



Capital and Risk Management (Pillar III) Report

Nordea Bank Finland Group 2013

Nordea Bank Finland hereby presents its capital position and how the size and composition of the capital base is related to the risks as measured in Risk-Weighted Assets (RWA). The national capital adequacy legislation is based on the Directive 2006/48/EC of the European Parliament and of the Council, commonly referred to as the Capital Requirements Directive (the CRD), which is in turn is based on the Basel II framework issued by the Basel Committee on Banking Supervision (BCBS).

The Nordea Bank Finland Group follows the Finnish Act on credit institutions and the Finnish financial supervisory authority's standards 4.5 Supervisory disclosure of capital adequacy information and 4.1 Establishment and maintenance of internal control and risk management. Furthermore, the disclosures are made in accordance with Nordea's internal policy and instructions for disclosing information on capital adequacy in the Nordea Group.

The Pillar III disclosure is made for the Nordea Group and for the subgroups Nordea Bank Danmark Group, Nordea Bank Finland Group and Nordea Bank Norge Group as well as Nordea Bank Polska S.A. These reports are presented on www.nordea.com and the key data on capital adequacy is also presented in the annual report of each legal entity.

The full Pillar III disclosure is made annually and the periodic information is published semi-annually, included in the semi-annual report for the entity. The format, frequency and content of the disclosures follow, to as large extent as possible with regards to local legislation, a common set-up in Nordea. Nordea has stated the common principles in a policy and instruction for disclosing information on capital adequacy in the Nordea Group. The Board of Directors in Nordea Bank Finland has approved a policy regarding Pillar III disclosure.

In this report, Nordea Bank Finland Group is defined as Nordea Bank Finland and Nordea Group is defined as Nordea.

TABLE OF CONTENTS

1.	HIGHLIGHTS OF 2013	3
2.	GOVERNANCE OF RISK AND CAPITAL MANAGEMENT	4
2	.1 THE FINANCIAL GROUP NORDEA BANK FINLAND IN THE CAPITAL ADEQUACY CONTEXT	4
2	2 RISK AND CAPITAL MANAGEMENT	4
3.	CAPITAL POSITION	7
3	.1 CAPITAL ADEQUACY ASSESSMENT	7
3	2 REGULATORY CAPITAL REQUIREMENTS AND RWA	7
3	.3 CAPITAL RATIOS	7
4.	CREDIT RISK	9
4	.1 MANAGEMENT, GOVERNANCE AND MEASUREMENT OF CREDIT RISK	9
4	.2 LINK BETWEEN CREDIT RISK EXPOSURE AND BALANCE SHEET	11
4	.3 CREDIT RISK APPROACH	14
4	4 DEVELOPMENT OF EXPOSURE AND RWA	14
4	5 CREDIT RISK EXPOSURE	15
4	.6 RATING AND SCORING	22
4	7 COLLATERAL	26
4	8 ESTIMATION AND VALIDATION OF CREDIT RISK PARAMETERS	27
_ 4	.9 LOAN PORTFOLIO, IMPAIRED LOANS AND LOAN LOSSES	
5.	MARKET RISK	
5	.1 MANAGEMENT, GOVERNANCE AND MEASUREMENT OF MARKET RISK	
5	2 CONSOLIDATED MARKET RISK FOR NORDEA BANK FINLAND	
5	3 MARKET RISK FOR THE TRADING BOOK	
5	4 CAPITAL REQUIREMENTS FOR MARKET RISK IN THE TRADING BOOK (PILLART)	
5	5 INTEREST RATE RISK IN THE BANKING BOOK	
5	6 STRUCTURAL INTEREST INCOME RISK	
5	2 EQUITY RISK IN THE BANKING BOOK	
5	.8 DETERMINATION OF FAIR VALUE OF FINANCIAL INSTRUMENTS	
6.	1 MANIA CEMENT COVEDNIANCE AND MEACUREMENT OF ODED ATIONAL DICK	
e	1 MANAGEMENT, GOVERNANCE AND MEASUREMENT OF OPERATIONAL RISK	
7 0	2 CAPITAL REQUIREMENTS FOR OPERATIONAL RISK	41
·	1 INTEODUCTION TO SECULIDITIE A TION AND CREDIT DEDIX A TIVES TO A DINC	42
7	1 INTRODUCTION TO SECURITISATION AND CREDIT DERIVATIVES TRADING	42
7	2 CREDIT DERIVATIVES TRADING	42
8		43
0. s	1 MANACEMENT COVERNANCE AND MEASUREMENT OF LIQUIDITY RISK	
8	 I INTRODUCTIVE RISK AND FUNDING ANALYSIS 	
9	ICAAP AND INTERNAL CAPITAL REQUIREMENT	40 47
, ,	1 ICAAP	47
ç	2 INTERNAL CAPITAL REQUIREMENTS	47
10.	CAPITAL BASE	
1	0.1 CAPITAL BASE DEFINITION	
1	0.2 CORE TIER 1 CAPITAL AND TIER 1 CAPITAL	
1	0.3 TIER 2 CAPITAL	54
11.	NEW REGULATIONS	56
1	1.1 FORTHCOMING REGULATORY FRAMEWORK	56
1	1.2 BASEL III AND THE CRD IV/CRR	56
1	1.3 CRISIS MANAGEMENT AND RECOVERY AND RESOLUTION	59
1	1.4 BANKING UNION	59
1	1.5 SEPARATION OF TRADING ACTIVITIES	60
1	1.6 TRADING BOOK REVIEW	60
1	1.7 ACCOUNTING STANDARDS	60
12.	REMUNERATION	61
1	2.1 THE BOARD REMUNERATION COMMITTEE	61
1	2.2 REMUNERATION RISK ANALYSIS	61
1	2.3 BONUS SCHEMES RISK ANALYSIS	62
1	2.4 ADDITIONAL DISCLOSURES ON REMUNERATION	63
13.	APPENDIX	64
1	3.1 GENERAL DESCRIPTION OF PILLAR I, II AND III	64
1	3.2 IRB APPROACH	65
_ 1	3.3 STANDARDISED APPROACH	67
LIS	[OF ABBREVIATIONS	68

1. Highlights of 2013

Nordea Bank Finland continued to show a solid risk position and capital ratios as well as credit quality in 2013. This was reflected in a core tier 1 capital ratio excluding transition rules of 16.0% and a loan loss ratio of 5bp, down from 14bp in 2012.

The Nordic economies have continued to perform well compared to the rest of Europe, although with differences within the region. Global growth has picked up, however growth and the outlook for the Nordic economies remains weak going forward.

Nordea Bank Finland is confident and well-prepared for the future, due to strong profitability, solid quality in its well-diversified credit portfolio, a strong capital position and a diversified funding base.

Continued solid credit quality and strong risk management

Credit quality remained overall solid in 2013 with a loan loss ratio of 5bp (14bp). The overall effect from migration in the portfolio was slightly negative and the impaired loans ratio increased to 181bp (91bp).

