Annual Report 2017
# Nordea Mortgage Bank Plc

# Contents

# Nordea Mortgage Bank Plc

## Overview of the Directors' Report

### Income statement[1]

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Net interest income | 192.1 | 51.4 |
| Net fee and commission income | -11.0 | 0.2 |
| Net result from items at fair value | -2.4 | -4.8 |
| Other operating income | 0.0 | 0.0 |
| **Total operating income** | **178.7** | **46.8** |
| General administrative expenses: | | |
| Staff costs | -1.9 | -0.3 |
| Other expenses | -45.9 | -11.5 |
| **Total operating expenses** | **-47.8** | **-11.8** |
| **Profit before loan losses** | **130.9** | **35.0** |
| Net loan losses | 0.7 | 0.4 |
| **Operating profit** | **131.6** | **35.4** |
| Income tax expense | -26.3 | -7.1 |
| **Net profit for the year** | **105.3** | **28.3** |

[1] Nordea Mortgage Bank Plc started its operations on 1 October 2016. Figures for October-December 2016 are not comparable with January-December 2017 figures.

### Balance sheet

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Cash and balances with central banks | 198.2 | 200.0 |
| Loans to central banks and credit institutions | 647.6 | 494.2 |
| Loans to the public | 23,530.1 | 23,912.4 |
| Derivatives | 535.4 | 789.8 |
| Other assets | 113.9 | 189.8 |
| **Total assets** | **25,025.2** | **25,586.2** |
| Deposits by credit institutions | 7,557.6 | 7,200.0 |
| Debt securities in issue | 15,469.6 | 16,299.9 |
| Derivatives | 160.2 | 127.4 |
| Subordinated liabilities | 200.5 | 200.6 |
| Other liabilities | 456.8 | 679.8 |
| Equity | 1,180.5 | 1,078.5 |
| **Total liabilities and equity** | **25,025.2** | **25,586.2** |

## Ratios and key figures[1]

| | 2017 | 2016 |
|---|---|---|
| Return on equity[2], % | 9.3 | 10.6 |
| Return on total assets[2], % | 0.4 | 0.4 |
| Cost/income ratio, % | 27 | 25 |
| Loan loss ratio[2], basis points | -0.3 | -0.7 |
| Common Equity Tier 1 capital ratio, incl. Basel I floor[3], % | 10.0 | 9.8 |
| Tier 1 capital ratio, incl. Basel I floor [3], % | 10.0 | 9.8 |
| Total capital ratio, incl. Basel I floor [3], % | 11.9 | 11.7 |
| Common Equity Tier 1 capital, incl. Basel I floor[3], EURm | 1,042.8 | 1,049.0 |
| Tier 1 capital[3], EURm | 1,042.8 | 1,049,0 |
| Risk exposure amount, incl. Basel I floor[3], EURm | 10,721.9 | 10,928.8 |
| Number of employees (full-time equivalents)[3] | 20 | 12 |
| Average number of employees | 18 | 6 |
| Salaries and remuneration[4], EURm | -1.4 | -0.2 |
| Equity to total assets, % | 4.7 | 4.2 |

[1] For more information regarding ratios and key figures and key figures defined as Alternative performance measures, see www.nordea.com/en/investor-relations/.

[2] Income statement figures for 2016 have been annualised when calculating the ratios for 2016.

[3] End of the year

[4] The figure for 2016 refers to the period October-December 2016.

# Business definitions and exchange rates

The definitions apply to the descriptions in the Annual Report.

**Cost/income ratio**
Total operating expenses divided by total operating income.

**Equity to total assets**
Total shareholders' equity as a percentage of total assets at year-end.

**Own funds**
Own funds include the sum of the Tier 1 capital and the supplementary capital consisting of subordinated loans, after the potential deduction for expected shortfall.

**Loan loss ratio**
Net loan losses (annualised) divided by the closing balance of loans to the public (lending), basis points.

**Return on equity (ROE)**
Net profit for the year as a percentage of average equity for the year. Average equity including net profit for the year and dividend until paid.

**Return on total assets (ROA)**
Operating profit less taxes as a percentage of average total assets. Average total assets are calculated as the mean of total assets at the beginning and end of the year.

**Risk exposure amount**
Total assets and off-balance-sheet items valued on the basis of the credit and market risks, as well as the operational risks in accordance with regulations governing capital adequacy, excluding carrying amount of shares which have been deducted from the capital base and intangible assets.

**Tier 1 capital**
The Tier 1 capital of an institution consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital of the institution. Common Equity Tier 1 capital includes shareholders´ equity excluding proposed dividend, deferred tax assets, intangible assets, the full expected shortfall deduction (the negative difference between expected losses and provisions) and finally other deductions such as cash flow hedges.

**Tier 1 capital ratio**
Tier 1 capital as a percentage of risk exposure amount. The Common Equity Tier 1 capital ratio is calculated as Common Equity Tier 1 capital as a percentage of risk exposure amount.

**Total capital ratio**
Own funds as a percentage of risk exposure amount.

**Exchange rates applied** (end of year rates as at 31 December 2017)

| | | | | | |
|---|---|---|---|---|---|
| **EUR** | 1.0000 | **USD** | 1.1993 | **DKK** | 7.4449 |
| **GBP** | 0.88723 | **CHF** | 1.1702 | **SEK** | 9.8438 |
| **NOK** | 9.8403 | | | | |

# Nordea Mortgage Bank Plc

# Directors' Report

Nordea Mortgage Bank Plc is domiciled in Helsinki and its business identity code is 2743219-6. The company is a wholly owned subsidiary of Nordea Bank AB (publ).

Nordea Mortgage Bank Plc (NMB) operates as an issuer of covered bonds in the Finnish market. Bonds issued by NMB are covered by a pool of loans consisting mainly of Finnish housing loans. NMB does not act as an originator of housing loans, but instead purchases loans from Nordea Bank AB (publ), Finnish Branch. Loans in NMB's balance sheet are generally long-term loans, mainly to Finnish households, with residential real estate as collateral.

## Macroeconomic environment

Economic growth of Finland is broad-based, exports are fuelling growth and at the same time domestic demand continues to be strong. Growth in private consumption is expected to continue and contribute positively to economic growth, despite showing some signs of abating. Positive developments in earnings growth and employment are estimated to boost households' purchasing power and to sustain consumer confidence. Household spending will continue to exceed disposable income. Therefore, the savings rate will remain negative and household indebtedness is expected to continue to increase.

Low interest rates have contributed to household indebtedness. The margin on housing loans has narrowed and the most commonly used reference rate continued to fall during 2017. In new housing loan agreements, the average interest rate currently stands at approximately 1.1%. Interest rates on housing loans will remain low over the forecast period. Slightly increasing inflation is resulting in even lower real interest rates.

Despite low interest rates and economic recovery, the increase in demand for new housing loans is estimated to be relatively modest. Moreover, the growth rate of Finland's housing loan stock is quite restrained compared with the rest of the euro area. The cyclical upswing in the economy will particularly strengthen households' purchasing power in 2018.

## Mortgage business development in 2017

The mortgage business has picked up during 2017 as a more positive outlook has motivated a release of the pent-up demand from the prolonged slump. The pick-up is supported by continued low interest rates. Construction of new apartments in the capital region as well as in growth centres has been significantly higher than in the past – supported by the gradual movement of population to growth centres from other parts of the country. In the whole country the housing prices of new apartments went up 3.9 % compared with the previous year. In the capital region, the housing prices increased 5.0% and in the rest of the country 3.4% compared with the previous year. Correspondingly, the prices of old apartments went up 1.1% from the previous year. In Greater Helsinki, prices went up 2.7%, whereas in the rest of Finland the prices went down 0.3%.

The buy-to-let-market has been growing throughout 2017, driven by new capacity in small apartments as well as rising rent levels (up 2.4% year-on-year in Q3). The rise in rents has been gradually slowing down through 2016 and 2017.

An area of interest is the polarisation of housing prices and employment opportunities between growth centres and other areas as the pressure is to move after employment into more urban areas. Nordea's mortgage business is weighted significantly towards the growth areas; however, this is a development which we will continue to follow closely.

The regulator has imposed a loan-to-value cap on mortgages at 90%; for first-home-buyers the cap is 95%. This cap was put into effect in July 2016, and has had relatively little effect on NMB's lending. Loan maturities are slowly lengthening, but Nordea caps maturity at origination at 35 years. The Finnish tradition of steady amortisation is likely to continue, with relatively short and few interest-only periods during the lifetime of the loan.

## Comments on the income statement

The income statement figures refer to the period January-December 2017.

Operating profit amounted to EUR 131.6m. Main drivers behind the development were the following items:

- Net interest income amounted to EUR 192.1m. Interest rates were on a very low level throughout the year and housing loan margins remained stable.
- Net fee and commission income was EUR -11.0m. Commission income related mainly to lending. Commission expenses amounting to EUR -16.1m relate mainly to the guarantee and the liquidity facility provided by Nordea Bank AB (publ), Finnish Branch.
- Net result from items at fair value amounted to EUR -2.4m. This amount represents the hedging inefficiency of financial instruments.
- The level of non-performing loans increased from EUR 63m at year-end 2016 to EUR 134.8m at year-end 2017. This development was expected since NMB started operating on 1 October 2016 with a healthy portfolio.
- Net loan losses were EUR 0.7m positive. There was only a minor amount of realised loan losses during 2017 and reversals of provisions were higher than provisions made.
- Return on equity was 9.3%.

## Comments on the balance sheet

**Lending**

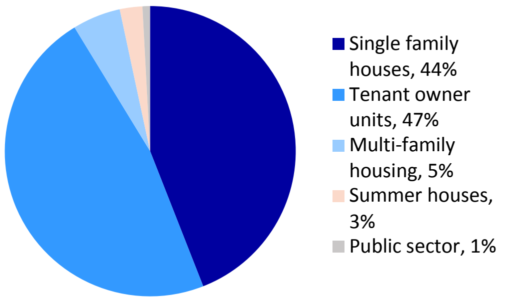
Lending to the public was EUR 23.5bn at the end of 2017 (31 Dec 2016: 23.9). Lending to households was EUR 21.6bn (21.8) and lending to corporates EUR 1.9bn (2.1).

**Funding**

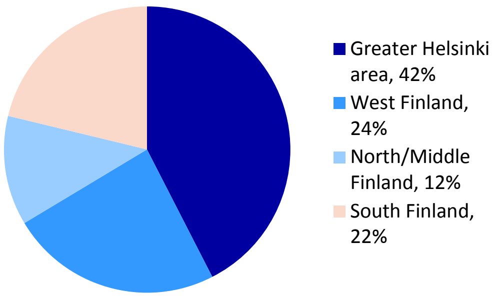
The company's main source of funding is covered bonds issued according to the Finnish Act on Mortgage Bank Operations. NMB issues covered bonds under its EUR 25bn Covered Bond Programme. Covered bond funding at the end of 2017 was EUR 15.5bn (16.3). Besides long-term funding, NMB regularly arranged short-term funding from the parent company Nordea Bank AB (publ) and its Finnish Branch. Intra-group funding at the end of 2017 amounted to EUR 7.6bn (7.2). In addition, the company has an outstanding subordinated debenture loan with a nominal value of EUR 200m issued by the Nordea Bank AB (publ), Finnish Branch.

Due to the good liquidity situation NMB only issued one EUR 1.5bn bond under its Covered Bond Programme during 2017. Bonds amounting to EUR 2.3bn matured during the year.

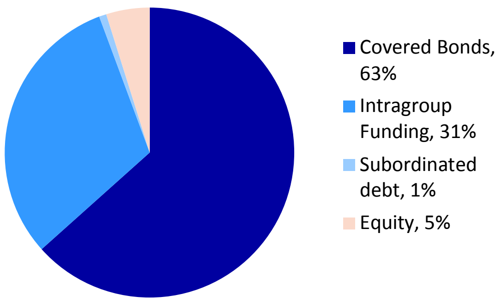
**Breakdown of lending in cover pool**




**Geographical distribution of loans in cover pool**




**Nordea Mortgage Bank's funding structure**



## Distribution of earnings

NMB's distributable funds on 31 December 2017 were EUR 933.6m of which the profit for the year is EUR 105.3m. It is proposed that a dividend of EUR 102.0m be paid whereafter the distributable funds will total EUR 831.6m.

## Commitments

NMB's off-balance sheet items mainly consist of credit commitments. Credit commitments amounted to EUR 209.6m (5.2).

## Derivatives

NMB's derivatives mainly pertain to interest rate swaps and forward currency exchange contracts (FX swaps). The nominal values of derivative contracts are provided in Note 11.

## Capital adequacy

Risk, liquidity and capital management section provides information and numerical data for assessing the company's capital adequacy.

## Rating

Moody's rating for the company's covered bonds was Aaa at year-end 2017.

## Human resources

Nordea Mortgage Bank Plc follows Nordea Group's HR policies. More information can be found in the Nordea Group's Annual Report.

## Sustainability

In accordance with the Nordea Group´s Corporate Social Responsibility (CSR) framework, Nordea Mortgage Bank is committed to sustainable development by combining financial activity with responsibility for the environment and society. Further information about how the Nordea Group works with CSR is available at www. nordea.com

## Legal proceedings

By the end of 2017, Nordea Mortgage Bank has not faced any claims in civil lawsuits or disputes.

## Subsequent events

No events have occurred after the balance sheet date that might affect the assessment of the annual financial statements.

## Outlook 2018

We expect the economy to grow through 2018, accompanied by an increased demand in housing loans.  We expect loan losses to develop in line with the overall lending volumes, but do not expect any significant proportional increase. The mortgage business in the growth areas of the country will continue to fuel the business at an increasing pace. We expect a controlled growth with no material changes in risk.

## Nordea Mortgage Bank's organisational structure

### Definitions

NMB = Nordea Mortgage Bank Plc

Branch = Nordea Bank AB (publ), Finnish Branch

Nordea Group/Group = Nordea Bank AB (publ) including all subsidiaries.

### Part of the Nordea Group

Nordea Mortgage Bank (NMB) is a wholly owned subsidiary of Nordea Bank AB (publ) and does not have its own subsidiaries or ownership in other companies. NMB's business is conducted in close integration with the Nordea Group and its branch business in Finland. NMB does not act as an originator of housing loans, but instead purchases loans from Nordea Bank AB (publ), Finnish Branch. Loans in NMB's balance sheet are generally long-term loans, mainly to Finnish households, with residential real estate as collateral. Different units within Nordea handle, according to outsourcing agreements, on NMB's behalf, e.g. accounting and reporting, liquidity management, risk management, IT systems, internal credit and quality control, credit administration and vault management. Furthermore, NMB is a product-responsible unit (PRU), which entails responsibility for, and ownership of, the mortgage process, a number of loan products and related systems/tools. Through the close cooperation with other Nordea units, it has been possible to limit the workforce of NMB to comprise only requisite staff for product and system development, management and risk management. As at year-end 2017, NMB had 20 employees.

### Funding Nordea Mortgage Bank's business

NMB funds its business by issuing covered bonds. NMB also obtains funding from Nordea Bank AB (publ) and its Finnish Branch. The European Central Bank has granted NMB an authorisation as a credit institution in accordance with the Finnish Credit Institutions Act (610/2014) and the Finnish Act on Mortgage Credit Bank Operations (688/2010).

All NMB's bonds outstanding as at year end have the status of covered bonds. NMB may, if so required, issue new bonds with covered bond status.

### Nordea Mortgage Bank's administrative and management bodies

***The Board of Directors***

The composition of the Board of Directors has changed since the previous Annual Report and the composition is now as follows:

- Petri Nikkilä (born 1971), Chairman, member since 19 September 2017, Head of Personal Banking Finland, Nordea
- Hanna-Maria Heikkinen (born 1979), member since 1 October 2016, Vice President, Investor Relations, Cargotec
- Nicklas Ilebrand (born 1980), Vice Chairman, member since 19 September 2017, Head of Products, Nordea
- Riikka Laine-Tolonen (born 1966), member since 4 February 2016, Deputy Head of Personal Banking Finland, Nordea
- Ola Littorin (born 1962), member since 4 February 2016, Head of Long Term Funding, Nordea
- Nina Luomanen (born 1969), member since 4 February 2016, Head of Change and Transformation, Nordea
- Markku Pehkonen (born 1962), member since 1 November 2016, Group CRO, Sampo Group.

***Management Group at 31 December 2017***

- Chief Executive Officer – Thomas Miller (born 1971)
- Chief Operating Officer – Tarja Ikonen (born 1959)
- Chief Risk Officer – Niko Nordlund (born 1974)
- Chief Financial Officer – Tomi Ylöstalo (born 1982)
- Head of Mortgage Products and Applications – Annina Valtonen (born 1978).

The registered address of the company is:
Nordea Mortgage Bank Plc
Satamaradankatu 5, Helsinki
FI-00020 NORDEA.

*Conflicts of interest*
The aforementioned persons are or may become customers and be granted mortgage loans that are purchased by NMB. As far as the company is aware, there are no conflicts between the company's interests and the private interests of the aforementioned persons. In order to avoid conflicts of interest and demonstrate how an individual shall act in the event of a conflict of interest, several guidelines established by the Nordea Group apply at NMB, such as ethical guidelines, guidelines for employee engagements beyond their position with the bank, and rules for employees' securities and foreign exchange dealings. In addition, board members are subject to the rules regarding bias stipulated by the Finnish Limited Liability Companies Act.

***Auditors***
PricewaterhouseCoopers Oy (re-elected by the Annual General Meeting 2017)

Auditor with main responsibility
Juha Wahlroos
Authorised Public Accountant.

## Risk management

### Risk management at the Nordea Group

***General information about risk management***
The risks to which the Nordea Group is exposed shall reflect the business strategy and the Group's long-term financial interests. They shall be consistent with the Group's capacity for risk-taking and remain within the risk profile established by the Board of Directors of Nordea Bank AB through its risk appetite. The objective of the risk management in the Group is the efficient monitoring of risk exposure, and verifying that the exposure is kept within the limits set by the risk appetite. Risk appetite and risk exposure shall be kept at a level that takes account of the Group's ability to absorb losses, and is therefore closely linked to the capital structure management of the Group.

***Nordea Group's risk management and control organisation***
It is the Board of Directors of Nordea that has the ultimate responsibility for limiting and monitoring the Group's risk exposure as well as for setting the targets for the capital ratios. Risk is measured and reported according to common principles and policies approved by Nordea Bank AB's Board of Directors. It is also Nordea Bank AB's Board of Directors that decides on policies for credit risk, counterparty credit risk, market risk, liquidity risk, business risk, operational risk, as well as the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). All policies are reviewed at least annually.

The Board of Directors of Nordea Bank AB has chosen to organise the Group's risk management into three lines of defence, with all business areas and group-wide functions making up the first line of defence. Group Risk Management & Control (GRMC) and Group Compliance (GC) constitute the second line of defence and are the Group's control functions. Group Internal Audit (GIA) is the third line of defence, independent of the others.

The first line of defence is responsible for its own risk and for remaining within its risk limits, and working in accordance with the Group's internal control and risk management framework. The second line of defence, which is independent of the first line, is responsible for preparing the internal control and risk management framework. This task includes ensuring that the business functions efficiently and that the information and controls in place are sufficient and appropriate for identifying and managing the risks in the business. The third line of defence, which is independent of the first and second line, has the task of protecting the Group's assets, reputation and viability by verifying that all risks in the business are identified and reported to the management and the Group's risk control functions.

### Risk management at Nordea Mortgage Bank

***General information about Nordea Mortgage Bank's risk management***
The majority of NMB's business is conducted by Nordea and its branch network, so it is inevitable that the majority of NMB's risk management is integrated with that of the Group. NMB's risk management has the same purpose and follows the same policies, directives and guidelines as the Group in general. NMB's Chief Risk Officer (CRO) and Management Group have the task of ensuring that the guidelines, proposed risk exposures and the risk appetite proposed in the Group are neither harmful nor inappropriate for NMB's specific business, and of taking sufficient measures if they are assessed as being harmful or inappropriate. NMB adjusts and adopts policies, directives and guidelines to ensure their appropriateness for its business and risk management.

***Nordea Mortgage Bank's risk management and control organisation***
NMB's Board of Directors has the ultimate and overall responsibility for the company and defines, oversees and is accountable for the implementation of the governance arrangements within NMB that ensure effective and prudent management of the institution. Furthermore, NMB's Board of Directors

approve capital injections, the risk strategy and the most significant risk limits, following proposals put forward by the company management and applicable committees in Nordea.

The Chief Executive Officer (CEO) of Nordea Mortgage Bank is responsible for the daily operations.

The company operates in three lines of defence. The second line of defence consists of the CRO function responsible for the implementation of risk policies, risk management framework and processes; and Compliance responsible for monitoring compliance with internal and external rules. The third line of defence consists of Internal Audit. All other functions in the company belong to the first line of defence. The second line of defence is independent of and controls the first line of defence. The third line of defence is independent of and controls the first and second lines. Together, the second and third lines of defence form the internal control functions, which have access and provide reporting directly to NMB's Board of Directors. The CRO function is headed by the Chief Risk Officer and seconded by the Senior Risk Officer. The services of the appointed Compliance Officer and the appointed Internal Auditor are purchased from the Nordea Bank AB (publ), Finnish Branch.

Since the majority of the company's business is conducted by Nordea's other units, NMB's risk management is strongly supported by the three lines of defence in the Nordea Group.

## Risks associated with Nordea Mortgage Bank's business

### *General information about risks to Nordea Mortgage Bank*

All companies that conduct business are exposed to various risks. In this business, a number of critical risks have been identified, and must be managed efficiently. Several risks cannot be eliminated; they are inherent in the very business and are fundamental to the ability to conduct the business operations. For NMB, the most significant financial risks are credit, market and liquidity risks, while the most significant non-financial risks are operational risks, including compliance risks.

## Credit risk

### *Credit risk - definition*

The risks in NMB's business are mainly attributable to credit risk. Credit risk occurs when a counterparty cannot or will not honour its payment obligations and pledged collateral does not suffice to cover the liability. Risks related to changes in the company's prospects of getting back funds invested in loans and other receivables from counterparties are risks which are inherent in the business operations. Negative changes to the credit quality of the company's borrowers and counterparties due to a general economic decline or systemic risks in the financial system, or due to declining collateral values, have a negative impact on the value of the company's assets. In such a situation, a necessary increase to the company's provisions for expected loan losses and realised loan losses, beyond provisioning already made, would have a considerable negative impact on the company's business, financial position and earnings.

### *Credit risk - Nordea Mortgage Bank's organisation for credit risk management*

Each customer area has, together with Group Credit Risk Management, the primary responsibility for managing the credit risks in its operations within the established framework and limits, including risk identification, control and reporting. The responsibility is regulated in outsourcing agreements between Nordea Mortgage Bank and Nordea Bank AB.

GRMC, as a second line of defence unit, is responsible for the overarching credit process í.e. guidelines, instructions and directives. GRMC is also responsible for controlling and monitoring the quality of the credit portfolio and the credit process.

Within NMB, credit quality and adherence to guidelines, instructions and directives is monitored based on reporting and controls performed by NMB's own staff, supplemented by reporting and controls from Nordea Group. Reports are provided to the Management Group and to the Board of Directors.

### *Credit risk - Key areas*

*Impairment testing*

Throughout the process of identifying and mitigating credit impairments, NMB continuously reviews the quality of the credit exposures. Weak and impaired exposures are closely and continuously monitored and reviewed at least on a quarterly basis in terms of current performance, business outlook, future debt servicing capacity and the possible need for provisions. A provision is recognised if there is objective evidence based on loss events and observable data that the customer's future cash flow is weakened to the extent that full repayment is unlikely, pledged collateral included. Exposures with provisions are considered as impaired. The size of the provision is equal to the estimated loss, being the difference between the book value of the outstanding exposure and the discounted value of the future cash flow, including the value of pledged collateral. Impaired exposures can be either servicing or non-servicing.

Exposures that have been past due more than 90 days are by definition regarded as defaulted and non-servicing, and reported as impaired or not impaired depending on the deemed loss potential. Forbearance is negotiated terms or restructuring due to the borrower experiencing or about to experience financial difficulties. The intention with granting forbearance for a limited period of time is to ensure full repayment of the outstanding debt. Examples of negotiated terms are changes in amortisation profile, repayment schedule or customer margin as well as ease of financial covenants.

Forbearance is undertaken on a selective and individual basis and followed by impairment testing. Loan loss provisions are recognised if necessary. Forborne rated customers without impairment charges are fully covered by either collateral and/or the net present value of future cash flows.

In addition to individual impairment testing of all individually significant customers, collective impairment testing is performed for groups of customers that have not been found to be impaired on an individual level. The purpose of collective loan loss reserves is to account for value reductions in the performing credit portfolio due to loss events that have occurred. Nordea's model for collective provisions uses a statistical model as a base-line for assessing the amount of provisions needed for the parts of Nordea's portfolios that are not individually assessed. The collective provisioning model is based on the migration of rated and scored customers in the credit portfolio. The assessment of collective impairment is built on an incurred loss concept, where the credit quality of each exposure is related to its initial credit quality. If the credit quality has deteriorated, collective provisions corresponding to a true and fair assessment of the expected loss are calculated by the model. Moreover, defaulted customers without individual provisions are also collectively assessed. The output of the model is complemented with an expert based analysis process to ensure adequate provisioning. The model is executed quarterly and the output is a result of a bottom-up calculation from sub-exposure level, taking the latest portfolio developments into account. Collective impairment is assessed quarterly. The rationale for this two-step procedure with both individual and collective assessment is to ensure that all incurred losses are accounted for up to and including each balance sheet date.

From 1 Jan 2018 Nordea will adhere to IFRS 9 for impairment of financial instruments. The impairment requirements in IFRS 9 are based on an expected credit loss model and replace the IAS 39 incurred loss model. IFRS 9 introduces a three-stage model for impairment where Stage 1 is considered as the good book, Stage 2 as the deteriorated book, and Stage 3 as the bad book. Collective and individual credit loss provisions will be based on three scenarios. These scenarios will be probability weighted and forward looking.

*Customer classification*
Rating and scoring are the main components in the risk management system for credit risk. The common denominator for the rating/scoring models is the ability to rank customers and predict insolvency. While the rating models are used for corporate customers, scoring models are used for household customers and smaller companies. Ratings are normally assigned in connection with limit/credit proposals or annual reviews and are approved by the credit committees. Scoring models are purely statistical methods used to predict the probability of default among customers.

*Collaterals and guarantees*
A crucial factor in the ability to avoid loan losses in the event of the counterparty failing to honour its payment obligations is that the value of pledged collateral and/or guarantees cover the claim of Nordea Mortgage Bank on the counterparty. For the purposes of calculating capital requirements and expected losses, the risk of loss is measured using various Credit Risk Models. Most such models account for risk protection methods, such as collateral and guarantees. Different collateral types have different Loss Given Default factors, which in turn impact the required capital. Collateral valuation processes are performed at the time of origination and periodically.

***Credit risk in figures***
*Credit portfolio (lending to the public and to credit institutions)*
NMB's lending to the public decreased slightly during 2017 and amounted to EUR 23.5bn (23.9). Out of lending to the public, corporate customers accounted for 8% of the exposure (9) and household customers for 92% (91). The distribution of lending on collateral and maturities is otherwise shown below in Note 25 and Note 27. NMB only mortgages properties in Finland. Credit commitments amounted to 209.6m (5.2).

As in the previous year, NMB did not have any assets in the form of bonds or other interest-bearing securities. Lending to credit institutions amounted at the end of the year to 0.6bn (0.5), all of which was placed in Group companies.

*Impaired loans*
Impaired loans, gross, amounted to EUR 135.4m, referring entirely to private individuals in 2017. Following a deduction of EUR 2m for provisioning for individually valued impaired loans, the net amount was EUR 133.4m (66.9), equaling 55bps (27) of loans to the public before allowances. Allowances for collectively assessed loans amounted to EUR 9.1m (11.8). The provisioning ratio was 8% (18). For more information, see also Note 10 “Loans and impairment”.

