Risk Management and Capital Adequacy (Pillar III) Report

Q4 2019

Bluestep Bank AB (publ)

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1 Introduction

1.1 Purpose

This report provides information on the key elements of internal risk management, capital adequacy, liquidity and remuneration for Bluestep Bank AB (publ) (“**BBAB**” or the “**Bank**”). The information published herein, together with certain information in BBAB’s financial statements, satisfies the regulatory requirements for disclosure applicable to BBAB and allows market participants, including analysts, partner banks, investors, and customers, to assess BBBAB from a risk, capital and liquidity perspective.

1.2 Regulatory context

This report is made in accordance with the disclosure requirements for credit institutions and investment firms set out in Part Eight of the Capital Requirements Regulation (“**CRR**”) along with provisions in the Swedish transposition of the Capital Requirements Directive (“**CRD IV**”) and relevant rules issued by the Swedish Financial Supervisory Authority (“**SFSA**”).[1]

The CRR and the CRD IV are the legislative instruments by which the international Basel III framework has been implemented in the European Union. This framework consists of three “pillars”:

<u>Pillar I</u>
Sets out minimum capital requirements, by providing rules for the measurement of credit risk, credit valuation adjustment risk, market and operational risks.

<u>Pillar II</u>
Establishes a process for assessing capital adequacy in relation to the Bank’s actual risk profile and for determining whether additional capital is required to cover these risks. This is achieved through the Internal Capital and Liquidity Adequacy Assessment Process (“**ICLAAP**”), and the requirement for the SFSA to undertake a supervisory review to assess the robustness of the Bank’s assessment and capabilities.

<u>Pillar III</u>
Supports market discipline with a comprehensive suite of disclosure requirements.

1.3 Scope of application

According to the CRR, BBAB is an institution conducting business in Sweden and in Norway through its branch Bluestep Bank AB (publ), Filial Oslo. During 2020, the Bank is planning to start conducting business in Finland through the branch, Bluestep Bank AB (publ), Filial i Finland.

BBAB is included in a financial group (“**Financial Group**”) for prudential reporting purposes. Bluestep Holding AB is the ultimate parent company in the Financial Group and the information disclosed in this report is therefore on the basis of Bluestep Holding AB’s consolidated situation. The following

[1] Regulation (EU) No 575/2013, The special supervision of credit institutions and investment firms act (2014:968), Regulations (FFFS 2014:12) regarding supervisory requirements and capital buffers, Regulations (FFFS 2010:7) regarding management of liquidity risks in credit institutions and investment firms.

companies are included in the Financial Group: BBAB, Bluestep Finans Funding No 1 AB, Bluestep Servicing AB, Bluestep Mortgage Securities No 2 DAC[2], Bluestep Mortgage Securities No 3 DAC (listed), and Bluestep Mortgage Securities No 4 DAC (listed). All entities are subject to full consolidation.[3]

1.4 Basis of preparation

The Board of Directors ("**Board**") of BBAB has reviewed and approved this report for publication. In this matter, the following terms apply:

- The information in this report is prepared solely to meet the disclosure requirements outlined in Section 1.2 and to provide certain specified information about capital and other risks and details about the management of those risks and for no other purpose. The disclosures do not constitute any form of financial statements relating to the Financial Group or any form of contemporary or forward-looking record or opinion about the Financial Group;
- These disclosures are subject to internal review, challenge and approval processes. An audit trail to support disclosures is maintained;
- Wherever possible and relevant, the Board has ensured consistency between the disclosures of the reporting under Pillar I requirements and the reporting under Pillar II ICLAAP content, e.g. information about risk management practices and capital resources at year-end.

In order not to conflict with requirements under accounting standards and to ease the validation process, the quantitative basis of the disclosures is extracted from the mandated set of reporting explaining the annual financial statements unless otherwise mentioned.

This report is published on the Bank's website: www.bluestepbank.com

1.5 Date and frequency of disclosure

This report reflects situation of the Financial Group as of 31st December 2019.

All disclosures herein are made on an annual basis in conjunction with the publication of the BBAB's financial statements.[4] BBAB assesses on an ongoing basis the need to publish any further disclosures more frequently than annually based on the characteristics of its business.

1.6 Exclusion of non-material, proprietary and confidential information

In accordance with the CRR, the Board may choose to omit certain information from publication in this report if the information is deemed immaterial, proprietary or confidential. These conditions are specified in the regulation as:

- Information is regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

[2] Since February 2019, Bluestep Mortgage Securities NO 2 DAC is a dormant company with no activity and is under liquidation.

[3] The scope of the "BBAB's accounting consolidation" includes all the entities referred to with the exception of Bluestep Holding AB; and, "BBAB's solo level" only includes the Bank and its Norwegian branch.

[4] The disclosures regarding own funds, capital requirements and liquidity risk are also made on a quarterly basis in line with the SFSA requirements.

- Information is regarded as proprietary if disclosing it to the public would undermine the Bank's competitive position.
- Information is regarded as confidential if the Bank has obligations to customers or other counterparty relationships binding it to confidentiality.

1.7 Declaration of the management body

BBAB's Board ensures that the risk management arrangements of the Bank are adequate with regard to its risk profile and strategy. These arrangements are either already implemented or are in the process of implementation as part of an approved action plan. This declaration is based on the reliability of the risk-related information communicated to the Board through the dedicated channels foreseen by the risk governance arrangements. In particular, the Audit, Risk and Compliance Committee ("**ARCCO**") of the Board (see Section 3.4), a sub-committee of the Board, which is the forum where the risk exposures are compared to the Board's risk appetite, and where significant risk events and issues are reported and discussed.

2 Business activities and related risks

2.1 Business overview

BBAB's key business lines are the provision of mortgages to customers in Sweden and Norway who have difficulties in obtaining loans from traditional banks. In addition, BBAB offers savings accounts in Sweden and Norway. To strengthen the strategic direction of mortgage lending, BBAB stopped offering personal loans in mid-February 2020 in Sweden. The Bank's funding is diversified and consists of retail deposits, issued securities (Residential Mortgage Backed Securities ("**RMBS**") and senior unsecured bonds) and contracted credit facilities. In November 2019, the Bank received permission from the SFSA to issue covered bonds in accordance with the Act (2003:1223) on the issue of covered bonds.

2.2 Risk identification

The key risks associated with BBAB's business activities are:

2.2.1 Credit risk

Credit risk is the risk of a counterparty failing to meet its obligations. Given the nature of the business, lending to the public, credit risk is the main risk that the Bank faces. Credit losses arise as a consequence of, firstly, defaults due to inability or unwillingness of a customer or a counterparty to meet their commitments in relation to lending (probability of default) and, secondly, the recoveries from the defaulted assets being insufficient to cover the principal, accrued interest and associated costs (loss given default). In addition, credit risk can be reflected as losses via provisions resulting from a reduction in portfolio values arising from actual or perceived deterioration in credit quality.