Nordea Bank Finland's market risk-taking activities are well-diversified and oriented towards the Nordic and European markets. The market risk is to a large extent driven by interest rate risk. The total consolidated market risk VaR increased to an average of EUR 43m in 2013 (EUR 31m).

Capital ratios already at strong levels

The core tier 1 capital ratio excluding transition rules decreased by 202bp, to reach 16.0% at the end of 2013 (18.0%). This was largely due to reduced effects from the guarantee issued by the parent company Nordea Bank AB (publ) for corporate exposures in Nordea Bank Finland.

Strong funding name maintained

Nordea Bank Finland remains a strong name in the funding market, with maintained high activity also in the long-term funding market.

CRD IV and CRR – new regulations for capital and liquidity risk

In Nordea Bank Finland, there is strong focus on capital, liquidity and risk management and the bank is wellprepared to meet the new regulatory environment, further described in Chapter 11.

2. Governance of risk and capital management

Management of risk, liquidity and capital are key success factors in the financial services industry. The maintaining of risk awareness in the organisation is incorporated in the business strategies. Nordea has defined clear risk, liquidity and capital management frameworks, including policies and instructions for different risk types, capital adequacy and capital structure.

2.1 The Financial Group Nordea Bank Finland in the capital adequacy context

The information given in this report refers to Nordea Bank Finland Plc with corporate registration number 1680235-8.

The financial statements are published semi-annually and the consolidated financial statements include the accounts of the parent company Nordea Bank Finland Plc and its subsidiaries according to International Accounting Standard (IAS) 27. In the Financial Group, the insurance companies of the Group are not consolidated, which is a different treatment to that for accounting purposes. Table 2.1 at the end of this chapter discloses the undertakings that have been consolidated and deducted from the capital base.

2.2 Risk and capital management

2.2.1 Risk and capital management principles and control

Risk and capital management in the Nordea Group is governed by principles and procedures stated in charters, policies, guidelines and instructions in effect throughout the organisation. All legal entities are subject to the same internal control and risk management environment, through the organisation of the business. Each Business Area is responsible for managing the risks in its operations, which includes identification, control, mitigating actions and reporting. Group Risk Management consolidates and monitors risk on Group level.

Nordea monitors aggregated risks via specific committees, as well as through reporting to Group Executive Management (GEM) and the Group Board of Directors and the local bank boards including the Board of Directors of Nordea Bank Finland Plc. More specifically, Nordea's risks and capital are monitored by the Risk Committee and the Asset and Liability Committee (ALCO).

2.2.1.1 Board of Directors and Board Risk Committee

The Board of Directors has the ultimate responsibility for limiting and monitoring Nordea's risk exposure as well as for setting targets for the capital ratios and risk appetite. Risk is measured and reported according to common principles and policies approved by the Board of Directors, which also decides on policies for credit risk, counterparty credit risk, market risk, liquidity risk, business risk, life insurance risk and operational risk management as well as the internal capital adequacy assessment process (ICAAP). All policies are reviewed at least annually.

In the credit instructions, the Board of Directors decides on powers-to-act for credit committees at different levels within the Business Areas. These authorisations vary for different decision-making levels, mainly in terms of size of limits but also depending on the internal rating of customers. The Board of Directors furthermore decides on the limits for market and liquidity risk in Nordea.

The Board Risk Committee assists the Board of Directors in fulfilling its oversight responsibilities concerning management and control of risk, risk frameworks as well as controls and processes associated with the Group's operations.

2.2.1.2 Responsibility of CEO and GEM

The Chief Executive Officer (CEO) has the overall responsibility for developing and maintaining effective risk, liquidity and capital management principles and control of the bank and the Group.

The CEO and GEM regularly review reports on risk exposure and have established a number of committees for risk, liquidity and capital management.

The Asset and Liability Committee, chaired by the Chief Financial Officer (CFO), prepares issues of major importance concerning Nordea's financial operations and balance sheet risks as well as capital management either for decision by the CEO in GEM or for recommendation by the CEO and for decision by the Group Board of Directors. ALCO also decides on certain issuances and capital injections for all wholly owned legal entities within the Group. The Asset and Liability Committee has established sub-committees for its work and decision-making within specific risk areas.

The Risk Committee, chaired by the Chief Risk Officer (CRO), oversees the management and control of the Group's risks on an aggregate level and evaluates the sufficiency of the risk frameworks, controls and processes associated with these risks. Furthermore, the Risk Committee decides, within the scope of resolutions adopted by the Board of Directors, the allocation of market risk limits as well as liquidity risk limits to the risk-taking units Nordea Markets and Group Treasury respectively. The limits are set in accordance with the business strategies and are reviewed at least annually. The heads of the units allocate the respective limits within the unit and may introduce more detailed limits and other risk mitigating techniques such as stop-loss rules. The Risk Committee has established sub-committees for its work and decision-making within specific risk areas.

The Group Executive Management Credit Committee (GEM CC) and Executive Credit Committee (ECC) are chaired by the CRO, while the Group Credit Committee Retail Banking (GCCR) and the Group Credit Committee Wholesale Banking (GCCW) are chaired by the Chief Credit Officer (CCO). These credit committees decide on major credit risk limits and industry policies for Nordea. Credit risk limits are granted as individual limits for customers or consolidated customer groups and as industry limits for certain defined industries.

2.2.1.3 Responsibility of Group Risk Management and Group Corporate Centre

Figure 2.1 illustrates Nordea's governance structure of risk, liquidity and capital management.





Within the Group, two units – Group Risk Management and Group Corporate Centre, are responsible for risk, capital, liquidity and balance sheet management. Group Risk Management, headed by the CRO, is responsible for the risk management framework and processes. Group Corporate Centre, headed by the CFO, is responsible for the capital policy, the composition of the capital base, the capital adequacy framework (including the IRB framework) and for liquidity risk management.

Each Business Area and Group Function is primarily responsible for managing the risks in its operations within the applicable limits and framework, including identification, control and reporting.

2.2.2 Monitoring and reporting

The "Policy for Internal Control and Risk Management in the Nordea Group" states that the management of risks includes all activities aiming at identifying, measuring, assessing, monitoring and controlling risks as well as measures to limit and mitigate the consequences of the risks. Management of risk is proactive, emphasising training and risk awareness. The Nordea Group maintains a high standard of risk management by means of applying available techniques and methodology to its own needs.

The control environment is, among other things, based on the principles of segregation of duties and independence. Monitoring and reporting of risk is conducted on a daily basis for market, counterparty credit risk and liquidity risk and on a monthly and quarterly basis for credit and operational risk. Risk appetite reporting is presented quarterly to the Risk Committee, GEM, the Board Risk Committee and the Board of Directors.

Detailed risk information, covering all risks as well as capital adequacy for the consolidated group, is regularly reported to the Risk Committee, GEM and the Board of Directors. In addition, the Board of Directors in Nordea Bank Finland receives risk reporting which covers market, credit and liquidity risk in Nordea Bank Finland. Nordea's internal capital requirement includes all types of risks and is regularly reported to ALCO.