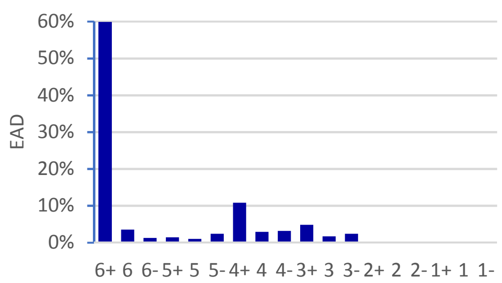
Past due loans (6 days or more) totalled EUR 168.0m (165.2).

*Customer classification*
Out of household customers, 50% (43) had a score of A- or better (on a scale of A+ to F- where A+ is the highest and F- the lowest score). 2% (3) of household customers had a score of F+ or lower. During the year, a net amount of 3 percent of household customers improved their score.

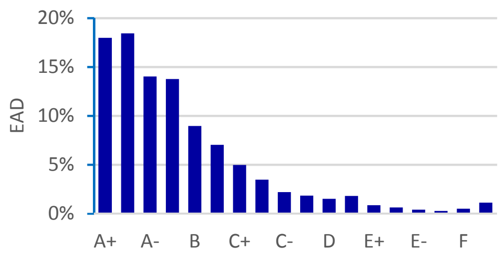
Out of corporate customers, 86% (90) were rated 4- or better (on a scale of 6+ to 1- where 6+ is the highest and 1- is the lowest rating). 4% (5) of corporate customers were rated 1+ or poorer. During the year, a net amount of 4 percent points of corporate customers improved their rating.

*Loan-to-value*
At year end, the cover pool’s weighted average loan-to-value was 51.0% (51.8), entailing that collateral covers the double of lending.

**Rating distribution, IRB Corporate customers**




**Risk grade distribution, IRB Retail customers**




**Market risk**

***Market risk – definition***
Market risk is defined as the risk of losses related to NMB’s financial exposures resulting from changes in market rates and related assumptions that affect the market value. These include changes to interest rates, foreign exchange rates and credit spreads. Market risk in NMB is mainly in the form of interest rate risk inherent in loans granted, and in the form of funding from the market and Nordea Bank AB (publ).

***Market risk – Nordea Mortgage Bank’s organisation for market risk management***
Group Treasury & Asset Liability Management (TALM) is responsible for managing market risk on NMB’s behalf, within the Group Internal Rules and risk strategy and risk limits established by NMB. The responsibility is regulated through outsourcing agreements. The business is largely integrated into the Group’s risk management so as to attain the most efficient management of market risk within the Group as a whole. TALM and GRMC are responsible for identifying, controlling and reporting the progression of risks.

Market-risk-related risk appetite and risk limits are based on co-operation between the CRO function and GRMC. Risk appetite limits are approved by NMB’s Board of Directors.

***Market risk – key areas***
*Structural Interest Income Risk (SIIR)*
SIIR is the amount by which NMB’s accumulated net interest income would change during the next 12 months if all interest rates were to change by 100 basis points. SIIR reflects the mismatches in the balance sheet and the off-balance sheet items due to differences in the interest rate repricing periods, volumes or reference rates of assets, liabilities and derivatives.

NMB’s SIIR is measured through dynamic simulations by calculating several net interest income scenarios and comparing the difference between these scenarios and the base net interest income expectation. Several interest rate scenarios are applied. The Board of Directors has set a risk limit for two parallel rate shift SIIR scenarios (increasing rates and decreasing rates). These scenarios measure the effect on the company’s net interest income for a 12-month period of a 100 basis point change in all interest rates where the balance sheet is assumed to be constant. Significant elements of customer behaviour and Nordea’s decision-making process concerning Nordea’s own rates are taken into account.

A SIIR limit has been set aiming to optimise financial structure, balanced risk taking and reliable earnings growth. TALM has the responsibility for the operational management of SIIR.

***Market risk in figures***

*SIIR*

At the end of the year, the SIIR for increasing market rates was EUR -7m (-29) and the SIIR for decreasing market rates was EUR 94m (135). These figures imply that the net interest income would decrease if interest rates rise and increase if interest rates fall.

## Liquidity risk

***Liquidity risk – definition***

Liquidity risk is the risk of NMB being able to meet liquidity commitments only at increased costs or, ultimately, being unable to meet obligations as they fall due. Liquidity risk in NMB is mainly associated with funding the operations through borrowings from the market and Nordea Bank AB (publ).

***Liquidity risk – Nordea Mortgage Bank's organisation for liquidity risk management***

According to outsourcing agreements TALM is responsible for managing NMB's liquidity. TALM performs this according to the Group Internal Rules and the risk strategy and risk limits set by NMB. The responsibility is regulated through outsourcing agreements. Liquidity risk management is integrated into the Group's liquidity risk management so as to create efficiency for the Group as a whole. Policy statements stipulate that the company's liquidity management reflects a conservative attitude towards liquidity risk.

TALM and GRMC are responsible for identifying, controlling and reporting the progression of risks. Liquidity-risk-related risk appetite limits are approved by the Board of Directors of NMB.

***Liquidity risk – key areas***

*Liquidity buffer*

To ensure funding in situations where the company is in urgent need of cash and the normal funding sources do not suffice, NMB holds a liquidity buffer. NMB's liquid assets consist of central bank deposits.

*Internal liquidity horizon*

NMB's cash flows are very predictable due to the nature of the business. The main short-term liquidity risk relates to covered bond maturities. Internal survival horizon metric is monitored, which shows the survival horizon in days or months, given the current liquidity buffer.

The main sources for liquidity are covered bonds issued by the company and funding from the Nordea Group.

*Liquidity coverage ratio*

The liquidity coverage ratio is a legal requirement, which in principle is calculated by dividing cash inflow within the liquidity window by cash outflow. A liquidity coverage ratio above 100% means the company holds excess liquidity. The liquidity coverage ratio limit is set, which ensures the liquidity buffer is increased prior to bond maturity entering the liquidity window.

*Net balance of stable funding*

The target for the net balance of stable funding (NBSF) is to ensure long-term assets are funded by long-term liabilities. For NMB, long-term liabilities mainly consist of funding from the Nordea Group, bonds and equity, while long-term assets mainly consist of lending to the public.

***Liquidity risk in figures***

At the end of 2017 the internal survival horizon for NMB was 8 months, liquidity coverage ratio was 1,585% and the net balance of stable funding was EUR -1.2bn.

## Operational risk

***Operational risk – definition***

Operational risk is defined as the risk of direct or indirect loss, or damaged reputation, resulting from inadequate or failed internal processes, from people and systems, or from external events. Legal risk and compliance risk, as well as criminal risk and process risk, including IT risk, constitute sub-categories of operational risk. Regarding own funds, the requirements for operational risk also cover legal risk and compliance risk. The management of operational risk includes all activities aimed at identifying, assessing, mitigating, monitoring and reporting risks. Risk exposures are governed by limits set within the boundaries of the risk appetite. Operational risks are mainly identified during incident reporting, during the risk management of proposed changes, as well as during regular risk assessments, both top-down and bottom-up.

Operational risk is inherent in all activities within the organisation, in outsourced activities and in all interactions with external parties. NMB's operational risk is largely attributable to the Branch's operational risk, since most of the business is outsourced there. NMB performs its own assessment of the most important risks that must be managed, and regulates the management thereof in the service agreements with the Branch.

The outcomes are reported to NMB's Board.

***Operational risk – Nordea Mortgage Bank's organisation for operational risk management***
In the Nordea Group the business areas and units are responsible for the management and limitation of the operational risks in their business activity. NMB is responsible for the management and limitation of the operational risks that arise in its own business, and for monitoring the risk management in relevant business units in the Branch and Nordea Bank AB (publ). Monitoring of risk management is regulated through service agreements between NMB and the service providing units. GRMC and GC, in consultation with the management of NMB, are responsible for the ongoing monitoring of the management of operational risks and issue guidelines, instructions and directives applicable to NMB's specific situation.

Risks are identified in accordance with the Group's operational risk policy with an emphasis on two different activities. A Risk and Control Self-Assessment (RCSA) is performed annually. In the 2017 RCSA process, business-relevant operational and compliance risks were identified and prioritised, and several mitigating actions for managing them (avoid or mitigate) were launched.

A Business Impact Analysis is conducted at minimum once every two years, aiming at identifying the most critical processes for the satisfactory functioning of NMB's business. Because a large part of NMB's processes are conducted by the Branch, this is done in consultation between NMB, the Branch, GRMC and GC. Besides these two primary activities, the following are also performed: Change Risk Management and Approval (CRMA) and Quality and Risk Analysis (QRA), incident reporting and Third-Party Risk Assessment. Due to the fact that NMB is a Product Responsible Unit (PRU), CRMA and incident reporting are high on the risk management's agenda.

***Operational risk – key areas and measures***
*External dependence*
NMB's business is conducted in close integration with Nordea Bank AB (publ) and its Finnish Branch and the online business in Finland. The most significant operational risk is considered to be this very dependence. If e.g. the Branch were to cease to conduct these services or otherwise neglect to fulfil its obligations towards NMB, this would have a negative effect on NMB's business. This risk has been addressed through an increase in the risk function resources in NMB. NMB has also started to develop more rigid control of, and reporting for, the services rendered by the Branch. Monitoring of the Branch's performance in Anti-Money Laundering (AML), Counter Terrorism Financing (CTF) and sanctions screening obligations are key control measures for NMB. To secure fit for purpose in-house competencies NMB has defined AML training needs per job description for its personnel.

*Critical processes*
Through Business Impact Analyses, eight critical processes have been identified in NMB and these have been addressed through Business Continuity Plans for each process. These plans include instructions to guide the organisation on how to respond, recover, resume and restore to a predefined level of operation following a disruption. A number of less critical areas have also been identified with action plans and controls implemented.

*Money laundering*
Nordea Mortgage Bank Plc is dependent on the Branch in money laundering issues. In the light of NMB's business, the risk of money laundering is considered to be moderate. However, several risk areas were identified in the 2017 Risk and Control Self-Assessment -process and action plans are in place to be implemented before the end of the first half of 2018.

**Compliance risk**
Nordea defines compliance risk as the risk of failing to comply with laws, regulations, rules and prescribed practices and ethical standards, governing Nordea's activities in any jurisdiction, which could result in material financial or reputational loss to the Group or in regulatory remarks or sanctions.

The key principle for the management of compliance risk is the three lines of defence. The business areas, legal entities and Group functions as a first line of defence are risk owners, and are responsible for their own daily risk management and control of compliance risks. Management on all levels is responsible for operating the business within the defined limits for risk exposure and in accordance with decided directives, instructions and risk management processes.

GC as a second line of defence risk control function in the Group coordinates, facilitates and oversees the effectiveness and integrity of the Group's compliance risk management. GC provides an independent view on compliance to relevant rules and regulations and advises, supports and trains the first line on ways to effectively and efficiently handle compliance obligations. On a quarterly basis, GC reports on all significant compliance risks to the Management Group and the Board of NMB to inform them about NMB's current risk exposure in relation to the predefined risk appetite and tolerance level. The quarterly report covers also GC findings about the effectiveness of the risk management and control framework in NMB. Risk reporting from the control functions enables efficient and risk-based decision-making procedures and approach for the Board and the Audit Committee of NMB.

GC has nominated a company Compliance Officer (CO) to support and advise NMB in compliance-related issues. The CO is dedicated to NMB and is supported by the resources of the GC function. The CO is responsible for the overall compliance action planning for NMB and aligning actions with the consolidated Group Compliance planning.

During 2017 Nordea introduced a new purpose and new core values, implemented across the Group through a cultural transformation programme. The values are applicable to all Nordea employees in conjunction with the Code of Conduct principles to strengthen and secure the foundation for a sound corporate culture. To strengthen the personal accountability and to combat misconduct, a Consequence Management Committee was established in Q1 2017.

In addition, Nordea is continuing to invest in enhanced compliance standards and processes, and to adequately resource the compliance functions.

## Capital management

***General information about the capital assessment***
NMB strives to be efficient in its use of capital and therefore actively manages its balance sheet with respect to different asset, liability and risk categories. The goal is to enhance returns to shareholders while maintaining a prudent capital structure. The Board of Directors of NMB decides ultimately on the targets for capital ratios, capital policy and the overall framework of capital management.

Minimum targets for Common Equity Tier 1 (CET1) capital ratio, Tier 1 capital ratio, total capital ratio, Basel I capital ratio and leverage ratio, that exceed the capital requirements set out by the Finnish Financial Supervisory Authority have been set by the Board of Directors of NMB.

NMB uses internal rating based (IRB) approach for the majority of its exposures. At the end of 2017, 99.5% (99.9) of the company’s total credit risk exposures were covered by the IRB approach.

NMB bases the internal capital requirements under the Internal Capital Adequacy Assessment Process (ICAAP) on the minimum capital requirements and on internally identified risks. The internal capital requirement is thus based on a combination of risk defined in the Capital Requirements Directive, and identified risks not covered by the Directive, i.e. Pillar II risks. The following major risk types are included in the assessment of the internal capital requirement for the company: credit risk, operational risk, concentration risk and Pillar II risks, such as Interest Rate in the Banking Book and a stress test add-on.

***Subordinated loans***
At the end of 2017 NMB had a dated subordinated debenture loan with a nominal value of EUR 200m.

***Own funds***
Own funds is the sum of Tier 1 and Tier 2 capital. Tier 1 capital consists of both Common Equity Tier 1 (CET1) and additional Tier 1 capital. CET1 capital is considered to be capital of the highest quality with ultimate loss-absorbance characteristics and consists predominately of paid-in capital and retained earnings. Profit may only be included after permission from the financial supervisory authority and after deduction of proposed dividend. Additional Tier 2 capital consists mostly of subordinated loans from Nordea Bank AB (publ).

Additional information regarding capital management and capital adequacy is provided in Note 21 “Capital adequacy”, and in the information provided in accordance with the disclosure requirements in Capital Requirement Regulation (CRR) and published on www.nordea.com.

**Summary of items included in own funds**

| EURm | 31 Dec 2017 | 31 Dec 2016[1] |
|---|---|---|
| Calculation of own funds | | |
| Equity in the consolidated situation | 1,075.2 | 1,078.5 |
| Proposed/actual dividend | - | - |
| Common Equity Tier 1 capital before regulatory adjustments | 1,075.2 | 1,078.5 |
| Deferred tax assets | - | - |
| Intangible assets | - | - |
| IRB provisions shortfall (-) | -33.3 | -27.2 |
| Deduction for investments in credit institutions (50%) | - | - |
| Pension assets in excess of related liabilities | - | - |
| Other items, net | 0.9 | -2.2 |
| Total regulatory adjustments to Common Equity Tier 1 capital | -32.4 | -29.4 |
| **Common Equity Tier 1 capital (net after deduction)** | **1,042.8** | **1,049.0** |
| Additional Tier 1 capital before regulatory adjustments | - | - |
| Total regulatory adjustments to Additional Tier 1 capital | - | - |
| Additional Tier 1 capital | - | - |
| **Tier 1 capital (net after deduction)** | **1,042.8** | **1,049.0** |
| Tier 2 capital before regulatory adjustments | 200.0 | 200.0 |
| IRB provisions excess (+) | 4.7 | 2.6 |
| Deduction for investments in credit institutions (50%) | - | - |
| Deductions for investments in insurance companies | - | - |
| Pension assets in excess of related liabilities | - | - |
| Other items, net | - | - |
| Total regulatory adjustments to Tier 2 capital | 4.7 | 2.6 |
| Tier 2 capital | 204.7 | 202.6 |
| **Own funds (net after deduction)[2]** | **1,247.5** | **1,251.7** |

[1] Including profit of the period
[2] Own funds adjusted for IRB provision, i.e. adjusted own funds equal EUR 1,276.1m by 31 Dec 2017
.

**Capital adequacy ratios**

| | 31 Dec 2017[2] | 31 Dec 2016[1] |
|---|---|---|
| **Excl. Basel I floor** | | |
| CET 1 capital ratio (%) | 32.7 | 37.9 |
| Tier 1 capital ratio (%) | 32.7 | 37.9 |
| Total capital ratio (%) | 39.2 | 45.2 |
| Capital adequacy quotient (own funds/capital requirement) | 4.9 | 5.6 |
| **Incl. Basel I floor** | | |
| CET 1 capital ratio (%) | 10.0 | 9.8 |
| Tier 1 capital ratio (%) | 10.0 | 9.8 |
| Total capital ratio (%) | 11.9 | 11.7 |
| Capital adequacy quotient (own funds/capital requirement) | 1.5 | 1.5 |

[1] Including profit for the period
[2] Excluding profit for the period

**New regulations**

The Capital Requirement Directive IV (CRD IV) and Capital Requirement Regulation (CRR) entered into force on 1 January 2014 followed by the Bank Recovery and Resolution Directive (BRRD) on 15 May 2014. The CRR became applicable in all EU countries from 1 January 2014 while the CRD IV and BRRD were implemented through national legislation within all EU member states during 2014. In Finland the law implementing CRD IV entered into force on 15 August 2014.

The CRD IV is implemented in the Credit Institution Act where buffer requirements, in addition to the minimum requirements, are defined. The buffer requirements are to be met with Common Equity Tier 1 capital. The capital conservation buffer (CCoB) requirement is set to 2.5% from 2015.

The Board of the Finnish Financial Supervisory Authority (FSA) has the power to impose binding macroprudential policy requirements. The counter-cyclical capital buffer (CCyB) is currently set to 0%. The Finnish FSA implemented a loan-to-collateral (LTC) ratio as a macroprudential instrument effective from 1 July 2016. The maximum loan-to-value (LTV) ratio is 95% for first-home purchases and 90% for the other residential mortgages granted by the Finnish credit institutions according to the Finnish Consumer Protection Act.

The O-SII buffer for credit institutions operating in Finland may be set at 0–2% of total risk exposure. Nordea Mortgage Bank is defined as other systemically important institution (O-SII) and is subject to an additional capital buffer requirement 0,5% as of 1 July 2018.

The Finnish Act on Credit institutions has been amended to give the Finnish FSA the mandate to apply the systemic risk buffer from 1 January 2019. A decision has also been taken to apply a minimum risk weight of 15% for residential mortgages in Finland applicable to credit institutions that have adopted the Internal Ratings Based Approach. The implementation entered into force on 1 January 2018 and is accords with the Article 458 of the CRR which allows authorities to target asset bubbles in the residential sector by increasing the risk weights within Pillar I.

As communicated in September 2017, Nordea has initiated a re-domiciliation of the parent company to Finland. A change of domicile to Finland means that Nordea will be subject to Finnish legislation and ECB supervision. A change of domicile will also mean that it will be the Single Resolution Board (SRB) that will set the MREL requirement for Nordea. In December 2017, the SRB published an updated policy statement on the MREL requirement that will serve as a basis for setting the MREL targets for banks under the remit of SRB.

From the implementation of Basel II in 2007, banks using internal models have been required to calculate the Basel I floor on the capital requirements as regulated prior to 2007. From 2009 the floor has been 80% of the Basel I rules. According to the CRR the application of the Basel I floor is not valid from 1 January 2018.

***Proposal on amended CRR, CRD IV and BRRD***

In November 2016, the European Commission (EC) published a proposal amending the BRRD, the CRD IV and the CRR. The amendments to the CRR, being a regulation, will be directly applicable in all EU countries once implemented whereas the amendments to the CRD IV and BRRD, being directives, need to be implemented into national legislation before being applicable. The proposal contains, among others, review to the Minimum Requirement for own funds and Eligible Liabilities (MREL), review to the market risk requirements (Fundamental Review of the Trading Book, FRTB), introduction of a leverage ratio requirement of 3% to be met by Tier 1 capital and amendments to the Pillar II framework. Negotiations in the EU process are on-going where the Council and the Parliament are preparing their counterproposals. Implementation is expected to start during 2019 at the earliest, with phasing-in for some parts.

In November 2017, an agreement was reached on some of the proposals in the review in a fast-tracking process. The first agreement was on the amendment of the BRRD regarding the ranking of unsecured debt instruments in insolvency proceedings (bank creditor hierarchy). The amendment makes it possible for banks to issue a new type of subordinated liabilities to meet the MREL requirement. The second agreement was on the CRR with transitional arrangements to phase in the regulatory capital impact of the IFRS 9 international accounting standard which will allow banks to add back to their Common Equity Tier 1 capital a portion of the increased expected credit loss (ECL) provisions as extra capital during a five-year transitional period. The CRR agreement also provides for a three-year phase-out of an exemption from the large exposure limit for banks' exposures to public sector debt denominated in the currency of another member state. These Directives and CRR entered into force on 1 January 2018.

***Finalised Basel III framework ("Basel IV")***

Basel III is a global, regulatory framework on bank capital adequacy, stress testing, and liquidity risk. In December 2017, the final parts of the Basel III framework, often called the Basel IV package, was published. The Basel IV package will be implemented in 2022 and includes revisions to credit risk, operational risk, credit valuation adjustment (CVA) risk and leverage ratio and introduces a new output floor. In addition, revisions to market risk (the Fundamental Review of the Trading Book) were agreed in 2016 and will be implemented together with the Basel IV package.

As regards credit risk, the package includes revisions to both the internal models (IRB) approach, where restrictions to the use of IRB for certain exposures are implemented, as well as to the standardised approach. For operational risk, the three approaches currently existing will be removed and replaced with one standardised approach to be used by all banks. As regards CVA risk, the internally modelled approach is removed and the standardised approach is revised. The package also includes the implementation of a minimum leverage ratio requirement of 3% Tier 1 capital with an additional leverage ratio buffer requirement for global systemically important banks (G-SIB) which is half of the G-SIB capital buffer requirement. Changes to the leverage ratio also include a revised leverage ratio exposure definition relevant for derivatives and central bank reserves.

The output floor is to be set to 72.5% of the standardised approaches on an aggregate level, meaning that the capital requirement under the floor will be 72.5% of the total Pillar I risk exposure amount calculated with the standardised approaches for credit-, market- and operational risk. The floor will be phased-in with 50% from 2022 to be fully implemented from 1 January 2027.

Before being applicable to Nordea, the Basel IV package needs to be implemented into EU regulations and will therefore be subject to negotiations between the EU Commission, Council and Parliament which might change the implementation and potentially also the timetable.

## Nordea Mortgage Bank Plc

## Income statement[1]

| EURm | Note | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|---|
| **Operating income** | | | |
| Interest income | 3 | 257.2 | 69.1 |
| Interest expense | 3 | -65.1 | -17.7 |
| **Net interest income** | 3 | **192.1** | **51.4** |
| Fee and commission income | 4 | 5.1 | 4.2 |
| Fee and commission expense | 4 | -16.1 | -4.0 |
| **Net fee and commission income** | 4 | **-11.0** | **0.2** |
| Net result from items at fair value | 5 | -2.4 | -4.8 |
| Other operating income | | 0.0 | 0.0 |
| **Total operating income** | | **178.7** | **46.8** |
| **Operating expenses** | | | |
| General administrative expenses: | | | |
| Staff costs | 6 | -1.9 | -0.3 |
| Other expenses | 7 | -45.9 | -11.5 |
| **Total operating expenses** | | **-47.8** | **-11.8** |
| **Profit before loan losses** | | **130.9** | **35.0** |
| Net loan losses | 8 | 0.7 | 0.4 |
| **Operating profit** | | **131.6** | **35.4** |
| Income tax expense | 9 | -26.3 | -7.1 |
| **Net profit for the year** | | **105.3** | **28.3** |
| **Attributable to:** | | | |
| Shareholders of Nordea Mortgage Bank Plc | | 105.3 | 28.3 |
| Non-controlling interests | | - | - |
| **Total** | | **105.3** | **28.3** |

## Statement of comprehensive income[1]

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **Net profit for the year** | **105.3** | **28.3** |
| **Items that may be reclassified subsequently to the income statement** | | |
| Cash flow hedges: | | |
| - Valuation gains/losses during the year | -4.1 | -1.5 |
| - Tax on valuation gains/losses during the year | 0.8 | -0.1 |
| **Items that may not be reclassified subsequently to the income statement** | | |
| Defined benefit plans: | | |
| - Remeasurement of defined benefit plans during the year | 0.0 | 0.0 |
| - Tax on remeasurement of defined benefit plans during the year | 0.0 | 0.0 |
| **Other comprehensive income, net of tax** | **-3.3** | **-1.6** |
| **Total comprehensive income** | **102.0** | **26.7** |
| **Attributable to:** | | |
| Shareholders of Nordea Mortgage Bank Plc | 102.0 | 26.7 |
| Non-controlling interests | - | - |
| **Total** | **102.0** | **26.7** |

[1] Nordea Mortgage Bank Plc started its operations on 1 October 2016. Figures for October-December 2016 are not comparable with January-December 2017 figures.

## Balance sheet

| EURm | Note | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with central banks | | 198.2 | 200.0 |
| Loans to credit institutions | 10 | 647.6 | 494.2 |
| Loans to the public | 10 | 23,530.1 | 23,912.4 |
| Derivatives | 11 | 535.4 | 789.8 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | | 82.3 | 99.1 |
| Deferred tax assets | 9 | 14.1 | 13.9 |
| Current tax assets | 9 | 0.6 | - |
| Prepaid expenses and accrued income | 12 | 16.9 | 76.8 |
| **Total assets** | | **25,025.2** | **25,586.2** |
| **Liabilities** | | | |
| Deposits by credit institutions | 13 | 7,557.6 | 7,200.0 |
| Debt securities in issue | 14 | 15,469.6 | 16,299.9 |
| Derivatives | 11 | 160.2 | 127.4 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | | 326.1 | 583.8 |
| Current tax liabilities | 9 | - | 6.6 |
| Other liabilities | 15 | 70.0 | 0.2 |
| Accrued expenses and prepaid income | 16 | 60.7 | 89.2 |
| Retirement benefit liabilities | 17 | 0.0 | 0.0 |
| Subordinated liabilities | 18 | 200.5 | 200.6 |
| **Total liabilities** | | **23,844.7** | **24,507.7** |
| **Equity** | | | |
| Share capital | | 250.0 | 250.0 |
| Other reserves | | 796.9 | 800.2 |
| Retained earnings | | 133.6 | 28.3 |
| **Total equity** | | **1,180.5** | **1,078.5** |
| **Total liabilities and equity** | | **25,025.2** | **25,586.2** |
| | | | |
| Assets pledged as security for own liabilities | 19 | 20,562.5 | 21,978.1 |
| Credit commitments | 20 | 209.6 | 5.2 |

**Other notes**

| | |
|---|---|
| Note 1 | Accounting policies |
| Note 2 | Segment reporting |
| Note 21 | Capital adequacy |
| Note 22 | Classification of financial instruments |
| Note 23 | Assets and liabilities at fair value |
| Note 24 | Financial instruments set off on balance or subject to netting agreements |
| Note 25 | Maturity analysis for assets and liabilities |
| Note 26 | Related-party transactions |
| Note 27 | Credit risk disclosures |
| Note 28 | IFRS 9 |

## Statement of changes in equity

| EURm | Attributable to the shareholders of Nordea Mortgage Bank Plc | | | | | |
|---|---|---|---|---|---|---|
| | | Other reserves | | | | |
| | Share capital[1] | Cash flow hedges | Other reserves | Defined benefit plans | Retained earnings | **Total equity** |
| **Balance at 1 Jan 2017** | **250.0** | **0.2** | **800.0** | **0.0** | **28.3** | **1,078.5** |
| Net profit for the year | - | - | - | - | 105.3 | 105.3 |
| *Items that may be reclassified subsequently to the income statement* | | | | | | |
| Cash flow hedges: | | | | | | |
| - Valuation gains/losses during the year | - | -4.1 | - | - | - | -4.1 |
| - Tax on valuation gains/losses during the year | - | 0.8 | - | - | - | 0.8 |
| *Items that may not be reclassified subsequently to the income statement* | | | | | | |
| Defined benefit plans: | | | | | | |
| - Remeasurement of defined benefit plans during the year | - | - | - | 0.0 | - | 0.0 |
| - Tax on remeasurement of defined benefit plans during the year | - | - | - | 0.0 | - | 0.0 |
| Other comprehensive income, net of tax | - | -3.3 | - | 0.0 | - | -3.3 |
| Total comprehensive income | - | -3.3 | - | 0.0 | 105.3 | 102.0 |
| **Balance at 31 Dec 2017** | **250.0** | **-3.1** | **800.0** | **0.0** | **133.6** | **1,180.5** |

| EURm | Attributable to the shareholders of Nordea Mortgage Bank Plc | | | | | |
|---|---|---|---|---|---|---|
| | | Other reserves | | | | |
| | Share capital[1] | Cash flow hedges | Other reserves | Defined benefit plans | Retained earnings | **Total equity** |
| **Balance at 1 Oct 2016** | **250.0** | **1.8** | **800.0** | **-** | **-** | **1,051.8** |
| Net profit for the year | - | - | - | - | 28.3 | 28.3 |
| *Items that may be reclassified subsequently to the income statement* | | | | | | |
| Cash flow hedges: | | | | | | |
| - Valuation gains/losses during the year | - | -1.5 | - | - | - | -1.5 |
| - Tax on valuation gains/losses during the year | - | -0.1 | - | - | - | -0.1 |
| *Items that may not be reclassified subsequently to the income statement* | | | | | | |
| Defined benefit plans: | | | | | | |
| - Remeasurement of defined benefit plans during the year | - | - | - | 0.0 | - | 0.0 |
| - Tax on remeasurement of defined benefit plans during the year | - | - | - | 0.0 | - | - |
| Other comprehensive income, net of tax | - | -1.6 | - | 0.0 | - | -1.6 |
| Total comprehensive income | - | -1.6 | 0.0 | 0.0 | 28.3 | 26.7 |
| **Balance at 31 Dec 2016** | **250.0** | **0.2** | **800.0** | **0.0** | **28.3** | **1,078.5** |

[1] Total shares registered were 257.7 million. All the shares in Nordea Mortgage Bank Plc are held by Nordea Bank AB (publ). Pursuant to the Articles of Association the Bank's minimum share capital is EUR 5m and maximum share capital EUR 500m.