2.2.2 Operational risk

Operational risk is defined as the risk of economic loss resulting from processes, people, systems and external events. The definition also includes legal risk.

2.2.3 Credit valuation adjustment risk

Credit valuation adjustment risk ("**CVA**") is part of the counterparty credit risk, meaning the risk of a counterparty to a transaction defaulting before the final settlement of the transaction. Specifically, CVA means that an adjustment is made to the mid-market valuation of a portfolio of transactions with counterparties to reflect the current market value of the credit risk of the counterparty but excludes the current market value of the credit risk of the institution to the counterparty.

2.2.4 Market risk

Market risk is the risk that changes in market prices (including foreign exchange rates and interest rates), will affect the Bank's income and/or the value of the financial instruments it holds.

2.2.5 Interest rate in the banking book

Interest rate risk is the risk to earnings or market values of a loan portfolio due to uncertain future interest rates. In particular, the Bank may suffer losses or reduced profits as interest rates fluctuate over time and as both its asset and liability base comprise a mixture of fixed and floating interest rate items of various maturities and resetting periods. The Bank is therefore exposed to the risk of losses arising from adverse movements in market interest rates and its lending and deposits offered.

2.2.6 Concentration risk

Concentration risk is defined as the risk of suffering losses from a lack of diversification and lending too heavily in one industry, market, geographic area or purchasing only one type of financial instrument. Concentration risk can also arise from concentration in funding and liquidity mix.

2.2.7 Liquidity risk

Liquidity risk is the risk of not being able to meet payment obligations on their due dates without the cost of obtaining the funds increasing considerably.

2.3 Effectiveness of hedges and mitigation

2.3.1 Credit risk

The Bank mainly provides residential mortgages in Sweden and Norway and personal loans up until mid-February 2020 in Sweden, basing its credit strategy on the borrowers' expected ability to repay their debts and credit history. In order to estimate probability of default, the Bank categorises borrowers into different risk grades (both for mortgages and personal loans).

Credit risk is mainly managed through the Bank's credit instructions in which the Bank's risk appetite is defined. Active credit risk management is also achieved through prudent customer selection by the Bank's credit departments, which is part of the first line of defence function within the business. This means that they are responsible for the credit decision process and for adhering to the credit policies and instructions established by the Board. Active credit risk management is also achieved through the collection departments by being responsible for the non-performing loans, i.e. where customers have ceased to service their debt obligations and in so breached their contractual terms and attempt to implore customers to return to orderly payments or take other actions to mitigate the risk of loss.

The performance of the loan books is continuously monitored, and risk drivers analysed, allowing for a better understanding of the underlying risk.

2.3.2 Operational risk

The Bank has a range of measures and tools in place for identifying, evaluating, documenting, controlling and reporting operational risks. During the Bank's history they have been developed into a solid set of policies, instructions, routines and procedures to ensure that staff has the proper competence, training and work experience to maintain the operational risks at an acceptable level in the business.

IT related risks specifically are mitigated through the development of reliable IT-systems with built-in controls, reconciliations, backup procedures and business continuity through contingency plans, continuity plans and disaster recovery plans in the event of a material disruption. The Bank frequently performs tests of continuity management plans.

The day-to-day management of the mortgage loan as well as the personal loan portfolios in Sweden and the administration of deposit accounts for Sweden is outsourced to the Bank's subsidiary Bluestep Servicing ("**BSAB**"). The management of the mortgage portfolio and the administration of deposit accounts for Norway is provided in-house. In order to manage operational risk, the Bank performs regular audits of outsourced business operations and internal controls, as well as their business continuity plans.

2.3.3 Credit valuation adjustment risk

As the Bank uses OTC derivatives for its hedging strategies, the CVA risk is very sensitive to mark-to-market valuations and the terms of the transaction. The Bank frequently assesses and reports CVA exposures. As CVA is a consequence of the hedging activities, and the average term of these activities is below three years, no risk mitigating actions are required.

2.3.4 Market risk

Given its operations in Norway and some funding in EUR, the Bank is exposed to market risk related to changes in foreign exchange rates. The Bank's Treasury function hedges this with derivatives and through currency-matching of liabilities and assets. The Bank has a documented process for managing its market risk exposures in its established policies.

2.3.5 Interest rate risk in the banking book

Following the SFSA's methodology for assessing individual types of risks, exposures to interest rate risk arising as a consequence of interest rate fluctuations are part of the Pillar II capital requirements and the Bank actively manages the risk by matching fixed and floating interest rates and durations of assets and liabilities or, when not possible, by mitigating the risk with hedging instruments. The Bank runs numerous stress scenarios and calculates the interest rate risk exposure under these scenarios. If the exposures breach the limits imposed in the established policy or are close to doing so, the Bank enters into new hedging instruments to reduce the interest rate exposure to within the limits.

While the Bank's Treasury function is responsible maintaining the exposures under the limits established by the Board, the Risk Management function is responsible for monitoring and reporting all aspects of interest rate risk within the Bank, and reports to the Board monthly.

The Bank uses derivative instruments to achieve desired reduction of interest rate risks. Interest rate risks are primarily attributable to fixed rates to a larger extent being applied to lending, whereas financing is to a larger extent conducted at variable rates. The Bank began to apply hedge accounting during 2016 for new derivative transactions.

The Bank measures interest risk exposures on an ongoing basis based on the SFSA's guidance on methods to assess individual risk types under Pillar II. The tables below show the implications for own funds and earning given a positive/negative change in market rates of 200 bps.

	Change	Absolute risk (SEK thousands)	Risk, % of capital base
Increased interest rates	+200bp	-7,196	-0.48%
Decreased interest rates	-200bp	5,390	0.36%

The calculation assumes that market rates increase/decrease by 200 bps and states the instantaneous change in the economic value for the Bank.

	Change	Absolute risk (SEK thousands)	Risk, % of net interest income
Increased interest rates	+200bp	30,125	4.71%
Decreased interest rates	-200bp	-47,979	-7.49%

The calculation assumes that market rates increase/decrease by 200 bps and states the change in the net interest income for the Bank over the next 12 months.

2.3.6 Concentration risk

Since the Bank operates only in Sweden and Norway, and the outstanding loan portfolio mainly consists of secured loans, a certain level of exposure to concentration risk is inherent in the Bank's business model. Concentration risk is one of the core focus areas in customer credit assessment, and the Bank's Risk Management function continuously monitors and assesses the risk to ensure that the risk profile is in line with expectations and managed appropriately. The Chief Risk Officer ("**CRO**") reports to the Board monthly and the Board sets the concentration risk limits through the credit risk strategy.

