



Nordax Bank

2015

RISK MANAGEMENT AND CAPITAL ADEQUACY REPORT

Nordax Group AB (publ)

Innehåll

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About This Report

Capital adequacy information in this report refers to information which disclosure is provided for in Chapter 6, Sections 3-4 of the Regulations and general recommendations (FFFS 2008:25) on the annual accounts of credit institutions and securities companies (investment firms) and which refers to information in the Swedish Financial Supervisory Authority's regulation regarding prudential requirements and capital buffers (FFFS 2014:12).

Risk management information in this report refers to FFFS 2014:12 and other information required under FFFS 2014:12 is provided on Nordax's website, www.nordax.se.

Information on the consolidated situation

The top company in the consolidated situation is Nordax Group AB (publ). The following companies are included in the consolidated financial statements for the group of financial companies in accordance with full IFRS and in the group-based financial statements for calculation of capital requirements: Nordax Group AB (publ), Nordax Group Holding AB, Nordax Holding AB, Nordax Bank AB (publ), Nordax Finans AS, PMO Sverige OY, Nordax Nordic AB (publ), Nordax Sverige AB, Nordax Sverige 3 AB (publ), Nordax Sverige 4 AB (publ), Nordax Nordic 2 AB and Nordax Nordic 3 AB (publ).

Nordax Group AB (publ) acquired as of May 11 2015, through a share exchange, Nelson Luxco Sarl which was the former ultimate parent company for the Nordax Group. The transaction was purely a share exchange under common control and is considered to be a pure reorganisation. Since this is a reorganisation under common control, and it was carried out through a share exchange Nordax Group AB (publ) cannot be considered the accounting acquirer. Accordingly, the consolidated financial statements prepared as a continuation of the previous Nordax Group.

Information on the Nordax Bank AB (publ)

Nordax Bank AB (publ), referred to as Nordax in this report, is the parent company of a group that includes the subsidiary Nordax Group Holding AB. In its turn, Nordax Group Holding AB owns companies whose business includes owning companies and managing shares in companies whose main operations consist of lending to private individuals in the Nordic region.

Information in this report pertains to conditions as of 31 December 2015 for Nordax Consolidated Situation.

Risk Management

RISK MANAGEMENT FRAMEWORK

Risk Governance

Nordax's Board of Directors has the ultimate responsibility for ensuring that Nordax has an appropriate risk management. The Board of Directors is responsible for adopting Nordax's risk strategy and risk appetite and determining the risk strategy and the risk appetite on a regular basis. The Board of Directors and the CEO are also responsible for regularly evaluating whether Nordax's total risks are being monitored and handled efficiently and appropriately.

The Board of Directors has established a Risk Committee that inter alia ensures that risk taking is measured and controlled. Its main responsibilities include supporting the Board of Directors in identifying and defining risks; monitoring and reviewing Nordax's risk strategy and the implementation thereof; monitoring and reviewing Nordax's risk appetite (including limits and exposures); and monitoring and reviewing risk management policies and practices.

The Board of Directors has further established an Audit Committee that inter alia ensures that Nordax has an effective internal control framework. Its duties include monitoring the financial reporting; internal audits, and risk management in respect of the financial reporting; keeping itself informed regarding audit of the annual report and group accounts; reviewing and monitoring the impartiality and independence of the external auditor; and assisting in the preparation of proposals to the Annual General Meeting's resolution regarding the election of the auditor.

In 2015 the Audit Committee had seven meetings and the Risk Committee had five meetings.

Nordax's Risk Profile Forum, consisting of the CEO, Deputy CEO, CFO, Chief Treasurer, Chief Legal Counsel and Credit risk manager reviews Nordax's risk profile with regards to changes and ranking of risks. The forum ensures that all material risks are monitored and mitigated. The manager for the Risk Control function is the chair of the Risk Profile Forum.

The Board of Directors and the CEO are responsible for adopting internal governing documents regarding risk management. All internal governing documents adopted by the Board of Directors (referred to as policies) or the CEO (referred to as instructions) are reviewed and updated annually or more frequently, if necessary. The Board of Directors has adopted a General Risk and Capital Policy that details the risk framework including risk management roles and responsibilities. The General Risk and Capital Policy is established in accordance with the SFSA's Regulations and General Guidelines regarding governance, risk management and control at credit institutions (FFFS 2014:1).

In addition Nordax has in excess of 30 policies adopted by the Board of Directors including, among others, a Financial Risk Policy, Credit Risk Policy, Operational Risk Policy, IT and Security Policy, Internal Capital Adequacy Assessment Process (ICAAP) Policy and an Outsourcing Policy. Instructions adopted by the CEO include, among others, the Incident Management Instruction, Legal Collection Instruction, Complaints Management Instruction and Delegation of Authority Instruction.