Nordea Bank Finland Plc has a Chief Risk Coordinator. Chief Risk Coordinator in Finland is an overall coordinator for risk related issues within Nordea Bank Finland Plc to secure that relevant and adequate risk information is given to the Board of Directors of Nordea Bank Finland Plc.

Group Internal Audit independently evaluates the processes regarding risk and capital management in accordance with the annual audit plan.

		Book	Voting		
	Number	value	power of		Consolidation
	of shares	EURm	holding %	Domicile	method
Group undertakings included in the Nordea Bank Finland Group					
Nordea Finance Finland Ltd	1,000,000	306	100	Espoo	purchase method
SIA promano Lat		30	100	Riga	purchase method
Promano Est Oü		10	100	Tallinn	purchase method
Promano Lit UAB		10	100	Vilnius	purchase method
SIA Realm		10	100	Riga	purchase method
UAB Inrec		2	100	Vilnius	purchase method
UAB Recourso		4	100	Vilnius	purchase method
Other companies		4			purchase method
Total included in the Nordea Bank Finland Group		376			
Over 10 % investments in credit institutions deducted from the capita	l base				
NF Fleet Oy		3	20	Espoo	equity method
Total investments in credit institutions deducted					
from the capital base		3			

Table 2.1 Specification over undertakings consolidated/deducted from Nordea Bank Finland, 31 December 2013

3. Capital position

The capital base for Nordea Bank Finland increased slightly in 2013. However, an increase in RWA caused capital ratios to decline compared to previous year. The decline was however subdued by continued RWA efficiency activities undertaken as part of the New Normal strategy.

3.1 Capital adequacy assessment

Banks need to keep sufficient capital to cover all risks taken over a foreseeable future. Therefore, Nordea Bank Finland strives to be efficient in its use of capital through active management of the balance sheet with respect to different asset, liability and risk categories. Nordea Bank Finland's goal is to enhance returns to shareholders while maintaining a prudent risk and return relationship. Strong capital and RWA management supports the strategic visions. In addition, it provides protection against unexpected losses that arise as a result of risks taken.

The internal capital adequacy assessment process (ICAAP) is established to determine internal capital requirements that reflect the risks and to assess capital adequacy.

3.2 Regulatory capital requirements and RWA

The regulatory capital requirements that Nordea Bank Finland fell under on the balance date for this report, 31 December 2013, are based on the consolidated version of the Capital Requirements Directive (CRD); EU Directive 2006/48/EC (including 2009/111/EC and 2010/76/EU).

Table 3.1 presents an overview of the capital requirements and RWA as of end 2013, split by risk type and with comparison to previous year. Of the RWA (excluding transition rules), credit risk accounts for approximately 75% while operational risk accounts for 10% and market risk 15%. The table also includes information about the approach used for calculation of the RWA. Out of the RWA for credit risk, 44% of the exposure has been calculated under the IRB approach and 56% under the standardised approach (see Table 4.2).

Total RWA for credit risk, market risk and operational risk of EUR 52.7bn is adjusted with an additional 3.4bn due to transition rules, ending at a total RWA of EUR 56.1bn including transition rules.

During the year, Nordea Bank Finland continued its RWA efficiency activities, which served to decrease RWA by EUR 2.2bn. However total RWA excluding transition rules increased by EUR 6.9bn during 2013.

3.2.1 Current capital base

As shown in Table 3.2, the capital base as of end 2013 was EUR 8.9bn, of which core capital tier 1 represented EUR 8.4bn. Tier 1 and tier 2 capital net of deductions was EUR 8.4and EUR 0.4bn respectively. See chapter 10 for further details regarding the capital base.

3.3 Capital ratios

To quantify the degree of capital coverage, different ratios based on different capital base items are used. These ratios include, but are not limited to:

- The core tier 1 capital ratio: calculated by dividing core tier 1 capital with RWA.
- The tier 1 capital ratio: calculated by dividing tier 1 capital with RWA.
- The capital ratio: calculated by dividing the capital base with RWA.

Nordea Bank Finland's core tier 1 capital ratio excluding transition rules was 16.0% at the end of 2013, representing a 202bp decrease on the 2012 figure. The decline in capital ratios was caused by the increase in RWA, mainly as a result of the reduced effect from the guarantee issued by Nordea Bank AB (publ). The tier 1 capital ratio excluding transition rules ended at 16.0% (18.0%) while the corresponding capital ratio ended at 16.8% (18.8%).

The core tier 1 capital ratio including transition rules was 15.0% (18.0%) while the tier 1 capital ratio and the capital ratio including transition rules were 15.0% (18.0%) and 15.8% (18.8%) respectively.

Table 3.2 shows the key capital adequacy figures for Nordea Bank Finland, both including and excluding transition rules.

Table 3.1 Capital requirements and RWA

	31 December 2013		31 De	ecember 2012
	Capital		Capital	
EURm	requirement	RWA	requirement	RWA
Credit risk	3,163	39 <i>,</i> 543	2,872	35,899
IRB	1,827	22,837	1,163	14,538
- of which institution	279	3,490	439	5,492
- of which corporate	1,217	15,217	408	5,103
- of which retail	313	3,910	299	3,732
- of which mortgage	194	2,430	164	2,052
- of which other retail	59	739	87	1,092
- of which SME	59	741	47	589
- of which other	18	220	17	210
Standardised	1,336	16,706	1,709	21,362
- of which sovereign	18	225	20	245
- of which institution	848	10,596	1,189	14,867
- of which corporate	92	1,153	121	1,513
- of which retail	318	3,975	302	3,769
- of which other	61	756	77	968
Market risk	644	8,048	379	4,732
- of which trading book, Internal approach	421	5,262	306	3,829
- of which trading book, Standardised approach	208	2,595	72	903
- of which banking book, Standardised approach	15	191		
Operational risk	405	5,060	408	5,101
Standardised	405	5,060	408	5,101
Sub total	4,212	52,652	3,659	45,733
Additional capital requirement due to transition rules	274	3,425	0	0
Total	4,486	56,077	3,659	45,733

Table 3.2 Key capital adequacy figures

EURm	31 December 2013	31 December 2012
RWA including transition rules	56,077	45,733
RWA excluding transition rules	52,652	45,733
Capital requirement including transition rules	4,486	3,659
Core tier 1 capital	8,430	8,246
Tier 1 capital	8,430	8,246
Capital base	8,866	8,607
Capital ratios excluding transition rules		
Core tier 1 capital ratio	16.0%	18.0%
Tier 1 capital ratio	16.0%	18.0%
Capital ratio	16.8%	18.8%
Capital adequacy quotient (Capital base/Capital requirement)	2.1	2.4
Capital ratios including transition rules		
Core tier 1 capital ratio	15.0%	18.0%
Tier 1 capital ratio	15.0%	18.0%
Capital ratio	15.8%	18.8%
Capital adequacy quotient (Capital base/Capital requirement)	2.0	2.4

4. Credit risk

Year 2013 showed an increase in the total credit risk RWA for Nordea Bank Finland. Credit quality remains solid with strongly rated customers, despite the credit portfolio experiencing some negative migration. Net loan losses decreased significantly, whereas impaired loans gross remained largely unchanged.