The concentration risk and associated capital requirements have been assessed under three different categories within the capital requirements for Pillar II: individual concentration, industry concentration and geographical concentration. The total capital requirement for the concentration risk is equal to the sum of the three different categories of concentration risk. Based on this, the Bank maintains sufficient capital for the assessed concentration risk.

2.3.7 Liquidity

The Bank has a low liquidity risk appetite and its policy for managing liquidity risk states that the Bank shall retain enough excess liquidity in a liquidity reserve to meet unforeseen cash outflows. The Bank's liquidity reserve is only composed of highly rated liquid securities (government bonds and covered bonds) and bank account balances according to the Bank's liquidity policy. The Board sets the limit for the minimum liquidity reserve and liquidity buffer that the Bank shall maintain at any time.

The Bank is mainly exposed to liquidity risk related to retail deposits and refinancing of issued securities (RMBS and senior unsecured bonds). As the Bank diversifies its funding sources, deposit product features and pricing are designed to maximize their cost/risk efficiency. The Bank's retail deposits from the public, consisting of Swedish and Norwegian deposit products, are covered by the respective country's deposit guarantee scheme, which also reduces liquidity risk.[5] The Bank offers different deposit products depending on the needs of the Bank and market prices, incorporating this risk into its decision making. For further information see Section 5.

[5] Only minor interest amounts (accrued- and capitalized interests) can exceed amounts guaranteed by the deposit guarantee schemes.

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3 Risk governance and management

3.1 Corporate governance structure

3.1.1 Board[6]

BBAB has a traditional corporate governance structure with shareholders appointing the Board, the Board in turn appointing a Chief Executive Officer ("**CEO**"), supplemented with internal and external auditors. The overall responsibility of the Board cannot be delegated; however, certain board committees (the ARCCO and the Remuneration Committee) monitor, prepare and evaluate issues in its respective areas for decision by the Board. The ultimate responsibility for the Bank's risk organisation and for the maintenance of good internal control lies with the Board.

The Board members are selected on the basis of skills and experience relevant to an organisation of the Bank's size, complexity and business activities. Due attention is paid to the need to ensure a diverse composition of Board members in order to ensure the Board is capable of making objective judgements and providing effective challenge regarding the running of the business.

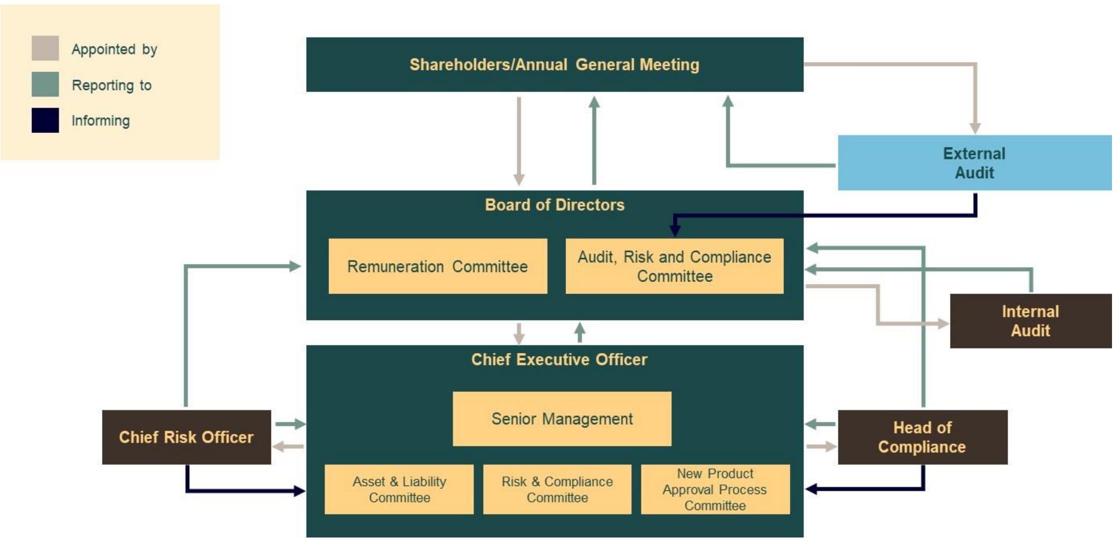
3.1.2 CEO

The CEO has the overall responsibility for managing all of BBAB's risks in accordance with Policies and Instructions adopted by the Board. The CEO shall ensure that the organisation and working methods are appropriate and that the business complies with external and internal rules. The CEO also has a special responsibility to present material information concerning BBAB's risks to the Board; however, there are also independent functions for Risk Management and Compliance that report directly to the Board on a monthly basis.

3.1.3 CRO

The Board appoints the CRO as the function responsible for independent identification, assessment, management, and reporting of risks arising within operations across all businesses and risk types within the organization. The CRO reports to both the Board and the CEO.

Figure 3.1 Risk management governance structure of BBAB



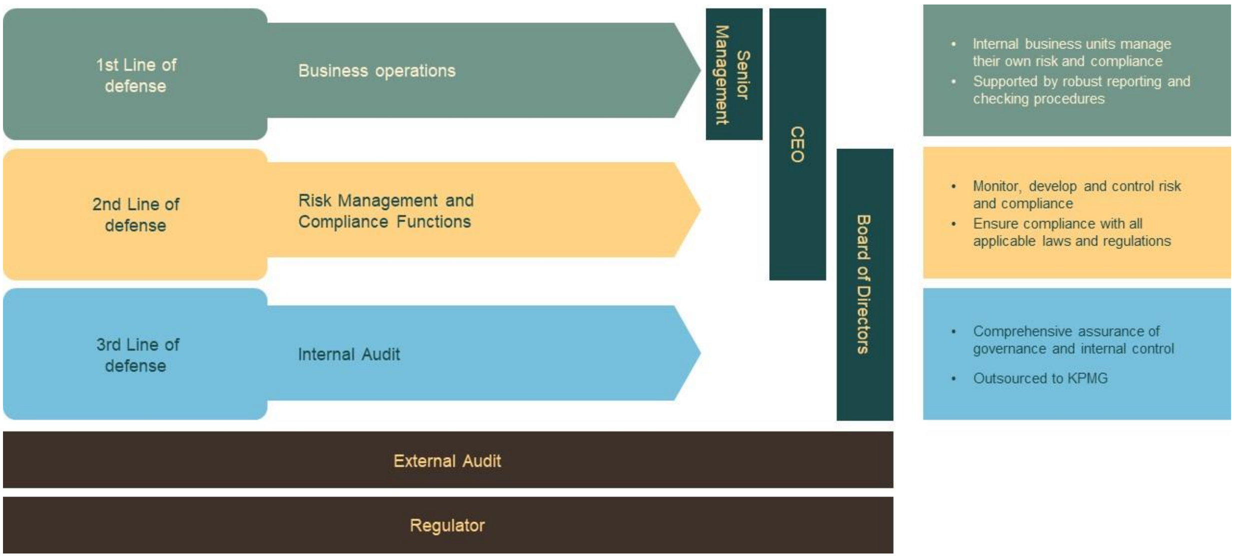
[6] The Board constitutes BBAB's "management body" in the meaning of Article 3.1 (8) CRD IV.