Three Lines of Defense

To ensure adequate control of risks and compliance with laws, regulations and internal governing documents, Nordax's risk management and internal control is built of three lines of defense.

The First Line of Defense – Risk Management by Operations

Nordax's business units and support functions (Credit Risk, Treasury, Decision Science, Legal, Finance, IT, HR, Marketing and Operations) are responsible for the risks that arise in their operations and must identify, assess, control and internally report risks. This includes responsibility for ensuring that clear processes and procedures are in place together with internal governing documents that govern how Nordax must operate in various respects. The first line of defense also includes the First Line Risk and Compliance Function, which assists managers in the operation in identifying, controlling and reporting operational and compliance risks. First line risk managers reports to the CEO and the Board of Directors at least 11 times per year and ad hoc when needed.

The Second Line of Defense – Independent Control Functions

The second line of defense consists of Nordax's Risk Control Function and Compliance Function. These functions are separate from the business operations and from each other and are responsible, in accordance with their policies, for monitoring and controlling that Nordax's business units manage the relevant risks and for advising and supporting employees, the CEO and the Board of Directors in carrying out their activities in accordance with internal and external governing documents. The Risk Control Function and the Compliance Function formally independently report directly to the Board of Directors and to the CEO, and are direct subordinates of the CEO. The members of the functions are knowledgeable of risk management methods and procedures and/or law practices. Regular management and follow-up of risks identified and recommendations issued by the Risk Control Function and the Compliance Function take place on a monthly basis in Nordax's Risk and Compliance Forum and at least quarterly to the Board of Directors.

The Third Line of Defense – Independent Audit

The third line of defense consists of Nordax's Internal Audit Function, which is an independent review function organized under the CEO, and it reports to the Audit Committee and the Board of Directors. The Internal Audit Function is responsible for reviewing and evaluating Nordax's first and second lines of defense in accordance with its policy. The purpose of the Internal Audit Function is to improve Nordax's risk management, governance and internal control.

Risk Appetite

The Board of Directors is responsible for deciding on Nordax's risk appetite which set the overall tone for Nordax's approach to risk taking. The risk appetite is the articulation in written form of the aggregate level of risk that Nordax is willing to accept and is documented in Nordax's general Risk and Capital policy. The risk appetite is further concretized by Nordax's limit framework for tolerated risk exposure. The risk

appetite and limit framework are designed to secure Nordax's desired risk profile. This includes clear roles, responsibilities, escalation, reporting routines and consequences in the event of any breaches to the risk appetite and limit framework. Nordax's risk profile is monitored and followed up in relation to the risk appetite by the Risk Control function. The Risk Control function reports developments in risk levels to the Risk Committee and the Board of Directors at least four times per year.

Risk Appetite Statement

Credit risk

"Nordax shall have a high credit quality portfolio based on lending to financially stable customers and not entering into any high risk markets."

Market risk

"Nordax shall minimize market risks to a great extent by limitation of interest rate risk by matching of lending assets and liabilities, and matching of assets and liabilities in the same currency."

Liquidity risk

"Nordax shall minimize liquidity and refinancing risk by holding a liquidity reserve consisting of assets with a very high degree of market liquidity, and having a well-diversified funding in terms of markets, investors, instruments, maturity, currencies and geography."

Operational risk

"Nordax shall reduce operational risks by having a high level of internal control with clear roles and responsibilities within the three lines of defense and a well-functioning incident reporting system."

Strategic risk

"Nordax shall have a conservative approach to strategic risk by limiting major strategic decisions or investments until successfully tested, and by maintaining capital strength in order to sustain its aggregated risks."

OVERVIEW OF NORDAX'S OVERALL RISK PROFILE

Credit risk

"Nordax shall have a high credit quality portfolio based on lending to financially stable customers and not entering into any high risk markets."

Nordax defines credit risk as the risk that a counterparty or obligor fails to meet its contractual obligations towards Nordax, including consumer loans, investments, derivatives and other assets.

The credit risk exposure is concentrated to the Nordic region and Germany; Norway is the bank's largest market, with a loan portfolio to the general public of 4.13 bn SEK, followed by Sweden with a loan portfolio of 4.03 bn SEK. The credit loss ratio increased from 1.2% to 1.5% in 2015, due to external macro-economic factors and maturation of the portfolio. Nordax does not enter any market positions for speculative purposes, and the counterparty exposure is very short and almost entirely against highly rated institutions.

Nordax had a liquidity reserve at 31 December 2015 of MSEK 2,552 (3,246). Of these investments, 55 (51) per cent was in Nordic banks, 16 (19) per cent in Swedish covered bonds and 29 (30) per cent in Swedish municipal papers. All investments had credit ratings ranging from AAA to A+ from Standard & Poor's, with an average rating of AA (except 27 MSEK in exposure to Avanza Bank AB). The average maturity was 48 (68) days. All bank holdings are accessible and all securities are repoable with central banks.