4.1 Management, governance and measurement of credit risk

Credit risk is defined as the risk of loss if customers fail to fulfil their agreed obligations and the pledged collateral does not cover existing claims. The credit risks stem mainly from various forms of lending, but also from issued guarantees and documentary credits, such as letters of credit. Furthermore, credit risk may also include counterparty credit risk, transfer risk and settlement risk.

4.1.1 Management of credit risk

For monitoring the distribution of a portfolio, improving risk management and defining a common strategy, there are specific industry credit policies and principles in place. The concentration risk in specific industries is followed by industry monitoring groups. Industry credit policies are established for industries where at least two of the following criteria are fulfilled:

- Significant weight in the Nordea loan portfolio
- High cyclicality and/or volatility of the industry
- Special skills and knowledge required

Nordea currently has Industry credit policies in place for the following industries:

- Shipping, Oil and Offshore
- Energy
- Leveraged buy-out (LBO)
- Financial Institutions
- Commercial Real Estate

Industry credit principles apply to:

- Forest
- Telecom
- Aircraft
- Hedge Funds

All industry credit policies are approved by the Executive Credit Committee and confirmed annually to the Board Risk Committee. The industry credit principles are approved by Group Credit Committee Wholesale Banking and confirmed by the Executive Credit Committee.

Decisions regarding credit risk limits for customers and customer groups are made by the relevant decision-making bodies on different levels within the Group. The responsibility for credit risk lies within the customer responsible unit, which continuously assesses customers' ability to fulfil their obligations and identifies deviations from agreed conditions and weaknesses in the customers' performance. In addition to building strong customer relationships and understanding each customer's financial position, monitoring of credit risk is based on all available information about the customer and macroeconomic factors. Information such as late payments data, behavioural scoring and rating migration are important parameters in the internal monitoring process. If new information indicates the need, the customer responsible unit must reassess the rating and assess whether the customer's repayment ability is threatened. If it is considered unlikely that the customer will be able to repay his/her debt obligations in full and the situation cannot be satisfactorily remedied, the customer must be tested for impairment. See section 4.9.1 for more details on impairment.

If credit weakness is identified in relation to a customer exposure, the exposure is assigned special attention in terms of more frequent reviewing. In addition to continuous monitoring, an action plan is

established outlining how to minimise the potential credit loss. If necessary, a special work-out team is set up to support the customer responsible unit. Nordea has a project organisation for handling work-out credits for corporate customers and individual work-out teams including relevant specialists are established for larger work-out cases. The credit organisation and other specialist units support customer responsible units in handling smaller work-out customers.

The follow-up of individual work-out cases is part of the quarterly credit risk review process. In this process the impairment of individual customers and customer groups is also assessed and the actions related to handling of work-out customers are reviewed and followed up.

The environmental risks of corporate customers are taken into account in the overall risk assessment through the Environmental Risk Assessment Tool (ERAT). Social and political risks are taken into account by the Social and Political Risk Assessment Tool (SPRAT). A project to develop the Environmental Social Governance (ESG) risk assessment tools and processes is on-going. The aim is to move towards a risk based approach to identify and focus our efforts on potential higher risk cases. For larger project finance transactions, Nordea has adopted the Equator Principles, a financial industry benchmark for determining, assessing and managing social and environmental risk in project financing. The Equator Principles are based on the policies and guidelines of the World Bank and International Finance Corporation.

4.1.1.1 Credit risk mitigation and collateral policy

Credit risk mitigation is a fundamental part of the credit decision process. In every credit decision and review, the valuation of collaterals as well as the adequacy of covenants and other risk mitigation measure are considered.

Pledging of collaterals is the main credit risk mitigation method. Local instructions emphasise that national practice and routines are timely and prudent in order to ensure that collateral items are controlled by Nordea and that loans and pledge agreements as well as collaterals are legally enforceable. Nordea is therefore entitled to liquidate collateral in the event of the obligor's default and can claim and control cash proceeds from a liquidation process.

To a large extent national standard loan and pledge agreements are used, thus ensuring legal enforceability.

The following collateral types are most common in Nordea Bank Finland:

- Residential real estate, commercial real estate and land situated in Nordea's home markets
- Other tangible assets such as machinery, equipment, vehicles, vessels, aircrafts and trains
- Inventory, receivables (trade debtors) and assets pledged under floating charge
- Financial collateral such as listed shares, listed bonds and other specific securities
- Deposits
- Guarantees

For each type of collateral, more specific instructions are added to the general valuation principle. A specific maximum collateral ratio is set for each collateral type. In the calculation of RWA, the collateral must fulfil certain eligibility criteria.

For large exposures, syndication of loans is the primary tool for managing concentration risk, while credit risk mitigation by the use of credit default swaps is applied to a very limited extent.

Covenants in credit agreements serve as a complement to both secured and unsecured exposures. All exposures of substantial size and complexity include appropriate covenants. Financial covenants are designed to highlight early warning signs and are closely monitored.

4.1.2 Governance of credit risk

Group Risk Management is responsible for the credit process framework and the credit risk management framework, consisting of policies, instructions and guidelines for the Group. Group Risk Management is also responsible for controlling and monitoring the quality of the credit portfolio and the credit process, and for ensuring that all incurred losses are covered by adequate allowances. Each division/unit is primarily responsible for managing the credit risks in its operations within the applicable framework and limits, including identification, control and reporting.

Within the powers-to-act granted by the Group Board of Directors, credit risk limits are approved by credit decision-making bodies on different levels in the organisation. The rating and exposure of the customer determine at what level the decision will be made (see Figure 4.1). Group Executive Management Credit Committee decides on proposals for the largest exposures and proposals related to major principle issues. Responsibility for the credit risk lies within the customer responsible unit. Customers are assigned a rating or risk grade in accordance with the framework for quantification of credit risk. The Board of Directors in Nordea Bank Finland makes the final credit decision concerning Nordea Bank Finland.



Figure 4.1 Credit risk decision making structure for main operations

4.1.3 Measurement of credit risk

Credit risk is measured, monitored and segmented in several dimensions. On-balance lending constitutes the major part of the credit portfolio and the basis for impaired loans and loan losses. Credit risk in lending is measured and presented as the principle amount of on-balance sheet claims, i.e. loans to credit institutions and the public as well as off-balance sheet potential claims on customers and counterparts net after allowances. Credit risk exposure also includes counterparty credit risk such as risk related to derivative contracts and securities financing. Nordea's loan portfolio is broken down by segment, industry and geography.

One way of assessing credit quality is through analysis of the distribution across rating grades for rated corporate customers and institutions, as well as the distribution across risk grades for scored retail customers.