3.2 Risk governance framework

The risk governance framework within BBAB follows the three lines of defense approach. Under this approach:

1. The first line of defense relies on the business units (and departments). They have the primary responsibility for the day-to-day risk management.
2. The second line of defense, represented by the Risk Management and Compliance functions, assisting in determining risk capacity, risk appetite allocation, strategies, policies and structures for managing risks. They also provide oversight, support, monitoring and reporting, and training.
3. The third line of defense, supported by Internal Audit function. They provide independent and objective assurance on the overall effectiveness of the risk governance framework. BBAB has appointed KPMG to manage the Bank's Internal Audit function.

Figure 3.2 Risk governance framework



3.3 Risk management framework

The nature of the business requires it to identify, measure, aggregate and manage its risk effectively, and allocate capital appropriately. Risk and capital are managed via a framework of principles, organizational structures and measurement and monitoring processes that are closely aligned with the activities of the business:

- The Board and the CEO provide overall risk and capital management supervision;
- The ARCCO assists the Board in risk management, compliance and audit areas;
- Three committees, the Asset and Liability Committee ("**ALCO**") and the Risk and Compliance Committee ("**RiCO**") support the CEO in risk and balance sheet management while the New Process Approval Process Committee ("**NPAP**") supports the business in the management of new or changed products and processes (including material organisational changes);
- The three-line defense model ensures business management, risk management oversight and assurance roles are played by functions independent of one another;
- Risk strategy and risk appetite are defined based on strategic plans in order to align risk, capital, and performance targets;

- All major risks are managed via risk management processes, including: credit risk, market risk, operational risk, liquidity risk, and interest rate risk;
- Other risks as business risk, strategic risk and reputational risk are assessed and quantified during the ICLAAP process;
- Where applicable, modelling and measurement approaches for quantifying risk and capital demand are implemented across the major risk classes; and,
- Effective processes and policies are a critical component of BBAB's risk management capability.

3.4 Roles of risk committees

3.4.1 ARCCO

Assists the Board in its oversight of:

- The integrity of the Bank's financial statements and the financial reporting process, including the system of disclosure controls,
- The Bank's compliance with legal and regulatory requirements,
- The performance of the Bank's internal and external audit functions,
- The effectiveness of the Bank's systems of internal controls and policies and procedures for risk assessment and risk management,
- The effectiveness of the Bank's procedures for risk assessment and risk management of material credit, market, interest rate, liquidity, operational, legal and compliance, and other material risks, and the adequacy of capital available to absorb such risks, and
- The review and approvals of certain policies delegated by the Board.

During 2019, the ARCCO met on nine (9) occasions.

3.4.2 ALCO

Assists the business in the management of balance-sheet related risks. These risks are mainly interest rate risk, liquidity risk, FX risk and credit risk. The ALCO is chaired by the Chief Financial Officer. During 2019, the ALCO met on eleven (11) occasions.

3.4.3 RiCO

Aims to improve and promote a strong risk management culture, processes and controls within the Bank by assisting the business in the management of operational and compliance risks. RiCO is chaired by the CRO. During 2019, the RiCO met on seven (7) occasions.

3.4.4 NPAP

Provides the Bank with a uniform procedure for the consideration and evaluation of new or changed products and processes (including material organisational changes). NPAP is chaired by the Head of Compliance. During 2019, the NPAP met on twelve (12) occasions.

3.5 Risk reporting and measurement systems

The Bank has centralized risk data and systems supporting regulatory reporting, as well as internal management reporting for its main risks. The risk infrastructure provides the basis for tailor-made reporting on risk positions and capital adequacy on a regular and ad-hoc basis. Both Finance and

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Treasury, as first line, and Risk Management function, as second line, assume responsibility for measurement, analysis and reporting of risk while ensuring sufficient quality and integrity of risk-related data.

The main risk report is the so-called 'Monthly Risk Report' which comprises an overview of the current risk, capital and liquidity situation of the Financial Group incorporating information on regulatory capital and economic capital adequacy. It is presented to the Board and the ARCCO by the CRO on a quarterly basis and reported monthly.

In addition to the internal reporting, the Bank files all regulatory reports to the supervisory authorities.

3.6 Relevant policies and instructions

The Bank maintains documented policies and instructions covering all material categories of risk the Bank is exposed to. All policies and instructions are approved by the Board or, if authorised, the ARCCO and are subject to review at least annually. Key policies include:

3.6.1 Risk Policy

The Bank's overarching Risk Policy is approved by the Board and ensures that risk taking decisions are made in an objective, documented, and transparent way; based on the Bank's risk appetite and strategy. The policy is not seeking to eliminate risk-taking behaviour or capital loss, but to ensure that they are controlled and managed within the risk appetite limits, and losses communicated at the right forum, in a prompt manner, which can be traced back to the original capital allocation decision. Additionally, better knowledge of the risk and loss drivers will allow the Bank to improve its overall risk management and business returns for each business line.

The Risk Policy oversees all other risk related policies, as well as the ICLAAP methodology, which guidelines the process to be followed during the ICLAAP itself.

3.6.2 Risk Management Policy

The Bank's Risk Management Policy sets the guidelines for the risk management framework. This policy establishes the Board's appointment of the CRO and its mandates, consisting mainly on implementing the Risk Policy.

3.6.3 Credit Instructions and Collections Mandates

These instructions document and define the risk appetite and are the principal means by which lending and collection activities are controlled form a credit risk perspective. Prudent client selection is achieved through the Bank's Credit departments who act as a first line of defence. Active management is also achieved through the Collection departments (collection policies). Finally, performance of the mortgage books is continuously monitored, and risk drivers analysed, allowing for a better understanding of the underlying risk.

3.6.4 Foreign Exchange Rate Risk Policy

The Foreign Exchange Rate Policy approved by the Board provides internal guidance on how exchange rate risks should be managed. The Bank has no trading book thus market risk exposures arise only through non-SEK positions in the banking book (NOK mortgages and EUR RMBS funding).