Market risk

"Nordax shall minimize market risks to a great extent by limitation of interest rate risk by matching of lending assets and liabilities, and matching of assets and liabilities in the same currency."

Nordax defines market risk as the risk that Nordax's result or equity decreases due to changes in risk factors in the financial markets. Market risk includes interest rate risk, price risk and exchange rate risk.

Nordax's interest rate risk exposure is attributable to cash flow and fair values, and is very limited. The interest rate risk is measured as a change in present values of the financial net position given a 200 bps increase of the present interest rate level (i.e. a parallel shift of yield curves). The interest rate risk exposure shall be calculated for each currency and be added as absolute numbers. The limit determined by the Board of Directors is a net exposure of MSEK 20 (20), and the actual exposure at year-end was 7 MSEK (11).

Price risk is attributable to changes in market values, which do not occur due to interest rate changes, of Nordax's investments of the liquidity reserve. The risk is mitigated by investments only in stable counterparties with satisfactory credit ratings and with relatively short maturities. Price risk is not subject to limitation by the Board.

Nordax is active in the Nordic countries and Germany and is exposed to currency risks arising from currency exposure in NOK, DKK and EUR against SEK. Currency risks are minimized by hedging. However, Nordax is exposed to some currency risk in its profit and loss account to ensure preservation of its capital ratios.

The current limit for currency risk adopted by the Board is 700 MSEK (700), and refers to maximum permitted net exposure in foreign currencies. Actual exposure totalled 624 MSEK (541), broken down into 394 MNOK (332), 13 MDKK (13) and 25 MEUR (18). A change of 5% in the value of SEK against the other currencies would cause a change in profit/loss of 31 MSEK (27), broken down into 20 MNOK (16), 0,6 MDKK (0.6) and 1.3 MEUR (0.9).

Liquidity risk

"Nordax shall minimize liquidity and refinancing risk by holding a liquidity reserve consisting of assets with a very high degree of market liquidity, and having a well-diversified funding in terms of markets, investors, instruments, maturity, currencies and geography."

The Group defines liquidity risk as the risk of failing to fulfil payment obligations at maturity without a significant increase in the cost of obtaining means of payment.

The strategy to have diversified funding was continued in 2015 by the launch of the bank's fifth ABS transaction, backed by a portfolio of Swedish consumer loans and ratings provided by Fitch and DBRS. To further strengthen the capital structure, 250 MSEK of subordinated Tier 2 capital, replacing the existing 200 MSEK subordinated loan, was issued.

At 31 December 2015 Nordax's sources of funding comprised MSEK 2,763 (3,110) in funding through the asset-backed securities market (securitised), MSEK 453 (500) in senior unsecured bonds, MSEK 2,891 (2,274) in warehouse funding facilities provided by international banks in addition to MSEK 5,991 (6,460) in Deposits from the general public. The figures refer to the nominal amounts.

At 31 December 2015 Nordax had a liquidity coverage ratio (according to the EBA definition) of 676 % (840 %) and a net stable funding ratio of 127% (146%).

Operational risk

"Nordax shall reduce operational risks by having a high level of internal control with clear roles and responsibilities within the three lines of defense and a well-functioning incident reporting system."

Nordax defines operational risk as the risk of loss resulting from inadequate or failed processes, people and systems or from external events, including legal and compliance risk.

Operational risks are kept at low levels by the bank's internal control framework. The bank has risk and compliance coordinators in the first line of defence that supports the business with implementation and daily follow up of regulatory requirements as well as ensuring efficient controls in the business's processes. In 2015 the bank invested in a system to support government, risk and compliance processes and further increase oversight and control.

The Board of Directors has approved a maximum limit for operational losses that is regularly monitored and followed up by the Risk Control function. In 2015, operational losses amounted to 0.55 MSEK; a very low level and in line with previous years.

Capital Management

CAPITAL MANAGEMENT AND CAPITAL ADEQUACY

Capital planning

Nordax's goal regarding its capital structure is, in addition to meeting the statutory capital requirements, to secure its ability to continue its operations with regards to generate returns to shareholders and benefits for other interested parties. Nordax assesses that after a period in which the global financial system was exposed to stress, a greater capital buffer is required than the amount considered to comprise the optimal capital structure under normal conditions. In line with this Nordax aims to keep a buffer that is larger than the capital requirements for tier 1 capital ratio and total capital ratio by 1.5%. The capital cover at the end of the financial year is being assessed as more than sufficient to meet requirements from governments and internal stress tests of the operations. Nordax intends to distribute dividend in line with dividend policy. After dividend Nordax capital structure will sustain the statutory capital requirements as well as internal buffer levels. Planned dividend has been deducted from own funds below.