No decision was made during the financial year to issue equity warrants or convertible bonds entitling to subscription of shares in the NMB. At the end of 2017, NMB held no authorisations given by the General Meeting for issuance or buybacks of shares, equity warrants or convertible bonds.

## Cash flow statement

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **Operating activities** | | |
| Operating profit | 131.6 | 35.4 |
| Adjustments for items not included in cash flow | 55.3 | -850.3 |
| Income taxes paid | -32.9 | - |
| **Cash flow from operating activities before changes in operating assets and liabilities** | **154.0** | **-814.9** |
| | | |
| **Changes in operating assets** | | |
| Change in loans to credit institutions | -560.0 | - |
| Change in loans to the public | 383.0 | 538.2 |
| Change in derivatives, net | 42.1 | 841.9 |
| | | |
| **Changes in operating liabilities** | | |
| Change in deposits by credit institutions | 357.6 | -1,500.0 |
| Change in debt securities in issue | -851.5 | 1,037.4 |
| Change in other liabilities | 69.7 | 0.1 |
| **Cash flow from operating activities** | **-405.2** | **102.7** |
| | | |
| **Financing activities** | | |
| Issued subordinated liabilities | 0.0 | 200.6 |
| Other changes | -3.3 | - |
| **Cash flow from financing activities** | **-3.3** | **200.6** |
| **Cash flow for the year** | **-408.5** | **303.3** |
| | | |
| Cash and cash equivalents at the beginning of year 2017 | 694.2 | 390.9 |
| Cash and cash equivalents at the end of year 2017 | 285.8 | 694.2 |
| **Change** | **-408.5** | **303.3** |

**Comments on the cash flow statement**
The cash flow statement shows inflows and outflows of cash and cash equivalents during the year for total operations. Nordea Mortgage Bank's cash flow has been prepared in accordance with the indirect method, whereby operating profit is adjusted for effects of non-cash transactions such as depreciation and loan losses. The cash flows are classified by operating and financing activities.

**Operating activities**
Operating activities are the principal revenue-producing activities and cash flows are mainly derived from the operating profit for the year with adjustment for items not included in cash flow and income taxes paid. Adjustment for items not included in cash flow includes:

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Loan losses | -0.7 | -0.4 |
| Unrealised gains/losses | 245.0 | -488.2 |
| Change in accruals and provisions | 51.8 | -59.1 |
| Other | -240.9 | -302.6 |
| **Total** | **55.3** | **-850.3** |

Changes in operating assets and liabilities consist of assets and liabilities that are part of normal business activities, such as loans, deposits and debt securities in issue. Changes in derivatives are reported net.

Cash flow from operating activities includes interest payments received and interest expenses paid with the following amounts:

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Interest payments received | 256.0 | 33.6 |
| Interest expenses paid | -68.0 | -14.8 |

## Cash flow statement, cont.

**Financing activities**
Financing activities are activities that result in changes in equity and subordinated liabilities, such as new issues of shares, dividends and issued/amortised subordinated liabilities.

**Cash and cash equivalents**

The following items are included in Cash and cash equivalents:

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Cash and balances with central banks | 198.2 | 200.0 |
| Loans to credit institutions, payable on demand | 87.6 | 494.2 |
| | **285.8** | **694.2** |

Cash comprises legal tender and bank notes in foreign currencies. Balances with central banks consist of deposits in accounts with central banks and postal giro systems under government authority, where the following conditions are fulfilled;
- the central bank or the postal giro system is domiciled in the country where the institution is established
- the balance on the account is readily available at any time.

Loans to credit institutions, payable on demand include liquid assets not represented by bonds or other interest-bearing securities.

## Notes to the financial statements

### Note 1 Accounting policies



#### 1. Basis for presentation

NMB's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU Commission. In addition, certain complementary rules in the Finnish Accounting Act, the Finnish Credit Institutions Act, the Financial Supervision Authority's Regulations and Guidelines and the Decree of the Ministry of Finance on the financial statements and consolidated statements of credit institutions have also been applied.

The disclosures, required in the standards, recommendations and legislation above, have been included in the notes, the Risk, Liquidity and Capital management section or in other parts of the "Financial statements".

On 28 February 2018 NMB's Board of Directors approved the financial statements, subject to final approval of the Annual General Meeting on 9 March 2018.

#### 2. Changed accounting policies and presentation

Nordea's accounting policies, basis for calculations and presentation are, in all material aspects, unchanged in comparison with the 2016 Annual Report. The new accounting requirements implemented during 2017 and their effects on Nordea Group's financial statements are described below.

The following new and amended standards and interpretations were implemented by Nordea Group 1 January 2017 but have not had any significant impact on the financial statements of Nordea Group:

- Amendment to IAS 12: "Recognition of Deferred Tax Assets for Unrealised Losses"
- Amendments to IAS 7: "Disclosure Initiative".

#### 3. Changes in IFRSs not yet applied

**IFRS 9 "Financial instruments"**

IASB has completed the new standard for financial instruments, IFRS 9 "Financial instruments". IFRS 9 covers classification and measurement, impairment and general hedge accounting and replaces the current requirements covering these areas in IAS 39. IFRS 9 is effective as from annual periods beginning on or after 1 January 2018. The standard is endorsed by the EU-commission. Earlier application is permitted, but Nordea Group has not early adopted the standard. The Group does not either intend to restate the comparative figures for 2017 in the annual report 2018 due to IFRS 9.

See Note 28 for more information on the impact from IFRS 9.

*Classification and measurement*

The classification and measurement requirements in IFRS 9 state that financial assets should be classified as, and measured at, amortised cost, fair value through profit and loss or fair value through other comprehensive income. The classification of a financial instrument is dependent on the business model for the portfolio where the instrument is included and on whether the cash flows are solely payments of principal and interest (SPPI).

In order to assess the business model, Nordea Group has divided its financial assets into portfolios and/or sub-portfolios based on how groups of financial assets are managed together to achieve a particular business objective. To derive the right level on which portfolios are determined, the Nordea Group has taken the current business area structure into account. When determining the business model for each portfolio the Group has analysed the objective with the financial assets as well as for instance past sales behaviour and management compensation.

Nordea Group has analysed whether the cash flows from the financial assets held per 31 December 2017 are SPPI compliant. This has been performed by grouping contracts which are homogenous from a cash flow perspective and conclusions have been drawn for all contracts within that group.

The analysis of the business model and the SPPI review described above have not resulted in any significant changes compared to how the financial instruments are measured under IAS 39. The new requirements will not have any significant impact on Nordea Group's capital adequacy, large exposures, risk management or alternative performance measures in the period of initial application.

*Impairment*
The impairment requirements in IFRS 9 are based on an expected loss model as opposed to the current incurred loss model in IAS 39. The scope of IFRS 9 impairment requirements is also broader than IAS 39. IFRS 9 requires all assets measured at amortised cost and fair value through other comprehensive income, as well as off-balance commitments including guarantees and loan commitments, to be included in the impairment test. Currently NMB does not calculate collective provisions for off balance sheet exposures or the financial instruments classified into the measurement category AFS.

The assets to test for impairment will be divided into three groups depending on the stage of credit deterioration. Stage 1 includes assets where there has been no significant increase in credit risk, stage 2 includes assets where there has been a significant increase in credit risk and stage 3 includes defaulted assets. Significant assets in stage 3 are tested for impairment on an individual basis, while for insignificant assets a collective assessment is performed. In stage 1, the provisions should equal the 12-month expected loss. In stage 2 and 3, the provisions should equal the lifetime expected losses.

One important driver for size of provisions under IFRS 9 is the trigger for transferring an asset from stage 1 to stage 2. For assets held at transition, Nordea Group has decided to use the change in internal rating and scoring data to determine whether there has been a significant increase in credit risk or not. For assets to be recognised going forward, changes to the lifetime Probability of Default (PD) will be used as the trigger. The Group has concluded it is not possible to calculate the lifetime PDs at origination without the use of hindsight for assets already recognised on the balance sheet at transition.

For assets evaluated based on lifetime PDs, the Group has decided to use a mix of absolute and relative changes in PD as the transfer criterion. In addition, customers with forbearance measures and customers with payments more than thirty days past due will also be transferred to stage 2.

Nordea Group's current model for calculating collective provisions defines a loss event as one notch deterioration in rating/scoring, while the triggering event for moving items from stage 1 to stage 2 under IFRS 9 will require several notches deterioration.

The provisions under IFRS 9 will be calculated as the exposure at default times the probability of default times the loss given default. For assets in stage 1 this calculation will only be based on the coming 12 months, while it for assets in stage 2 will be based on the expected lifetime of the asset.

For assets where there has been a significant increase in credit risk, NMB currently holds provisions based on the losses estimated to occur during the period between the date when the loss event occurred and the date when the loss event is identified on an individual basis, the so called "Emergence period" while IFRS 9 will require provisions equal to the lifetime expected loss.

When calculating lifetime losses under IFRS 9, including the staging assessment, the calculation will be based on probability weighted forward looking information. Nordea Group has decided to apply three macro-economic scenarios to address the non-linearity in expected credit losses. The different scenarios are used to adjust the relevant parameters for calculating expected losses and a probability weighted average of the expected losses under each scenario are recognised as provisions.

The quantitative impact from the new impairment requirements on NMB's total allowances and provisions for on- and off-balance exposures is an increase of EUR 25.5m. Equity is reduced by 20.4m. The impact on the Common Equity Tier 1 capital ratio is insignificant. NMB will not apply the transitional rules issued by the EU allowing a phase in of the impact on Common Equity Tier 1 capital. There is no material impact to large exposures.

Impairment calculations under IFRS 9 will require more experienced credit judgement by the reporting entities than is required by IAS 39 today and a higher subjectivity is thus introduced. The inclusion of forward looking information adds complexity and makes provisions more dependent on management's view of the future economic outlook. It is expected that the impairment calculations under IFRS 9 will be more volatile and pro-cyclical than under IAS 39, mainly due to the significant subjectivity applied in the forward looking scenarios.

*Hedge accounting*
The main change to the general hedge accounting requirements is that the standard aligns hedge accounting more closely with the risk management activities. As Nordea Group generally uses macro (portfolio) hedge accounting Nordea Group's assessment is that the new requirements will not have any significant impact on Nordea Group's or NMB's financial statements, capital adequacy, large exposures, risk management or alternative performance measures in the period of initial application.

Nordea Group will continue to use the IAS 39 hedge accounting requirements also after IFRS 9 has been implemented.

**IFRS 15 "Revenue from Contracts with Customers"**
The IASB published the new standard, IFRS 15 "Revenue from Contracts with Customers" in 2014. Clarifications to the standard were published in April 2016. The new standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition standards and interpretations within IFRS, such as IAS 18 "Revenue". The standard does not apply to financial instruments, insurance contracts or lease contracts. The new standard is effective for annual periods beginning on or after 1 January 2018, with earlier application permitted. The standard and its clarifications have been endorsed by the EU-commission. Nordea Group has not early adopted the standard.

The new standard will have no impact on NMB's revenue recognition. IFRS 15 will consequently not have any significant impact on NMB's financial statements, capital adequacy or large exposures in the period of initial application.

**Amendments to IFRS 10 and IAS 28 "Sale or Contribution of Assets between an Investor and its Associate or Joint Venture"**
The IASB has amended the requirements in IFRS 10 and IAS 28 regarding sales and contributions of assets between an investor and its associated undertaking or joint venture due to inconsistent treatment of gains and losses of such transactions in those standards. The IASB has thereafter proposed to defer indefinitely the effective date and permit earlier application. The amendments are not yet endorsed by the EU-commission. Nordea Group does not currently intend to early adopt the amendments. The new requirements are not expected to have any impact on Nordea Group's financial statements, capital adequacy, or large exposures in the period of initial application as the new requirements are in line with Nordea Group's current accounting policies.

**IFRS 16 "Leases"**
The IASB has published the new standard, IFRS 16 "Leases". The new standard changes the accounting requirements for lessees. All leases (except for short term- and small ticket leases) should be accounted for on the balance sheet of the lessee as a right to use the asset and a corresponding liability, and the lease payments should be recognised as amortisation and interest expense. The accounting requirements for lessors are unchanged. Additional disclosures are also required. The new standard is effective for annual periods beginning on or after 1 January 2019 and earlier application is permitted. The standard was endorsed by the EU-commission in 2017. Nordea Group does not intend to early adopt the standard.

The main impact on Nordea Group's financial statements is expected to come from the accounting of property leases. Such leasing contracts will be accounted for on the balance sheet to a larger extent than today. No significant impact is currently expected on the income statement or equity, although the presentation is expected to change in the income statement. It is too early to comment on the impact on large exposures and capital adequacy as the relevant requirements are not yet final.

**Other changes in IFRS**
The IASB has published the following new or amended standards that are assessed to have no significant impact on Nordea Group's or NMB's financial statement, capital adequacy or large exposures in the period of initial application:

- Amendments to IFRS 4 "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts"
- Amendments to IFRS 2: "Classification and Measurement of Share based Payment Transactions
- Amendments to IAS 40: "Transfers of Investment Property"
- Amendments to IFRS 9: "Prepayment Features with Negative Compensation"
- Amendments to IAS 28: "Long-term Interest in Associates and Joint Ventures"
- Annual Improvements to IFRS Standards 2014-2016 Cycle
- Annual Improvements to IFRS Standards 2015-2017 Cycle.

## 4. Critical judgements and estimation uncertainty

The preparation of financial statements in accordance with generally accepted accounting principles requires, in some cases, the use of judgements and estimates by management. Actual outcome can later, to some extent, differ from the estimates and the assumptions made. In this section a description is made of:

the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year, and the judgements made when applying accounting policies (apart from those involving estimations) that have the most significant effect on the amounts recognised in the financial statements.

Critical judgements and estimates are in particular associated with:

- the fair value measurement of certain financial instruments
- the impairment testing of loans to the public/credit institutions
- the effectiveness testing of cash flow hedges
- the actuarial calculations of pension liabilities and plan assets related to employees
- the translations of assets and liabilities denominated in foreign currencies
- the valuation of deferred tax assets
- claims in civil lawsuits.

**Fair value measurement of certain financial instruments**

Nordea Group's accounting policy for determining the fair value of financial instruments is described in section 9 "Determination of fair value of financial instruments" and Note 23 "Assets and liabilities at fair value". Critical judgements that have a significant impact on the recognised amounts for financial instruments are exercised when determining fair value of OTC derivatives and other financial instruments that lack quoted prices or recently observed market prices. Those judgements relate to the following areas:

- The choice of valuation techniques.
- The determination of when quoted prices fail to represent fair value (including the judgement of whether markets are active).
- The construction of fair value adjustments in order to incorporate relevant risk factors such as credit risk, model risk and liquidity risk.
- The judgement of which market parameters are observable.

The critical judgements required when determining fair value of financial instruments that lack quoted prices or recently observed market prices also introduce a high degree of estimation uncertainty.

In all of these instances, decisions are based upon professional judgement in accordance with Nordea Group's accounting and valuation policies.

Sensitivity analysis disclosures covering fair values of financial instruments with significant unobservable inputs can be found in Note 23 "Assets and liabilities at fair value".

**Impairment testing of loans to the public/credit institutions**

Nordea Group's accounting policy for impairment testing of loans is described in section 12 "Loans to the public/credit institutions".

Management is required to exercise critical judgements and estimates when calculating loan impairment allowances on both individually assessed and collectively assessed loans. For more information, see Note 10 "Loans and impairment".

The most judgemental area is the calculation of collective impairment allowances. When testing a group of loans collectively for impairment, judgement has to be exercised when identifying the events and/or the observable data that indicate that losses have been incurred in the group of loans. Nordea Mortgage Bank monitors its portfolio through rating migrations and a loss event is an event resulting in a negative rating migration. Assessing the net present value of the cash flows generated by the customers in the group of loans also includes estimation uncertainty. This includes the use of historical data on probability of default and loss given default supplemented by acquired experience when adjusting the assumptions based on historical data to reflect the current situation.

**Effectiveness testing of cash flow hedges**

Nordea Group's accounting policies for cash flow hedges are described in section 8 "Hedge accounting".

One important judgement in connection to cash flow hedge accounting is the choice of method used for effectiveness testing.

Where Nordea Group applies cash flow hedge accounting the hedging instruments used are predominantly cross currency interest rate swaps, which are always held at fair value. The currency component is designated as a cash flow hedge of currency risk and the interest component as a fair value hedge of interest rate risk. The hypothetical derivative method is used when measuring the effectiveness of these cash flow hedges, meaning that the change in a perfect hypothetical swap is used as proxy for the present value of the cumulative change in expected future cash flows on the hedged transaction (the currency component). Critical judgement has to be exercised when defining the characteristics of the perfect hypothetical swap.

**Actuarial calculations of pension liabilities and plan assets related to employees**
Nordea Group's accounting policy for post-employment benefits is described in section 14 "Employee benefits".

The defined benefit obligation for major pension plans is calculated by external actuaries using demographic assumptions based on the current population. As a basis for these calculations a number of actuarial and financial parameters are used.

The estimation of the discount rate is subject to uncertainty around whether corporate bond markets are deep enough, of high quality and also in connection to the extrapolation of yield curves to relevant maturities. In Finland the discount rate is determined with reference to high-quality corporate bonds. Other parameters, like assumptions about salary increases and inflation, are based on the expected long-term development of these parameters and also subject to estimation uncertainty. The main parameters used at year-end are disclosed in Note 17 "Retirement benefit obligations" together with a description of the sensitivity to changes in assumptions.

**Translation of assets and liabilities denominated in foreign currencies**
Nordea Group's accounting policies covering the translation of assets and liabilities denominated in foreign currencies is described in section 7 "Translation of assets and liabilities denominated in foreign currencies".

## 5. Recognition of operating income and impairment

**Net interest income**
Interest income and expense are calculated and recognised based on the effective interest rate method or, if considered appropriate, based on a method that results in an interest income or interest expense that is a reasonable approximation of using the effective interest rate method as basis for the calculation. The effective interest includes fees considered to be an integral part of the effective interest rate of a financial instrument (generally fees received as compensation for risk). The effective interest rate equals the rate that discounts the estimated future cash flows to the net carrying amount of the financial asset or financial liability.

Interest income and expenses from financial instruments are, with the exceptions described below, classified as "Net interest income".

The interest component in FX swaps, and the interest paid and received in interest rate swaps plus changes in accrued interest, is classified as "Net result from items at fair value", apart for derivatives used for hedging, including economical hedges of NMB's funding, where such components are classified as "Net interest income".

**Net fee and commission income**
NMB earns commission income from different services provided to its customers. The recognition of commission income depends on the purpose for which the fees are received. Fees are either recognised as revenue when services are provided or in connection to the execution of a significant act. Fees received in connection to performed services are recognised as income in the period these services are provided.

Commission income and commission expenses are normally transaction based and recognised in the period when the services are received.

**Net result from items at fair value**
Realised and unrealised gains and losses on financial instruments measured at fair value through profit or loss are recognised in the item "Net result from items at fair value".

Realised and unrealised gains and losses derive from:

- Interest-bearing securities and other interest-related instruments
- Foreign exchange gains/losses
- Other financial instruments.

The ineffective portion of cash flow hedges is recognised in "Net result from items at fair value".

This item also includes realised gains and losses from financial instruments measured at amortised cost, such as interest compensation received and realised gains/losses on buy-backs of issued own debt.

"Net result from items at fair value" includes also losses from counterparty risk on instruments classified into the category Financial assets at fair value through profit or loss. Impairment losses from instruments within other categories are recognised in the item "Net loan losses".

**Net loan losses**
Impairment losses from financial assets classified into the category Loans and receivables (see section 11 "Financial instruments"), in the items "Loans to central banks", "Loans to credit institutions" and "Loans to the public" on the balance sheet, are reported as "Net loan losses". Losses are reported net of any collateral and other credit enhancements. NMB's accounting policies for the calculation of impairment losses on loans can be found in section 12 "Loans to the public/credit institutions".

Counterparty losses on instruments classified into the category Financial assets at fair value through profit or loss, are reported under "Net result from items at fair value".

### 6. Recognition and derecognition of financial instruments on the balance sheet

Derivative instruments, quoted securities and foreign exchange spot transactions are recognised on and derecognised (and an asset or a liability is recognised as "Other assets" or "Other liabilities" on the balance sheet between trade date and settlement date) from the balance sheet on the trade date. Other financial instruments are recognised on the balance sheet on settlement date.

Financial assets, other than those for which trade date accounting is applied, are derecognised from the balance sheet when the contractual rights to the cash flows from the financial asset expire or are transferred to another party. The rights to the cash flows normally expire or are transferred when the counterpart has performed by e.g. repaying a loan to Nordea, i.e. on settlement date.

Loans where cash flows are modified or part of a restructuring are derecognised, and a new loan recognised, if the terms and conditions of the new loan is substantially different from the old loan. This is normally the case if the present value of the cash flows of the new loan discounted by the original interest rate is more than 10% different from the present value of the remaining expected cash flows of the old loan. The same principles apply to financial liabilities.

Financial liabilities are derecognised from the balance sheet when the liability is extinguished. Normally this occurs when NMB performs, for example when NMB repays a deposit to the counterpart, i.e. on settlement date. Financial liabilities under trade date accounting are generally derecognised and a liability is recognised as "Other liabilities" on the balance sheet on trade date.

### 7. Translation of assets and liabilities denominated in foreign currencies

The functional currency of NMB is euro (EUR). Foreign currency is defined as any currency other than the functional currency of the entity. Foreign currency transactions are recorded at the exchange rate on the date of the transaction. Monetary assets and liabilities including foreign exchange trades, currency denominated cash balances and derivatives are translated at the exchange rate on the balance sheet date.

Exchange differences arising on the settlement of transactions at rates different from those at the date of the transaction, and unrealised translation differences on unsettled foreign currency monetary assets and liabilities, are recognised in the income statement in the item "Net result from items at fair value".

### 8. Hedge accounting

Nordea Group applies the EU carve out version of IAS 39 for portfolio hedges of both assets and liabilities. The EU carve out macro hedging enables a group of derivatives (or proportions thereof) to be viewed in combination and be designated as the hedging instrument. It also removes some of the limitations in fair value hedge accounting relating to hedging core deposits and under-hedging strategies.

Nordea Group uses hedge accounting in order to have a symmetrical accounting treatment of the changes in fair value of the hedged item and changes in fair value of the hedging instruments as well as to hedge the exposure to variability in future cash flows and the exposure to net investments in foreign operations.

NMB currently applies fair value hedge accounting and cash flow hedge accounting.

**Fair value hedge accounting**

Fair value hedge accounting is used when derivatives are hedging changes in fair value of a recognised asset or liability attributable to a specific risk. The risk of changes in fair value of assets and liabilities in NMB's financial statements originates mainly from loans, securities and deposits with a fixed interest rate, causing interest rate risk. Changes in fair value from derivatives as well as changes in fair value of the hedged item attributable to the risks being hedged are recognised separately in the income statement in the item "Net result from items at fair value". Given an effective hedge, the two changes in fair value will more or less balance, meaning the net result is close to zero. The changes in fair value of the hedged item attributable to the risks hedged with the derivative instrument are reflected in an adjustment to the carrying amount of the hedged item, which is also recognised in the income statement. The fair value change of the hedged items held at amortised cost in a portfolio hedge of interest rate risks is reported separately from the portfolio in the item "Fair value changes of the hedged items in portfolio hedge of interest rate risk" on the balance sheet.

Fair value hedge accounting in Nordea is performed mainly on a portfolio basis. Any ineffectiveness is recognised in the income statement under the item "Net result from items at fair value".

*Hedged items*

A hedged item in a fair value hedge can be a recognised single asset or liability, an unrecognised firm commitment, or a portion thereof. The hedged item can also be a group of assets, liabilities or firm commitments with similar risk characteristics. Hedged items in Nordea Group consist of both individual assets or liabilities and portfolios of assets and/or liabilities.

*Hedging instruments*
The hedging instruments used in NMB are predominantly interest rate swaps and cross currency interest rate swaps, which are always held at fair value. Cash instruments are only used as hedging instruments when hedging currency risk.

**Cash flow hedge accounting**
Cash flow hedge accounting can be used for the hedging of exposure to variations in future interest payments on instruments with variable interest rates and for the hedging of currency exposures. The portion of the gain or loss on the hedging instrument, that is determined to be an effective hedge, is recognised in other comprehensive income and accumulated in the cash flow hedge reserve in equity. The ineffective portion of the gain or loss on the hedging instrument is recycled to the item “Net result from items at fair value” in the income statement.

Gains or losses on hedging instruments recognised in the cash flow hedge reserve in equity through other comprehensive income are recycled and recognised in the income statement in the same period as the hedged item affects profit or loss, normally in the period that interest income or interest expense is recognised.

*Hedged items*
A hedged item in a cash flow hedge can be highly probable floating interest rate cash flows from recognised assets or liabilities or from future assets or liabilities. NMB uses cash flow hedges when hedging currency risk in future payments of interest and principal in foreign currency and when hedging interest rate risk in lending with floating interest rates.

*Hedging instruments*
The hedging instruments used in NMB are predominantly cross currency interest rate swaps, which are always held at fair value, where the currency component is designated as a cash flow hedge of currency risk and the interest component as a fair value hedge of interest rate risk. When hedging the interest rate risk in lending with floating interest rates NMB uses interest rate swaps as hedging instruments, which are always held at fair value.