The Foreign Exchange Rate Policy defines the criteria and the necessary hedging to manage the exposures, sets out the method for calculating FX exposures (in line with CRR) and specifies limits for BBAB's exchange rate risks in terms of capital for individual currencies and total exposure.

3.6.5 Interest Rate Risk Management Policy

The Interest Rate Risk Management Policy approved by the Board sets the guidelines in order to manage interest rate risk in the banking book. The policy follows relevant guidelines from the SFSA and establishes the exposure limits. The Bank actively manages its interest rate exposure in order to be compliant with the policy.

3.6.6 Liquidity and Finance Policy and Instruction

The Bank's Liquidity and Finance Policy and Instruction approved by the Board provides guidance on liquidity risk management regarding the Bank's funding strategy, its risk appetite, stress tests, investments criteria for liquidity reserve and funding contingency plan.

3.6.7 Operational Risk Policy and Instruction

The Bank's Operational Risk Policy and Instruction approved by the Board establishes the approach to manage operational risks within risk appetite limits defined by the Board of the Bank. In line with the Risk Policy, this policy does not seek to eliminate risk-taking behavior or capital loss, but to ensure that they are controlled and managed with losses communicated at the right forum, in a prompt manner, and can be traced back to the original capital allocation decision.

3.6.8 Capital Policy

The Bank's Capital Policy defines the principles and guidelines used by the Bank for capital planning, capital issuance, capital composition and distribution of dividends. The ultimate goal of the policy is to secure the Bank's ability to continue its operations and, thereby, generating returns and benefits for shareholders and other stakeholders.

3.6.9 Recovery Plan

The Recovery Plan approved by the Board defines the procedures to ensure the promptly implementation of recovery actions as well as recovery options. The Recovery Plan contemplates a range of scenarios of macroeconomic and financial stress relevant to the Bank. Recovery plan indicators are monitored and presented in the monthly risk report.

3.6.10 Business Continuity Plans

The Business Continuity Plans ("**BCP**") detail how the Bank, its branch BBNB and its subsidiary BSAB, would continue to operate in the event of a material short or long-term loss or limitation on resources required to operate the business until it is in a position to return to business-as-usual (e.g. in the event of fires, floods, IT-related breakdowns or similar emergencies). The BCPs cover both the contingency and continuity plans. These plans are supplemented with disaster recovery plans for all defined material processes within the business and are included in the Disaster Recovery Plan Instructions ("**DRP**") approved by the CEO.

4 Capital adequacy position

This section summarises the own funds and liquidity situation of the Financial Group, as well as information on the main approaches, requirements and conclusions reported to the SFSA as part of the quarterly COREP reporting and the annual ICLAAP.

4.1 Own funds and capital adequacy per 31 December 2019

Own funds and its composition as of the end of December 2019 and December 2018 are shown in Table 4.1.

Table 4.1 Own funds at Financial Group level

Own Funds (all amounts in thousand SEK, except %)	Amount at 31-Dec-2019	Amount at 31-Dec-2018
Common Equity Tier 1 (CET1) capital: instruments and reserves		
Capital instruments and the related share premium accounts	4,477,416	4,477,416
of which: instrument type 1	*4,477,416*	*4,477,416*
Retained earnings	144,835	-4,069
Independently reviewed interim profits net of any foreseeable charge or dividend	209,993	148,904
Common Equity Tier 1 (CET 1) capital before regulatory adjustments	**4,832,244**	**4,622,251**
CET1 capital: regulatory adjustments		
Intangible assets (net of related tax liability) (-)	-3,357,374	-3,319,201
Total regulatory adjustments to CET1	**-3,357,374**	**-3,319,201**
CET1 capital	**1,474,870**	**1,303,050**
Additional Tier 1 (AT1) capital: instruments		
AT 1 capital before regulatory adjustments	-	-
AT1 capital: regulatory adjustments		
Total regulatory adjustments to AT1 capital	-	-
AT1 capital	-	-
Tier 1 capital (T1= CET1 + AT1)	**1,474,870**	**1,303,050**
Tier 2 (T2) capital: instruments and provisions		
T2 capital before regulatory adjustments	-	-
T2 capital: regulatory adjustments		
Total regulatory adjustments to T2 capital	-	-
Tier 2 capital	-	-
Total capital (TC = T1 + T2)	**1,474,870**	**1,303,050**
Total risk weighted assets	**8,252,345**	**7,466,357**
Capital ratios and buffers		
CET1 (as a % of total risk exposure amount)	*17.87%*	*17.45%*
T1 (as a % of total risk exposure amount)	*17.87%*	*17.45%*
TC (as a % of total risk exposure amount)	*17.87%*	*17.45%*
Institution specific buffer requirement	*5.00%*	*4.50%*
of which: capital conservation buffer requirement	*2.50%*	*2.50%*
of which: countercyclical buffer requirement	*2.50%*	*2.00%*
of which: systemic buffer requirement	-	-
of which: G-SII or O-SII buffer	-	-
CET1 available to meet buffers (as a % of risk exposure amount)	*9.87%*	*9.45%*

4.2 Capital requirements as per 31 December 2019

The Financial Group’s total capital requirements consists of three elements:

4.2.1 Pillar I minimum capital requirement

Calculation of the minimum capital requirement according to Pillar I is performed in accordance with the SFSA’s regulations and general guidelines on prudential requirements and capital buffers.

1. BBAB uses the standardised approach in calculating the credit risk. Credit risk is calculated on all asset items.
2. The capital requirement for foreign exchange risks cover all items on the balance sheet and translated to Swedish kronor at the exchange rate in effect on the balance sheet date. The capital requirement amounts to 8% of the total net position for the majority of the exposures; for closely correlated currencies a lower capital requirement of 4% applies.

3. The capital requirement for operational risks is calculated using the standardised approach, in which all business lines within the Bank have been designated as retail business whereby the capital requirement is 12% of the average net operating income for the last three fiscal years.
4. Capital requirements for CVA are calculated using the standardised approach and relate to positions in OTC derivatives.

4.2.2 Additional requirements under Pillar II

In addition to the statutory minimum capital requirement, credit institutions are expected to make their own assessments of their risks and capital requirements, the ICLAAP under Pillar II. Within the ICLAAP, BBAB performs stress tests to analyse the capital requirement for risks that are not included in the calculation of Pillar I requirements. Based on the outcome of the stress tests, an analysis is made of the institution's total capital requirements and a plan to maintain the capital level. Pillar II requirements will always be beyond Pillar I requirements and together they constitute the Bank's minimum capital requirement.

The SFSA reviews and evaluates risk management and performs controls to ensure that sufficient capital is held for the significant risks that BBAB is exposed to due to its regular supervisory review and evaluation process ("**SREP**").