Nordax's strategies and methods for valuing and maintaining the own funds requirement are based on its risk management. The risk management aims at identifying and analysing the risks to which Nordax is exposed in its operations and at establishing appropriate limitations to these and also at ensuring that controls are in place. The risks are monitored and controls are undertaken on an on-going basis to ensure that the limits are not exceeded.

Internal capital adequacy assessment process

In order to assess whether the regulatory capital is sufficient for current and future operations, and in order to ensure that the own funds is of the correct amount and composition, Nordax has a process for Internal Capital Adequacy Assessment.

ICAAP encompasses Nordax's internal views on material risks and the amount of capital it considers necessary in addition to the requirements of the regulatory framework for capital adequacy. This process is a tool ensuring that Nordax, in a clear and reliable manner, identifies and assesses all the risks to which it is exposed, as well as making an assessment of Nordax's internal capital requirements in relation to hereto. This includes ensuring that Nordax has appropriate guidance and control functions and risk management systems. The internal capital assessment is performed, as a minimum, on an annual basis.

Based on possible scenarios, plans are established in order to limit any harmful effects on Nordax and ensuring an adequate capital buffer to absorb these losses without the necessity of capital injections to ensure the minimum statutory requirements. Historical information is also utilised, for example, the manner in which credit losses can develop through an economic cycle. Nordax subsequently stress test the capital requirement to ensure a sufficient capital supply through the periods showing the possible worst case scenarios.

CAPITAL ADEQUACY

Disclosure according to Article 5 in Commission implementing regulation (EU) 1423/2013

All amounts are in MSEK

	Consolidated situation	
	31 DECEMBER 2015	31 DECEMBER 2014
OWN FUNDS		
Common Equity Tier 1 capital	1,678	1,538
Deduction from Tier 1 capital	-309	-304
Tier 1 capital	1,369	1,234
Tier 2 capital	217	159
Net own funds	1,586	1,393
Risk exposure amount for credit risk	8,745	8,234
Risk exposure amount for market risk	624	541
Risk exposure amount for operational risk	1,465	1,271
Total amount of risk exposure	10,834	10,046
Core Tier 1 capital ratio	12.64%	12.28%
Tier 1 capital ratio	12.64%	12.28%
Total capital ratio	14.64%	13.86%
Capital adequacy ratio (own funds / capital requirement)	1.83	1.73
Total Common Equity Tier 1 capital requirement including buffer requirement	7.72%	7.00%
- of which capital conservation buffer requirement	2.50%	2.50%
- of which countercyclical capital buffer requirement	0.72%	-
Common Equity Tier 1 capital available for use as buffer ¹	8.14%	7.78%
Specification of own funds		
Common Equity Tier 1 capital		
- Capital instruments and related share premium reserve	847	847
- of which share capital	111	1
- of which other paid-in capital	736	846
- Retained earnings	691	437
- Independently reviewed interim results, adjusted for forecast dividend ²	140	254
Common Equity Tier 1 capital before regulatory adjustments	1,678	1,538
Regulatory adjustments:		
- Intangible assets	-309	-304
Total regulatory adjustments for CET 1	-309	-304
Tier 1 capital	1,369	1,234
Tier 2 capital		
-Tier 2 capital, instruments	217	159
Tier 2 capital	217	159
Total capital	1,586	1,393
Specification of amount of risk exposure³		
Institutional exposures	365	444
Covered bonds	41	60
Household exposures	7,629	7,085
Past due items	669	597
Other items	41	48
Total risk exposure amount for credit risk, Standardised Approach	8,745	8,234
Exchange rate risk		
Total risk exposure amount for market risk	624	541
	624	541
Basic Indicator Approach		
Total risk exposure amount for operational risks	1,465	1,271
	1,465	1,271
LEVERAGE RATIO		
Exposure measure for calculating leverage ratio		
Leverage ratio	13,862	13,893
Gross Equity ratio	9.88%	8.88%

¹ Common Equity Tier 1 capital ratio 12.64% less the statutory minimum requirement of 4.5% excluding the capital conservation buffer requirement. A total capital requirement of a further 6.72% of which a capital conservation buffer of 2.50%, a counter cyclical capital buffer of 0.72% and other capital of 3.5%.

² Of which net profit SEK 195 (254) million and SEK -55 (-) million adjustment for forecast dividend. The Swedish Financial Supervisory Authority has approved Nordax's application to increase the capital base on condition that the responsible auditor has reviewed the surplus, that the surplus has been calculated in accordance with applicable accounting rules, that predicted costs and dividends have been deducted in accordance with Regulation (EU) No 575/2013 and that the calculation has been made in accordance with Regulation (EU) No 241/2014.

³ The capital requirement is 8% of the amount of risk exposure pursuant to Regulation (EU) No 575/2013 (CRR).