**Hedge effectiveness**
The application of hedge accounting requires the hedge to be highly effective. A hedge is regarded as highly effective if at inception and throughout its life it can be expected that changes in fair value of the hedged item as regards the hedged risk can be essentially offset by changes in fair value of the hedging instrument. The result should be within a range of 80–125 per cent. When assessing hedge effectiveness retrospectively NMB measures the fair value of the hedging instruments and compares the change in fair value of the hedging instrument to the change in fair value of the hedged item. The effectiveness measurement is made on a cumulative basis. The hypothetical derivative method is used when measuring the effectiveness of cash flow hedges, meaning that the change in a perfect hypothetical swap is used as proxy for the present value of the cumulative change in expected future cash flows from the hedged transaction (the currency component).

If the hedge relationship does not fulfil the requirements, hedge accounting is terminated. For fair value hedges the hedging instrument is reclassified to a trading derivative and the change in the fair value of the hedged item, up to the point when the hedge relationship is terminated, is amortised to the income statement on a straight-line basis over the remaining maturity of the hedged item.

In cash flow hedges, changes in the unrealised value of the hedging instrument will prospectively from the last time it was proven effective be accounted for in the income statement. The cumulative gain or loss on the hedging instrument that has been recognised in the cash flow hedge reserve in equity through other comprehensive income from the period when the hedge was effective is reclassified from equity to “Net result from items at fair value” in the income statement if the expected transaction no longer is expected to occur. If the expected transaction no longer is highly probable, but is still expected to occur, the cumulative gain or loss on the hedging instrument that has been recognised in other comprehensive income from the period when the hedge was effective remains in other comprehensive income until the transaction occurs or is no longer expected to occur.

## 9. Determination of fair value of financial instruments

Financial assets and liabilities classified into the categories Financial assets/liabilities at fair value through profit or loss (including derivative instruments) are recorded at fair value on the balance sheet with changes in fair value recognised in the income statement in the item “Net result from items at fair value”.

Fair value is defined as the price that at the measurement date would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants under current market conditions in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure financial assets and financial liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an on-going basis. The absolute level for liquidity and volume required for a market to be considered active vary with the instrument classes. For some classes low price volatility is seen, also for those instruments within the class where the trade frequency is high. For instruments in such a class the liquidity requirements are lower and, correspondingly, the age limit for the prices used for establishing fair value is higher.

The trade frequency and volume are monitored regularly in order to assess if markets are active or non-active.

NMB is predominantly using published price quotations to establish fair value for items disclosed under the following balance sheet items:

- Interest-bearing securities
- Derivatives (listed).

If quoted prices for a financial instrument fail to represent actual and regularly occurring market transactions or if quoted prices are not available, fair value is established by using an appropriate valuation technique. The adequacy of the valuation technique, including an assessment of whether to use quoted prices or theoretical prices, is monitored on a regular basis.

Valuation techniques can range from simple discounted cash flow analysis to complex option pricing models. Valuation models are designed to apply observable market prices and rates as input whenever possible, but can also make use of unobservable model parameters. The adequacy of the valuation model is assessed by measuring its capability to hit market prices. This is done by comparison of calculated prices to relevant benchmark data, e.g. quoted prices from exchanges, the counterparty´s valuations, price data from consensus services etc.

Nordea Group is predominantly using valuation techniques to establish fair value for items disclosed under the following balance sheet items:

- Interest-bearing securities (when quoted prices in an active market are not available)
- Derivatives (OTC-derivatives).

For financial instruments, where fair value is estimated by a valuation technique, it is investigated whether the variables used in the valuation model are predominantly based on data from observable markets. By data from observable markets, the Group considers data that can be collected from generally available external sources and where this data is judged to represent realistic market prices. If non-observable data has a significant impact on the valuation, the instrument cannot be recognised initially at the fair value estimated by the valuation technique and any upfront gains are thereby deferred and amortised through the income statement over the contractual life of the instrument. The deferred upfront gains are subsequently released to income if the non-observable data becomes observable.

Note 23 “Assets and liabilities at fair value” provides a breakdown of fair values of financial instruments measured on the basis of:

- quoted prices in active markets for the same instrument (level 1),
- valuation technique using observable data (level 2), and
- valuation technique using non-observable data (level 3).

The valuation models applied by Nordea Group are consistent with accepted economic methodologies for pricing financial instruments and incorporate the factors that market participants consider when setting a price.

New valuation models are subject to approval by the Model Risk Committee and all models are reviewed on a regular basis.

For further information, see Note 23 “Assets and liabilities at fair value”.

### 10. Cash and balances with central banks

Cash comprises legal tender and bank notes in foreign currencies. Balances with central banks consist of deposits in accounts with central banks and postal giro systems under government authority, where the following conditions are fulfilled:

- The central bank or the postal giro system is domiciled in the country where the institutions is established
- The balance is readily available at any time.

### 11. Financial instruments

**Classification of financial instruments**

Financial assets are classified into the category Loans and receivables or into the category Financial assets at fair value through profit or loss. Financial liabilities are classified into the category Other financial liabilities. NMB also holds derivative instruments for hedge accounting.

All financial assets and liabilities are initially measured at fair value. The classification of financial instruments into different categories forms the basis for how each instrument is subsequently measured on the balance sheet and how changes in its value are recognised. The classification of the financial instruments on Nordea’s balance sheet into different categories is presented in Note 22 “Classification of financial instruments”.

*Loans and receivables*

Loans and receivables are non-derivative financial assets, with fixed or determinable payments, that are not quoted in an active market. These assets and their impairment are further described in the separate section 12 “Loans to the public/credit institutions”.

*Financial assets and financial liabilities at fair value through profit or loss*
Financial assets and financial liabilities at fair value through profit or loss are measured at fair value, excluding transaction costs. All changes in fair values are recognised directly in the income statement in the item “Net result from items at fair value”.

The category consists of two sub-categories; Held for trading and Designated at fair value through profit or loss (fair value option).

The sub-category Held for trading contains derivative instruments that are held for trading purposes.

*Other financial liabilities*
Financial liabilities, other than those classified into the category Financial liabilities at fair value through profit or loss, are measured at amortised cost. Interest on Other financial liabilities is recognised in the item “Interest expense” in the income statement.

**Derivatives**
All derivatives are recognised on the balance sheet and measured at fair value. Derivatives with total positive fair values, including any accrued interest, are recognised as assets in the item “Derivatives” on the asset side. Derivatives with total negative fair values, including any accrued interest, are recognised as liabilities in the item “Derivatives” on the liability side.

Realised and unrealised gains and losses from derivatives are recognised in the income statement in the item “Net result from items at fair value”.

**Offsetting of financial assets and liabilities**
NMB offsets financial assets and liabilities on the balance sheet if there is a legal right to offset, in the ordinary course of business and in case of bankruptcy, and if the intent is to settle the items net or realise the asset and settle the liability simultaneously.

Exchanged traded derivatives are generally accounted for as settled on a daily basis when cash is paid or received and the instrument is reset to market terms.

**Issued debt and equity instruments**
A financial instrument issued by NMB is either classified as a financial liability or equity. Issued financial instruments are classified as a financial liability if the contractual arrangement results in NMB having a present obligation to either deliver cash or another financial asset, or a variable number of equity instruments to the holder of the instrument. If this is not the case, the instrument is generally an equity instrument and classified as equity, net of transaction costs. Where issued financial instruments contain both liability and equity components, these are accounted for separately.

## 12. Loans to the public/credit institutions

Financial instruments classified as “Loans to the public/credit institutions” (including loans to central banks) on the balance sheet and into the category Loans and receivables are measured at amortised cost (see also the separate section 6 “Recognition and derecognition of financial instruments on the balance sheet” as well as Note 22 ”Classification of financial instruments”).

NMB monitors loans as described in the separate section on Risk, Liquidity and Capital management. Loans attached to individual customers or groups of customers are identified as impaired if the impairment tests indicate an objective evidence of impairment.

*Impairment test of individually assessed loans*
NMB tests all loans for impairment on an individual basis. The purpose of the impairment tests is to find out if the loans have become impaired. As a first step in the identification process for impaired loans, NMB monitors whether there are indicators of impairment (loss event) and whether these loss events represent objective evidence of impairment. More information on the identification of loss events can be found in the Risk, Liquidity and Capital management section.

Loans that are not individually impaired will be transferred to a group of loans with similar risk characteristics for a collective impairment test.

*Impairment test of collectively assessed loans*
Loans not impaired on an individual basis are collectively tested for impairment.

These loans are grouped on the basis of similar credit risk characteristics that are indicative of the debtors´ ability to pay all amounts due according to the contractual terms. NMB monitors its portfolio through rating migrations, the credit decision and annual review process supplemented by quarterly risk reviews. Through these processes NMB identifies loss events indicating incurred losses in a group. A loss event is an event resulting in a deterioration of the expected future cash flows. Only loss events incurred up to the reporting date are included when performing the assessment of the group.

The objective for the group assessment process is to evaluate if there is a need to make a provision due to the fact that a loss event has occurred, which has not yet been identified on an individual basis. This period between the date when the loss event occurred and the date when it is identified on an individual basis is called “Emergence period”. The impairment remains related to the group of loans until the losses have been identified on an individual basis. The identification of the loss is made through a default of the engagement or by other indicators.

For corporate customers and bank counterparts, NMB uses the existing rating system as a basis when assessing the credit risk. Nordea Group uses historical data on probability of default to estimate the risk for a default in a rating class. These loans are rated and grouped mostly based on type of industry and/or sensitivity to certain macro parameters, e.g. dependency to oil prices etc.

Personal customers and small corporate customers are monitored through scoring models. These are based mostly on historical data, as default rates and loss rates given a default, and experienced judgement performed by management. Rating and scoring models are described in more detail in the separate section on Risk, Liquidity and Capital management.

*Impairment loss*
If the carrying amount of the loans is higher than the sum of the net present value of estimated cash flows (discounted with the original effective interest rate), including the fair value of the collaterals and other credit enhancements, the difference is the impairment loss.

For significant loans that have been individually identified as impaired the measurement of the impairment loss is made on an individual basis.

For insignificant loans that have been individually identified as impaired and for loans not identified as impaired on an individual basis the measurement of the impairment loss is measured using a portfolio based expectation of the future cash flows.

If the impairment loss is not regarded as final, the impairment loss is accounted for on an allowance account representing the accumulated impairment losses. Changes in the credit risk and accumulated impairment losses are accounted for as changes in the allowance account and as ”Net loan losses” in the income statement (see also section 5 “Recognition of operating income and impairment”).

If the impairment loss is regarded as final, it is reported as a realised loss and the value of the loan and the related allowance for impairment loss are derecognised. An impairment loss is regarded as final when the obligor is filed for bankruptcy and the administrator has declared the economic outcome of the bankruptcy procedure, or when NMB forgives its claims either through a legal based or voluntary reconstruction or when NMB, for other reasons, deem it unlikely that the claim will be recovered.

*Discount rate*
The discount rate used to measure impairment is the original effective interest rate for loans attached to an individual customer or, if applicable, to a group of loans. If considered appropriate, the discount rate can be based on a method that results in an impairment that is a reasonable approximation of using the effective interest rate method as basis for the calculation.

*Restructured loans*
In this context a restructured loan is defined as a loan where NMB has granted concessions to the obligor due to its deteriorated financial situation and where this concession has resulted in an impairment loss for NMB. After a reconstruction the loan is normally regarded as not impaired if it performs according to the new conditions. Concessions made in reconstructions are regarded as loan losses unless NMB retains the possibility to regain the loan losses incurred. In the event of a recovery the payment is reported as a recovery of loan losses.

### 13. Taxes

The item “Income tax expense” in the income statement comprises current- and deferred income tax. The income tax expense is recognised in the income statement, except to the extent the tax effect relates to items recognised in other comprehensive income or directly in equity, in which case the tax effect is recognised in other comprehensive income or in equity respectively.

Current tax is the tax expense on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities are recognised, using the balance sheet method, for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for temporary differences arising on initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, nor for differences relating to investments in group undertakings and associated undertakings to the extent that it is probable that they will not reverse in the foreseeable future.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are not discounted. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences, tax losses carry forward and unused tax credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Current tax assets and current tax liabilities are offset when the legal right to offset exists and Nordea intends to either settle the tax asset and the tax liability net or to recover the asset and settle the liability simultaneously. Deferred tax assets and deferred tax liabilities are offset if there is a legally enforceable right to offset current tax assets and current tax liabilities.

## 14. Employee benefits

All forms of consideration given by NMB to its employees as compensation for services performed are employee benefits. Short-term benefits are to be settled within twelve months after the reporting period when the services have been performed. Post-employment benefits are benefits payable after the termination of the employment. Post-employment benefits in NMB consist only of pensions. Termination benefits normally arise if an employment is terminated before the normal retirement date, or if an employee accepts an offer of voluntary redundancy.

### Short-term benefits

Short term benefits consist mainly of fixed and variable salary. Both fixed and variable salaries are expensed in the period when the employees have performed services to Nordea Mortgage Bank. Nordea has also issued share-based payment programmes, which are further described in section 17 “Share-based payment”.

More information can be found in Note 6 “Staff costs”.

### Post-employment benefits

*Pension plans*

The companies within Nordea Group have various pension plans, consisting of both defined benefit pension plans and defined contribution pension plans, reflecting national practices and conditions in the countries where the Group operates. The major defined benefit pension plans are funded schemes covered by assets in pension funds/foundations. If the fair value of plan assets, associated with a specific pension plan, is lower than the gross present value of the defined benefit obligation determined using the projected unit credit method, the net amount is recognised as a liability (“Retirement benefit liabilities”). If not, the net amount is recognised as an asset (“Retirement benefit assets”). Non-funded pension plans are recognised as “Retirement benefit liabilities “.

Most pensions are based on defined contribution arrangements that hold no pension liability for Nordea Group. All defined benefit pension plans are closed for new employees. The Group also contributes to public pension systems.

*Pension costs*

Obligations for defined contribution pension plans are recognised as an expense as the employee renders services to the entity and the contribution payable in exchange for that service becomes due. NMB’s net obligation for defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned for their service in the current and prior periods. That benefit is discounted to determine its present value. Actuarial calculations including the projected unit credit method are applied to assess the present value of defined benefit obligations and related costs, based on several actuarial and financial assumptions (as disclosed in Note 17 “Retirement benefit obligations”).

When establishing the present value of the obligation and the fair value of any plan assets, remeasurement effects may arise as a result of changes in actuarial assumptions and experience effects (actual outcome compared to assumptions). The remeasurement effects are recognised immediately in equity through other comprehensive income.

When the calculation results in a benefit the recognised asset is limited to the present value of any future refunds from the plan or reductions in future contributions to the plan.

*Discount rate in defined benefit pension plans*

The discount rate is determined by reference to high quality corporate bonds, where a deep enough market for such bonds exists. In countries where no such market exists the discount rate is determined by reference to government bond yields. In Finland the discount rate is determined with reference to corporate bonds.

### Termination benefits

As mentioned above termination benefits normally arise if an employment is terminated before the normal retirement date, or if an employee accepts an offer of voluntary redundancy. Termination benefits do not arise if the employees have to continue performing services and the termination benefits can be considered to be normal compensation for those services.

Termination benefits are expensed when NMB has an obligation to make the payment. An obligation arises when there is a formal plan committed to on the appropriate organisational level and when NMB is without realistic possibility of withdrawal, which normally occurs when the plan has been communicated to the group affected or to their representatives.

Termination benefits can include both short-term benefits, for instance a number of months' salary, and post-employment benefits, normally in the form of early retirement. Short-term benefits are classified as "Salaries and remuneration" and post-employment benefits as "Pension costs" in Note 6 "Staff costs".

### 15. Equity

**Other reserves**
In addition to non-restricted reserves, other reserves comprise income and expenses, net after tax effects, which are reported in equity through other comprehensive income. These reserves include fair value reserves for cash flow hedges and accumulated remeasurements of defined benefit pension plans, as well as a reserve for translation differences.

### 16. Credit commitments

The contractual amount of irrevocable credit commitments is recognised off-balance in the item "Commitments".

### 17. Share-based payment

**Cash-settled programmes**
NMB has to defer payment of variable salaries under Nordic FSA's regulations and general guidelines, as is also the case with the Executive Incentive Programme (EIP). The deferred amounts are to some extent indexed using Nordea's TSR (Total Shareholders' Return) and these "programmes" are cash-settled share-based programmes. These programmes are fully vested when the payments of variable salaries are initially deferred and the fair value of the obligation is remeasured on a continuous basis. The remeasurements are, together with the related social charges, recognised in the income statement in the item "Net result from items at fair value".

For more information see Note 6 "Staff costs".

### 18. Related party transactions

NMB defines related parties as:

- Shareholders with significant influence
- Group undertakings
- Key management personnel
- Other related parties.

All transactions with related parties are made on an arm's length basis, apart from loans granted to employees, see Note 6 "Staff costs".

**Shareholders with significant influence**
Shareholder with significant influence is the sole shareholder of NMB that has the power to participate in the financial and operating decisions of NMB but do not control those policies. Nordea Bank AB (publ) is considered having such a power.

**Group undertakings**
Nordea Group undertakings means the subsidiaries of the parent company Nordea Bank AB (publ).

Group internal transactions between legal entities are performed according to arm's length principles in conformity with OECD requirements on transfer pricing. These transactions are eliminated in the consolidated accounts.

**Key management personnel**
Key management personnel includes the following positions:

- The Board of Directors of Nordea Mortgage Bank Plc and Nordea Bank AB (publ)
- The Chief Executive Officer (CEO) of Nordea Mortgage Bank Plc and the deputy to the CEO
- Management Group of Nordea Mortgage Bank Plc

For information about compensation, pensions and other transactions with key management personnel, see Note 6 "Staff costs".

**Other related parties**
Other related parties comprise close family members to individuals in key management personnel. Other related parties also include companies significantly influenced by key management personnel in NMB as well as companies significantly controlled by close family members to these key management personnel.

Information concerning transactions between NMB and other related parties is found in Note 26 "Related-party transactions".

## Note 2 Segment reporting

**Measurement of Operating segments' performance**

The measurement principles and allocation between operating segments follow the information reported to the Chief Operating Decision Maker (CODM). In NMB the CODM has been defined as Group Executive Management of Nordea.

**Operating segments**

The financial results of Nordea Mortgage Bank are presented as a single entity. All the operations of Nordea Mortgage Bank relate to the issuance of covered bonds. All the material operative decisions of Nordea Mortgage Bank are prepared by the Chief Executive Officer and decided by the Board of Directors. Due to the business model of Nordea Mortgage Bank, the nature of its operations and its governance structure, the entity as a whole is the relevant operating segment to be reported.

**Income statement**

| | Mortgage Banking | |
|---|---|---|
| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
| Net interest income | 192.1 | 51.4 |
| Net fee and commission income | -11.0 | 0.2 |
| Net result from items at fair value | -2.4 | -4.8 |
| Other income | 0.0 | 0.0 |
| **Total operating income** | **178.7** | **46.8** |
| Staff costs | -1.9 | -0.3 |
| Other expenses | -45.9 | -11.5 |
| **Total operating expenses** | **-47.8** | **-11.8** |
| **Profit before loan losses** | **130.9** | **35.0** |
| Net loan losses | 0.7 | 0.4 |
| **Operating profit** | **131.6** | **35.4** |
| Income tax expense | -26.3 | -7.1 |
| **Net profit for the year** | **105.3** | **28.3** |

| **Balance sheet, EURm** | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Loans to the public | 23,530.1 | 23,912.4 |
| Debt securities in issues | 15,469.6 | 16,299.9 |

**Total operating income split on product groups**

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Mortgage Banking products | 178.7 | 46.8 |
| **Total** | **178.7** | **46.8** |

**Geographical information**

| | Total operating income | | Assets | |
|---|---|---|---|---|
| EURm | Jan-Dec 2017 | Oct-Dec 2016 | 31 Dec 2017 | 31 Dec 2016 |
| Finland | 178.7 | 46.8 | 25,025.2 | 25,586.2 |
| **Total** | **178.7** | **46.8** | **25,025.2** | **25,586.2** |

### Note 3 Net interest income

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **Interest income** | | |
| Loans to credit institutions | -0.7 | - |
| Loans to the public | 249.2 | 66.5 |
| Interest-bearing securities | - | -0.1 |
| Other interest income | 8.7 | 2.7 |
| **Interest income** | **257.2** | **69.1** |
| | | |
| **Interest expense** | | |
| Deposits by credit institutions | -3.0 | -0.3 |
| Debt securities in issue | -241.5 | -67.5 |
| Subordinated liabilities | -2.2 | -0.6 |
| Other interest expenses[1] | 181.6 | 50.7 |
| **Interest expense** | **-65.1** | **-17.7** |
| **Net interest income** | **192.1** | **51.4** |

[1] The net interest income from derivatives, measured at fair value, related to Nordea Mortgage Bank's funding. This can have both a positive and negative impact on other interest expense, for further information see Note 1.

Interest income from financial instruments not measured at fair value through profit and loss amounted to EUR 257.2m. Interest expenses from financial instruments not measured at fair value through profit and loss amounted to EUR -251.8m.

Interest on impaired loans amounted to an insignificant portion of interest income.

### Note 4 Net fee and commission income

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Brokerage, securities issues and corporate finance | -0.3 | - |
| - of which income | - | - |
| - of which expense | -0.3 | - |
| Custody and issuer services | -0.1 | 0.0 |
| - of which income | - | - |
| - of which expense | -0.1 | 0.0 |
| Lending Products | 7.5 | 1.9 |
| - of which income | 7.5 | 1.9 |
| - of which expense | - | - |
| Guarantees | -15.7 | -4.0 |
| - of which income | - | 0.0 |
| - of which expense | -15.7 | -4.0 |
| Other | -2.4 | 2.3 |
| - of which income | -2.4 | 2.3 |
| - of which expense | 0.0 | 0.0 |
| **Total** | **-11.0** | **0.2** |

Fee income, not included in determining the effective interest rate, from financial assets and liabilities not measured at fair value through profit or loss amounts to EUR 7.5m.

## Note 5 Net result from items at fair value

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Interest related instruments and foreign exchange gains/losses | -2.4 | -4.8 |
| **Total** | **-2.4** | **-4.8** |

**Net result from categories of financial instruments**

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Financial instruments held for trading | -0.4 | -0.7 |
| Financial instruments under fair value hedge accounting | -2.5 | -3.9 |
| - of which net result on hedging instruments | -244.7 | -284.5 |
| - of which net result on hedged items | 242.2 | 280.6 |
| Financial assets measured at amortised cost[1] | 0.5 | 0.1 |
| Foreign exchange gains/losses excl. currency hedges | 0.0 | -0.3 |
| **Total** | **-2.4** | **-4.8** |

[1] Of which EUR 0.5m related to instruments classified into the category "Loans and receivables".

## Note 6 Staff costs

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Salaries and remuneration | -1.4 | -0.2 |
| Pension costs (specification below) | -0.3 | -0.1 |
| Social security contributions | -0.1 | 0.0 |
| Allocation to profit-sharing foundation | 0.0 | 0.0 |
| Other staff costs | -0.1 | 0.0 |
| **Total** | **-1.9** | **-0.3** |

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **Pension costs:** | | |
| Defined benefit plans (Note 17) | 0.0 | - |
| Defined contribution plans | -0.3 | -0.1 |
| **Total** | **-0.3** | **-0.1** |

**Additional disclosures on remuneration under Nordic FSAs' regulation and general guidelines**
The qualitative disclosures under these regulations can be found in the separate section on remuneration in the Board of Director's Report, while the quantitative disclosures will be published in a separate report on Nordea's homepage (www.nordea.com) no later than one week before the Annual General Meeting of Nordea on 15 March 2018.

**Compensation etc. to the Board of Directors and Chief Executive Officer**
As at 31 December 2017, five members of the Board of Directors of Nordea Mortgage Bank Plc were employed by Nordea Bank AB (publ) and two members were external. Fees paid to external members of the Board amounted to 7,000 euros in 2017. Salaries, fees and other staff related expenses to the other members of the Board were paid by Nordea Bank AB (publ). Salaries, fees, pensions and other staff related expenses paid to the Chief Executive Officer in 2017 are presented below.

**Remuneration to the Chief Executive Officer of Nordea Mortgage Bank Plc**

| EUR | Fixed salary 2017 | Executive Incentive Programme 2017 | Benefits 2017 | **Total 2017** |
|---|---|---|---|---|
| Chief Executive Officer of NMB: | | | | |
| Thomas Miller | 134,536 | 11,489 | 5,820 | **151,845** |

| EUR | Fixed salary 2016 | Executive Incentive Programme 2016 | Benefits 2016 | **Total 2016** |
|---|---|---|---|---|
| Chief Executive Officer of NMB: | | | | |
| Thomas Miller (1 Oct - 31 Dec) | 31,721 | - | 1,455 | **33,176** |

## Note 6 Staff costs, cont.

There was no pension obligation for the Chief Executive Officer of Nordea Mortgage Bank Plc at the year-end 2017 or 2016.

**Loans granted to the Chief Executive Officer of Nordea Mortgage Bank Plc and members of the Board of Directors of Nordea Mortgage Bank Plc**

| EUR | Loans in the balance sheet of Nordea Mortgage Bank Plc 2017 | Paid interest to Nordea Mortgage Bank Plc 2017 | Loans in the balance sheet of Nordea Mortgage Bank Plc 2016 | Paid interest to Nordea Mortgage Bank Plc 2016 |
|---|---|---|---|---|
| Chief Executive Officer of NMB: | | | | |
| Thomas Miller | 397,694 | 4,073 | 410,611 | 4,210 |
| To members of the Board of Directors of NMB | 1,419,462 | 4,850 | 1,590,326 | 2,442 |
| **Total** | **1,817,156** | **8,923** | **2,000,937** | **6,652** |

Loans to key management personnel as defined in Note 1 section 18 amounted to EUR 2,255,830. Interest income on these loans amounted to EUR 9,512.

Loans to other related parties amounted to EUR 1,226,894. Interest on these loans amounted to EUR 3,989.

In Finland the employee interest rate for loans granted before 1 September 2014 corresponds to Nordea's funding cost with a margin of 10 basis points up to EUR 400,000, and 30 basis points on the part that exceeds EUR 400,000. Interest rate for loans granted as from 1 September 2014 corresponds to Nordea's funding cost with a margin of 40 basis points up to EUR 400,000, and 60 basis points on the part that exceeds EUR 400,000.

Loans to family members of key management personnel are granted on normal market terms, as well as loans to key management personnel who are not employed by Nordea.

**Guarantees and other off-balance-sheet commitments**
NMB has not pledged any assets or other collateral or committed to contingent liabilities on behalf of any key management personnel or auditors.

The members of the administrative and controlling boards have no holdings of shares, equity warrants or convertible bonds issued by Nordea Mortgage Bank Plc.

**Cash-settled share-based payment transactions**
Nordea operates share-linked deferrals on parts of variable compensation for certain employee categories, indexed with Nordea Total Shareholder Returns (TSR) and either transferred after three years or transferred in equal instalments over a three to five year period. Since 2011 Nordea also operates TSR-linked retention on part of variable compensation for certain employee categories. As the allocation of variable compensation is not finally decided during the current year, the deferred amount during the year relates to variable compensation earned the previous year.

In addition, Nordea introduced in 2013 the Executive Incentive Programme ("EIP") which aims to strengthen Nordea's capability to retain and recruit the best talents. The aim is further to stimulate the managers and key employees whose efforts have direct impact on Nordea's result, profitability and long-term value growth. EIP reward performance meeting agreed predetermined targets on Group, business unit and individual level. The effect on the long-term result is to be considered when determining the targets. The EIP shall not exceed the fixed salary. EIP shall be paid in the form of cash and be subject to TSR-indexation, deferral, forfeiture clauses and retention as per relevant remuneration regulations. Participation in the programme is offered to up to 400 managers and key employees, except GEM who are instead offered a GEM EIP (further information about the GEM EIP can be found in the Annual Report of Nordea Bank AB (publ)), within the Nordea Group. EIP is offered instead of Nordea's LTIP and VSP for the invited employees. 80% of the allocated amount will be subject to TSR-indexation.