4.2 Link between credit risk exposure and balance sheet

This section discloses the link between the loan portfolio as defined in accordance with accounting standards and exposure as defined in accordance with the CRD. The main differences are outlined in this section to illustrate the link between the different reporting methods. A detailed definition of exposure classes used in the capital adequacy calculations is shown in appendix 13.2 and 13.3.

Original exposure is the exposure before taking into account substitution effects stemming from credit risk mitigation, credit conversion factors (CCFs) for off-balance exposure and allowances within the standardised approach. In this report, however, exposure is defined as exposure at default (EAD) for IRB exposure and exposure value for standardised exposure unless otherwise stated.

Credit risk exposure presented in this report, in accordance with the CRD, is divided into exposure classes where each exposure class is divided into exposure types as follows:

- On-balance sheet items
- Off-balance sheet items (e.g. guarantees and unutilised amounts of credit facilities)
- Securities financing (e.g. reversed repurchase agreements and securities lending)
- Derivatives

Items presented in the Annual Report are divided as follows (in accordance with the accounting standards):

- On-balance sheet items (e.g. loans to central banks and credit institutions, loans to the public, reversed repurchase agreements, positive fair value for derivatives and interest-bearing securities)
- Off-balance sheet items (e.g. guarantees and unutilised lines of credit)

Table 4.1 shows the link between the CRD credit risk exposure and items presented in the Annual Report.

Table 4.1 Specification of on-balance and off-balance items for Nordea Bank Finland, 31 December 2013

		Items	Repos,				
		related to	derivatives,				
EURm	Balance sheet	market	securities		Original		
On-balance sheet items	(accounting)	risk	lending	Other	exposure	Adjustments ¹	Exposure
Cash and balances with central							
banks	30,904				30,904		30,904
Treasury bills, other interest-							
bearing securities and pledged							
instruments	43,985	-26,073			17,912		17,912
Loans to credit institutions	35,767		-7,131	0	28,636		28,636
Loans to the public	113,779		-40,176	820	74,422	-127	74,295
Derivatives	70,234		-70,234				
Intangible assets	100			-100			
Other assets and prepaid	9,991	-7,271	-65	-1,104	1,551		1,551
Total	304,761	-33,344	-117,607	-384	153,425	-127	153,299

		Incl. in	
Off-balance sheet items in the	Off-bal. sheet	derivatives	Included in
Annual Report	(accounting)	& sec fin	CRD off-bal.
Assets pledged as security for own liabilities	35,061	-35,061	
Contingent liabilities	15,836		15,836
Commitments	16,603		16,603
Total	67,500	-35.061	32.439

	Included in	Incl. in			
	CRD off-	CRD			
	bal. (from	(not in	Original		
Off-balance items in CRD	AR)	AR) ²	exposure	CCF%	Exposure
Credit facilities and credit accounts	13,435	4,676	18,111	31%	5,633
Loan commitments	2,767	259	3,026	26%	793
Guarantees	14,760		14,760	57%	8,415
Other (leasing and documentary					
credits)	1,476		1,476	31%	459
Total	32,439	4,935	37,374		15,301

Derivatives and securities financing	Original exposure	Exposure
Derivatives Securities Financing Transactions & Long Settlement	18,698	18,698
Transactions	1,740	1,740
Total credit risk (CRD definition)	211,238	189,038

1) The on-balance exposures can have a lower EAD than original exposure due to provisions in the standardised approach, financial collateral in the standardised approach and

 2) Off-balance exposures included in the CRD but not included in the Annual Report (AR), such as exposures related to undrawn credit facilities which are unconditionally cancellable.

4.2.1 On-balance sheet items

The following items have been excluded from the balance sheet, when calculating on-balance sheet exposure in accordance with the CRD:

- Market risk related items in the trading book, such as certain interest-bearing securities and pledged instruments.
- Repos, derivatives and securities lending. These transactions are either included in the calculation of market risk in the trading book or reported as separate exposure types (derivatives or securities financing).
- Other, mainly allowances, intangible assets and deferred tax assets.

4.2.2 Off-balance sheet items

The following off-balance sheet items specified in the Annual Report are excluded when off-balance sheet exposure is calculated in accordance with the CRD:

- Assets pledged as security for own liabilities and Other assets pledged (apart from leasing). These transactions are reported as securities financing (i.e. a separate exposure type).
- Derivatives.

4.2.3 Derivatives and securities financing

Derivatives can be both on-balance (i.e. positive fair value) and off-balance (i.e. nominal amounts) in accordance with accounting standards. However, in the CRD, the derivatives and securities financing are reported as separate exposure types. Also, repurchase agreements and securities lending/borrowing transactions are in the balance sheet calculated based on nominal value. In the CRD calculations these exposure types are determined net of collateral.

4.3 Credit risk approach

Nordea Bank Finland is approved by the Finnish FSA to use the IRB approach for the main part of the credit portfolio.

As of the balance date of this report, Nordea Bank Finland and Nordea Finance Finland used the FIRB approach for calculating the capital requirements in the institution and corporate exposure classes and the IRB approach for the retail exposure classes in Nordea Bank Finland (excluding foreign branches). In the Finance companies in Finland, Nordea Bank Finland is approved to use the Foundation IRB approach for the corporate and institution exposure classes. Other legal entities and exposure classes are reported according to the standardised approach.

In January 2014, Nordea Bank Finland was approved to use the AIRB approach for the majority of the corporate exposures. Nordea Bank Finland aims to continue the roll-out of the IRB approaches in the forthcoming years. Acquisitions of new portfolios are treated under the standardised approach until approved for the IRB approach by the supervisory authorities.

4.4 Development of exposure and RWA

This section includes an overview of the credit risk portfolio distribution. For more detailed information on the principles for RWA calculations under the IRB and standardised approaches see appendix 13.2 and 13.3.

Table 4.2 shows original exposure, exposure, average risk weight, RWA and the capital requirements, distributed by exposure class. Some exposure classes have been merged in the table due to insignificant exposure. The IRB exposure classes contain the portfolios for which Nordea Bank Finland has been approved to use IRB methods. The standardised approach is currently used for the remaining portfolios, such as Nordea Finance in the Baltics and Poland.

Tuble 1.2 cupitul lequilements for clean fisk, spin by exposure class, of December 2015

	Original		Average		Capital
EURm	exposure	Exposure	risk weight	RWA	requirement
IRB exposure classes					
Institutions	17,799	16,914	21%	3,490	279
Corporates	69,486	32,684	47%	15,217	1,217
Retail	34,637	32,954	12%	3,910	313
- of which mortgage	28,790	28,689	8%	2,430	194
- of which other retail	4,670	3,283	23%	739	59
- of which SME	1,178	982	75%	741	59
Other non-credit obligation assets	256	220	100%	220	18
Total IRB approach	122,179	82,773	28%	22,837	1,827
Standardised exposure classes					
Central government and central banks	40,618	43,511	0%	103	8
Regional governments and local authorities	2,688	3,054	4%	122	10
Institutions	28,970	47,192	22%	10,596	848
Corporates	1,528	1,153	100%	1,153	92
Retail	7,821	4,059	75%	3,045	244
Exposures secured by real estate	2,722	2,659	35%	931	74
Other ¹	4,712	4,637	16%	756	61
Total standardised approach	89,059	106,265	16%	16,706	1,336
Total	211,238	189,038	21%	39,543	3,163

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, past due items, short term claims, covered bonds and other items.