**OWN FUNDS
(cont.): Tier 2 capital**

Disclosure template for main features of regulatory capital instruments, Consolidated situation		31 DECEMBER 2015
1	Issuer	Nordax Bank AB
2	Unique identifier (eg CUSIP, ISIN, or Bloomberg identifier for private placement)	ISIN:SE0006758249
3	Governing law(s) of the instrument	Swedish
	Regulatory treatment	
4	Transitional Basel III rules	Tier 2
5	Post-transitional Basel III rules	Tier 2
6	Eligible at solo/group/group&solo	Solo and Group
7	Instrument type	Tier 2 Subordinated debt
8	Amount recognised in regulatory capital (Currency in millions, as of most recent reporting date)	SEK 217,000,000
9	Par value of instrument	SEK 250,000,000
10	Accounting classification	Liability - amortised cost
11	Original date of issuance	18 March 2015
12	Perpetual or dated	Dated
13	Original maturity date	18 March 2025
14	Issuer call subject to prior supervisory approval	Yes
15	Optional call date, contingent call dates and redemption amount	18 March 2020 at 100 %, Tax call and regulatory treatment call.
16	Subsequent call dates, if applicable	Each Interest Payment Date
	Coupons/dividends	
17	Fixed or floating dividend/coupon	Floating
18	Coupon rate and any related index	3-month STIBOR plus 5,75 %
19	Existence of a dividend stopper	No
20	Fully discretionary, partially discretionary or mandatory	Mandatory
21	Existence of a step up or other incentive to redeem	No
22	Noncumulative or cumulative	N/A
23	Convertible or non-convertible	Non-convertible
24	If convertible, conversion trigger (s)	
25	If convertible, fully or partially	
26	If convertible, conversion rate	
27	If convertible, mandatory or optional conversion	
28	If convertible, specify instrument type convertible into	
29	If convertible, specify issuer of instrument it converts into	
30	Write-down feature	No
31	If write-down, write-down trigger (s)	
32	If write-down, full or partial	
33	If write-down, permanent or temporary	
34	If temporary write-down, description of write-down mechanism	
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Senior debt
36	Non-compliant transitioned features	No
37	If yes, specify non-compliant features	

Credit Risk

CREDIT RISK MANAGEMENT

The Board of Directors has adopted an umbrella Credit Policy with principles for Nordax's credit risk strategy, credit risk management, and the credit rules applicable in a credit assessment. In addition to this umbrella policy, the Board of Directors has adopted country-specific credit and collection policies with requirements and reserves policies.

Approval process

Credit decisions are made on the basis of a credit scoring model in combination with a number of policy rules and affordability calculation.

The credit score cards are used to measure an applicant's likelihood of paying back the debt. The model combines several characteristics, evaluates them and calculates a numerical expression which indicates the applicant's likelihood of being both willing and able to pay back the loan based on historical patterns. The score models are monitored regularly, and if needed, adjusted or replaced with new models to ensure that they perform according to expectations.

The calculated score value provides the basis for Nordax's risk classification. Each approved customer is assigned a risk class at the time of approval. These are harmonised across all markets to enhance Nordax's ability to analyse comparative credit risk in all markets. When the customer applies for an additional loan the risk classification is re-evaluated based on the current information.

Limits and risk reviews

In the last stage of the core underwriting activities and underwriting process, Nordax assigns a credit limit to the applicant. The limit is derived using a limit matrix based on the applicant's risk score from Nordax's internal scoring model in combination with the applicant's income.

After receiving the loan application, Nordax conducts fraud and anti-money laundering control and determines whether the applicant is an existing customer. Nordax has clearly defined policy rules aimed at ensuring the automatic rejection of applicants who do not meet the minimum criteria. The minimum criteria include, but are not limited to, a regular income equal to or above defined levels, minimum and maximum age, a permanent address, a telephone number and the absence of bad debt. No deviations from these policy rules are accepted.

Measurement of credit risk

Credit risk in the portfolio is monitored on an on-going basis against established goals. Among other things, this monitoring is carried out on the basis of the development of the credits over time, depending both on the age of the individual credits (so-called vintage) and on the maturity of the total portfolio.

An analysis is made of the risk that a credit will lead to a claim, as well as regards any write-down requirement.

Additionally, continuous analyses are made of various segments that are of significance for credit scoring. The results of these measurements then form the basis for the on-going assessment made on the basis of the parameters in the scoring model. If necessary, the model forming the foundation for credit granting is adjusted.

The Credit risk department prepares monthly standard credit risk reports that include information on vintages, demographics, roll rates and forecasts, scorecard performance, underwriting performance, sourcing channel performance, macroeconomic trends, collections demographics approval rates and fraud. In addition, the Credit risk department prepares ad hoc reports on limit matrix performance and follow-up reports on marketing and operations, among others.