4.2.3 Combined buffer requirement

In addition to the capital requirements under Pillar I and Pillar II, all institutions covered by the CRR/CRD IV need to hold extra capital in form of a capital buffer. The purpose of this buffer is to serve as a cushion to absorb losses in periods of financial stress. The calculation is performed according to the capital buffers act (2014:966), implementing the capital buffers act (2014:967) and the SFSA's regulations and general guidelines regarding prudential requirements and capital buffers (FFFS 2014:12). The combined buffer requirement shall be met with CET1. If the buffer requirement is not fulfilled restrictions apply on payment of dividends and bonuses.

The combined buffer requirement refers to total CET1 capital required to meet the requirement for the capital conservation buffer ("**CCB**") extended by the following, as applicable:

a) an institution-specific countercyclical capital buffer ("**CCyCB**");

b) a G-SII buffer, not applicable to the Bank;

c) an O-SII buffer, not applicable to the Bank; and,

d) a systemic risk buffer, not applicable to the Bank.

As of the end of December of 2019, the Bank had relevant credit exposures in Sweden and Norway, and the CCyCB factors applied in the jurisdictions were 2.5% in both Sweden and Norway respectively of total risk exposures amounts. Table 4.2 shows the combined buffer requirement at Financial Group level.

Table 4.2 Combined buffers requirement at Financial Group level

Capital buffers requirement (all amounts in thousand SEK)	Amount
Combined buffer requirement	**412,617**
Capital conservation buffer	206,309
Conservation buffer due to macro-prudential or systemic risk identified at the level of a Member State	-
Institution specific countercyclical capital buffer	206,309
Systemic risk buSum of long and short positions of trading book exposures for standardised approaches	-
Global SystemicValue of trading book exposures for internal models	-
Other Systemically Important Institution buffer	-

4.2.4 Combined capital requirements

As a result of applying the methods described in the CRR, the risk weighted exposures amounts ("**REAs**") are those shown in Table 4.3. Capital requirements resulting from these REAs and Pillar 2 needs are shown in Table 4.4.

Table 4.3 Risk weighted exposure amounts for the Financial Group

Risk Weighted Exposure Amount (all amounts in thousand SEK)	Exposure Amounts at 31-Dec-2019	Exposure Amounts at 31-Dec-2018
TOTAL RISK EXPOSURE AMOUNT	**8,252,345**	**7,466,357**
RISK WEIGHTED EXPOSURE AMOUNTS FOR CREDIT, COUNTERPARTY CREDIT AND DILUTION RISKS AND FREE DELIVERIES	6,889,128	6,266,447
Standardised Approach (SA)	6,889,128	6,266,447
SA exposure classes excluding securitisation positions	*6,889,128*	*6,266,447*
Institutions	403,432	459,049
Corporates	-	-
Retail	769,658	748,765
Secured by mortgages on immovable property	5,260,721	4,730,365
Exposures in default	306,754	236,054
Covered bonds	53,406	52,672
Claims on institutions and corporates with a short-term credit assessment	-	-
Other items	95,156	39,541
Securitisation positions SA	-	-
TOTAL RISK EXPOSURE AMOUNT FOR POSITION, FOREIGN EXCHANGE AND COMMODITIES RISKS	259,647	157,784
Risk exposure amount for position, foreign exchange and commodities risks under standardised approaches (SA)	259,647	157,784
Foreign Exchange	259,647	157,784
TOTAL RISK EXPOSURE AMOUNT FOR OPERATIONAL RISK (OpR)	1,036,132	880,826
OpR Standardised (STA) / Alternative Standardised (ASA) approaches	1,036,132	880,826
TOTAL RISK EXPOSURE AMOUNT FOR CREDIT VALUATION ADJUSTMENT	67,439	161,301
Standardised method	67,439	161,301

Table 4.4 Capital needs including Pillar 2 risks for the Financial Group

	Total capital needs ('000 SEK)
Credit risk and counterparty risk	629,261
- which concentration risk	72,736
- including risks associated with exposure to the Swedish mortgages	236,537
- of which reciprocity in other countries' demands	-
Market risk	41,353
- including interest rate risk arising from non-trading book	20,582
Operational risk	82,891
Pension risk	-
Other	412,617
Diversification effects	-
Total	**1,166,122**

4.2.5 Leverage ratio

The leverage ratio is a key ratio that assesses the ability of BBAB to meets its financial obligations. Table 4.5 shows information about the leverage ratio. BBAB shows a healthy leverage ratio level.

Table 4.5 Leverage ratio calculation at Financial Group level

Leverage ratio calculation (all amounts in thousand SEK)	
Exposure Values	**Amount / Ratio**
Total Leverage Ratio exposure	19,268,759
Capital	
Tier 1 capital	1,474,870
Leverage Ratio	
Leverage Ratio	7.65%

5 Liquidity position

5.1 Liquidity risk management

Liquidity risk is the risk of not being able to meet payment obligations on their due dates without the cost of obtaining the funds increasing considerably. The extent of the risk depends on the Financial Group's ability to rise necessary funding to meet its obligations.

The day to day handling of liquidity risk is managed through the Treasury function within BBAB. The CRO acts as the central function for independent control of liquidity and reports to the Board and the CEO.

The liquidity risk appetite of the Financial Group shall be low, and it will retain material amounts of excess liquidity in a liquidity reserve. The liquidity reserve will only be invested in highly rated and liquid investments according to the BBAB Liquidity Policy.

Measurement and reporting of liquidity risk are performed on a daily basis and reported to Senior Management. Liquidity risk is reported monthly to the Board. The reports show key figures on liquidity risk as liquidity reserve, liquidity coverage ratio ("**LCR**") and net stable funding ratio ("**NSFR**") among others. Furthermore, liquidity risk is measured under different scenarios, including stress scenarios.

5.2 Liquidity planning

BBAB runs different scenarios in order to present and better understand liquidity risk. These scenarios include a base case scenario and four stress scenarios which assume that inflow from deposits ceases. The four stress scenarios apply different assumptions on withdrawal of instant access deposits.

The Liquidity Risk Policy also includes a liquidity contingency funding plan in which available funding sources are analysed depending on the severity of the events that can drive BBAB to a shortage of liquidity breaching the limits imposed in the liquidity indicators.

5.3 Liquidity metrics per 31 December 2019

As of the end of December 2019, as shown in Table 5.1, the Financial Group had a LCR of 361%, above the minimum LCR requirement of 100% as established in the CRR for 2019.

Table 5.1 Liquidity coverage ratio at Financial Group level

Liquidity Coverage Ratio ('000 SEK)	Dec-19	Dec-18
Liquidity Coverage Ratio	**361%**	**324%**
High quality liquid assets	926,911	673,152
Total Outflows	1,028,068	832,043
Outflows from retail deposits	918,162	831,406
Other outflows	109,906	637
Total inflows (Max 75% of total outflows)	771,051	624,032
Inflows from retail customers, lending activities	218,025	200,663
Other inflows	1,560,468	1,521,003

Table 5.2 shows the composition of the liquidity reserve as of the end of December 2019.