**Number of employees**

| Average number of employees | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Full-time employees | 18 | 6 |
| Part-time employees | - | - |
| **Total** | **18** | **6** |
| | | |
| **Total number of employees (FTEs), end of period** | **20** | **12** |

## Note 7 Other expenses

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Information technology | -0.1 | 0.0 |
| Marketing and representation | -0.1 | - |
| Postage, transportation, telephone and office expenses | -0.1 | - |
| Rents, premises and real estate | 0.0 | - |
| Other[1] | -45.6 | -11.5 |
| **Total** | **-45.9** | **-11.5** |

[1] Relates mainly to services bought from Nordea Group companies.

**Auditors' fees**

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **PricewaterhouseCoopers** | | |
| Auditing assignments | -0.2 | - |
| Audit-related services | -0.1 | -0.1 |
| **Total** | **-0.3** | **-0.1** |

## Note 8 Net loan losses

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| **Loan losses divided by class** | | |
| **Loans to the public[1]** | | |
| Realised loan losses | 0.0 | - |
| Provisions | -2.9 | - |
| Reversals of previous provisions | 3.6 | 0.4 |
| **Net loan losses** | **0.7** | **0.4** |

[1] See Note 10 "Loans and impairment"

**Key ratios**

| | 2017 | 2016 |
|---|---|---|
| Loan loss ratio, basis points[2] | -0.3 | -0.7 |
| - of which individual | 0.9 | - |
| - of which collective | -1.2 | -0.7 |

[2] Net loan losses (annualised) divided by the closing balance of loans to the public (lending).

## Note 9 Taxes

**Income tax expense**

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Current tax | -25.7 | -6.6 |
| Deferred tax | -0.6 | -0.4 |
| **Total** | **-26.3** | **-7.1** |

For current and deferred tax recognised in Other comprehensive income, see Statement of comprehensive income.

## Note 9 Taxes, cont.

The tax on NMB's operating profit differs from the theoretical amount that would arise using the tax rate of Finland as follows:

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Profit before tax | 131.6 | 35.4 |
| Tax calculated at a tax rate of 20 % | -26.3 | -7.1 |
| **Tax charge** | **-26.3** | **-7.1** |
| Average effective tax rate | 20% | 20% |

| EURm | Deferred tax assets 31 Dec 2017 | Deferred tax assets 31 Dec 2016 | Deferred tax liabilities 31 Dec 2016 |
|---|---|---|---|
| **Deferred tax related to:** | | | |
| Loans to the public | 14.1 | 13.9 | 0.1 |
| Retirement benefit assets/obligations | 0.0 | 0.0 | - |
| Netting between deferred tax assets and liabilities | 0.0 | -0.1 | -0.1 |
| **Total** | **14.1** | **13.9** | **0.0** |

There were no unrecognised deferred tax assets in 2017.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities, when the deferred tax income relates to the same fiscal authority.

## Note 10 Loans and impairment

| | Total | |
|---|---|---|
| EURm | 31 Dec 2017 | 31 Dec 2016 |
| Loans, not impaired | 24,053.4 | 24,351.5 |
| Impaired loans[1] | 135.4 | 66.9 |
| - Servicing | 0.6 | 3.6 |
| - Non-servicing | 134.8 | 63.3 |
| **Loans before allowances** | **24,188.8** | **24,418.4** |
| Allowances for individually assessed impaired loans | -2.0 | - |
| - Servicing | -0.2 | - |
| - Non-servicing | -1.8 | - |
| Allowances for collectively assessed impaired loans | -9.1 | -11.8 |
| **Allowances** | **-11.1** | **-11.8** |
| **Loans, carrying amount** | **24,177.7** | **24,406.6** |

| | Credit institutions | | The public | |
|---|---|---|---|---|
| EURm | 31 Dec 2017 | 31 Dec 2016 | 31 Dec 2017 | 31 Dec 2016 |
| Loans, not impaired | 647.6 | 494.2 | 23,405.8 | 23,857.3 |
| Impaired loans[1] | - | - | 135.4 | 66.9 |
| - Servicing | - | - | 0.6 | 3.6 |
| - Non-servicing | - | - | 134.8 | 63.3 |
| **Loans before allowances** | **647.6** | **494.2** | **23,541.2** | **23,924.2** |
| Allowances for individually assessed impaired loans | - | - | -2.0 | - |
| - Servicing | - | - | -0.2 | - |
| - Non-servicing | - | - | -1.8 | - |
| Allowances for collectively assessed impaired loans | - | - | -9.1 | -11.8 |
| **Allowances** | **-** | **-** | **-11.1** | **-11.8** |
| **Loans, carrying amount** | **647.6** | **494.2** | **23,530.1** | **23,912.4** |

[1] Whole amount relates to household loans.

## Note 10 Loans and impairment, cont.

**Movements of allowance accounts for impaired loans**

| | The public | | |
|---|---|---|---|
| EURm | Individually assessed | Collectively assessed | Total |
| **Opening balance at 1 Jan 2017** | **-** | **-11.8** | **-11.8** |
| Provisions | -2.0 | -0.9 | -2.9 |
| Reversals of previous provisions | - | 3.6 | 3.6 |
| **Changes through the income statement** | **-2.0** | **2.7** | **0.7** |
| Allowances used to cover realised loan losses | - | - | - |
| **Closing balance at 31 Dec 2017** | **-2.0** | **-9.1** | **-11.1** |

| | The public | | |
|---|---|---|---|
| EURm | Individually assessed | Collectively assessed | Total |
| **Opening balance at 1 Oct 2016** | **-** | **-12.2** | **-12.2** |
| Provisions | - | 0.0 | 0.0 |
| Reversals of previous provisions | - | 0.4 | 0.4 |
| **Changes through the income statement** | **-** | **0.4** | **0.4** |
| Allowances used to cover realised loan losses | - | - | - |
| **Closing balance at 31 Dec 2016** | **-** | **-11.8** | **-11.8** |

**Allowances and provisions**

| EURm | Credit institutions 31 Dec 2017 | The public 31 Dec 2017 | Total 31 Dec 2017 |
|---|---|---|---|
| Allowances for items in the balance sheet | - | -11.1 | -11.1 |
| Provisions for off balance sheet items | - | - | - |
| **Total allowances and provisions** | **-** | **-11.1** | **-11.1** |

| EURm | Credit institutions 31 Dec 2016 | The public 31 Dec 2016 | Total 31 Dec 2016 |
|---|---|---|---|
| Allowances for items in the balance sheet | - | -11.8 | -11.8 |
| Provisions for off balance sheet items | - | - | - |
| **Total allowances and provisions** | **-** | **-11.8** | **-11.8** |

**Key ratios**

| | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Impairment rate, gross[2], basis points | 56 | 27 |
| Impairment rate, net[3], basis points | 55 | 27 |
| Total allowance rate[4], basis points | 5 | 5 |
| Allowances in relation to impaired loans[5], % | 1 | - |
| Total allowances in relation to impaired loans [6], % | 8 | 18 |
| Non-performing loans, not impaired[7], EURm | 13.5 | 8.1 |

[2] Individually assessed impaired loans before allowances divided by total loans before allowances.
[3] Individually assessed impaired loans after allowances divided by total loans before allowances.
[4] Total allowances divided by total loans before allowances.
[5] Allowances for individually assessed impaired loans divided by individually assessed impaired loans before allowances.
[6] Total allowances divided by total impaired loans before allowances.
[7] Past due loans, not impaired due to future cash flows (included in Loans, not impaired).

## Note 11 Derivatives and hedge accounting

| 31 Dec 2017, EURm | Fair value Positive | Negative | Total nominal amount |
|---|---|---|---|
| **Derivatives held for trading** | | | |
| **Interest rate derivatives** | | | |
| Interest rate swaps | 0.6 | 3.0 | 14,480.0 |
| Options | 13.2 | 12.2 | 8,898.6 |
| **Total** | **13.8** | **15.2** | **23,378.6** |
| **Total derivatives held for trading** | **13.8** | **15.2** | **23,378.6** |
| **Derivatives used for hedge accounting** | | | |
| Interest rate derivatives | 496.9 | 145.0 | 26,732.5 |
| Foreign exchange derivatives | 24.7 | - | 116.2 |
| **Total derivatives used for hedge accounting** | **521.6** | **145.0** | **26,848.7** |
| - of which cash flow hedges | 24.7 | - | 116.2 |
| - of which fair value hedges | 496.9 | 145.0 | 26,732.5 |
| **Total derivatives** | **535.4** | **160.2** | **50,227.3** |

**Periods when hedged cash-flows are expected to occur and when they are expected to affect the income statement**

| 31 Dec 2017, EURm | <1 year | 1-3 years | 3-5 years | 5-10 years | over 10 years |
|---|---|---|---|---|---|
| Cash inflows (assets) | - | - | - | - | - |
| Cash outflows (liabilities) | 3.1 | 6.1 | 131.2 | - | - |
| **Net cash outflows** | **3.1** | **6.1** | **131.2** | **-** | **-** |

| 31 Dec 2016, EURm | Fair value[1] Positive | Negative | Total nominal amount |
|---|---|---|---|
| **Derivatives held for trading** | | | |
| **Interest rate derivatives** | | | |
| Interest rate swaps | 2.7 | 1.9 | 14,474.6 |
| **Total** | **2.7** | **1.9** | **14,474.6** |
| **Total derivatives held for trading** | **2.7** | **1.9** | **14,474.6** |

[1] As at 31 Dec 2016 the netting effect to positive and negative market values of derivatives was EUR 1 m.

| 31 Dec 2016, EURm | Fair value Positive | Negative | Total nominal amount |
|---|---|---|---|
| **Derivatives used for hedge accounting** | | | |
| Interest rate derivatives | 742.7 | 125.5 | 21,362.5 |
| Foreign exchange derivatives | 44.4 | - | 123.9 |
| **Total derivatives used for hedge accounting** | **787.1** | **125.5** | **21,486.4** |
| - of which cash flow hedges | 55.2 | 10.7 | 1,954.1 |
| - of which fair value hedges | 731.9 | 114.8 | 19,532.3 |
| **Total derivatives** | **789.8** | **127.4** | **35,960.9** |

**Periods when hedged cash-flows are expected to occur and when they are expected to affect the income statement**

| 31 Dec 2016, EURm | <1 year | 1-3 years | 3-5 years | 5-10 years | over 10 years |
|---|---|---|---|---|---|
| Cash inflows (assets) | - | - | - | - | - |
| Cash outflows (liabilities) | 13.0 | 6.7 | 146.3 | - | - |
| **Net cash outflows** | **13.0** | **6.7** | **146.3** | **-** | **-** |

## Note 12  Prepaid expenses and accrued income

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Accrued interest income | 16.9 | 16.5 |
| Other accrued income[1] | - | 60.3 |
| **Total** | **16.9** | **76.8** |

[1]Unsettled debt between Nordea Bank AB, Finnish Branch and Nordea Mortgage Bank. Consists of customer's interest payments and amortisations.

## Note 13  Deposits by credit institutions

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Banks | 7,557.6 | 7,200.0 |
| **Total** | **7,557.6** | **7,200.0** |

## Note 14  Debt securities in issue

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Covered bonds | 15,469.6 | 16,299.9 |
| **Total** | **15,469.6** | **16,299.9** |

## Note 15  Other liabilities

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Accounts payable | 0.0 | - |
| Other | 70.0 | 0.2 |
| **Total** | **70.0** | **0.2** |

## Note 16  Accrued expenses and prepaid income

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Other accrued expenses | 9.8 | 30.2 |
| Prepaid income | 50.9 | 59.0 |
| **Total** | **60.7** | **89.2** |

## Note 17 Retirement benefit obligations

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Defined benefit plans, net | 0.0 | 0.0 |
| **Total** | **0.0** | **0.0** |

NMB has both defined benefit plans and defined contribution plans. Defined benefit plans are arranged in Nordea Pension Foundation. IAS 19 secures that the pension obligations net of plan assets backing these obligations are reflected on the company's balance sheet. The defined benefit plans are closed to new employees and instead, pensions for new employees are based on defined contribution (DCP) arrangements. Defined contribution plans are not reflected on the balance sheet except when earned pension rights have not yet been paid for.

The plans are structured in accordance with local regulations, legislations and local practice and where applicable, collective agreements. Plan assets are generally held in a separate pension fund or foundation. Minimum funding requirement differ between plans but generally the pension obligation measured using local requirements shall be covered in full or with a predetermined surplus.

**Characteristics of the Nordea Pension Foundation**
Nordea Pension Foundation plan is a final salary and service based pension plan providing pension benefits on top of the statutory systems. The employer has promised a certain level of benefit after retirement to a certain group of employees within the plan. Plan's operation is managed by the Board of Members. The board consists of both employers' and employee's representatives. The Board of Members has named a managing director to take care of regular operations in the foundation.

The plan exposes the employer to certain risks. If the return of foundation's assets is not enough to cover the increment of liability and benefit payments over the financial year then the employer funds the deficit with contributions. The present value of the defined benefit liability is calculated using a discount rate determined by reference to high quality bond yields. A decrease in the corporate bond yields increases the liabilities along with increment of plan's benefit obligation calculated according to IAS 19. However, part of increment of obligation is offset by asset increment along with the increment of plan's bond holdings. Asset volatility may also impact NMB although basically the distribution of assets to different asset classes is strictly dictated by authorities so significant concentration risk cannot be borne. The plan's benefits in payment are tied to TyEL-index which depends on inflation (80 %) and common salary index (20 %). Higher inflation increases the TyEL-index which leads to an increase in liabilities. Higher inflation causes extra challenges to investment activities from which the employer in the last resort is responsible. The present value of the defined benefit plan liability is calculated by reference to the best estimate of the mortality of plan participants both during and after their employment. An increase in life expectancy of the plan participants will increase the plan's liability.

**IAS 19 pension calculations and assumptions**

Calculations on defined benefit plans are performed by external liability calculators and are based on the actuarial assumptions.

| Assumptions[1] | Finland |
|---|---|
| **2017** | |
| Discount rate[2] | 1.29% |
| Salary increase | 1.75% |
| Inflation | 1.25% |
| Mortality | New TyEL mortality |
| Increase in income base amount | 1.70% |
| **2016** | |
| Discount rate[2] | 1.56% |
| Salary increase | 1.75% |
| Inflation | 1.25% |
| Mortality | New TyEL mortality |
| Increase in income base amount | 1.70% |

[1] The assumptions disclosed for 2017 had an impact on the liability calculation by year-end 2017, while the assumptions disclosed for 2016 were used for calculating the pension expense in 2017.

[2] More information on the discount rate can be found in Note 1, section 14. The sensitivities to changes in discount rate can be found in the table below.

| Sensitivities - Impact on Defined Benefit Obligation (DBO) % | 2017 | 2016 |
|---|---|---|
| Discount rate - Increase 50bps | -12.4% | -12.2% |
| Discount rate - Decrease 50bps | 14.6 % | 14.3 % |
| Salary increase - Increase 50bps | 5.5 % | 5.7% |
| Salary increase - Decrease 50bps | -5.3 % | -5.4% |
| Inflation - Increase 50bps | 13.0 % | 12.8% |
| Inflation - Decrease 50bps | -11.3 % | -11.2% |
| Mortality - Increase 1 year | 3.2 % | 3.1% |
| Mortality - Decrease 1 year | -3.2 % | -3.1% |

The sensitivity analyses are prepared by changing one actuarial assumption while keeping the other assumptions unchanged. This is a simplified approach since the actuarial assumptions usually are correlated. However, it enables the reader to isolate one effect from another.

## Note 17 Retirement benefit obligations, cont.

The method used for calculating the impact on the obligation is the same as when calculating the obligation accounted for in the financial statements.

**Net retirement benefit liabilities/assets**

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Obligations | 0.2 | 0.2 |
| Plan assets | 0.2 | 0.2 |
| **Net liability(-)/asset (+)** | **0.0** | **0.0** |
| - of which retirement benefit liabilities | 0.0 | 0.0 |
| - of which retirement benefit assets | - | - |

**Movements in the obligation**

| EURm | 2017 | 2016 |
|---|---|---|
| Opening balance | 0.2 | - |
| Current service cost | 0.0 | - |
| Interest expense | 0.0 | - |
| Remeasurement from changes in financial assumptions | 0.0 | 0.0 |
| Remeasurement from changes experience adjustments | 0.0 | - |
| Plan inclusion | - | 0.2 |
| **Closing balance** | **0.2** | **0.2** |

The average duration of the obligation is 13 years (15). The duration is based on discounted cash flows. The fact that the defined benefit plans are closed for new entrants leads to a lower duration.

**Movements in the fair value of plan assets**

| EURm | 2017 | 2016 |
|---|---|---|
| Opening balance | 0.2 | - |
| Interest income (calculated using the discount rate) | 0.0 | - |
| Remeasurement (actual return less interest income) | 0.0 | 0.0 |
| Plan inclusion | - | 0.2 |
| **Closing balance** | **0.2** | **0.2** |

**Asset composition**
The combined return on assets in 2017 was 3%. At the end of the year, the equity exposure in pension foundation represented 29% (27) of total assets.

| Asset composition in funded schemes | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Bonds | 55% | 55% |
| - sovereign | 29% | 33% |
| - covered bonds | 5% | - |
| - corporate bonds | 21% | 22% |
| - issued by Nordea entities | - | - |
| - with quoted market price in an active market | 55% | 55% |
| Equity | 29% | 27% |
| - domestic | 7% | 7% |
| - European | 7% | 7% |
| - US | 8% | 7% |
| - emerging | 6% | 5% |
| - Nordea shares | 0% | 0% |
| - with quoted market price in an active market | 29% | 27% |
| Real Estate[1] | 14% | 14% |
| - occupied by Nordea | 4% | 4% |
| Cash and cash equivalents | 2% | 5% |

[1] The geographical location of the real estate follows the geographical location of the relevant pension plan.

The company is not expected to pay contribution to its defined benefit plans in 2018.

## Note 17 Retirement benefit obligations, cont.

**Defined benefit pension cost**

Only a minor pension cost related to defined benefit plans has been recognised in the income statement (as staff costs) in 2017. Total pension costs comprise defined benefit pension costs as well as costs related to defined contribution plans (see specification in Note 6).

| Recognised in other comprehensive income, EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Remeasurement from changes in financial assumptions | 0.0 | 0.0 |
| Remeasurement from experience adjustments | 0.0 | - |
| Remeasurement of plan assets (actual return less interest income) | 0.0 | 0.0 |
| **Pension cost on defined benefit plans (expense+, income-)** | **0.0** | **0.0** |

| Net retirement benefit asset//liability | 2017 | 2016 |
|---|---|---|
| Opening balance | 0.0 | - |
| Pension cost in the income statement | 0.0 | - |
| Remeasurements in other comprehensive income | 0.0 | 0.0 |
| Plan inclusion | - | 0.0 |
| **Closing balance** | **0.0** | **0.0** |

**Key management personnel**

As at 31 December 2017, five members of the Board of Directors of Nordea Mortgage Bank Plc were employed by Nordea Bank AB (publ) and two members were external.

Information on salaries, loans and pension liabilities regarding the members of the Board and the Chief Executive Officer is presented in Note 6.

## Note 18 Subordinated liabilities

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Dated subordinated debenture loans | 200.5 | 200.6 |
| **Total** | **200.5** | **200.6** |

These debenture loans are subordinated to other liabilities. Dated debenture loans entitle the lender to payment before undated subordinated loans and hybrid capital loans. Within each respective category, the loans entitle lenders to equal payment rights.

| Issued by | Year of issue / maturity | Nominal value, EURm | Carrying amount, EURm | Interest rate (coupon) |
|---|---|---|---|---|
| Nordea Bank AB (publ), Finnish Branch[1] | 2016/2026 | 200.0 | 200.5 | Floating 3-month EURIBOR +1,42% |

[1] Call date 1 October 2021

## Note 19 Assets pledged as security for own liabilities

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| **Assets pledged for own liabilities** | | |
| Loans to the public | 20,562.5 | 21,978.1 |
| **Total** | **20,562.5** | **21,978.1** |
| | | |
| **The above pledges pertain to the following liabilities** | | |
| Debt securities in issue | 15,469.6 | 16,299.9 |
| **Total** | **15,469.6** | **16,299.9** |

Loans to the public amounting to EUR 20,562.5m have been registered as collateral for issued Finnish covered bonds amounting to EUR 15,469.6m. In the event of the company's insolvency, the holders of these bonds have priority to the assets registered as collateral. Collaterals are valuated up to the first 70% of the market value of the property.

## Note 20 Commitments

| EURm | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Loan commitments | 209.6 | 5.2 |
| **Total** | **209.6** | **5.2** |

## Note 21 Capital adequacy

Capital adequacy is a measure of the financial strength of a bank, usually expressed as a ratio of capital to assets. There is now a worldwide capital adequacy standard (Basel III) drawn up by the Basel Committee on Banking Supervision. Within the EU, the capital adequacy requirements are outlined in the Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR).

CRD IV was implemented through national law within all EU countries during 2014, while the CRR entered into force in all EU countries the first of January 2014.

The Basel III framework is built on three Pillars:

- Pillar I – requirements for the calculation of REA and capital
- Pillar II – rules for the Supervisory Review Process (SRP) including the Internal Capital Adequacy Assessment Process (ICAAP)
- Pillar III – rules for the disclosure on risk and capital management, including capital adequacy.

Nordea performs an ICAAP with the purpose to review the management, mitigation and measurement of material risks within the business environment in order to assess the adequacy of capitalisation and to determine an internal capital requirements reflecting the risks of the institution.

The ICAAP is a continuous process which increases awareness of capital requirements and exposure to material risks throughout the organisation, both in the business area and legal entity dimensions. Stress tests are important drivers of risk awareness, looking at capital and risk from a firm-wide perspective on a regular basis and on an ad-hoc basis for specific areas or segments. The process includes a regular dialogue with supervisory authorities, rating agencies and other external stakeholders with respect to capital management, measurement and mitigation techniques used. NMB's capital levels continue to be adequate to support the risks taken, both from an internal perspective as well as from the perspective of supervisors. Heading into 2018, Nordea will continue to closely follow the development of the new capital requirement regime as well as maintain its open dialogue with the supervisory authorities.

**Common Equity Tier 1 capital and Tier 1 capital**
The capital recognised as Common Equity Tier 1 (CET1) capital holds the ultimate characteristics for loss absorbance defined from a going concern perspective and represents the most subordinated claim in the event of liquidation.

The Tier 1 capital is defined as the sum of CET1 capital and Additional Tier 1 (AT1) capital where AT1 capital is the total of instruments (hybrids) issued by the bank which are fully compliant with CRD IV and those that meet the transitional regulatory criteria and not included in the CET1 net after AT1 deductions.

**Additional Tier 1 instruments**
The inclusion of undated subordinated loans in AT1 capital is restricted and repurchase can normally not take place until five years after original issuance of the instrument. AT1 instruments may be repaid only upon decision by the Board of Directors in NMB and with the permission of the Supervisory Authority. Further, there are restrictions related to step-up conditions, order of priority, and interest payments under constraint conditions. AT1 instruments issued that fulfil the CRD IV requirements are fully included whereas remaining instruments are phased out according to transitional rules.

For the AT1 instruments, conditions specify appropriation in order to avoid being obliged to enter into liquidation. To the extent that may be required to avoid liquidation, the principal amounts of AT1 instruments (together with accrued interest) would be written down and converting such amount into a conditional capital contribution.

**Tier 2 capital**
Tier 2 capital must be subordinated to depositors and general creditors of the bank. It cannot be secured or covered by a guarantee of the issuer or related entity or include any other arrangement that legally or economically enhances the seniority of the claim vis-à-vis depositors and other bank creditors.

**Tier 2 instruments**
Tier 2 instruments are subordinated instruments. The basic principle for subordinated instruments in own funds is the order of priority in case of a default or bankruptcy situation. Under such conditions, the holder of the subordinated instrument would be repaid after other creditors, but before shareholders. Tier 2 instruments have an original maturity of at least five years. According to the regulation, Tier 2 instruments that fulfil the CRD IV requirements are fully included whereas remaining instruments are phased out according to transitional rules.

The inclusion of outstanding Tier 2 instruments in the Tier 2 capital is reduced if the remaining maturity is less than five years.

The table on the next page shows the main features of outstanding Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments.