The Credit risk department is responsible for reporting Nordax's credit risk to the CEO and the Board of Directors. The Risk Control function is responsible for reporting developments in credit risk levels and follows up against approved limits to the CEO and Board of Directors.

INVESTMENT RISK AND COUNTERPARTY RISK IN DERIVATIVE CONTRACTS

Investment risk is related to all investments apart from the loan portfolios, i.e. on bank accounts as well as time deposits and securities.

Counterparty risk is related to derivative transactions or another type of counterparty exposure. For transactions where the future obligations are transferred to a clearing organization the counterparty risk is assumed to be immaterial, i.e. zero. Nordax is exposed to counterparty risk primarily as a result of its use of derivative contracts for hedging currency risk.

Nordax is also exposed to some limited counterparty risk as a result of its intra-group loans to funding subsidiaries.

Management of Investment and Counterparty risk

Investment risk is measured per nominal amount and per counterparty. The risk should be recognized from the day the contractual obligation is entered into, i.e. the trade date when buying securities. At redemption, if the redeemed amount is immediately reinvested with the same counterparty, the counterparty exposure is not to be calculated twice between the trade date and the value date. The risk ends on the day that money is received, i.e. when the obligation has been fulfilled.

Counterparty risk is measured as a combination of compensation costs and a risk of further negative changes in value, in accordance with the guidelines for SFSA reporting.

To mitigate investment risk and counterparty risk, Nordax enters into investments and hedging transactions only with stable counterparties with satisfactory credit ratings. Pursuant to Nordax's Financial Risk Policy, it may only invest in approved instruments with specified minimum credit ratings, or other instruments approved by the Board of Directors.

CREDIT RISK INFORMATION

Risk concentrations in financial assets with credit risk exposure – geographical areas

A breakdown of credit exposure by geographical area is presented below. The values are carrying amounts. The allocations based on the domiciles of borrowers.

CONSOLIDATED SITUATION

31 December 2015, MSEK	Sweden	Norway	Denmark	Finland	Germany	TOTAL
Lending to credit institutions	1,810					1,810
Lending to the general public	4,025	4,125	179	1,964	548	10,841
Bonds and other fixed-income securities	1,157					1,157
Total	6,992	4,125	179	1,964	548	13,808

31 December 2014, MSEK	Sweden	Norway	Denmark	Finland	Germany	TOTAL
Lending to credit institutions	2,212					2,212
Lending to the general public	3,880	3,934	246	1,688	294	10,042
Bonds and other fixed-income securities	1,585					1,585
Total	7,677	3,934	246	1,688	294	13,839

CONSOLIDATED SITUATION

All amounts are in MSEK	31 DECEMBER 2015	31 DECEMBER 2014
Credit quality pertaining to fully functioning loan receivables¹		
Rating A	707	762
Rating B	1,982	1,849
Rating C	3,843	3,394
Rating D	2,712	2,578
Rating E	445	520
No rating	159	36
Total	9,848	9,139

¹ Credit quality is based on ratings A to E, where A is the lowest risk and E is the highest risk. Creditworthiness is determined using a model for calculating the probability that a borrower will be able to adhere to the concluded agreements ("credit scoring").

Market Risk

MARKET RISK MANAGEMENT

Nordax's market risk exposure comprises of interest rate risk, price risk and foreign exchange risk.

Nordax is exposed to interest rate risks attributable to cash flow and fair value. The major part of Nordax's assets and liabilities have a fixed interest term of one month. Subsequently, Nordax's interest rate risks are very limited, both in respect of the fair value of assets and liabilities and the margin between interest income and interest expenses.

Price risk is attributable to changes in market values, which do not occur due to interest rate changes, of Nordax's investments of the liquidity reserve. The risk is mitigated by investments only in stable counterparties with satisfactory credit ratings and with relatively short maturities. Price risk is not subject to limitation by the Board.

Nordax's most significant currency risk arises in the translation of receivables and liabilities in foreign currencies. Nordax's policy is to limit the risk by matching assets and liabilities in the same currency and when considered necessary, to use derivative instruments to attain this balance. Nordax protects its regulatory capital by taking on some currency risk, which may arise due to exchange rate effects with respect to the portfolios that are denominated in foreign currency. The impact on the regulatory capital due to exchange rate effects on the portfolios is then offset by a corresponding effect on group earnings.

Measurement of interest rate risk

The interest rate risk is measured as a change in present values of the financial net position given a 200 bps increase of the present interest rate level (i.e. a parallel shift of yield curves). The interest rate risk exposure shall be calculated for each currency and be added as absolute numbers. The limit determined by the Board of Directors is a net exposure of 20 MSEK (20), and the actual exposure at year-end was 7 MSEK (11).