Table 5.2 Liquidity reserve at Financial Group level

Liquidity Reserve ('000 SEK)	Dec-19	Dec-18
Cash and balances with central banks	266,018	57,432
Deposits in other banks	1,681,714	1,806,381
Securities issued or guaranteed by sovereigns, central banks or multinational development banks	209,405	170,729
Covered bonds	534,058	526,721
Issued by other institutions	534,058	526,721
Securities issued by financial corporates (excl. Covered bonds)	-	-
Total	**2,691,195**	**2,561,262**

6 Unencumbered assets

Table 6.1 contains details on the level of encumbered and unencumbered assets of the Financial Group.

Table 6.1 The Financial Group's asset encumbrance

Disclosure on asset encumbrance ('000 SEK)		
Assets		
	Carrying amount of encumbered assets	Carrying amount of unencumbered assets
Assets of the reporting institution	**6,038,456**	**17,057,730**
Loans on demand	596,325	1,947,729
Equity instruments	-	-
Debt securities	-	743,463
Loans and advances other than loans on demand	5,265,633	10,880,319
Other assets	176,498	3,486,219

7 Remuneration

7.1 Remuneration Policy

BBAB has a Remuneration Policy (the "Policy") which secures sound remuneration structures within the business. The Policy is in agreement with and promotes an effective risk management, thus preventing excessive risk taking and takes into account the size and nature, scope and complexity of the Bank's operation in accordance with the proportionality principle contained in relevant SFSA regulations.[7] In particular, the Bank is not considered to be a Significant Company (*Swe. Betydande företag*).

Furthermore, the Policy, which is based on the Bank's risk analysis, is designed so that remuneration to individual employees does not counteract the Bank's long-term interest. The Bank believes in, and promotes, a sound and dynamic performance culture as a means for achieving long-term success and encourage performance, the right behaviour, and balanced risk taking in line with shareholders'

[7] The SFSA's regulations (FFFS 2011:1) regarding remuneration structures in credit institutions, investment firms and fund management companies licensed to conduct discretionary portfolio management. When adopting the Policy, the SFSA Regulations and General Guidelines (FFFS 2014:1) regarding Governance, Risk Management and Control in Credit institutions and the Commission's delegated regulation (EU) No 604/2014 of 4 March 2014 has also been considered.

expectations. In addition, the Policy supports the Bank's ability to attract, develop, and retain highly motivated, skilled and performance-oriented employees.

The Board resolves the Policy and sees to that it is applied and followed. The Board has elected a Remuneration Committee (the "Committee") to oversee the Policy and that it is implemented, followed-up and that it is based on an analysis of the risks facing the Bank. The Committee consists of two non-executive directors. The Committee has held six (6) meetings during 2019.

To avoid any conflict of interest, the Committee will recommend compensation levels for all identified Remuneration Code Staff ("RCS") (*Swe. "Anställda vars arbetsuppgifter har en väsentlig inverkan på företagets riskprofil"*) in the business and the CEO, or his assignee, will set compensation levels for all non-RCS.

A control function shall when appropriate, and at least annually, review and see to that remuneration within the Bank complies with the Policy. The control function shall immediately report the result of its review to the Board at least annually and no later than in conjunction with the adoption of the annual accounts. To avoid any conflict of interest, the control function will consist of the Bank's Internal Auditors. The control function performed its latest review in March 2020 and presented its statement to the Board on the 22nd of April 2020.

7.2 Risk analysis

As set out in the FFFS 2011:1, financial institutions shall, when it establishes a remuneration policy, conduct a risk analysis with respect to this policy. Before taking any decision relating to the remuneration system, or significant changes to this, a risk analysis shall be conducted with respect to how the remuneration system affects the risks the company is exposed to and how these risks are managed.

The Bank has activities in Sweden, Norway and Finland (2020). BBAB offers, in both Sweden and Norway, predominately two lines of business to the market, one being mortgage lending to private individuals and the other is to take deposits from the general public, in Finland only mortgages will be offered. Furthermore, the Bank did also, up until mid-February 2020, offer personal loans to private individuals in Sweden.

As laid out and analysed in Sections 2 and 3 the Bank's activities give rise to various risks that, if not controlled and handled correctly, could influence the Bank's financial position and result. For example, credit risk, meaning that wrong credit decisions are taken, causing future losses, is together with liquidity risk seen as the main and most severe risk for the Bank. In addition to credit risk and liquidity risk the business faces other material risks which are listed below:

1. Product documentation
2. Reputational (including miss-selling) risk
3. Product design and pricing
4. Market risk
5. Interest Rate and Currency Risk
6. Concentration risk
7. Operational risk
8. Regulatory compliance

Based on the remuneration structure, the control mechanisms in the Bank, the Policy in itself, and the definition of RCS including the claw-back structure enabling BBAB to reduce previously granted bonuses in case risk taking in previous years do not fulfil the long term goals or desired sustainability of the Bank's financial position, it is not believed that the Bank's variable remuneration, nor the Policy, in any way will encourage risk taking beyond what is stipulated through the business strategies set by the Board, but rather should encourage increasing long term shareholder value.

7.3 Remuneration structure

The Bank's remuneration structure is based upon three major components:

- Fixed Salary
- Bonus
- Pension and Insurance schemes

The components are used to achieve an adequate total remuneration with a sound balance between fixed and variable remuneration and short- and long-term remuneration. The Bank has analysed and acknowledges the importance of paying the required compensation, as defined in the Policy, in order to get the appropriately qualified, experienced, capable, and motivated staff. It has also acknowledged the importance to assess the value of the individual to the business based on previous performance within the business or externally and the availability of similarly calibre staff within, or outside, the group. The total remuneration shall reflect the complexity, responsibility, and leadership skills required in the position as well as the performance of the employee.

In order to ensure that the Bank can gain and retain appropriate skills and knowledge to ensure good and adequate level of staff and management, the Board has decided that part of the Bank's remuneration structure shall be variable (Bonus). This is seen to encourage employees to participate in reaching the Bank's strategies, goals and objectives, and at the same time be able to reward employees that show good or exceptional performance in their work.

The balance between fixed and variable remuneration is heavily weighted in favour of fixed remuneration and the variable component does not encourage nor reward excessive risk taking. Furthermore, bonuses may never exceed 100 per cent of any employee's annual fixed compensation.

