m with a parallel decrease of the interest rate curve.

As of 31 December 2018, the Bank had interest rate swaps with a contract value of SEK 2.1 bn (2.5). The swaps' net fair value as of 31 December 2018 totalled SEK -7.7 m (-4.7) consisting of assets of SEK 0.0 m (1.6) and liabilities of SEK 7.7 m (6.3).

## Interest rate exposure – fixed interest periods for assets and liabilities

2018 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
<b>Assets</b>								
Cash and balances with central banks	36	-	-	-	-	-	36	0.1 years
Treasury bills	924	-	171	188	-	-	1 282	0.5 years
Loans to credit institutions	2 151	-	-	-	-	-	2 151	0.1 years
Loans to the public	16 757	2 259	3 946	3 959	368	-	27 289	0.6 years
Leasing receivables	8 661	150	267	1 129	85	-	10 291	0.5 years
Bonds and other interest-bearing securities	1 497	181	-	553	-	-	2 232	0.6 years
Other assets	158	11	-	-	-	1 281	1 450	0.0 years
<b>Total assets</b>	<b>30 184</b>	<b>2 602</b>	<b>4 384</b>	<b>5 829</b>	<b>452</b>	<b>1 281</b>	<b>44 731</b>	
<b>Liabilities and equity</b>								
Liabilities to credit institutions	1 807	443	-	-	-	-	2 250	0.2 years
Deposits from the public	20 701	1 082	1 444	2 979	-	-	26 206	0.4 years
Issued securities	5 289	580	570	700	-	-	7 138	0.3 years
Other liabilities	0	8	-	-	-	2 467	2 475	0.0 years
Subordinated liabilities	-	839	-	-	-	-	839	0.4 years
Equity and untaxed reserves	-	-	-	-	-	5 822	5 822	0.0 years
<b>Total liabilities and equity</b>	<b>27 797</b>	<b>2 952</b>	<b>2 014</b>	<b>3 679</b>	<b>-</b>	<b>8 289</b>	<b>44 731</b>	
<b>Difference assets and liabilities</b>	<b>2 386</b>	<b>-351</b>	<b>2 370</b>	<b>2 150</b>	<b>452</b>	<b>-7 008</b>	<b>-</b>	
Interest rate derivatives, long positions <sup>1)</sup>	22	2 084	-	-	-	-	2 106	
Interest rate derivatives, short positions <sup>1)</sup>	-	-	276	1 830	-	-	2 106	

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.

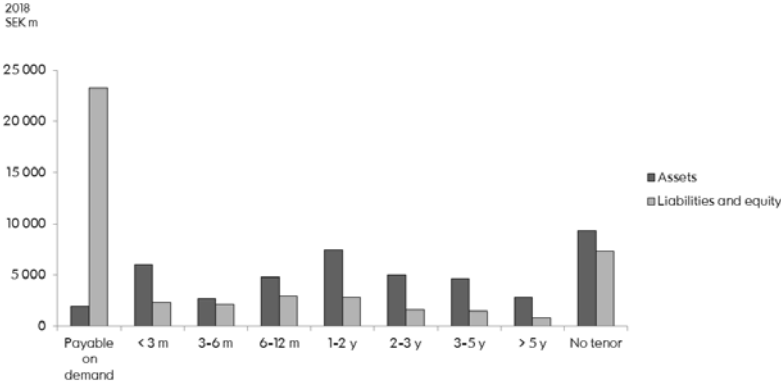
The Bank carries out regular stress tests on liquidity in order to increase its preparedness and assess the ability of the Bank to meet its payment obligations under conditions deviating from normal conditions. The analyses are based on the Bank's risk tolerance, and include both company-specific and 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.