Management of interest rate risk

The interest rate risk is measured and managed by Nordax's Treasury Department. The Board of Directors determines the limits for the maximum allowed interest rate risk. Interest rate risk levels are reported monthly to the Board of Directors by the Treasury department and the Risk Control function. Interest margin is monitored by Nordax's Interest margin forum on a monthly basis, which is responsible for analysing the development of the net margin. The Interest margin forum is chaired by the CFO and participants are the CEO, Deputy CEO, Treasurer and representatives from senior management from respective departments.

Measurement of foreign exchange rate risk

Nordax divides foreign exchange exposure into groups:

Transaction exposure: Future contracted cash flows in foreign currency (will eventually turn into translation exposure). Any contracted future in- or outflows of cash in other currencies than SEK. A contracted cash flow is defined by the amount and time set for payment. Deferred purchase price payable by a funding subsidiary to Nordax under the funding structures are classified as contracted cash flows. Future interest payments, not yet accrued, on financial items in foreign currency are to be excluded from the transaction exposure.

Translation exposure: Assets and liabilities denominated in foreign currency on the balance sheet. Translation exposure is measured for each subsidiary separately. The translation exposure is calculated as the net exposure (assets + liabilities) in other currencies than Nordax's reporting currency. Only nominal amounts will be considered, not accrued interests. The Board of Directors may approve strategic exposures towards currencies in which Nordax conducts business. Such approved strategic exposures should be deducted from the translation net exposure.

Management of foreign exchange rate risk

The Board of Directors has adopted a policy stipulating that Nordax continually measures and reports its foreign exchange-rate risk. The policy contains adopted limits for maximum permitted net exposure in foreign currencies. The current limit adopted by the Board is 700 MSEK (700), and actual exposure totalled 624 MSEK (541), broken down into 394 MNOK (332), 13 MDKK (13) and 25 MEUR (18). A change of 5% in the value of SEK against the other currencies would cause a change in profit/loss of 31 MSEK (27), broken down into 20 MNOK (16), 0,6 MDKK (0.6) and 1,3 MEUR (0.9).

Liquidity Risk

LIQUIDITY RISK MANAGEMENT

The Group's long-term strategy is to match lending assets with the maturities of liabilities. The strategy is aimed at achieving a diversified funding platform comprising equity, subordinated debt, asset backed securities ("ABS"), bank warehouse funding facilities, deposits from the general public and senior unsecured bonds. The Group uses asset-backed borrowing in which parts of the Group's asset portfolios are pledged as collateral for the loans.

The goal is to use funding sources which:

- Provide a high degree of matching, of currencies and interest period as well as maturities, between assets and liabilities.
- Offer diversification in terms of markets, investors, instruments, maturities, currencies, counterparties and geography.
- Carry a low liquidity risk and offer a high possibility of refinancing at maturity, as evidenced by price stability, regularity of issuance and a broad investor base.
- Provide access to relatively large volumes, to meet the funding requirements for a growing balance sheet.

Management of Liquidity risk

Liquidity is measured on a daily basis and reported to Nordax's management. Liquidity risk is reported to the Board of Directors at each board meeting.

Cash flows expected to result from the liquidation of all assets, liabilities and off-balance sheet items are calculated. Key ratios from the balance sheet (such as the cash ratio, loan-to-deposit ratio, liquidity coverage ratio, net stable funding ratio and deposit usage) are calculated and monitored over time to illustrate the financial structure and the Group's liquidity risk. Liquidity risk is measured monthly for different scenarios and events (such as less favourable advance rates and changed cash flows) and analysed separately and in combination.

Nordax's liquidity contingency plan specifies roles and responsibilities and contains instructions for how Nordax should respond in a liquidity crisis situation. The plan specifies appropriate actions for managing the consequences of different crisis situations and contains definitions of events which shall trigger and escalate the contingency plan. The contingency plan is regularly tested and updated.

Nordax had a liquidity reserve at 31 December 2015 of MSEK 2,552 (3,246). Of these investments, 55 (51) per cent was in Nordic banks, 16 (19) per cent in Swedish covered bonds and 29 (30) per cent in Swedish municipal papers. All investments had credit ratings ranging from AAA to A+ from Standard & Poor's, with an average rating of AA (except 27 MSEK in exposure to Avanza Bank AB). The average maturity was 48 (68) days. All bank holdings are accessible and all securities are repo-able with central banks.