## Note 21 Capital adequacy, cont.

**Common Equity Tier 1 capital: instruments and reserves**

| EURm | | (A) amount at disclosure date | (C) amounts subject to pre-regulation (EU) no 575/2013 treatment or prescribed residual amount of regulation (EU) no 575/2013 |
|---|---|---|---|
| 1 | Capital instruments and the related share premium accounts | 250.0 | |
| | of which: Share capital | 250.0 | |
| 2 | Retained earnings | 828.3 | |
| 3 | Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards) | -3.1 | |
| 5 | Minority Interests (amount allowed in consolidated CET1) | - | - |
| 5a | Independently reviewed interim profits net of any foreseeable charge or dividend | - | |
| 6 | **Common Equity Tier 1 (CET1) capital before regulatory adjustments** | 1,075.2 | |
| **Common Equity Tier 1 (CET1) capital: regulatory adjustments** | | | |
| 7 | Additional value adjustments (negative amount) | -0.2 | |
| 8 | Intangible assets (net of related tax liability) (negative amount) | - | |
| 10 | Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount) | - | |
| 11 | Fair value reserves related to gains or losses on cash flow hedges | 3.1 | |
| 12 | Negative amounts resulting from the calculation of expected loss amounts | -33.3 | |
| 14 | Gains or losses on liabilities valued at fair value resulting from changes in own credit standing | -2.0 | |
| 15 | Defined-benefit pension fund assets (negative amount) | - | |
| 25b | Foreseeable tax charges relating to CET1 items (negative amount) | - | |
| 26a | Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468 | - | |
| | Of which: …filter for unrealised loss on AFS debt instruments | - | |
| | Of which: …filter for unrealised gain on AFS debt instruments | - | |
| 28 | **Total regulatory adjustments to Common Equity Tier 1 (CET1)** | -32.4 | |
| 29 | **Common Equity Tier 1 (CET1) capital** | 1,042.8 | |
| **Additional Tier 1 (AT1) capital: instruments** | | | |
| 30 | Capital instruments and the related share premium accounts | - | |
| 36 | **Additional Tier 1 (AT1) capital before regulatory adjustments** | - | |
| **Additional Tier 1 (AT1) capital: regulatory adjustments** | | | |
| 43 | **Total regulatory adjustments to Additional Tier 1 (AT1) capital** | - | |
| 44 | **Additional Tier 1 (AT1) capital** | - | |
| 45 | **Tier 1 capital (T1 = CET1 + AT1)** | 1,042.8 | |
| **Tier 2 (T2) capital: instruments and provisions** | | | |
| 46 | Capital instruments and the related share premium accounts | 200.0 | |
| 47 | Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2 | - | |
| 50 | Credit risk adjustments | 4.7 | |
| 51 | **Tier 2 (T2) capital before regulatory adjustments** | 204.7 | |
| **Tier 2 (T2) capital: regulatory adjustments** | | | |
| 57 | **Total regulatory adjustments to Tier 2 (T2) capital** | - | |
| 58 | **Tier 2 (T2) capital** | 204.7 | |
| 59 | **Total capital (TC = T1 + T2)** | 1,247.5 | |
| 60 | **Total risk weighted assets** | 3,184.4 | |

### Note 21 Capital adequacy, cont.

| | | |
|---|---|---|
| **Capital ratios and buffers** | | |
| 61 | Common Equity Tier 1 (as a percentage of risk exposure amount) | 32.7% |
| 62 | Tier 1 (as a percentage of risk exposure amount) | 32.7% |
| 63 | Total capital (as a percentage of risk exposure amount) | 39.2% |
| 64 | Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount) | 2.5% |
| 65 | of which: capital conservation buffer requirement | 2.5% |
| 66 | of which: countercyclical buffer requirement | 0.0% |
| 67 | of which: systemic risk buffer requirement | - |
| 67a | of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer | - |
| 68 | Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount) | 26.7% |
| **Amounts below the thresholds for deduction (before risk weighting)** | | |
| 72 | Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions) | - |
| 73 | Direct and indirect holdings by the institution of the CET 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions) | - |
| 75 | Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met) | 0.0 |
| **Applicable caps on the inclusion of provisions in Tier 2** | | |
| 78 | Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap) | 4.7 |
| 79 | Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach | 15.8 |
| **Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)** | | |
| 84 | Current cap on T2 instruments subject to phase out arrangements | - |
| 85 | Amount excluded from T2 due to cap (excess over cap after redemptions and maturities) | - |

## Note 21 Capital adequacy, cont.

**Minimum capital requirement and REA**

| EURm | 31 Dec 2017 Minimum capital requirement | 31 Dec 2017 REA | 31 Dec 2016 Minimum capital requirement | 31 Dec 2016 REA |
|---|---|---|---|---|
| **Credit risk** | **230.9** | **2,886.3** | **196.8** | **2,459.4** |
| - of which counterparty credit risk | 9.4 | 117.0 | 14.3 | 180.5 |
| IRB | 210.1 | 2,625.9 | 173.5 | 2,168.0 |
| - sovereign | 0.2 | 2.3 | - | - |
| - corporate | 17.7 | 221.5 | 14.0 | 174.9 |
| - advanced | 17.7 | 221.5 | 14.0 | 174.9 |
| - retail | 192.0 | 2,399.7 | 159.5 | 1,993.1 |
| - secured by immovable property collateral | 146.4 | 1,829.6 | 120.5 | 1,506.9 |
| - other retail | 45.6 | 570.0 | 38.9 | 486.3 |
| - other | 0.2 | 2.2 | - | - |
| Standardised | 20.8 | 260.5 | 23.3 | 291.3 |
| - central governments or central banks | 1.1 | 14.1 | 1.1 | 13.9 |
| - institutions | 19.7 | 246.4 | 22.2 | 277.5 |
| **Operational risk** | **23.8** | **298.1** | **23.8** | **298.1** |
| Standardised | 23.8 | 298.1 | 23.8 | 298.1 |
| **Additional risk exposure amount, Article 3 CRR** | **-** | **-** | **1.0** | **12.8** |
| **Sub total** | **254.8** | **3,184.4** | **221.6** | **2,770.3** |
| **Adjustment for Basel I floor** | | | | |
| Additional capital requirement according to Basel I floor | 603.0 | 7,537.5 | 652.5 | 8,158.5 |
| **Total** | **857.8** | **10,721.9** | **874.1** | **10,928.8** |

**Leverage ratio**

| | 31 Dec 2017 | 31 Dec 2016[1] |
|---|---|---|
| Tier 1 capital, transitional definition, EURm | 1,042.8 | 1,049.0 |
| Leverage ratio exposure, EURm | 25,143.0 | 25,673.9 |
| Leverage ratio, percentage | 4.1 | 4.1 |

[1] Including profit of the period

## Note 22 Classification of financial instruments

| 31 Dec 2017, EURm | Loans and receivables | Financial assets at fair value through profit or loss: Held for trading | Derivatives used for hedging | Non-financial assets | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with central banks | 198.2 | - | - | - | 198.2 |
| Loans to credit institutions | 647.6 | - | - | - | 647.6 |
| Loans to the public | 23,530.1 | - | - | - | 23,530.1 |
| Derivatives | - | 13.8 | 521.6 | - | 535.4 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | 82.3 | - | - | - | 82.3 |
| Deferred tax assets | - | - | - | 14.1 | 14.1 |
| Current tax assets | - | - | - | 0.6 | 0.6 |
| Prepaid expenses and accrued income | 16.9 | - | - | - | 16.9 |
| **Total** | **24,475.1** | **13.8** | **521.6** | **14.7** | **25,025.2** |

| 31 Dec 2017, EURm | Financial liabilities at fair value through profit or loss: Held for trading | Derivatives used for hedging | Other financial liabilities | Non-financial liabilities | Total |
|---|---|---|---|---|---|
| **Liabilities** | | | | | |
| Deposits by credit institutions | - | - | 7,557.6 | - | 7,557.6 |
| Debt securities in issue | - | - | 15,469.6 | - | 15,469.6 |
| Derivatives | 15.2 | 145.0 | - | - | 160.2 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | - | - | 326.1 | - | 326.1 |
| Other liabilities | - | - | 0 | 70.0 | 70.0 |
| Accrued expenses and prepaid income | - | - | 50.9 | 9.8 | 60.7 |
| Retirement benefit liabilities | - | - | - | 0.0 | 0.0 |
| Subordinated liabilities | - | - | 200.5 | - | 200.5 |
| **Total** | **15.2** | **145.0** | **23,604.7** | **79.8** | **23,844.7** |

| 31 Dec 2016, EURm | Loans and receivables | Financial assets at fair value through profit or loss: Held for trading | Derivatives used for hedging | Non-financial assets | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with central banks | 200.0 | - | - | - | 200.0 |
| Loans to credit institutions | 494.2 | - | - | - | 494.2 |
| Loans to the public | 23,912.4 | - | - | - | 23,912.4 |
| Derivatives | - | 2.7 | 787.1 | - | 789.8 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | 99.1 | - | - | - | 99.1 |
| Deferred tax assets | - | - | - | 13.9 | 13.9 |
| Prepaid expenses and accrued income | 16.5 | - | - | 60.3 | 76.8 |
| **Total** | **24,722.2** | **2.7** | **787.1** | **74.2** | **25,586.2** |

## Note 22 Classification of financial instruments, cont.

| 31 Dec 2016, EURm | Financial liabilities at fair value through profit or loss<br>Held for trading | Derivatives used for hedging | Other financial liabilities | Non-financial liabilities | Total |
|---|---|---|---|---|---|
| **Liabilities** | | | | | |
| Deposits by credit institutions | - | - | 7,200.0 | - | 7,200.0 |
| Debt securities in issue | - | - | 16,299.9 | - | 16,299.9 |
| Derivatives | 1.9 | 125.5 | - | - | 127.4 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | - | - | 583.8 | - | 583.8 |
| Current tax liabilities | - | - | - | 6.6 | 6.6 |
| Other liabilities | - | - | - | 0.2 | 0.2 |
| Accrued expenses and prepaid income | - | - | 59.0 | 30.2 | 89.2 |
| Retirement benefit liabilities | - | - | - | 0.0 | 0.0 |
| Subordinated liabilities | - | - | 200.6 | - | 200.6 |
| **Total** | **1.9** | **125.5** | **24,343.3** | **37.0** | **24,507.7** |

## Note 23 Assets and liabilities at fair value

**Fair value of financial assets and liabilities**

| | 31 Dec 2017 | | 31 Dec 2016 | |
|---|---|---|---|---|
| EURm | Carrying amount | Fair value | Carrying amount | Fair value |
| **Financial assets** | | | | |
| Cash and balances with central banks | 198.2 | 198.2 | 200.0 | 200.0 |
| Loans | 24,260.0 | 24,750.1 | 24,505.7 | 24,608.2 |
| Derivatives | 535.4 | 535.4 | 789.8 | 789.8 |
| Prepaid expenses and accrued income | 17.0 | 17.0 | 16.5 | 16.5 |
| **Total financial assets** | **25,010.6** | **25,500.7** | **25,512.0** | **25,614.5** |
| | | | | |
| **Financial liabilities** | | | | |
| Deposits and debt instruments | 23,553.9 | 23,796.6 | 24,284.3 | 24,385.6 |
| Derivatives | 160.2 | 160.2 | 127.4 | 127.4 |
| Other liabilities | 0.0 | 0.0 | - | - |
| Accrued expenses and prepaid income | 50.9 | 50.9 | 59.0 | 59.0 |
| **Total financial liabilities** | **23,765.0** | **24,007.7** | **24,470.7** | **24,572.0** |

For information about valuation of items measured at fair value on the balance sheet, see Note 1 and the section "Determination of fair values for items measured at fair value on the balance sheet" in this note. For information about valuation of items not measured at fair value on the balance sheet, see the section "Financial assets and liabilities not held at fair value on the balance sheet" in this note.

### Note 23 Assets and liabilities at fair value, cont.

**Assets and liabilities held at fair value on the balance sheet**

**Categorisation into the fair value hierarchy**

| 31 Dec 2017, EURm | Quoted prices in active markets for same instrument (Level 1) | Valuation technique using observable data (Level 2) | Valuation technique using non-observable data (Level 3) | Total |
|---|---|---|---|---|
| **Assets at fair value on the balance sheet**[1] | | | | |
| Derivatives | - | 535.4 | - | 535.4 |
| **Total** | **-** | **535.4** | **-** | **535.4** |
| **Liabilities at fair value on the balance sheet**[1] | | | | |
| Derivatives | - | 160.2 | - | 160.2 |
| **Total** | **-** | **160.2** | **-** | **160.2** |

[1] All items are measured at fair value on a recurring basis at the end of each reporting period.

| 31 Dec 2016, EURm | Quoted prices in active markets for same instrument (Level 1) | Valuation technique using observable data (Level 2) | Valuation technique using non-observable data (Level 3) | Total |
|---|---|---|---|---|
| **Assets at fair value on the balance sheet**[1] | | | | |
| Derivatives | - | 789.8 | - | 789.8 |
| **Total** | **-** | **789.8** | **-** | **789.8** |
| **Liabilities at fair value on the balance sheet**[1] | | | | |
| Derivatives | - | 127.4 | - | 127.4 |
| **Total** | **-** | **127.4** | **-** | **127.4** |

[1] All items are measured at fair value on a recurring basis at the end of each reporting period.

**Determination of fair values for items measured at fair value on the balance sheet**
Fair value measurements of assets and liabilities carried at fair value have been categorised under the three levels of the IFRS fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The categorisation of these instruments is based on the lowest level input that is significant to the fair value measurement in its entirety.

Level 1 in the fair value hierarchy consists of assets and liabilities valued using unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an on-going basis. NMB does not have any Level 1 instruments.

## Note 23 Assets and liabilities at fair value, cont.

Level 2 in the fair value hierarchy consists of assets and liabilities that do not have directly quoted market prices available from active markets. The fair values are based on quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in markets that are not active. Alternatively, the fair values are estimated using valuation techniques or valuation models based on market prices or rates prevailing at the balance sheet date and where any unobservable inputs have had an insignificant impact on the fair values. This is the case for the majority of Nordea’s OTC derivatives and other instruments where active markets supply the input to the valuation techniques or models.

Level 3 in the fair value hierarchy consists of those types of assets and liabilities for which fair values cannot be obtained directly from quoted market prices or indirectly using valuation techniques or models supported by observable market prices or rates. NMB does not have any Level 3 instruments.

All valuation models, both complex and simple models, make use of market parameters. These parameters comprise interest rates, volatilities, correlations etc. Some of these parameters are observable while others are not. For most non-exotic currencies the interest rates are all observable, and the volatilities and the correlations of the interest rates and FX rates are observable up to a certain maturity. Volatilities and correlations are also observable for the most liquid equity instruments in the short end. For less liquid equity instruments the option market is fairly illiquid, and hence the volatilities and correlations are unobservable. For each instrument the sensitivity towards unobservable parameters is measured. If the impact from unobservable parameters on the valuation is significant the instrument is categorised as Level 3 in the fair value hierarchy.

For OTC derivatives valuation models are used for establishing fair value. For vanilla derivatives standard models such as Black-Scholes are used for valuation. For more exotic OTC derivatives, more complex valuation models are used. The models are usually in-house developed, and based on assumptions about the behaviour of the underlying asset and statistical scenario analysis. Most OTC derivatives are categorised as Level 2 in the fair value hierarchy implying that all significant model parameters are observable in active markets.

Fair value of financial assets and liabilities are generally calculated as the theoretical net present value of the individual instruments, based on independently sourced market parameters as described above, and assuming no risks and uncertainties. This calculation is supplemented by a portfolio adjustment.

Nordea incorporates credit valuation adjustments (CVA) and debit valuation adjustments (DVA) into derivative valuations. CVA and DVA reflect the impact on fair value of the counterparty's credit risk and Nordea’s own credit quality, respectively. Calculations are based on estimates of exposure at default, probability of default and recovery rates, on a counterparty basis.

Generally, exposure at default for CVA and DVA is based on expected exposure and estimated through the simulation of underlying risk factors. Where possible, probabilities of defaults (PDs) and recovery rates are sourced from the CDS markets. For counterparties where this information is not directly available, PDs and recovery rates are estimated using a cross sectional approach where the illiquid counterparties are mapped to comparable liquid CDS names.

Another important part of the portfolio adjustment serves to adjust the net open market risk exposures from mid-prices to ask or bid prices (depending on the net position). For different risk categories, exposures are aggregated and netted according to internal guidelines and aggregated market price information on bid-ask spreads are applied in the calculation. Spreads are updated on a regular basis.

**Financial assets and liabilities not held at fair value on the balance sheet**

| 31 Dec 2017, EURm | Carrying amount | Fair value | Level in fair value hierarchy |
|---|---|---|---|
| **Assets not held at fair value on the balance sheet** | | | |
| Cash and balances with central banks | 198.2 | 198.2 | 3 |
| Loans | 24,260.0 | 24,750.1 | 3 |
| Prepaid expenses and accrued income | 17.0 | 17.0 | 3 |
| **Total** | **24,475.2** | **24,965.3** | |
| | | | |
| **Liabilities not held at fair value on the balance sheet** | | | |
| Deposits and debt instruments | 23,553.9 | 23,796.6 | 3 |
| Other liabilities | 0.0 | 0.0 | 3 |
| Accrued expenses and prepaid income | 50.9 | 50.9 | 3 |
| **Total** | **23,604.8** | **23,847.5** | |

## Note 23 Assets and liabilities at fair value, cont.

| 31 Dec 2016, EURm | Carrying amount | Fair value | Level in fair value hierarchy |
|---|---|---|---|
| **Assets not held at fair value on the balance sheet** | | | |
| Cash and balances with central banks | 200.0 | 200.0 | 3 |
| Loans | 24,505.7 | 24,608.2 | 3 |
| Prepaid expenses and accrued income | 16.5 | 16.5 | 3 |
| **Total** | **24,722.2** | **24,824.7** | |
| | | | |
| **Liabilities not held at fair value on the balance sheet** | | | |
| Deposits and debt instruments | 24,284.3 | 24,385.6 | 3 |
| Accrued expenses and prepaid income | 59.0 | 59.0 | 3 |
| **Total** | **24,343.3** | **24,444.6** | |

**Cash and balances with central banks**
The fair value of" Cash and balances with central banks", is due to its short-term nature, assumed to equal the carrying amount and is thus is categorised into Level 3 in the fair value hierarchy.

**Loans**
The fair value of "Loans to central banks", "Loans to credit institutions" and "Loans to the public" have been estimated by discounting the expected future cash flows with an assumed customer interest rate that would have been used on the market if the loans had been issued at the time of the measurement. The assumed customer interest rate is calculated as the benchmark interest rate plus the average margin on new lending.

The fair value measurement is categorised into Level 3 in the fair value hierarchy.

**Prepaid expenses and accrued income**
The balance sheet items "Prepaid expenses and accrued income" consist of short receivables, mainly accrued interest receivables. The fair value is therefore considered to equal the carrying amount and is categorised into Level 3 in the fair value hierarchy.

**Deposits and debt instruments**
"The fair value of ”Deposits by credit institutions”,  “Debt securities in issue” and “Subordinated liabilities” has been calculated as the carrying amount adjusted for fair value changes in interest rate risk and in own credit risk. The fair value is categorised into Level 3 in the fair value hierarchy. The fair value changes related to interest rate risk is based on changes in relevant interest rates compared with corresponding nominal interest rate in the portfolios. The fair value changes in the credit risk is calculated as a difference between the credit spread in the nominal interest rate compared with the current spread that is observed in the market. This calculation is performed on an aggregated level for all long-term issuances recognised in the balance sheet items “Debt securities in issue” and “Subordinated liabilities”. As the contractual maturity is short for “Deposits by credit institutions” and “Deposits and borrowing from the public” the changes in Nordea´s own credit risk related to these items is assumed not to be significant. This is also the case for short term issuances recognised in the balance sheet items “Debt securities in issue” and “Subordinated liabilities”.

**Accrued expenses and prepaid income**
The balance sheet items "Accrued expenses and prepaid income" consist of short-term liabilities, mainly liabilities on securities settlement. The fair value is therefore considered to be equal to the carrying amount and is categorised into level 3 in the fair value hierarchy.

## Note 24 Financial instruments set off on balance or subject to netting agreements

| 31 Dec 2017, EURm | Gross recognised financial assets[1] | Gross recognised financial liabilities set off on the balance sheet | Net carrying amount on the balance sheet | Amounts not set off but subject to master netting agreements and similar agreements: Financial instruments | Financial collateral received | Cash collateral received | Net amount |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Derivatives | 535.4 | - | 535.4 | -48.0 | - | - | 487.4 |
| **Total** | **535.4** | **-** | **535.4** | **-48.0** | **-** | **-** | **487.4** |

| 31 Dec 2017, EURm | Gross recognised financial liabilities[1] | Gross recognised financial assets set off on the balance sheet | Net carrying amount on the balance sheet | Amounts not set off but subject to master netting agreements and similar agreements: Financial instruments | Financial collateral pledged | Cash collateral pledged | Net amount |
|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | |
| Derivatives | 160.2 | - | 160.2 | -48.0 | - | - | 112.2 |
| **Total** | **160.2** | **-** | **160.2** | **-48.0** | **-** | **-** | **112.2** |

[1] All amounts are measured at fair value.

| 31 Dec 2016, EURm | Gross recognised financial assets[1] | Gross recognised financial liabilities set off on the balance sheet | Net carrying amount on the balance sheet | Amounts not set off but subject to master netting agreements and similar agreements: Financial instruments | Financial collateral received | Cash collateral received | Net amount |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Derivatives | 789.8 | - | 789.8 | -30.4 | - | - | 759.3 |
| **Total** | **789.8** | **-** | **789.8** | **-30.4** | **-** | **-** | **759.3** |

| 31 Dec 2016, EURm | Gross recognised financial liabilities[1] | Gross recognised financial assets set off on the balance sheet | Net carrying amount on the balance sheet | Amounts not set off but subject to master netting agreements and similar agreements: Financial instruments | Financial collateral pledged | Cash collateral pledged | Net amount |
|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | |
| Derivatives | 127.4 | - | 127.4 | -30.4 | - | - | 97.0 |
| **Total** | **127.4** | **-** | **127.4** | **-30.4** | **-** | **-** | **97.0** |

[1] All amounts are measured at fair value.

**Enforceable master netting arrangements and similar agreements**
The fact that financial instruments are being accounted for on a gross basis on the balance sheet, would not imply that the financial instruments are not subject to master netting agreements or similar arrangements. Generally financial instruments (derivatives, repos and securities lending transactions), would be subject to master netting agreements, and as a consequence Nordea would be allowed to benefit from netting both in the ordinary course of business and in the case of default towards its counter parties, in any calculations involving counterparty credit risk. The reason why the netted exposures are not reflected under assets and liabilities on the balance sheet, would in most instances depend on the limited application of net settlement of financial transactions.

For a description of counterparty risk see section Risk, Liquidity and Capital management, counterparty credit risk, in the Board of Directors' report.

## Note 25 Maturity analysis for assets and liabilities

**Expected maturity**

| EURm | Note | 31 Dec 2017 Expected to be recovered or settled: Within 12 months | After 12 months | Total | 31 Dec 2016 Expected to be recovered or settled: Within 12 months | After 12 months | Total |
|---|---|---|---|---|---|---|---|
| Cash and balances with central banks | | 198.2 | - | 198.2 | 200.0 | - | 200.0 |
| Loans to credit institutions | 10 | 87.6 | 560.0 | 647.6 | 494.2 | - | 494.2 |
| Loans to the public | 10 | 230.8 | 23,299.3 | 23,530.1 | 212.8 | 23,699.6 | 23,912.4 |
| Derivatives | 11 | 23.2 | 512.2 | 535.4 | 49.4 | 740.4 | 789.8 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | | 2.7 | 79.6 | 82.3 | 6.2 | 92.9 | 99.1 |
| Deferred tax assets | 9 | 14.1 | - | 14.1 | 13.9 | - | 13.9 |
| Current tax assets | 9 | 0.6 | - | 0.6 | - | - | - |
| Prepaid expenses and accrued income | 12 | 16.9 | - | 16.9 | 76.8 | - | 76.8 |
| **Total assets** | | **574.1** | **24,451.1** | **25,025.2** | **1,053.3** | **24,532.9** | **25,586.2** |
| Deposits by credit institutions | 13 | - | 7,557.6 | 7,557.6 | - | 7,200.0 | 7,200.0 |
| Debt securities in issue | 14 | 1,722.2 | 13,747.4 | 15,469.6 | 2,289.3 | 14,010.6 | 16,299.9 |
| Derivatives | 11 | 15.4 | 144.8 | 160.2 | 1.6 | 125.8 | 127.4 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | | 26.8 | 299.3 | 326.1 | 8.1 | 575.7 | 583.8 |
| Current tax liabilities | 9 | - | - | - | 6.6 | - | 6.6 |
| Other liabilities | 15 | 70.0 | - | 70.0 | 0.2 | - | 0.2 |
| Accrued expenses and prepaid income | 16 | 60.7 | - | 60.7 | 88.9 | 0.3 | 89.2 |
| Retirement benefit liabilities | 17 | - | 0.0 | 0.0 | - | 0.0 | 0.0 |
| Subordinated liabilities | 18 | - | 200.5 | 200.5 | - | 200.6 | 200.6 |
| **Total liabilities** | | **1,895.1** | **21,949.6** | **23,844.7** | **2,394.7** | **22,113.0** | **24,507.7** |

**Contractual undiscounted cash flows**

| 31 Dec 2017, EURm | On demand | 0-3 months | 3-12 months | 1-5 years | >5 Years | **Total** |
|---|---|---|---|---|---|---|
| Interest bearing financial assets | 285.8 | 529.3 | 1,663.9 | 8,364.8 | 17,802.0 | **28,645.8** |
| Non-interest bearing assets | | | | | 99.3 | **99.3** |
| Non-financial assets | | | | | 14.6 | **14.6** |
| **Total assets** | **285.8** | **529.3** | **1,663.9** | **8,364.8** | **17,915.9** | **28,759.7** |
| Interest bearing financial liabilities | | 127.2 | 1,786.9 | 17,337.7 | 4,850.3 | **24,102.1** |
| Non-interest bearing liabilities | | | | | 377.1 | **377.1** |
| Non-financial liabilities and equity | | | | | 1,260.1 | **1,260.1** |
| **Total liabilities and equity** | **-** | **127.2** | **1,786.9** | **17,337.7** | **6,487.5** | **25,739.3** |
| Derivatives, cash inflow | | 84.6 | 74.4 | 587.5 | 152.3 | **898.8** |
| Derivatives, cash outflow | | -1.3 | 1.4 | 356.2 | 172.0 | **528.3** |
| **Net exposure** | **-** | **85.9** | **73.0** | **231.3** | **-19.7** | **370.5** |
| **Exposure** | **285.8** | **488.0** | **-50.0** | **-8,741.6** | **11,408.7** | **3,390.9** |
| **Cumulative exposure** | **285.8** | **773.8** | **723.8** | **-8,017.8** | **3,390.9** | |

### Note 25 Maturity analysis for assets and liabilities, cont.

**Contractual undiscounted cash flows**

| 31 Dec 2016, EURm | On demand | 0-3 months | 3-12 months | 1-5 years | >5 Years | **Total** |
|---|---|---|---|---|---|---|
| Interest bearing financial assets | 694.2 | 525.8 | 1,680.2 | 7,784.0 | 18,116.0 | **28,800.2** |
| Non-interest bearing assets | | 22.7 | | | 92.9 | **115.6** |
| Non-financial assets | | | | | 74.0 | **74.0** |
| **Total assets** | **694.2** | **548.5** | **1,680.2** | **7,784.0** | **18,282.9** | **28,989.8** |
| Interest bearing financial liabilities | | 96.6 | 2,465.7 | 16,647.6 | 5,445.0 | **24,654.9** |
| Non-interest bearing liabilities | | 67.1 | | | 575.7 | **642.8** |
| Non-financial liabilities and equity | | 37.0 | | | 1,078.5 | **1,115.5** |
| **Total liabilities and equity** | | **200,7** | **2,465.7** | **16,647.6** | **7,099.2** | **26,413.2** |
| Derivatives, cash inflow | | 3.0 | 18.5 | 39.4 | 24.8 | **85.7** |
| Derivatives, cash outflow | | 7.5 | 23.9 | 150.0 | 7.1 | **188.5** |
| **Net exposure** | | **-4.5** | **-5.4** | **-110.6** | **17.7** | **-102.8** |
| **Exposure** | **694.2** | **343,3** | **-790,9** | **-8,974,2** | **11,201,4** | **2,473,8** |
| **Cumulative exposure** | **694.2** | **1,037,5** | **246,6** | **-8,727,6** | **2,473,8** | |

The table is based on contractual maturities for the balance sheet items. For derivatives, the expected cash inflows and outflows are disclosed for both derivative assets and derivative liabilities, as derivatives are managed on a net basis. In addition to the instruments on the balance sheet items, NMB has credit commitments amounting to EUR 209.6m (5.2), which could be drawn on at any time.

## Note 26 Related-party transactions

| EURm | Group undertakings 31 Dec 2017 | Group undertakings 31 Dec 2016 |
|---|---|---|
| **Assets** | | |
| Loans | 647.6 | 494.2 |
| Derivatives | 535.0 | 791.8 |
| Prepaid expenses and accrued income | 0.1 | 60.4 |
| **Total assets** | **1,182.7** | **1,346.4** |
| | | |
| **Liabilities** | | |
| Deposits | 7,557.6 | 7,200.0 |
| Debt securities in issue | 11.6 | 1.4 |
| Derivatives | 148.9 | 118.9 |
| Subordinated liabilities | 200.5 | 200.6 |
| Other liabilities | 69.6 | 0.2 |
| Accrued expenses and deferred income | 55.3 | 64.8 |
| **Total liabilities** | **8,043.6** | **7,585.8** |
| **Off balance[1]** | **40,512.1** | **32,398.7** |

[1] Including nominal values on derivatives.

**Income statement**

| EURm | Jan-Dec 2017 | Oct-Dec 2016 |
|---|---|---|
| Net interest income | 183.0 | 47.9 |
| Net fee and commission income | -15.7 | -4.0 |
| Net result from items at fair value | -247.4 | -273.9 |
| Other operating income | - | 0.0 |
| Total operating expenses | -44.3 | -11.4 |
| **Profit before loan losses** | **-124.5** | **-241.4** |

Compensations and loans to Key management personnel are specified in Note 6.