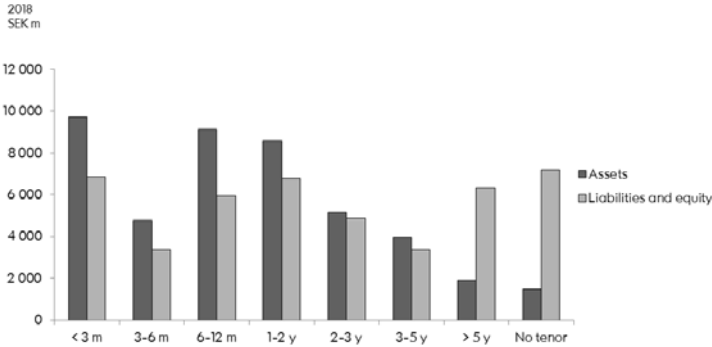
The first graph below shows the Bank’s maturity exposure based on the reported cash flow’s contractual remaining maturity as of 31 December 2018. Deposits from the public are comprised of both fixed term and non-fixed term

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. 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. A liquidity reserve in addition to committed and uncommitted credit facilities is maintained to be able to handle potential changes in the customer’s expected behaviour.

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 sur-

vive 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 Bank also has other liquidity creating measures at its disposal, such as immediately accessible overdraft facilities as well as committed credit facilities. The composition and size of the Bank's liquidity portfolio and liquidity reserve is regulated in the Bank's steering documents, which are adopted 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 that quality levels of securities included in the Bank's liquidity reserve are in line with the LCR Delegated Act. 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 committed bank overdraft facilities in the Bank's cash pool.

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 funding 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 (or equivalent according to Moody's).

The Bank's liquidity reserve amounts to SEK 2.5 bn and consists of high quality assets, liquid in private markets and eligible as collateral with the Swedish Central Bank.

The liquidity portfolio as of 31 December 2018 totalled SEK 5.6 bn excluding overdraft facilities and constitutes 21.2 percent of deposits from the public. It includes cash and balances with banks, the liquidity reserve and other interest-bearing securities with a value of SEK 1.0 bn. None of the assets are being utilised as collateral and no non-performing loans exist. In addition to the liquidity portfolio, committed credit facilities for a total of SEK 2.8 bn are available.

As of 31 December 2018, the Bank's LCR totalled 191 percent. This measure shows how the Bank's highly liquid assets relate to net outflows over a thirty-day period under strained market conditions. A statutory limit for the liquidity coverage ratio of 100 percent is applied since 1 January 2018.

### Encumbered assets

Information on the Bank's encumbered assets can be found in the Bank's Annual Report and its website [www.ikanobank.se](http://www.ikanobank.se) – Additional information Pillar 3.

#### Summary of liquidity reserve

SEK 000	2018
Securities issued by municipalities and other public units	1 282 293
Securities issued by financial companies	153 990
Covered bonds	1 071 660
<b>Liquidity reserve</b>	<b>2 507 943</b>
Operating liquidity invested in securities	1 006 285
Cash and balances with central banks and other financial institutes	2 125 575
<b>Total liquidity portfolio</b>	<b>5 639 803</b>
<b>Other liquidity creating measures</b>	
Unused committed credit facilities	2 821 579

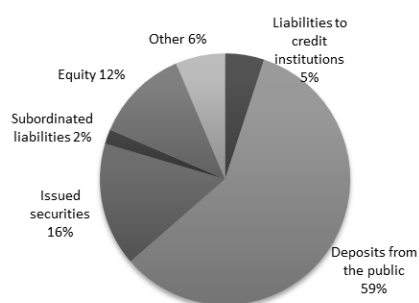
## Sources of funding

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	2018
Liabilities to credit institutions	2 250 366
Deposits from the public	26 206 463
Issued securities	7 138 497
Subordinated liabilities	839 330
Equity	5 444 229
Other	2 852 425
<b>Total</b>	<b>44 731 310</b>



### Other information

SEK 000	2018
Total assets	44 731 310
Loans to the public	27 289 123
Deposits from the public	26 206 463
Ratio deposits/total assets	59%
Ratio liquidity portfolio/deposits	22%

## 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 risk, credit valuation adjustment risk (CVA risk), operational risk and foreign exchange risk. 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.

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.

To ensure that Ikano Bank's capital situation is satisfactory to cover the risks that the Bank is or may be exposed to, an internal capital and liquidity adequacy assessment (ICAAP/ILAAP) is conducted at least annually. The ICAAP/ILAAP is the Board's tool for assessing the need for changes in the own funds requirement. In the assessment process, stress tests and scenario analyses are carried out to assess potential additional own funds requirements, including strategic decisions or external events that affect the business and its development. As a part of this process, a risk analysis is performed to ensure underlying risks are adequately addressed and mirror the Bank's actual risk profile and capital requirements. The risk control function is responsible for monitoring the process of the Bank's capital adequacy assessment. The capital requirements resulting from the ICAAP are regularly reported to the SFSA.