4.5 Credit risk exposure

4.5.1 *Exposure by exposure class and exposure type*

Table 4.3 shows exposures split by exposure class and exposure type. The average quarterly exposure in 2013, split by exposure type and exposure class is presented in Table 4.4.

	On-balance	Off-balance	Securities		
EURm	sheet items	sheet items	financing	Derivatives	Total
IRB exposure classes					
Institutions	10,217	703	803	5,192	16,914
Corporates	19,471	8,600	670	3,943	32,684
Retail	32,211	649	0	95	32,954
- of which mortgage	28,477	213			28,689
- of which other retail	2,987	233	0	62	3,283
- of which SME	747	203	0	33	982
Other non-credit obligation assets	215	6			220
Total IRB approach	62,113	9,957	1,473	9,230	82,773
Standardised exposure classes					
Central governments and central banks	41,055	499	107	1,850	43,511
Regional governments and local authorities	1,555	107	10	1,382	3,054
Institutions	37,411	4,688	56	5,037	47,192
Corporates	1,151	3			1,153
Retail	4,017	42		0	4,059
Exposures secured by real estate	2,656	3			2,659
Other ¹	3,341	2	94	1,200	4,637
Total standardised approach	91,186	5,343	267	9,469	106,265
Total exposure	153,299	15,301	1,740	18,698	189,038

Table 4.3 Exposure split by exposure class and exposure type, 31 December 2013

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, past due items, short-term claims, covered bonds and other items.

Table 4.4 Average quarterly exposure during 2013, split by exposure class and exposure type

	On-balance	Off-balance	Securities		
EURm	sheet items	sheet items	financing	Derivatives	Total
IRB exposure classes					
Institutions	10,660	858	597	5,523	17,638
Corporates	16,454	7,001	530	4,023	28,009
Retail	31,825	699	0	84	32,609
- of which mortgage	27,851	233			28,084
- of which other retail	3,217	266	0	51	3,533
- of which SME	757	201	0	33	991
Other non-credit obligation assets	194	5			198
Total IRB approach	59,133	8,564	1,127	9,630	78,454
Standardised exposure classes					
Central governments and central banks	36,348	531	234	1,971	39,085
Regional governments and local authorities	1,593	105	26	1,585	3,309
Institutions	45,723	6,113	73	6,161	58,070
Corporates	1,334	2		0	1,337
Retail	3,927	43	0	0	3,970
Exposures secured by real estate	2,507	3			2,510
Other ¹	3,442	5	127	730	4,304
Total standardised approach	94,874	6,802	460	10,447	112,584
Total exposure	154,007	15,366	1,588	20,078	191,038

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, past due items, short-term claims, covered bonds and other items.

4.5.2 *Exposure by geography*

In Table 4.5, exposure is split by geography, based on where the exposure is booked.

	-									
		- of	- of	- of	- of					
	Nordic	which	which	which	which	Baltic				
EURm	countries	Denmark	Finland	Norway	Sweden	countries	Poland	Russia	Other ²	Total
IRB exposure classes										
Institution	14,327		14,327			145			2,441	16,914
Corporate	20,380		20,380			2,853			9,451	32,684
Retail	32,954		32,954							32,954
- of which mortgage	28,689		28,689							28,689
- of which other retail	3,283		3,283							3,283
- of which SME	982		982							982
assets	167		167			41			13	220
Total IRB approach	67,829		67,829			3,039			11,905	82,773
Standardised exposure										
classes										
Central governments and										
central banks	16,981		16,981			555	0		25,974	43,511
Regional governments and	a 000		a 000			1.774				2.054
local authorities	2,880		2,880			1/4				3,054
Institution	44,588		44,588			1,894	0		710	47,192
Corporate	150		150			881	122		0	1,153
Retail	3,086		3,086			963			11	4,059
Exposures secured by real										
estates	513		513			2,146				2,659
Other ¹	4,455		4,455			181	1		0	4,637
Total standardised										
approach	72,653		72,653			6,794	123		26,695	106,265
Total exposure	140,482		140,482			9,834	123		38,599	189,038

Table 4.5 Exposure split by exposure class and geography, 31 December 2013

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, past due items, short-term claims, covered bonds, and other items. Associated companies not included in exposure.

2) Includes International Units.

4.5.3 Exposure by industry

Table 4.6 splits exposure by industry and by the main exposure classes. The industry breakdown mainly follows the Global Industries Classification Standard (GICS) and is based on NACE codes (statistical classification codes of economic activities in the European community).

		IRB appro	ach		Standardised approach		
					Central governments and	Regional governments and	
EURm	Institutions	Corporates	Retail	Other	central banks	local authorities	Other ¹
Retail mortgage			28,689				2,659
Other retail			3,283				4,059
Central and local governments					12,129	3,054	
Banks	14,082				31,381		47,127
Industry group							
Construction and engineering		1,210	120				39
Consumer durables (cars, appliances, e	tc.)	762	24				10
Consumer staples (food, agriculture etc	2.)	1,329	37				98
Energy (oil, gas, etc.)		1,085	1				3
Health care and pharmaceuticals		388	37				7
Industrial capital goods		2,245	9				4
Industrial commercial services		2,282	139				131
IT software, hardware and services		531	22				8
Media and leisure		361	91				8
Metals and mining materials		105	4				10
Other financial institutions Other materials (chemical, building	2,831	2,430	23				2,116
materials, etc.)		1,729	38				68
Other, public and organisations		1,906	20	220			2,972
Paper and forest materials Real estate management and		610	10				16
Investment		4,729	124				13
Retail trade		1,963	207				67
Shipping and offshore		4,215	3				0
Telecommunication equipment		112	1				0
Telecommunication operators		175	2				2
Transportation		1,170	66				276
Utilities (distribution and production)		3,346	5				7
Total exposure	16,914	32,684	32,954	220	43,511	3,054	59,701

Table 4.6 Exposure split by industry group and by main exposure class, 31 December 2013

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, standardised institutions, standardised corporates, standardised retail, standardised exposures secured by real estate, past due items, short term claims, covered bonds and other items.

4.5.3.1 Specification of exposure against central government and central banks

Nordea applies the standardised approach for exposure to central governments and central banks. In this approach, the rating from an eligible rating agency is converted to a credit quality step (the mapping is defined by the financial supervisory authorities). Each credit quality step corresponds to a fixed risk weight. Nordea uses Standard & Poor's as eligible rating agency. Table 4.7 presents the central government and central bank exposure distributed by credit quality step.