## Note 27 Credit risk disclosures

**Past due loans, excl. impaired loans**

The table below shows loans past due 6 days or more that are not considered impaired, split by corporate and household customers. Past due loans to corporate customers, not considered impaired, were at end of 2017 EUR 14.8m (15.8). Past due loans for household increased to EUR 153.2m (149.4) at the end of 2017.

| | 31 Dec 2017 | | 31 Dec 2016 | |
|---|---|---|---|---|
| EURm | Corporate customers | Household customers | Corporate customers | Household customers |
| 6-30 days | 5.1 | 93.3 | 6.5 | 96.4 |
| 31-60 days | 6.0 | 38.3 | 7.2 | 33.4 |
| 61-90 days | 1.7 | 10.0 | 1.4 | 12.8 |
| >90 days | 2.0 | 11.5 | 0.7 | 6.9 |
| **Total** | **14.8** | **153.2** | **15.8** | **149.4** |
| Past due not impaired loans divided by loans to the public after allowances, % | 0.8 | 0.7 | 0.8 | 0.7 |

**Rating and risk grade distribution**

| IRB Corporate portfolio | EAD amount, EURm | |
|---|---|---|
| Rating grade | 31 Dec 2017 | 31 Dec 2016 |
| 6+ | 947.7 | 903.3 |
| 6 | 55.6 | 76.3 |
| 6- | 19.9 | 22.7 |
| 5+ | 22.5 | 23.4 |
| 5 | 15.8 | 17.5 |
| 5- | 37.2 | 27.6 |
| 4+ | 171.4 | 235.6 |
| 4 | 46.3 | 46.2 |
| 4- | 50.5 | 34.8 |
| 3+ | 75.8 | 26.4 |
| 3 | 26.9 | 23.0 |
| 3- | 38.0 | 20.6 |
| 2+ | 3.0 | 8.5 |
| 2 | 3.3 | 3.4 |
| 2- | 3.3 | 1.0 |
| 1+ | 2.9 | 4.5 |
| 1 | 0.8 | 2.3 |
| 1- | 0.3 | 1.7 |
| Unrated | 61.6 | 62.5 |
| **Total** | **1,582.7** | **1,541.1** |

| IRB Retail portfolio | EAD amount, EURm | |
|---|---|---|
| Risk grade | 31 Dec 2017 | 31 Dec 2016 |
| A+ | 3,931.9 | 2,630.2 |
| A | 4,036.2 | 3,948.3 |
| A- | 3,067.9 | 3,033.7 |
| B+ | 3,013.2 | 3,124.2 |
| B | 1,960.9 | 2,390.9 |
| B- | 1,542.2 | 1,654.7 |
| C+ | 1,091.3 | 1,388.3 |
| C | 758.3 | 831.5 |
| C- | 484.3 | 658.4 |
| D+ | 406.6 | 488.8 |
| D | 332.1 | 445.2 |
| D- | 400.6 | 343.0 |
| E+ | 193.4 | 290.9 |
| E | 141.8 | 189.8 |
| E- | 89.1 | 129.2 |
| F+ | 64.9 | 101.6 |
| F | 109.8 | 140.3 |
| F- | 249.2 | 317.3 |
| Unrated | 6.1 | - |
| **Total** | **21,879.6** | **22,106.1** |

**Collateral distribution**

The table below presents the distribution of collateral used in the capital adequacy calculation process. The table shows residential real estate to constitute a major share of eligible collateral items.

| | 31 Dec 2017 | 31 Dec 2016 |
|---|---|---|
| Financial Collateral | 0.7% | 0.4% |
| Residential Real Estate | 98.3% | 99.3% |
| Commercial Real Estate | 0.7% | 0.2% |
| Other Physical Collateral | 0.3% | 0.1% |
| **Total** | **100.0%** | **100.0%** |

**Forborne loans**

At the end of 2017 forborne loans amounted to EUR 130.8m (114.1) of which EUR 128.4m (107.9) related to households.

## Note 28 IFRS 9

**Classification of assets and liabilities under IFRS 9**

| **Assets** 1 Jan 2018, EURm | Amortised cost (AC) | Fair value through profit or loss (FVPL) Mandatorily | Derivatives used for hedging | Non-financial assets | Total |
|---|---|---|---|---|---|
| Cash and balances with central banks | 198.2 | | | | 198.2 |
| Loans to credit institutions | 647.6 | | | | 647.6 |
| Loans to the public | 23,504.7 | | | | 23,504.7 |
| Derivatives | | 13.8 | 521.6 | | 535.4 |
| FV change of the hedged item in portfolio hedge of interest rate risk | 82.3 | | | | 82.3 |
| Deferred tax assets | | | | 19.2 | 19.2 |
| Current tax assets | | | | 0.6 | 0.6 |
| Prepaid expenses and accrued income | 16.9 | | | | 16.9 |
| **Total assets** | **24,449.7** | **13.8** | **521.6** | **19.8** | **25,004.9** |

| **Liabilities** 1 Jan 2018, EURm | Amortised cost (AC) | Fair value through profit or loss (FVPL) Mandatorily | Derivatives used for hedging | Non-financial liabilities | Total |
|---|---|---|---|---|---|
| Deposit by credit institutions | 7,557.6 | | | | 7,557.6 |
| Deposits and borrowings from the public | 15,469.6 | | | | 15,469.6 |
| Derivatives | | 15.2 | 145.0 | | 160.2 |
| Fair value changes of the hedged items in portfolio hedge of interest rate risk | | | | 326.1 | 326.1 |
| Other liabilities | | | | 70.0 | 70.0 |
| Accrued expenses and prepaid income | 50.9 | | | 9.8 | 60.7 |
| Provisions | | | | 0.1 | 0.1 |
| Retirement benefit liabilities | | | | 0.0 | 0.0 |
| Subordinated liabilities | 200.5 | | | | 200.5 |
| **Total liabilities** | **23,278.6** | **15.2** | **145.0** | **406.0** | **23,844.8** |

**Reclassification of assets and liabilities at transition**

| Assets, EURm | Amortised cost (AC) | Fair value through profit or loss (FVPL) Mandatorily | Derivatives used for hedging | Non-financial assets | Total |
|---|---|---|---|---|---|
| **Balance at 31 Dec 2017 under IAS 39** | **24,475.1** | **13.8** | **521.6** | **14.7** | **25,025.2** |
| Remeasurement under IFRS 9 | -25.4 | - | - | 5.1 | -20.3 |
| **Balance at 1 Jan 2018 under IFRS 9** | **24,449.7** | **13.8** | **521.6** | **19.8** | **25,004.9** |

| Liabilities, EURm | Amortised cost (AC) | Fair value through profit or loss (FVPL) Mandatorily | Derivatives used for hedging | Non-financial liabilities | Total |
|---|---|---|---|---|---|
| **Balance at 31 Dec 2017 under IAS 39** | **23,278.6** | **15.2** | **145.0** | **405.9** | **23,844.7** |
| Remeasurement under IFRS 9 | - | - | - | 0.1 | 0.1 |
| **Balance at 1 Jan 2018 under IFRS 9** | **23,278.6** | **15.2** | **145.0** | **406.0** | **23,844.8** |

## Note 28 IFRS 9, cont.

**Impact on equity**
The total impact on equity from IFRS 9 at transition amounts to EUR -20.4m.

**Reclassification of provisions at transition**

| EURm | Loans & receivables | Amortised cost (AC) | Off balance | Total |
|---|---|---|---|---|
| **Balance at 31 Dec 2017 under IAS 39** | **11.1** | **-** | **-** | **11.1** |
| Reclassification to AC | -11.1 | 11.1 | - | 0.0 |
| Remeasurement under IFRS 9, collective provisions | - | 25.4 | 0.1 | 25.5 |
| **Balance at 1 Jan 2018 under IFRS 9** | **-** | **36.5** | **0.1** | **36.6** |

**Exposures measured at amortised cost, before allowances**

| | % |
|---|---|
| Stage 1 | 92.2 |
| Stage 2 | 7.2 |
| Stage 3 | 0.6 |
| **Total** | **100.0** |

**Allowances for credit losses**

| EURm | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|
| Loans to the public | 5.8 | 20.7 | 10.0 | 36.5 |
| Off balance | 0.1 | 0.0 | - | 0.1 |
| **Total** | **5.9** | **20.7** | **10.0** | **36.6** |

**Accounting principles under IFRS 9**

**Classification of financial instruments under IFRS 9**
Each financial instrument has been classified into one of the following categories:

Financial assets:
- Amortised cost
- Financial assets at fair value through profit or loss:
  – Mandatorily measured at fair value through profit and loss
  – Designated at fair value through profit or loss (fair value option)
- Financial assets at fair value through other comprehensive income

Financial liabilities:
- Amortised cost
- Financial liabilities at fair value through profit or loss:
  – Mandatorily measured at fair value through profit and loss
  – Designated at fair value through profit or loss (fair value option)

The classification of a financial asset is dependent on the business model for the portfolio where the instrument is included and on whether the cash flows are solely payments of principal and interest (SPPI).

Financial assets with cash flows that are not solely payments of principle and interest (SPPI) are measured at fair value through profit and loss. All other assets are classified based on the business model. Instruments included in a portfolio with a business model where the intention is to keep the instruments and collect contractual cash flows are measured at amortised cost. Instruments included in a business model where the intention is to both keep the instruments to collect the contractual cash flows and sell the instruments are measured at fair value through other comprehensive income. Financial assets included in any other business model are measured at fair value through profit and loss.

In order to assess the business model, Nordea has divided its financial assets into portfolios and/or sub-portfolios based on how groups of financial assets are managed together to achieve a particular business objective. To derive the right level on which portfolios are determined, Nordea has taken the current business area structure into account. When determining the business model for each portfolio, Nordea has analysed the objective with the financial assets, as well as, for instance past sales behaviour and management compensation.

## Note 28 IFRS 9, cont.

All financial assets and liabilities are initially measured at fair value. The classification of financial instruments into different categories forms the basis for how each instrument is subsequently measured on the balance sheet and how changes in its value are recognised. The table "Classification of assets and liabilities under IFRS 9" above presents the classification of the financial instruments on NMB's balance sheet into the different categories under IFRS 9.

*Amortised cost*
Financial assets and liabilities measured at amortised cost are initially recognised on the balance sheet at fair value, including transaction costs. Subsequent to initial recognition, the instruments within this category are measured at amortised cost. In an amortised cost measurement, the difference between acquisition cost and redemption value is amortised in the income statement over the remaining term using the effective interest rate method. Amortised cost is defined as the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance. For more information about the effective interest rate method see Note 1 section 5, "Net interest income". For information about impairment under IFRS 9, see Impairment section below.

Interest on assets and liabilities classified at amortised cost is recognised in the items "Interest income" and "Interest expense" in the income statement.

This category consists of mainly loans to central banks, credit institutions and public.

*Financial assets and financial liabilities at fair value through profit or loss*
Financial assets and financial liabilities at fair value through profit or loss are measured at fair value, excluding transaction costs. All changes in fair values are recognised directly in the income statement in the item "Net result from items at fair value".

The category consists of two sub-categories: mandatorily measured at fair value through profit and loss and designated at fair value through profit or loss (fair value option).

The sub-category mandatorily measured at fair value through profit and loss contains interest-bearing securities included in the liquidity buffer, and derivative instruments.

*Financial assets at fair value through other comprehensive income*
Financial assets at fair value through other comprehensive income are measured at fair value plus transaction costs. This category mainly consists of the interest-bearing securities included in the liquidity buffer. Changes in fair values, except for interest, foreign exchange effects and impairment losses, are recognised in the fair value reserve in equity through other comprehensive income. Interest is recognised in the item "Interest income" and foreign exchange effects and impairment losses in the item "Net result from items at fair value" in the income statement. When an instrument is disposed of, the fair value changes that previously have been accumulated in the fair value reserve in other comprehensive income are removed from equity and recognised in the income statement in the item "Net result from items at fair value". For information about impairment under IFRS 9, see Impairment section below.

**Impairment of financial instruments under IFRS 9**

*Scope*
Financial instruments classified as "Amortised cost" or "Fair value through other comprehensive income" are in scope for recognising impairment due to credit risk. This includes assets recognised on the balance sheet as "Loans to central banks", Loans to credit institutions", "Loans to the public" and "Interest bearing securities". These balance sheet lines also include assets classified as "Fair value through profit or loss", which are not in scope for impairment calculations. See Classification section above for further information on the classification of financial instruments.

Off-balance sheet commitments, contingent liabilities and loan commitments are also in scope for impairment calculations.

*Recognition and presentation*
Amortised cost assets are recognised gross with an offsetting allowance for the expected credit losses if the loss is not regarded as final. The allowance account is disclosed net on the face of the balance sheet, but the allowance account is disclosed separately in the notes. Changes in the allowance account are recognised in the income statement and classified as "Net loan losses".

If the impairment loss is regarded as final, it is reported as a realised loss and the carrying amount of the loan and the related allowance for impairment loss are derecognised. An impairment loss is regarded as final when the obligor is filed for bankruptcy and the administrator has declared the economic outcome of the bankruptcy procedure, or when Nordea forgives its claims either through a legal based or voluntary reconstruction, or when Nordea, for other reasons, deems it unlikely that the claim will be recovered.

Provisions for off-balance sheet exposures are classified as "Provisions" on the balance sheet, with changes in provisions classified as "Net loan losses".

Assets classified as "Fair value through other comprehensive income" are recognised at fair value on the balance sheet. Impairment losses calculated in accordance with IFRS 9 are recognised in the income statement and classified as "Net result from items at fair value". Any fair value adjustments are recognised in "Other comprehensive income".

*Impairment testing of individually assessed loans*
Nordea tests all exposures for impairment on an individual basis. The purpose of the impairment tests is to find out if the exposures have become credit impaired (stage 3). Nordea monitors whether there are indicators of exposures being credit impaired by identifying events that have a detrimental impact on the estimated future cash flows (loss event). Nordea applies the same definition of default as the Capital Requirements Regulation. More information on the identification of loss events can be found in the "Risk, liquidity and capital management" section. Exposures that are not individually assessed as credit impaired will be part of the collective impairment calculation.

**Note 28 IFRS 9, cont.**

For significant exposures that have been individually identified as credit impaired, the measurement of the impairment loss is made on an individual basis. The carrying amount of the exposures is compared with the sum of the net present value of expected future cash flows. If the carrying amount is higher, the difference is recognised as an impairment loss. The expected cash flows are discounted with the original effective interest rate and include the fair value of the collaterals and other credit enhancements. The estimate is based on three different forward-looking scenarios that are probability weighted to derive the net present value.

For insignificant exposures that have been individually identified as credit impaired, the impairment loss is measured using the collective model described below, but based on the fact that the exposures are already in default.

*Impairment testing of collectively assessed loans*
For exposures not impaired on an individual basis, a collective model is used for calculating impairment losses. The provisions are calculated as the exposure at default times the probability of default times the loss given default. For assets in stage 1 this calculation is only based on the coming 12 months, while for assets in stage 2 it is based on the expected lifetime of the asset.

The provisions for exposures where there has been no significant increase in credit risk since initial recognition are based on the 12-month expected loss (stage 1). Provisions for exposures where there has been a significant increase in credit risk since initial recognition, but that are not credit impaired, are based on the lifetime expected losses (stage 2).

Nordea uses two different models to identify whether there has been a significant increase in credit risk or not. For assets held at transition on 1 January 2018, the change in internal rating and scoring data is used to determine whether there has been a significant increase in credit risk or not. Internal rating/scoring information is used to assess the risk of the customers and a deterioration in rating/scoring indicates an increase in the credit risk of the customer. Nordea has concluded it is not possible to calculate the lifetime PDs at origination without undue cost or effort and without the use of hindsight for assets already recognised on the balance sheet at transition. Changes to the lifetime probability of default (PD) are used as the trigger for assets recognised after transition.

For assets evaluated based on lifetime PDs, Nordea uses a mix of absolute and relative changes in PD as the transfer criterion. Assets where the relative increase in lifetime PD is more than 250 percent or where the absolute increase in lifetime PD is more than 150 basis points, are considered as having a significant increase in credit risk. For assets where rating and scoring models are used, the change in rating/scoring notches is calibrated to match the significant increase in credit risk based on lifetime PD. In addition, customers with forbearance measures and customers with payments more than thirty days past due are also transferred to stage 2, unless already identified as credit impaired (stage 3). Exposures more than 90 days past due will normally be classified as stage 3, but this classification will be rebutted if there is evidence the customer is not in default. Such exposures will be classified as stage 2.

Nordea does not use the “low credit risk exemption” in the banking operations.

When calculating provisions, including the staging assessment, the calculation is based on probability weighted forward looking information. Nordea applies three macro-economic scenarios to address the non-linearity in expected credit losses. The different scenarios are used to adjust the relevant parameters for calculating expected losses and a probability-weighted average of the expected losses under each scenario is recognised as provisions.

*Discount rate*
The discount rate used to measure impairment is the original effective interest rate for loans attached to an individual customer or, if applicable, to a group of loans. If considered appropriate, the discount rate can be based on a method that results in an impairment that is a reasonable approximation of using the effective interest rate method as basis for the calculation.

*Restructured loans and modifications*
In this context a restructured loan is defined as a loan where Nordea has granted concessions to the obligor due to its deteriorated financial situation and where this concession has resulted in an impairment loss for Nordea. After a reconstruction the loan is normally regarded as not impaired if it performs according to the new conditions. In the event of a recovery the payment is reported as a recovery of loan losses.

Modifications of the contractual cash flows for loans to customers in financial distress (forbearance) reduce the gross carrying amount of the loan. Normally this reduction is less than the existing provision and no loss is recognised in the income statement due to modifications. If significant, the gross amounts (loan and allowance) are reduced.

## The proposal of the Board of Directors to the Annual General Meeting

The distributable funds on 31 December 2017 were EUR 933,560,992.50 of which the profit for the year was EUR 105,279,543.60. The Board of Directors proposes that a dividend of EUR 102,000,000.00 be paid whereafter the distributable funds will be EUR 831,560,992.50.

Signatures of the Directors' report and of the Financial Statements:

Helsinki, 28 February 2018

| | |
|---|---|
| Petri Nikkilä | Hanna-Maria Heikkinen |
| Nicklas Ilebrand | Ola Littorin |
| Nina Luomanen | Markku Pehkonen |
| Riikka Laine-Tolonen | Thomas Miller<br>Chief Executive Officer |

**The Auditor's Note**

Our auditors' report has been issued today.

Helsinki, 28 February 2018

PricewaterhouseCoopers Oy
Authorised Public Accountants

Juha Wahlroos
Authorised Public Accountant

# Auditor’s Report (Translation from the Finnish Original)

To the Annual General Meeting of Nordea Mortgage Bank Plc

## Report on the Audit of the Financial Statements

**Opinion**
In our opinion the financial statements, which are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, give a true and fair view of the company’s financial position, financial performance and cash flows and comply with statutory requirements.

Our opinion is consistent with the additional report to the Audit Committee.

***What we have audited***
We have audited the financial statements of Nordea Mortgage Bank Plc (business identity code 2743219-6) for the year ended 31 December 2017. The financial statements comprise the balance sheet, income statement, statement of comprehensive income, statement of changes in equity, statement of cash flows and notes, including a summary of significant accounting policies.

**Basis for Opinion**
We conducted our audit in accordance with good auditing practice in Finland. Our responsibilities under good auditing practice are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

***Independence***
We are independent of the company in accordance with the ethical requirements that are applicable in Finland and are relevant to our audit, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, the non-audit services that we have provided to the company are in accordance with the applicable law and regulations in Finland and we have not provided non-audit services that are prohibited under Article 5(1) of Regulation (EU) No 537/2014. The non-audit services that we have provided are disclosed in note 7.

**Our Audit Approach**

***Overview***


- Overall materiality was € 75 million, which represents 0.3 % of total assets

- Key audit matters:
  - Impairment of loans to customers
  - Valuation of certain Level II financial instruments held at fair value
  - IT systems supporting processes over financial reporting

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

***Materiality***
The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the financial statements as a whole.

| | |
|---|---|
| ***Overall group materiality*** | € 75 million |
| ***How we determined it*** | 0.3 % of total assets |
| ***Specific materiality*** | € 6.5 million |
| ***How we determined it*** | 5 % of profit before tax |
| ***Rationale for the materiality benchmark applied*** | We chose total assets as the benchmark because, in our view, key driver of the business and determinants of the bank's profit potential are best reflected in the balance sheet.<br>A number of key performance indicators of the bank are driven by income statement items, therefore we have applied a specific materiality to all income statement items after Net interest income.<br>The benchmarks determined are within the range of acceptable quantitative materiality thresholds in auditing standards. |

**Key Audit Matters**
Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

| Key audit matter in the audit of the company | How our audit addressed the key audit matter |
|---|---|
| ***Impairment of loans to customers*** | |
| *Refer to the Note 1 Accounting policies (Critical judgements and estimation uncertainty), Note 8 Net loan losses and Note 10 Loans and impairment to the financial statements*<br>Accounting for impairment of loans to customers require management's judgment over timing of recognition of impairment and the size of any such impairment allowance.<br>Nordea Mortgage Bank Plc makes allowances for incurred credit losses both on an individual and on a collective basis. | Our audit included a combination of testing of internal controls over financial reporting and substantive testing.<br>We assessed and tested the design and operating effectiveness of the controls over:<br>• Rating and scoring of customers<br>• Individually assessed loan impairment calculations<br>• Collectively assessed loan impairment calculations. |

| Key audit matter in the audit of the company | How our audit addressed the key audit matter |
|---|---|
| Important areas of impairment of loans to customers relate to:<br>• Identification of impaired loans including completeness of the customer accounts that are included in the impairment calculation<br>• Assumptions and estimates made by management underlying the calculation of individual and collective impairment allowances. Examples of these relate to the probability to default and loss given default calculations. | We performed detailed testing on a sample of loans to ascertain whether we concur with the risk assessment as expressed by the internal rating or scoring.<br>We tested a sample of loans which had been indentified by management as impaired. In addition, we examined a sample of loans and advances which had not been identified by management as impaired.<br>We also assessed the appropriateness of relevant parameters in the collective impairment models. |
| ***Valuation of certain Level II financial instruments held at fair value***<br>*Refer to the Note 1 Accounting policies (Critical judgements and estimation uncertainty), Note 11 Derivatives and hedge accounting, Note 22 Classification of financial instruments and Note 23 Assets and liabilities at fair value to the financial statements.*<br>Significant portfolios of financial instruments on Level II are valued based on models and certain assumptions that are not observable by third parties.<br>Important areas in valuation of financial instruments held at fair value relate to:<br>• Framework and policies relating to models and valuation;<br>• Internal controls relating to fair value hierarchy, fair value adjustments, price testing and model control & governance; and<br>• Levelling and disclosures of financial instruments. | In our audit, we assessed and tested the design and operating effectiveness of the controls over<br>• the identification, measurement and oversight of valuation of financial instruments<br>• fair value hierarchy, fair value adjustments and independent price verification<br>• model control and governance.<br>We examined the Company’s independent price verification processes, model validation and approval processes, controls over data feeds and inputs to valuation and the Company’s governance and reporting processes and controls.<br>For the valuations which involve a higher degree of judgement, we assessed the assumptions, methodologies and models used by the Company. We performed an independent valuation of a sample of positions.<br>In respect of fair value adjustments for derivatives, we assessed the methodology applied. |
| ***IT systems supporting processes over financial reporting***<br>The Company’s financial reporting is highly dependent on IT systems supporting automated accounting and reconciliation procedures. To ensure complete and accurate financial records it is important that the IT general controls are designed properly and they operates effectively. | For relevant IT systems and controls relating to financial reporting we assessed and tested the design and operating effectiveness.<br>We examined the framework of governance over the Company’s IT organisation and the controls over program development and changes, access to program and data and IT operations.<br>• For logical access to program and data, audit activities included testing that new access, removal of access rights and that access rights were periodically monitored for appropriateness. |

| Key audit matter in the audit of the company | How our audit addressed the key audit matter |
|---|---|
| ***IT systems supporting processes over financial reporting*** | Other areas tested included security configurations, controls over changes to IT-systems including appropriate segregation of duties. |

There are no significant risks of material misstatement referred to in Article 10(2c) of Regulation (EU) No 537/2014 with respect to financial statements.

**Responsibilities of the Board of Directors and the Managing Director for the Financial Statements**
The Board of Directors and the Managing Director are responsible for the preparation financial statements that give a true and fair view in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and comply with statutory requirements. The Board of Directors and the Managing Director are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors and the Managing Director are responsible for assessing the company's ability to continue as going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting. The financial statements are prepared using the going concern basis of accounting unless there is an intention to liquidate the company or cease operations, or there is no realistic alternative but to do so.

**Auditor's Responsibilities for the Audit of the Financial Statements**
Our objectives are to obtain reasonable assurance on whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with good auditing practice will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance good auditing practice, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the parent company's or the group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of the Board of Directors' and the Managing Director's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events so that the financial statements give a true and fair view.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## Other Reporting Requirements

**Appointment**

We were first appointed as auditors by execution of the demerger plan on 1 October 2016. Our appointment represents a total period of uninterrupted engagement of 2 years.

**Other Information**

The Board of Directors and the Managing Director are responsible for the other information. The other information comprises information included in the report of the Board of Directors and in the Annual Report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. With respect to the report of the Board of Directors, our responsibility also includes considering whether the report of the Board of Directors has been prepared in accordance with the applicable laws and regulations.

In our opinion the information in the report of the Board of Directors is consistent with the information in the financial statements and the report of the Board of Directors has been prepared in accordance with the applicable laws and regulations.

If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact. We have nothing to report in this regard.

Helsinki 28 February 2018

**PricewaterhouseCoopers Oy**
Authorised Public Accountants

Juha Wahlroos
Authorised Public Accountant (KHT)

## Management and auditors

### Management

The Board of Directors of Nordea Mortgage Bank Plc comprises seven members.
Thomas Miller acts as the CEO of Nordea Mortgage Bank Plc and Tarja Ikonen as his deputy.

### Board of Directors as from 1 January 2017 until 1 September 2017

**Topi Manner, Chairman**
Born 1974. Member since 4 February 2016.
Head of Personal Banking
Nordea

**Riikka Laine-Tolonen**
Born 1966. Member since 4 February 2016.
Head of Personal Banking
Nordea Bank AB (publ), Finnish Branch

**Nina Luomanen**
Born 1969. Member since 4 February 2016.
Head of Change and Transformation, Core Banking
Nordea

**Markku Pehkonen**
Born 1962. Member since 1 November 2016.
Group CRO
Sampo Group

**Hanna-Maria Heikkinen**
Born 1979. Member since 1 October 2016.
Vice president, Investor Relations
Cargotec

**Ola Littorin**
Born 1962. Member since 4 February 2016.
Head of Long Term Funding
Nordea Bank AB (publ)

**Jussi Mekkonen**
Born 1972. Member since 4 February 2016.
Head of Personal Banking Finland
Nordea Bank AB (publ), Finnish Branch

### Board of Directors as from 1 September 2017 until 19 September 2017

**Markku Pehkonen, Vice chairman**
Born 1962. Member since 1 November 2016.
Group CRO
Sampo Group

**Riikka Laine-Tolonen**
Born 1966. Member since 4 February 2016.
Head of Personal Banking
Nordea Bank AB (publ), Finnish Branch

**Nina Luomanen**
Born 1969. Member since 4 February 2016.
Head of Change and Transformation, Core Banking
Nordea

**Hanna-Maria Heikkinen**
Born 1979. Member since 1 October 2016.
Vice president, Investor Relations, Cargotec

**Ola Littorin**
Born 1962. Member since 4 February 2016.
Head of Long Term Funding
Nordea Bank AB (publ)

**Jussi Mekkonen**
Born 1972. Member since 4 February 2016.
Head of Personal Banking Finland
Nordea Bank AB (publ), Finnish Branch

## Board of Directors as from 19 September 2017

**Petri Nikkilä, Chairman**
Born 1971. Member since 19 September 2017.
Head of Personal Banking Finland
Nordea Bank AB (publ), Finnish Branch

**Nicklas Ilebrand**
Born 1980. Member since 19 September 2017.
Head of Products, Personal Banking
Nordea Bank AB (publ)

**Ola Littorin**
Born 1962. Member since 4 February 2016.
Head of Long Term Funding
Nordea Bank AB (publ)

**Markku Pehkonen**
Born 1962. Member since 1 November 2016.
Group CRO
Sampo Group

**Hanna-Maria Heikkinen**
Born 1979. Member since 1 October 2016.
Vice president, Investor Relations
Cargotec

**Riikka Laine-Tolonen**
Born 1966. Member since 4 February 2016.
Head of Personal Banking
Nordea Bank AB (publ), Finnish Branch

**Nina Luomanen**
Born 1969. Member since 4 February 2016.
Head of Change and Transformation, Core Banking
Nordea

## Auditors

The company's auditors were elected by the shareholder's meeting of Nordea Mortgage Bank Plc on 9 March 2017.