As of 31 December 2018, the Bank had own funds of SEK 6.4 bn (6.0) of which SEK 5.6 bn are common equity Tier 1. The statutory own funds requirement for Pillar 1-risk amounted to

SEK 3.0 bn (2.9). 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 3.3 bn remain available as common equity Tier 1 capital. The internal own funds requirement in addition to Pillar 1 requirements totalled SEK 746 m and is covered by available capital. The total capital ratio was 17.2 percent with a common equity tier 1 capital ratio of 14.9 percent.

Per 1 January 2018, the new accounting standards IFRS 9 Financial Instruments entered into force. As mentioned in the Annual Report 2017, Ikano Bank has notified the SFSA of its decision to apply the transitional rules introduced with article 473a capital requirements regulation (EU No 575/2013) regarding the Day one effect. For the Bank, this effect was SEK 222 m after tax that will be gradually phased in into the capital adequacy over five years. The table on page 16 provides a comparison of Ikano Bank's own funds as well as capital and leverage ratios with and without the application of transitional arrangements for IFRS 9 as introduced by the EBA guidelines 2018/01 for standardised disclosure requirements for transitional arrangements according to IFRS 9.

### 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 932 m and is covered 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 Bank are located. The institution-specific countercyclical buffer amounts to 1.15 percent or SEK 427 m after weighting the applicable geographic requirements, which for the Bank mainly means Sweden, Norway and the UK. Ikano Bank's combined buffer requirement is SEK 1,359 m.

For further information on the countercyclical capital buffer, see the Bank's website [www.ikanobank.se](http://www.ikanobank.se) - Additional information Pillar 3.

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

SEK 000	2018
Tier 1 capital	5 555 103
Tier 2 capital	839 330
<b>Own funds</b>	<b>6 394 433</b>
<b>Total risk exposure amount</b>	<b>37 282 567</b>
<b>Total own funds requirements</b>	<b>2 982 605</b>
<b>Total Capital ratio</b>	<b>17.2%</b>
<b>Tier 1 Capital ratio</b>	<b>14.9%</b>
<b>Common equity Tier 1 ratio</b>	<b>14.9%</b>
<b>Available common equity Tier 1 Capital</b>	<b>3 318 149</b>
<b>Available common equity Tier 1 Capital in relation to Total risk exposure amount</b>	<b>8.9%</b>
Capital conservation buffer	932 064
Counter-cyclical capital buffer	427 328
<b>Combined buffer requirement</b>	<b>1 359 393</b>

### Own funds

The Bank's own funds totalled SEK 6.4 bn whereof SEK 5.6 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 valued at fair value through other comprehensive income. 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 CET 1 capital.

Deductions from the CET 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 13 m is not included in the Bank's Own funds, recognised as a deduction from common equity Tier 1. Also an Additional Value Adjustment has been deducted from CET 1 in line with EBA's technical standard for prudent valuation. Aim of the deduction is to adjust for uncertainty of positions measured and recognised at fair value.

At 31 December 2018, the Bank has no deferred tax liabilities that rely on future profitability and that under certain circumstances should have been deducted from Own funds. Below is a specification of Ikano Bank's Own funds as of 31 December 2018.

For standardised settlement of equity instruments and capital, see the Bank's website [www.ikanobank.se](http://www.ikanobank.se) – Additional information Pillar 3. The Bank's balance sheet is described in the Bank's Annual Report for 2018.