Bonuses are assessed based on what the individual achieves and contributes in addition to what is generally expected from the position. Bonus rewards are based on the individual's contribution, the contribution of the business unit the individual work in, and the overall performance of the Bank. At the start of each year performance targets (sales, credit and risk profile, costs, compliance, customer service, and other, from time to time, relevant measures) are agreed with each member of staff and these are assessed throughout the year and adjusted if necessary to reflect changes in the business outlook (e.g. changes in credit risk profile, volume targets, service level, and other, from time to time, relevant measures). The overriding core driver behind all targets is to get the desired long-term credit and liquidity risk profile within the business and having this at an acceptable level is the key priority.

In regards of the relation between result and paid remuneration, the remuneration reflects sustained business performance in combination with sound risk management by taking into account the availability and cost of funds, liquidity, desired credit risk profile, capital position and levels of credit losses.

7.4 Remuneration Code Staff and deferred variable remuneration

The general guidelines (FFFS 2011:1) on how financial institutions shall measure, govern, report and exercise control over the risks that may arise from a remuneration system came into force on the 1st of March 2011.

The definition of RCS in the Bank is based on Chapter 2, section 3 of FFFS 2011:1 and in accordance with the CRR, and is in general defined as employees, or other persons part of the Bank, that can significantly influence the risk or risk level of the latter.

To define the RCS in the Bank, BBAB has interpreted the regulations in view of the Bank's business nature, size and complexity. The interpretations have then been used to recognise RCS based on risk areas and risk levels. This analysis has then been discussed internally, in the Committee and the Board has finally decided on who are to be included as RCS. The Board, through recommendations from the Committee, will continuously evaluate the RCS structure and who are included in this group. As of the 31st of December 2019, eighteen (18) employees in the Bank are identified as RCS for 2019.

For these employees, at least 40 per cent of the variable remuneration should be deferred for at least three years. The Board has resolved that the RCS for 2019 shall have their variable remuneration deferred as follows:

Terms of deferral for RCS 2019			
Deferral Period	3 years	5 years	Total*
Employees	6	12	18
Per cent of Deferral	40 %	60 %	Total*
Employees	6	12	18

The deferred variable remuneration may be paid out *pro rata* during the deferral period, commencing one year after the deferral. The deferred variable remuneration may be cancelled in part or in whole if at a later date it is demonstrated that the employee, department or the Bank did not fulfil the performance measures. Employees that leave the Bank during the deferral period do not lose their deferred variable remuneration, other than as required by potential risk adjustments.

To ensure that the material risks recognised and used in setting the deferred remuneration pay-out do not materially impact the Bank, a separate study has been done to stress test the triggers for a payment of the deferred remuneration. The study shows that the deferred remuneration pay-out triggers, based on the company's ICLAAP calculation, do not cause the ICLAAP capital requirements, the retained earnings, the liquidity position, or the need of emergency equity support to be affected in such way that material risk triggers would cause the Bank a long-term issue.

7.5 Remuneration in the Financial Group *(all amounts are in SEK)*

7.5.1 Expensed remuneration 2019

Total remuneration to employees in the Financial Group				
	Total remuneration excluding variable pay[1)]	Total number of employees*	Short- and long-term variable pay[1)]	Number of employees with variable pay**
Sweden	*115 202 084*	*298*	*6 205 611*	*170*
Norway	*44 189 771*	*92*	*2 350 291*	*57*
Total	**159 391 855**	**390**	**8 555 902**	**227**
	Total remuneration excluding variable pay[1)]	**Total number of employees**	**Short- and long-term variable pay[1)]**	**Number of employees with variable pay**
RCS [2)]	*27 129 236*	*18*	*1 469 770*	*15*
Total	**27 129 236**	**18**	**1 469 770**	15

* Total number of individuals that have received fixed remuneration during the year

** Total number of individuals that have received variable remuneration during the year

1) Variable pay is defined as short-term cash-based Bonus (including the deferred part of the Bonus). All other remunerations reported as fixed remuneration and include Fixed Salary and Pension and Insurance schemes. The reported remuneration does not include social charges.

2) As stated in the regulations, information should be published in such manner that the economic conditions for individuals are not revealed. Due to the fact that only three out of the identified RCS are Executives, the Bank has chosen to publish the information for all RCS in totality instead of separating Executives and other RCS. This with the exception for the information published in the annual account in accordance with the Annual Accounts Act for Credit Institutions and Securities Companies.

7.5.2 Specification of remuneration 2019

Short-term cash-based bonus	100 %
Long-term incentive programme*	0 %

* The Financial Group does not offer any long-term incentive programme

7.5.3 Vested, deferred and paid out remuneration

Vested 2019 (total remuneration)				
	Total remuneration excluding variable pay[1)]	Total number of employees	Short- and long-term variable pay	Number of employees with variable pay
RCS [2)]	*17 391 661*	*13*	*2 132 215*	*13*
Non-RCS	*93 209 726*	*212*	*5 460 148*	*212*
Total	**110 601 386**	**225**	**7 592 364**	**225**

Deferred variable remuneration for 2019		
	Total deferred amount*	Total number of employees*
RCS [2)]	*1 098 178*	*11*
Total	**1 098 178**	**11**

Paid out deferred variable remuneration total		
	Total deferred amount paid out	Total number of employees
RCS [2)]	*2 456 933*	*18*
Total	**2 456 933**	**18**

Accumulated deferred variable remuneration		
	Total deferred amount	Total number of employees
RCS [2)]	*4 215 397*	*20*
Total	**4 215 397 [3)]**	**20**

*No RCS bonuses have been awarded for 2019

1) Variable pay is defined as short-term cash-based Bonus (including the deferred part of the Bonus). All other remunerations reported as fixed remuneration and include Fixed Salary and Pension and Insurance schemes. The reported remuneration does not include social charges.
2) As stated in the regulations, information should be published in such a manner that the economic conditions for individuals are not revealed. Due to the fact that only three out of the identified RCS are Executives, the Bank has chosen to publish the information for all RCS in totality instead of separating Executives and other RCS. This with the exception for the information published in the annual account in accordance with the Annual Accounts Act for Credit Institutions and Securities Companies.
3) The deferred variable remuneration may be paid out pro rata during the deferral period, commencing one year after the deferral. The deferred variable remuneration may be cancelled in part or in whole if at a later date it is demonstrated that the employee, department or the Bank did not fulfil the performance measures.

Number of employees in the Financial Group being remunerated EUR 1,000,000 or more in 2019	
Total number of employees	0

7.5.4 Severance pay and guaranteed bonus

Paid out severance pay and guaranteed bonus 2019		
	Total paid out amount	**Total number of employees**
Severance pay	*6 248 328*	*7*
Guaranteed bonus	*0*	*0*
Total	**6 248 328**	**7**