Credit quality step	- Standard & Poor's rating	Risk weight	Exposure (EURm)
1	AAA to AA-	0%	43,269
2	A+ to A-	20%	63
3	BBB+ to BBB-	50%	175
4 to 6 or blank	BB+ and below, or without rating	100 - 150%	3
Total			43,511

Table 4.7 Exposures to central governments and central banks, 31 December 2013

4.5.4 Specification of off-balance exposure

For the RWA calculation the off-balance amounts are converted to on-balance equivalents through the application of a CCF between 0% and 100%. The main categories within off-balance sheet items are guarantees, credit commitments and unutilised lines of credit. Credit commitments and unutilised lines of credit constitute external commitments that have not been utilised. The CCF is set depending on the calculation approach, product type and whether the commitments are unconditionally cancellable or not.

For the IRB retail portfolio an internal CCF model is used. The model is built on a product based approach. There are three explanatory variables that determine which CCF value an IRB retail off-balance exposure will receive: customer type, product type and country in which the reporting is made. The CCF is based on internal estimates of the expected total exposure at the time of default.

Table 4.8 shows the weighted average CCF for the IRB retail exposure.

Table 4.8 Average credit conversion factor and off-balance sheet exposure split by IRB exposure class, 31 December 2013

EURm	Exposure after substitution effects	Exposure	CCF
Retail	1,227	649	53%
- of which mortgage	313	213	68%
- of which other retail	577	233	40%
- of which SME	337	203	60%

4.5.5 Counterparty credit risk

Counterparty credit risk is the risk that Nordea's counterpart in an FX, interest, equity, credit or commodity derivative contract defaults prior to maturity of the contract and that Nordea at that time has a claim on the counterpart. Counterparty credit risk can also exist in repurchasing agreements and other securities financing transactions.

Derivative contracts are financial instruments, such as futures, forwards, swaps or options that derive their value from underlying interest rates, currencies, equities, credit spreads or commodity prices. The derivative contracts are often traded over the counter (OTC), which means the terms connected to the specific contract are individually defined and agreed on with the counterpart.

Nordea enters into derivative contracts based on customer demand, both directly and in order to hedge positions that arise through such activities. Group Treasury also uses interest rate swaps and other derivatives in its hedging activities of the assets and liability mismatches in the balance sheet. Furthermore, Nordea may, within clearly defined restrictions, use derivatives to take open positions in its operations. Derivatives affect counterparty credit risk and market risk as well as operational risk.

Counterparty credit risk is subject to credit limits like other credit exposure and is treated accordingly.

4.5.5.1 Pillar I method for counterparty credit risk

Nordea has approval from the FSAs in Sweden and Finland to use the internal model method (IMM) for calculating the regulatory counterparty credit risk (CCR) capital in accordance with the credit risk framework in the CRD. Nordea implemented the IMM approach for regulatory capital in the first quarter of 2013. The method is used for FX and interest rate products which constitute the predominant share of the CCR exposures in Nordea, while the mark-to-market method, also called the current exposure method (CEM), is

used for the remaining products. The IMM method implies that the exposure amount is calculated as a factor 1.4 times the effective expected positive exposure calculated one year ahead in time.

The expected exposure profile is calculated for IMM approved trades by simulating a large set of future scenarios for the underlying price factors and then revaluating the trade in each scenario at different time horizons.

In these calculations, netting is done of the exposure on contracts within the same legally enforceable netting agreement. Moreover, procedures are in place to take account for specific wrong-way risk (i.e. situations where the future exposure to a specific counterparty is positively correlated with the counterparty's probability of default due to the nature of the transactions with the counterparty).

For the remaining part, Nordea uses the CEM method for derivative exposures which is calculated using a standardised method for the sum of current exposure (replacement cost) and potential future exposure. The potential future exposure is an estimate reflecting possible changes in the future market value of the individual contract during the remaining life of the contract and is measured as the notional principal amount multiplied by the add-on factor. The size of the add-on factor depends on the contract's underlying asset and time to maturity. Table 4.9 shows the CCR exposures as well as RWA split by exposure class.

Nordea continues to clear interest rate derivatives and repos with central counterparties, mainly via LCH.Clearnet and Eurex. This serves to reduce both the current exposure and the potential future exposure.

Table 4.9 Counterparty credit risk exposures by exposure class, 31 December 2013

EURm	Exposure	RWA
IRB exposure classes		
Institution	5,192	1,563
Corporate	3,943	1,375
Retail	95	37
Total IRB approach	9,230	2,975
Standardised exposure classes		
Central government and central banks	1,850	88
Other	7,619	1,156
Total standardised approach	9,469	1,243
Total exposure	18,698	4,218

Exposures are after closeout netting and collateral agreements and only include derivatives.

4.5.5.2 Counterparty credit risk for internal credit limit purposes

Counterparty credit risk for internal credit limit purposes is for the main part of Nordea Bank Finland's OTC derivatives exposure calculated using a simulation model which is based on the internal model method (IMM). The model used for internal limit purposes (in contrast to the model used for regulatory CCR capital) is based on a stressed calibration. Model parameters are based on data from a specific three-year period, including a one-year period identified to have the most significant increase in credit spreads in recent times. Thereby general wrong-way risk is taken into account in counterparty credit risk management. In addition, the exposures included in IMM are subject to daily and periodic stress tests with the aim to identify adverse scenarios affecting exposures on counterparty, industry and country level. Table 4.10 presents the counterparty credit risk for different types of counterparties for internal exposures.

As of December 2013, the current exposure net (after close-out netting and collateral reduction) was EUR 8.9bn and the pre-settlement risk (current exposure and potential future exposure) was EUR 43.3bn, comprised of both simulated and non-simulated trades.

On traded OTC contracts, Nordea performs fair value adjustments, which are adjustments to the counterparty credit risk exposure made by including an estimate of the cost of hedging the specific counterparty credit risk. This cost of hedging is either based directly on market prices or on a theoretical calculation based on the credit rating of the counterparty.

The IMM is also used for internal capital purposes (EC framework).