## Specification of Own funds

SEK 000	2018
<b>Own funds</b>	
<b>Tier 1 capital</b>	
<b>Equity reported in the balance sheet</b>	<b>5 444 229</b>
Share capital	78 994
Statutory reserve	193 655
Fund for development expenses	276 316
Fund for fair value	204 105
Retained earnings	4 149 951
Net result for the year	541 208
Adjustment for IFRS 9 one-off effect according to transitional arrangements	211 001
Untaxed reserves (78% of which)	294 962
Deductions:	
Intangible assets	-378 747
Cash flow hedge	-12 622
Value adjustments due to the requirements for prudential valuation	-3 720
<b>Total Tier 1 Capital</b>	<b>5 555 103</b>
<b>Total Common Equity Tier 1 Capital</b>	<b>5 555 103</b>
<b>Tier 2 capital</b>	
Subordinated liabilities	839 330
<b>Total Tier 2 Capital</b>	<b>839 330</b>
<b>Total own funds</b>	<b>6 394 433</b>

## 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 28.9 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, distributed across respective exposure classes according to regulations.

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 5.1 bn, resulting in an own funds requirement of SEK 404 m.

The risk exposure amount for foreign exchange risk covers on and off balance sheet items measured at the current market value and converted to Swedish kronor in accordance with the closing rate. Own funds requirements of eight percent are applied to the total net position in foreign currency subject to capital requirements for foreign exchange risk. The Bank's risk exposure amount for foreign exchange risk is SEK 3.3 bn, with an own funds requirement of SEK 266 m.

The Bank's risk exposure amount for CVA risk is SEK 40 m, giving an own funds requirement of SEK 3.2 m.

## Specification of risk exposure amounts and own funds requirements

SEK 000	2018	
	Risk exposure amount	Own funds requirements
<b>Credit risk according to the standardised approach</b>		
Exposures to states and central banks	-	-
Exposures to regional governments or local authorities	11 304	904
Exposures to public sector entities	-	-
Institutional exposure	513 564	41 085
Corporate exposure	3 872 700	309 816
Retail exposure	22 712 835	1 817 027
Equity exposure	29 299	2 344
Past due items	1 181 492	94 519
Covered bond exposure	107 746	8 620
Other items	428 674	34 294
<b>Total credit risk</b>	<b>28 857 614</b>	<b>2 308 609</b>
<b>Operational risk according to the basic indicator approach</b>	<b>5 056 084</b>	<b>404 487</b>
<b>Foreign exchange risk according to the standardised approach</b>	<b>3 328 850</b>	<b>266 308</b>
<b>CVA risk according to the standardised approach</b>	<b>40 019</b>	<b>3 202</b>
<b>Total</b>	<b>37 282 567</b>	<b>2 982 605</b>

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 quar-

ter during the period. Total exposures refer to exposures in the balance sheet after provisions for loan losses and unused credit limits and other commitments.

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

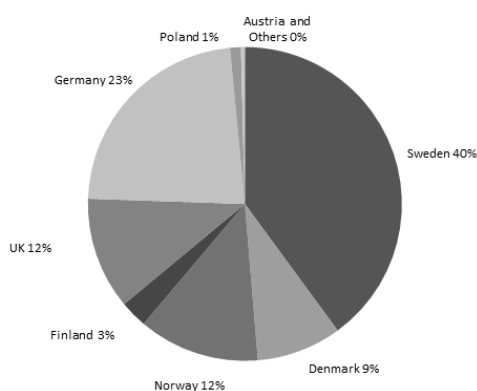
2018 SEK m	Total exposure	Own fund requirement	Average exposure amount
Government and central banks	2 577	-	2 246
Local government and comparable associations	478	1	785
Public sector entities	-	-	4
Institutional exposure	2 524	41	2 326
Corporate exposure	11 518	310	10 021
Retail exposure	62 354	1 817	66 583
Exposures in default	975	95	929
Covered bond exposure	1 077	9	1 109
Equity exposure	29	2	24
Other items	464	34	477
<b>Total</b>	<b>81 996</b>	<b>2 309</b>	<b>84 505</b>