The Annual General Meeting of Nordea Mortgage Bank Plc elects the company's auditors for a period of one year at a time. The auditor must be an audit firm authorised by the Finnish Chamber of Commerce.

**PricewaterhouseCoopers Oy**
Authorised Public Accountants

Auditor with main responsibility
Juha Wahlroos
Authorised Public Accountant

# Corporate Governance Report 2017

## Application by Nordea Mortgage Bank Plc

Nordea Mortgage Bank Plc (NMB) is a Finnish public limited liability company and a wholly-owned subsidiary of Nordea Bank AB (publ), the listed parent company of the whole Nordea Group. In this report the Nordea Group is referred to as "Nordea". A description of corporate governance in Nordea is included in the 2017 Annual Report of Nordea Bank AB (publ).

All the operations of Nordea Mortgage Bank Plc are integrated into the operations of Nordea. Nordea has established the corporate governance framework at group level and the framework is reviewed on a continuous basis. Information on corporate governance in Nordea and this report are available on www.nordea.com. Nordea Mortgage Bank Plc has given a description of governance arrangements in accordance with the Finnish Act on Credit Institutions. The description is available on www.nordea.com.

Strong corporate governance is about companies having clear and systematic decision-making processes, thus providing clarity about responsibilities, avoiding conflicts of interest and ensuring satisfactory internal control, risk management and transparency. Commitment to Nordea's mission and vision requires the integration of sound corporate governance practices into regular business activities to attain – as far as possible – a company that is both well governed and well managed.

Nordea follows generally adopted principles of corporate governance including the rules and principles set forth in the Swedish Code of Corporate Governance. Although the codes differ in details between the countries, they are all based on the general international development and common Nordic approach within this field and thus show a fundamental resemblance to one another.

Nordea Mortgage Bank Plc submits this Corporate Governance Report as an issuer of bonds. This report has been prepared following the guideline on Corporate Governance Statement in the Finnish Corporate Governance Code 2015 where applicable. This report is submitted as a separate report from the Annual Report 2017 and it is available on www.nordea.com.

The Board of Directors and the Board Audit Committee of Nordea Mortgage Bank Plc have reviewed this Corporate Governance Report.

**On Internal Governance in Nordea Mortgage Bank Plc**

**Division of powers and responsibilities**
Subject to the principles set out in the Governance Requirements, the Group Board has the overall responsibility for adequate Internal Governance across the Group and for ensuring that there is a governance framework appropriate to its structure, business and risks. The Group Board shall consider the interests of all Group Subsidiaries including Nordea Mortgage Bank Plc, and the way strategies and policies contribute to the interest of each of them as well as the whole Group over the long term.

The management and control of Nordea Mortgage Bank Plc is divided among the shareholder (at the General Meeting), the Board of Directors and the Chief Executive Officer (CEO), pursuant to the provisions of the external framework, the Articles of Association and the internal instructions set forth by the Board of Directors.

**General Meeting**
NMB is the wholly-owned subsidiary of Nordea Bank AB (publ). The General Meeting is the highest decision-making body at which the shareholder exercises its voting rights. At the General Meeting, decisions are taken regarding matters such as the annual accounts, dividend, election of the Board of Directors and auditors and remuneration for Board members and auditors.

**The Board of Directors**
The Board of Directors of NMB shall be responsible for managing the company and organising its activities in a proper manner and for representing NMB. The Board of Directors of NMB consists of seven members, two of which are external board members. According to the Articles of Association, the Board of Directors shall consist of not less than three and not more than seven members. The Board of Directors shall appoint the Chairman and the Deputy Chairman of the Board.

Members of the Board of Directors of NMB until 1 September 2017 were Topi Manner (Chairman), Hanna-Maria Heikkinen, Riikka Laine-Tolonen, Ola Littorin, Nina Luomanen, Jussi Mekkonen and Markku Pehkonen.

As from 1 September 2017 until 19 September 2017 the members of the Board were Markku Pehkonen (Deputy Chairman), Hanna-Maria Heikkinen, Riikka Laine-Tolonen, Ola Littorin, Nina Luomanen and Jussi Mekkonen.

As from 19 September 2017 the members of the Board were Petri Nikkilä (Chairman), Hanna-Maria Heikkinen, Nicklas Ilebrand, Riikka Laine-Tolonen, Ola Littorin, Nina Luomanen and Markku Pehkonen.

Further information on the members of the Board of Directors can be found in the section of “Management and auditors” in the Annual Report 2017 of Nordea Mortgage Bank Plc and on www.nordea.com.

The term of office of the members of the Board of Directors is not limited. The retirement age for members of the Board of Directors shall be 70.

Of the members of the Board of Directors Hanna-Maria Heikkinen and Markku Pehkonen are independent of NMB and its shareholders. Petri Nikkilä (Chairman), Nicklas Ilebrand, Riikka Laine-Tolonen, Ola Littorin and Nina Luomanen are all employees in the Nordea Group. None of the members of the Board of Directors take part in the day-to-day management of NMB.

The Board of Directors shall, in the Instructions for the Board of Directors of Nordea Mortgage Bank Plc approved by it, confirm the authorisation to act for and on behalf of NMB and the distribution of duties between the members of the Board of Directors and the CEO.

The Board of Directors is responsible for the organisation and administration of NMB and its business. The Board shall manage NMB’s affairs with due expertise and care in accordance with legislation, the Articles of Association, existing Instructions and Group Board Directives, Group CEO Instructions and Guidelines as well as internal guidelines issued by NMB’s Board.

*It is particularly incumbent upon the Board of Directors to:*
a. set up the governance structure of NMB,
b. ensure that NMB’s organisation with respect to accounting and NMB’s financial circumstances generally includes satisfactory controls,
c. approve the risk strategy and other strategic goals as well as ensure that the surveillance of the goals and strategy is reliable
d. appoint and discharge the CEO and the Deputy CEO and exercise supervision to ensure that the CEO fulfils his or her obligations,
e. determine matters relating to the funding operations,
f. resolve on and submit annual reports and interim reports for NMB,
g. regularly monitor and assess NMB’s financial situation and risks,
h. convene and prepare items for the Annual General Meeting.

The Board has approved a policy for NMB to advance diversity in the composition of the Board. When the selection process of board members is carried out by NMB’s Board of Directors the following shall be considered:

Sufficient diversity as to education, competence and professional experience of the individual member as well as of the Board to present a variety of views and experiences. Sufficient diversity of the Board, inter alia as regards gender, age and geographical provenance, to present a variety of views and experiences.

Gender balance shall be promoted when appointing members of the Board of Directors.

**Work of the Board of Directors**

In 2017, the Board of Directors held 15 meetings. Four meetings were held in Helsinki while 11 meetings were held per capsulam.

Meeting attendance in 2017:

*As from 1 January 2017 until 1 September 2017*

| | |
|---|---|
| Topi Manner, Chairman | 10/10 |
| Jussi Mekkonen | 10/10 |
| Hanna-Maria Heikkinen | 9/10 |
| Riikka Laine-Tolonen | 9/10 |
| Ola Littorin | 10/10 |
| Nina Luomanen | 10/10 |
| Jussi Mekkonen | 10/10 |

*As from 1 September 2017 until 19 September 2017*

| | |
|---|---|
| Markku Pehkonen, Deputy Chairman | 1/1 |
| Hanna-Maria Heikkinen | 1/1 |
| Riikka Laine-Tolonen | 1/1 |
| Ola Littorin | 1/1 |
| Nina Luomanen | 1/1 |
| Jussi Mekkonen | 1/1 |

*As from 19 September 2017 until 31 December 2017*

| | |
|---|---|
| Petri Nikkilä, Chairman | 4/4 |
| Nicklas Ilebrand | 4/4 |
| Hanna-Maria Heikkinen | 4/4 |
| Riikka Laine-Tolonen | 2/4 |
| Ola Littorin | 4/4 |
| Nina Luomanen | 3/4 |
| Markku Pehkonen | 3/4 |

The Board regularly follows up on the strategy, financial position and development as well as risks. The financial targets and the strategy will be reviewed on an annual basis. In 2017, the Board discussed issues related to the risk strategy and risk appetite framework, AML, internal control and compliance, recovery planning details, housing loan and covered bond market etc.

The Secretary of the Board of Directors is Tarja Ikonen, Chief Operating Officer of Nordea Mortgage Bank Plc.

**Board committees**
The Board of Directors of Nordea Mortgage Bank Plc has one Board committee: The Audit Committee (AC) or Committee). The Audit Committee has tasks set out to it in the Finnish Act on Credit Institutions and in the Charter for the Audit Committee approved by the Board of Directors of NMB.

The members of the Audit Committee were Hanna-Maria Heikkinen (Chairman), Markku Pehkonen and Satu Vartiainen until 12 October 2017. As from 12 October 2017 the composition of the Audit Committee was Hanna-Maria Heikkinen (Chairman), Nicklas Ilebrand and Markku Pehkonen.

Generally, the Chief Internal Auditor (CIA) and the Chief Financial Officer (CFO) as well as the external auditor of NMB are present at meetings with the right to participate in discussions but not in decisions.

The majority of the members of the AC are to be independent of NMB and its shareholders. The AC assists the Board in ensuring the quality of NMB’s financial reporting process and in that connection reviews and monitors NMB’s quarterly financial reporting and the external auditors’ reports on key matters arising from their audit of NMB’s financial statements and reviews NMB’s annual and interim reports. The Committee assesses that the management takes necessary corrective actions in a timely manner to address control weaknesses in relation to the financial reporting, non-compliance with laws, regulations and policies, and other problems identified by the internal and external auditors. The AC shall receive update on NMB’s risk management issues. The AC shall review the external audit plan. Further the Committee shall assess in discussions with the external auditor the threats to their independence and the safeguards applied to mitigate those threats as documented by them, to monitor and establish guidelines on the provision of other services in addition to audit that the external auditor is allowed to provide to NMB, and annually review the external auditor's disclosure of such other services and shall assess and ensure that the internal and external auditors annually confirm in writing their impartiality and independence. The AC shall review Group Internal Audit's (GIA) annual risk assessment and audit plan as well as GIA's periodic reports, including the audit log. The AC shall prepare the election of the external auditor prior to the Annual General Meeting and shall annually review the Audit Committee Instructions. In 2017, the AC held four meetings.

**Chief Executive Officer (CEO), Deputy CEO and Management Group**
Nordea Mortgage Bank Plc has a Chief Executive Officer (CEO) and a Deputy CEO. The CEO of Nordea Mortgage Bank is Thomas Miller and Tomi Ylöstalo was his deputy until 15 May 2017. As from 15 May 2017 his deputy was Tarja Ikonen.

The CEO of Nordea Mortgage Bank Plc has established a Management Group to assist and support him in the management of the daily operations of NMB. The Management Group consists of the CEO, the Chief Financial Officer (CFO), Head of Mortgage Products, the Chief Operating Officer (COO) and the Chief Risk Officer (CRO) of NMB and the Entity Compliance Officer. The CRO and the Entity Compliance Officer are members of the Management Group but they do not take part in business decisions. While it is their task to ensure that risk are considered in business decisions, the accountability remains with the business.

**Internal Control Process**
The Board of Directors is responsible for setting and overseeing an adequate and effective Internal Control Framework.

The Internal Control Framework is designed to ensure effective and efficient operations, adequate identification, measurement and mitigation of risks, prudent conduct of business, sound administrative and accounting procedures, reliability of financial and non-financial information reported or disclosed (both internally and externally) and compliance with laws, regulations, supervisory requirements, the Nordea Group Internal Rules and the company specific internal guidelines.

The internal control process is carried out by NMB's Board of Directors, senior management, risk management functions and other staff. The internal control process aims to create the necessary fundamentals for the entire organisation to contribute to the effectiveness and high quality of internal control through, for instance, clear definitions, assignment of roles and responsibilities and common tools and procedures.

Roles and responsibilities with respect to internal control and risk management are divided into three lines of defence. In the first line of defence, NMB and Group Functions are risk owners, and thus responsible for conducting the business within the risk exposure limits and risk appetite and in accordance with the Internal Control Framework.

**Risk management**
As the second line of defence, the control functions are responsible for maintaining the Internal Control Framework and for monitoring the implementation of the policies and procedures within this Framework.

**Chief Risk Officer**
NMB has a Chief Risk Officer (CRO). The CRO is an independent second line of defence risk management function within NMB. The CRO shall provide a complete view of the whole range of risks in NMB to the Board of Directors and ensure the coordination of risk management activities and adequate risk management set-up in the legal entity. The CRO also reports to Group Risk Management and Control (GRMC) which is responsible for identifying, measuring, monitoring and reporting on all risks on the Nordea Group level.

**Compliance**
Group Compliance is responsible for ensuring and monitoring compliance with internal and external rules and for establishing policies and processes to manage compliance risks and to ensure compliance. It is responsible for providing the framework for the internal control of non-financial risks, by designing relevant processes as well as issuing relevant internal rules. The second line of defence is responsible for activities such as identifying, assessing, monitoring, controlling and reporting of issues related to risks, including compliance with internal rules and regulations.

NMB has outsourced its compliance activities to Nordea Bank AB (publ), Finnish Branch, Personal Banking Compliance. The Compliance function has the overall responsibility for co-ordinating the control of NMB's compliance risk, and for producing and following up on appropriate compliance risk assessments, for planning compliance activities and for compliance risk reporting in respect of NMB. The Entity Compliance Officer regularly reports to the CEO of NMB and reports on significant compliance observations are also provided to the Board of Directors of NMB.

**Internal audit**
GIA is an independent function commissioned by the Board of Directors. The Audit Committee is responsible for guidance on and evaluation of GIA within NMB. The Chief Internal Auditor reports on a functional basis to the Board of Directors and the Audit Committee and on an administrative basis to the CEO.

The purpose of GIA is to support the Board of Directors in protecting the assets, reputation and sustainability of NMB. GIA does this by assessing whether all significant risks are identified and appropriately reported by management and the risk functions to the Board, Audit Committee and the senior management; by assessing whether all significant risks are adequately controlled; and by challenging the senior management to improve the effectiveness of governance, risk management and internal controls.

GIA does not engage in consulting activities unless otherwise instructed by the AC.

All activities and entities of the Group fall within the scope of GIA. GIA makes a risk-based decision as to which areas within its scope should be included in the audit plan approved by the Group Board. After the approval of the Nordea Group audit plan, the audit plan of NMB is composed by GIA and approved by the Board of Directors of NMB.

GIA shall operate free from interference in determining the scope of internal auditing, in performing its audit work and in communicating its results. For example, this means that GIA is authorised to inform the financial supervisory authorities of any matter without further approval. The Chief Internal Auditor has unrestricted access to the CEO and Chairman of the AC, and should meet with the Chairman of the AC informally and formally throughout the year, even without the presence of the executive management. GIA is authorised to carry out all investigations and obtain all information required to discharge its duties. This includes the right to sufficient and timely access to the organisation's records, systems, premises and staff. GIA has the right to attend and observe e.g. Board Committee and senior management meetings when relevant and necessary.

**Insider Administration**
The Nordea Group and Nordea Mortgage Bank Plc have in accordance with laws and regulations adopted internal guidelines governing handling of insider information and trading in Nordea securities.

**Leading officials**
Members of the Board of Directors, the CEO and the Deputy CEO of NMB are considered to hold positions in which they discharge managerial responsibilities in NMB and are thus classified as Leading Officials.
Other persons in such leading positions that they are to be considered as Leading Officials, are members of NMB's Management Group following decision and notification by the Group Compliance Officer. The same will apply to other persons in such leading positions in NMB, or with other qualified duties of a permanent nature, that would normally involve access to undisclosed information regarding circumstances that may affect the price of covered bonds issued by NMB who have the power to take managerial decisions affecting the future developments and business prospects of the company.

**Insider lists**
The Group Compliance Officer identifies and notifies the persons who due to their position or employment have access either regularly or on an occasional basis to Inside Information regarding NMB and who thereby are to be included on the specific insider lists. Such persons are required to separately acknowledge in writing the duties related to their position as insiders and are aware of the sanctions applicable to insider dealing and unlawful disclosure of Inside Information.

Employees who receive Inside Information relating to NMB in connection with a project, a transaction or the support of their legitimate role must be entered on a case-based insider list. The person heading the project or unit where the Inside Information is at hand shall always assess the need to establish a case-based insider list and report the case to the unit's Compliance Officer.

**Trading in Securities issued by Nordea Mortgage Bank Plc**
Leading Officials may only trade in securities issued by NMB during a two-week period following the publication of the interim financial reports or year-end reports of NMB. The two-week period ("open window") starts the day after the publication of the report, i.e. the trading restriction applies on the publication day.

Any time a Leading Official has Inside Information about NMB, he/she must abstain from trading. Regarding other financial instruments the above mentioned Leading Officials may not engage in short-time trading where the time between the acquisition of ownership of certain securities and the intended or actual disposal or execution of the securities is shorter than one month ("the one-month rule").

**Report on the key aspects of the systems for internal control and risk management regarding financial reports for the financial year 2017**
Nordea Mortgage Bank Plc belongs to the Nordea Group. The internal control and risk management systems in relation to the financial reporting process are organised at Nordea level. Financial reporting processes are fully integrated within Nordea. The Board of Directors of Nordea Mortgage Bank Plc monitors financial and risk reporting at Nordea Mortgage Bank Plc level and has dealt with the risk reports at Nordea Mortgage Bank Plc level. Nordea Mortgage Bank Plc complies with the Group Internal Rules and supporting instructions to the extent applicable.

The systems for internal control and risk management of financial reporting are designed to provide reasonable assurance about the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, applicable laws and regulations, and other requirements for listed companies. The internal control and risk management activities are included in Nordea's planning and resource allocation processes. Internal control and risk management of financial reporting at Nordea can be described in accordance with the COSO Framework as follows below.

**Control Environment**
The control environment constitutes the basis for Nordea's internal control and centres around the culture and values established by the Board of Directors and Group Executive Management of Nordea Bank AB (publ), and the organisational structure, with clear roles and responsibilities.

A clear and transparent organisational structure is of importance for the control environment. Nordea's business structure aims to support the overall strategy, ensuring strong business momentum and increased requirements on capital and liquidity. The business and the organisation are under continuous development.

Clear roles and responsibilities are critical in the governance of the internal control of financial reporting where the risk owners in the business areas and Group Finance & Treasury are responsible for the risk management activities. A risk management function supports the Group CFO in maintaining a Group wide set of controls (in Nordea defined as Accounting Key Controls (AKC)), in line with the risk framework, which covers the control of risks and the risk identification process that to a large extent is based on the actual business and financial closing processes in place. An independent risk control function that is responsible for identifying, controlling and reporting on financial reporting risk has been established in Group Risk Management and Control (GRMC). In addition, the internal audit function provides the Group Board with an assessment of the overall effectiveness of the governance, risk management and control processes.

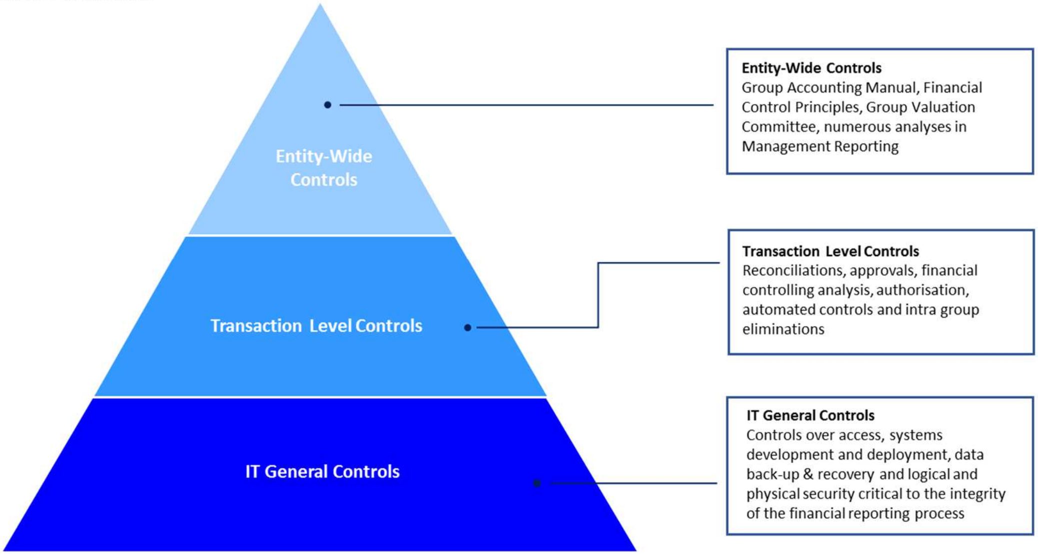
The control environment is implemented in NMB where the CFO of NMB is responsible for maintaining the set of controls covering the control of risks and the risk identification process in accordance with the AKC. The CRO of NMB is the independent second line of defence risk management function within NMB responsible for identifying, controlling and reporting on financial reporting risk. GIA as the third line of defence function provides the Board of NMB with an assessment of the overall effectiveness of the governance, risk management and control processes.

**Risk Assessment**
The Group Board of Directors bears the ultimate responsibility for limiting and monitoring Nordea's risk exposure. Risk management is considered to be an integral part of running the business and the main responsibility for performing risk assessments regarding financial reporting risks lies with the business

organisation. Performing risk assessments close to the business increases the possibility of identifying the most relevant risks. In order to govern the quality, central functions stipulate in governing documents when and how these assessments are to be performed. Examples of risk assessments, performed at least annually, are Quality and Risk Analysis for changes and Risk and Control Self-Assessments.

Risk assessment in relation to reliable financial reporting involves the identification and analysis of risks of material misstatements. Financial reporting risk control work in Nordea focuses on risks and processes which could lead to material financial misstatements, i.e. if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item. Structured risk assessment procedures determine in which divisions, locations and/or processes risks for material financial misstatements exist and therefore will need to be monitored under the AKC framework to ensure reasonable assurance of the reliability of Nordea's external financial reporting.

**Control Activities**




The heads of the respective units are primarily responsible for managing the risks associated with the units' operations and financial reporting processes. This responsibility is primarily supported by the Group Accounting Manual (GAM), the Financial Control Principles and various governing bodies, such as the Group Valuation Committee. The GAM includes a standard reporting package used by all entities to ensure consistent use of Nordea's principles and coordinated financial reporting. Fundamental internal control principles at Nordea are the segregation of duties and the four-eyes principle when approving, for instance, transactions and authorisations.

AKC control structure is based on that Transaction Level Controls (TLC) are identified through analysing risks based on high level processes with an end-to-end product focus. After deciding on the TLCs, an analysis is performed to decide what systems/applications are in scope for AKC where specific IT General Controls are governed. The analysis aims at scoping in the major systems where there is a risk that data, which is not detected in the TLC control structure, could become corrupt.

The quality assurance vested in the management reporting process, where a detailed analysis of the financial outcome is performed, constitutes one of the most important control mechanisms associated with the reporting process. The reconciliations constitute another set of important controls with which Nordea works continuously to further strengthen the quality.

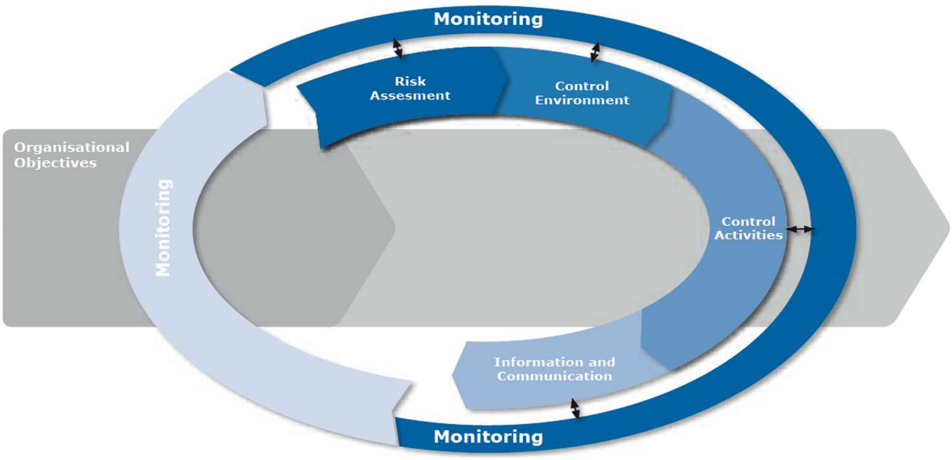
**Information & Communication**
Group Finance & Treasury is responsible for ensuring that the Group Accounting Manual and the Financial Control Principles are up-to-date and that changes are communicated with the responsible units. These governing documents are broken down into instructions and standard operating procedures in the responsible units. Accounting specialists from Group Finance & Treasury continuously provide accountants and controllers with information on changes in existing and updated rules and regulations with an impact on Nordea.

The key criteria applied when communicating financial information to the market are “correct, relevant, consistent, reliable and timely”. The information is to be disclosed in such a way that the information is made available to the public in a fast and non-discriminatory manner.

Nordea interacts with relevant subject-matter experts to ensure fulfilment of financial reporting objectives. Nordea actively participates in relevant national forums, such as forums established by the financial supervisory authorities, central banks and associations for financial institutions.

AKC reporting procedures provide the management at different levels in the organisation with information related to the performance and assessment of the identified AKCs in the form of Process Owner reports and Management Dashboard reports with a summary of the assessment outcome and high risk areas. As all the operations of NMB are integrated into the operations of the Nordea Group, also the AKC reporting procedures are applicable to it. The CFO and CRO receive AKC reporting quarterly.

**Monitoring**
Nordea has established a process with the purpose of ensuring the proper monitoring of the quality of financial reporting and the follow-up regarding possible deficiencies. This interactive process aims to cover all COSO components in the framework and is illustrated with the diagram below:




The Risk and Control Self-Assessment process includes monitoring the quality of internal control for financial reporting and follow-up regarding possible deficiencies. The assessment is presented in the annual Group Operational and Compliance Risk Map, which is submitted to the CEO in Group Executive Management, the Board Risk Committee and the Board of Directors of Nordea Bank AB (publ).

The Board of Directors, the Board Audit Committee and the Board Risk Committee of Nordea Bank AB (publ), as well as Group Internal Audit (GIA), have important roles in respect of overseeing and monitoring the internal control of financial reporting in the whole Nordea Group. Similarly, the Board of Directors and the Board Audit Committee of Nordea Mortgage Bank Plc have an important role with regard to monitoring the internal control of financial reporting in Nordea Mortgage Bank Plc.

Group Finance & Treasury has also established specific quarterly reporting regarding the internal control of financial reporting to the Group CFO covering risk management and high risk areas. The independent risk control function within GRMC reports specifically on financial reporting risk to the Board Audit Committee and the CEO in Group Executive Management on a quarterly basis.

**Auditors**

According to the Articles of Association, the auditor must be elected by the General Meeting for a term of one year. NMB's auditors were elected by the Annual General Meeting of Nordea Mortgage Bank Plc on 9 March 2017. The auditor must be an audit firm authorised by the Finnish Chamber of Commerce.

The current auditor:

PricewaterhouseCoopers Oy
Authorised Public Accountants

Auditor with main responsibility
Juha Wahlroos
Authorised Public Accountant

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This Corporate Governance Report has not been reviewed by the external auditors and the report is not part of the formal financial statements.

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