CONSOLIDATED SITUATION

Encumbered and non-encumbered assets

31 December 2015, MSEK	Matching liabilities, contingent liabilities or securities lent	of which: from other entities of the group	Assets, collateral received and own-debt securities issued other than covered bonds and ABSs encumbered	of which: collateral received re-used	of which: own debt securities encumbered
Carrying amount of selected financial liabilities	3,187	0	4,646	0	0
Derivatives					
of which: Over-The-Counter					
Deposits					
Repurchase agreements					
of which: central banks					
Collateralised deposits other than repurchase agreements					
of which: central banks					
Debt securities issued	3,187		4,646		
of which: covered bonds issued					
of which: asset-backed securities issued					
Other sources of encumbrance	2,880	0	5,141	0	0
Nominal of loan commitments received					
Nominal of financial guarantees received					
Fair value of securities borrowed with non cash-collateral					
Other	2,880		5,141		
TOTAL SOURCES OF ENCUMBRANCE	6,067	0	9,787	0	0

	Carrying amount of encumbered assets	of which: issued by other entities of the group	of which: central bank's eligible	Carrying amount of non-encumbered assets	of which: issued by other entities of the group	of which: central bank's eligible
Assets of the reporting institution	9,787	0	0	4,375	0	0
Loans on demand	597			1,213		
Equity instruments						
Debt securities				1,157		
of which: covered bonds				412		
of which: asset-backed securities						
of which: issued by general governments				745		
of which: issued by financial corporations						
of which: issued by non-financial corporations						
Loans and advances other than loans on demand	9,190			1,651		
of which: mortgage loans						
Other assets				353		

Operational Risk

OPERATIONAL RISK MANAGEMENT

The Board of Directors has adopted a policy for the management of operational risks. The policy contains the Board's principles for ensuring that Nordax has a sound and effective risk management with regards to identification, measurement, monitoring and control of operational risks.

Nordax has put great emphasis on establishing an organization with routines and instructions designed to achieve both a high level of internal control as well as backup routines in the event of damage. Nordax has a function in the first line of defense with compliance and risk coordinators supporting the business with implementation and daily follow up of regulatory requirements as well as ensuring efficient controls in the department's processes. In 2015 the bank invested in a system to support government, risk and compliance processes and further increase oversight and control.

The Board of Directors has approved a maximum limit for operational losses that is regularly monitored and followed up by the Risk Control function.

Risk and Control Self-Assessments

All business units and functions regularly and at least annually performs a self-assessment of the operational risks in their processes. The Risk Control function is responsible for providing criteria and measures for systematic assessment of probability and impact of identified risks and for reporting material identified risks to the Board of Directors and the CEO. Each function is responsible for establishing action plans to manage identified risks within the risk appetite decided by the Board of Directors.

Incident Reporting

Nordax defines an incident as an adverse event that has caused or has the potential to cause damage to Nordax's business, assets, reputation and/or personnel.

All employees are encouraged to, and responsible for, reporting incidents that occur in the organisation through Nordax's centralized incident reporting system. Nordax's first line control function is responsible for analysing, follow up and documenting reported incidents.

Risk Indicators

Nordax has adopted a number of risk indicators that shall warn about increased operational risk levels in the organisation. The risk indicators are monitored by the business units responsible for the risk and are followed up by the Risk Control function and the Board of Directors on a monthly basis.

New Product Approval Process

To ensure that all operational risks arising in connection to new or materially altered products, services, markets processes, IT-systems or other major changes to the organisation, are identified and managed Nordax has adopted a new product approval process (NPAP). Project Coordinators assists Nordax's project managers with ensuring that the NPAP is carried through. The Risk Control function is responsible for reporting new identified or significantly increased risks to the Board of Directors and the CEO.

Ethical Standards

Nordax has a process for ensuring that the Board of Directors and the employees regularly receive information and training regarding ethical standards, including bank secrecy and Nordax's whistle-blowing process.

Business Continuity Management

The CEO has adopted an instruction for the principles of and internal processes to manage major business disruptions. The instruction includes roles and responsibilities for Nordax to be able to continue its operations, and recover, in case of a crisis. Nordax has routines and procedures in place for its continuity management, including contingency plans, continuity plans and disaster recovery plans.

Definitions

Common Equity Tier 1 capital

Shareholders' equity excluding proposed dividend, deferred tax assets, intangible assets and certain other regulatory adjustments defined in Regulation (EU) No 575/2013 (CRR).

Common Equity Tier 1 capital ratio

Common Equity Tier 1 capital as a percentage of risk exposure amount.

Leverage ratio

Tier 1 capital as a percentage of total assets including off balance sheet items with conversion factors according to the standardized approach.

Liquidity reserve

A separate reserve of high quality liquid assets that can be used to secure the company's short-term ability to pay for loss or reduced access to commonly available sources of funding.

Own funds

The sum of Tier 1 and Tier 2 capital.

Risk exposure amount

Total assets and off balance sheet items, weighted in accordance with capital adequacy regulation for credit and market risks. The operational risks are measured and added as risk exposure amount. Risk exposure amounts are only defined for the consolidated situation.

Tier 1 capital ratio

Tier 1 capital as a percentage of risk exposure amount.

Tier 1 capital

Common Equity Tier 1 capital plus qualifying forms of subordinated loans.

Tier 2 capital

Mainly subordinated loans not qualifying as Tier 1 capital contribution.

Total capital ratio

Total own funds as a percentage of