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

2018	United									
SEK 000	Sweden	Denmark	Norway	Kingdom	Finland	Germany	Poland	Austria	Others	
Exposures to Central governments or central banks	-	-	-	-	-	-	-	-	-	-
Exposure to Regional governments or local authorities	826	567	9 842	-	69	-	-	-	-	-
Exposures to institutions	342 525	98 990	1 430	25 736	217	3 811	40 855	-	-	-
Corporate exposure	1 910 393	867 475	413 354	4 059	562 195	2 528	20 234	212	92 250	-
<i>Specific credit risk adjustments deducted above</i>	28 796	10 944	11 193	0	2 815	80	2	-	1 832	-
Retail exposure	8 915 997	2 758 510	1 795 903	4 354 229	496 006	3 937 298	379 112	60 917	14 863	-
<i>Specific credit risk adjustments deducted above</i>	134 459	110 990	69 140	92 257	14 134	110 404	4 116	2 337	353	-
<i>Exposures in default</i>	342 887	233 889	167 750	85 232	95 708	238 864	3 854	7 602	5 706	-
Equity exposures	29 299	-	-	-	-	-	-	-	-	-
Covered bond exposure	73 800	1 515	32 431	-	-	-	-	-	-	-
Other items	261 942	14 303	61 324	19 106	1 292	67 330	3 377	-	-	-
<b>Total Risk Exposure Amount for Credit risk</b>	<b>11 877 670</b>	<b>3 975 249</b>	<b>2 482 034</b>	<b>4 488 363</b>	<b>1 155 486</b>	<b>4 249 832</b>	<b>447 432</b>	<b>68 730</b>	<b>112 818</b>	-
<b>Exposures to small and medium sized companies</b>	-	-	-	-	-	-	-	-	-	-
Corporate exposure	155 345	76 848	26 095	-	22 453	-	96	-	-	-
Retail exposure	2 039 237	1 049 593	592 727	-	262 093	-	0	-	-	-

## Geographical breakdown of exposures



## Total remaining contractual term of exposures shown by class of exposure

2018							Total
SEK m	On demand	<3 months	3-12 months	1-5 years	> 5 years	No tenor	
Government and central banks	499	282	498	1 282	16	-	<b>2 577</b>
Local government and comparable	421	6	13	35	1	-	<b>478</b>
Public sector entities	-	-	-	-	-	-	-
Institutional exposure	18	541	514	1 399	53	-	<b>2 524</b>
Corporate exposure	7 074	1 162	929	2 215	138	-	<b>11 518</b>
Household exposure	30 769	3 842	5 649	12 405	2 521	7 168	<b>62 354</b>
Past due items	26	107	223	596	24	-	<b>975</b>
Covered bond exposure	-	170	153	754	0	-	<b>1 077</b>
Equity exposure	-	3	7	18	1	-	<b>29</b>
Other items	-	52	109	291	12	-	<b>464</b>
<b>Total credit risks</b>	<b>38 806</b>	<b>6 167</b>	<b>8 095</b>	<b>18 995</b>	<b>2 766</b>	<b>7 168</b>	<b>81 996</b>

## Comparison of own funds and capital and leverage ratios with and without the application of transitional arrangements for IFRS 9

SEK m	31 Dec 2018
<b>Available capital</b>	
Common Equity Tier 1 (CET1) capital	5 555
Common Equity Tier 1 (CET1) capital as if IFRS 9 transitional arrangements had not been applied	5 344
Tier 1 capital	5 555
Tier 1 capital as if IFRS 9 transitional arrangements had not been applied	5 344
Total capital	6 394
Total capital as if IFRS 9 transitional arrangements had not been applied	6 183
<b>Risk-weighted assets</b>	
Total risk-weighted assets	37 283
Inphasing	126
Total risk-weighted assets as if IFRS 9 transitional arrangements had not been applied	37 157
<b>Capital ratios</b>	
Common Equity Tier 1 (as a percentage of risk exposure amount)	14.9%
Common Equity Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 transitional arrangements had not been applied	14.4%
Tier 1 (as a percentage of risk exposure amount)	14.9%
Tier 1 (as a percentage of risk exposure amount) as if IFRS 9 transitional arrangements had not been applied	14.4%
Total capital (as a percentage of risk exposure amount)	17.2%
Total capital (as a percentage of risk exposure amount) as if IFRS 9 transitional arrangements had not been applied	16.6%
<b>Leverage ratio</b>	
Leverage ratio total exposure measure	47 259
Leverage ratio	11.8%
Leverage ratio as if IFRS 9 transitional arrangements had not been applied	11.4%

### 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 2018 is 11.8 percent (10.9) and thus above the proposed binding measure. For a specification of Ikanobank's leverage ratio see the file Additional information pillar 3 published on [www.ikanobank.se](http://www.ikanobank.se).