Table 4.10 Counterparty credit risk exposures (internal), split by type of counterparty

_	31 December 2013		31 Decemb	er 2012
	Current exposure	Pre-settlement	Current exposure	Pre-settlement
EURm	net	risk	net	risk
To central banks and credit institutions	1,122	13,830	1,100	12,735
- of which credit institutions	956	13,038	946	11,970
- of which central banks	167	792	154	765
To the public	7,759	29,507	9,574	29,734
- of which corporate	7,590	28,470	9,389	28,943
Construction and engineering	84	168	119	167
Consumer durables (cars, appliances etc.)	67	337	76	257
Consumer staples (food, agriculture etc.)	259	575	371	670
Energy (oil, gas etc.)	11	97	13	163
Health care and pharmaceuticals	109	336	205	448
Industrial capital goods	70	469	79	375
Industrial commercial services, etc.	679	1,963	1,067	2,422
IT software, hardware and services	11	46	19	44
Media and leisure	75	261	116	235
Metals and mining materials	9	72	34	109
Other financial institutions	2,187	11,152	1,034	10,099
Other materials (chemical, building materials,	59	254	112	540
etc.) Other public and organisations	1 232	5 5 4 7	1 825	5 377
Paper and forest materials	1,232	3,547	1,825	301
Pool estate management and investment	97 1 /10	2 680	2 295	2 169
Real estate management and investment	1,419	2,660	2,293	5,108
Retail trade	189	625	248	749
	107	024	239	009
	106	48	150	45
Telecommunication operators	106	445	153	508
Iransportation	263	902	502	886
Utilities (distribution and production)	474	1,369	776	1,500
- ot which public sector	168	1,037	184	792
Total	8,881	43,337	10,674	42,470

4.5.5.3 Regulatory development

Nordea proactively upgrades its counterparty credit risk framework in order to be compliant with expected regulatory developments. One of the main expectations for regulatory development is the addition of capital to be held for potential counterparty migration termed credit valuation adjustment (CVA) risk.

4.5.5.4 Mitigation of counterparty credit risk exposure

To reduce the exposure towards single counterparties, risk mitigation techniques are used. The most common is the use of closeout netting agreements, which allow Nordea to net positive and negative replacement values of contracts under the agreement in the event of default of the counterparty. In addition, Nordea also mitigates the exposure towards large banks, hedge funds and institutional counterparties by an increasing use of financial collateral agreements, where collateral on daily basis is placed or received to cover the current exposure. The collateral is largely cash (EUR, USD, DKK, SEK and NOK), as well as government bonds and to a lesser extent mortgage bonds are accepted.

Table 4.11 shows counterparty credit risk mitigated through closeout netting and collateral agreements.

Table 4.11 Mitigation of counterparty credit risk exposure, 31 December 2013

	Current exposure	Reduction from closeout netting	Reduction from held	
EURm	(gross)	agreements	collateral	Current exposure net
Total	133,859	118,070	6,908	8,881

Nordea's financial collateral agreements do not normally contain any trigger dependent features, e.g. rating triggers. For a few agreements the minimum exposure level for further posting of collateral will be lowered in case of downgrading. Separate credit guidelines are in place for handling financial collateral agreements.

Finally, Nordea also uses a risk mitigation technique based upon a condition in some of the long-term derivative contracts, which gives the option to terminate a contract at a specific time or upon the occurrence of specified credit-related events.

4.5.5.5 Settlement risk

Settlement risk is a type of credit risk arising during the process of settling a contract or execution of a payment.

The risk amount is the principal of the transaction, and a loss could occur if a counterpart were to default after Nordea has given irrevocable instructions for a transfer of a principal amount or security, but before receipt of the corresponding payment or security has been finally confirmed.

The settlement risk on individual counterparts is restricted by settlement risk limits. Each counterpart is assessed in the credit process and clearing agents, correspondent banks and custodians are selected with a view of minimising settlement risk.

Nordea is a shareholder of, and participant in, the global FX clearing system CLS (Continuous Linked Settlement), which eliminates the settlement risk of FX trades in those currencies and with those counterparts that are eligible for CLS clearing.

4.5.6 Other items

In the exposure class Other items, Nordea's equity holdings in the banking book are included. Investments in companies in which Nordea Bank Finland holds over 10% of the capital are deducted from the capital base (see Table 2.1) and are hence not included in Other items. For more information about equity holdings in the banking book see section 5.7.

4.6 Rating and scoring

4.6.1 Rating and scoring definition

The common denominator of the rating and scoring is the aim to predict defaults and rank customers according to their default risk. Rating and scoring are used as integrated parts of the credit risk management and decision-making process, including:

- The credit approval process
- Calculation of RWA
- Calculation of economic capital and expected loss (EL)
- Monitoring and reporting of credit risk
- Performance measurement using the economic profit (EP) framework
- Collective impairment assessment

While rating is used for corporate and institution exposure, scoring is used for retail exposure.

A rating is an estimate that reflects the risk of customer default. The rating scale in Nordea consists of 18 grades; from 6+ to 1– for non-defaulted customers and three grades from 0+ to 0– for defaulted customers. The default risk of each rating grade is quantified by a one-year PD. Rating grades 4– and better are comparable to investment grade as defined by rating agencies such as Moody's and Standard & Poor's (S&P). Rating grades 2+ and lower are considered as weak or critical, and require special attention.

Rating	
Internal	Standard & Poor's
6+, 6, 6-	AAA to AA-
5+, 5, 5-	A+ to A-
4+, 4, 4-	BBB+ to BBB-
3+, 3, 3-	BB+ to BB-
2+, 2, 2-,1+	B+ to B-
1, 1-	CCC
0+, 0, 0-	D

Table 4.12 Indicative mapping between internal ratings and the S&P rating scale

The mapping of the internal ratings to S&P's rating scale, shown in Table 4.12, is based on a predefined set of criteria, such as comparison of default and risk definitions. The mapping does not intend to indicate a fixed relationship between Nordea's internal rating grades and S&P's rating grades since the rating approaches differ.

Ratings are assigned in conjunction with credit proposals and the annual review of the customers, and are approved by the credit committees. However, a customer is down-graded as soon as new information indicates a need for it. The consistency and transparency of the ratings are ensured by the use of rating models. A rating model is a set of specified and distinct rating criteria which, given a set of customer characteristics, produces a rating. It is based on the predictability of customers' future performance based on their characteristics.

Nordea has different rating models for different customer types to better reflect the risk. Rating models have therefore been developed for several general as well as specific segments such as real estate management and shipping. Different methods ranging from statistical to purely expert-based, depending on the segment in question, have been used when developing the rating models. The models are largely based on an overall framework, in which financial factors are combined with qualitative factors as well as customer factors.

Models used in the household segment and for the SME retail segment are based on scoring, which is a statistical technique used to predict the probability of customer default. The models are based on internal data and takes account customer characteristics as well as behavioural information of the customer. The models are used to support both the credit approval process, e.g. automatic approvals or decision support, and the risk management process, e.g. "early warning" for high risk customers and monitoring of portfolio risk levels. As a supplement to the scoring models, credit bureau information is used in the credit process. The scoring models are used to predict PDs, in order to calculate the economic capital and RWA for customers. The risk grade scale used for scored customers in order to represent the scores consists of 18 grades, named A+ to F– for non-defaulted customers and three grades from 0+ to 0– for defaulted customers.

Nordea has established an internal validation process in accordance with the CRD requirements with the aim to ensure and improve the performance of the models, procedures and systems and to ensure the accuracy of the PD estimates.

The rating and scoring models are validated annually and the validation includes both a quantitative and a qualitative validation. The quantitative validation includes statistical tests of the models' discriminatory power, i.e. the models' ability to distinguish default risk on a relative basis, and cardinal accuracy, i.e. the ability to predict default levels.

The Parameters, Scoring and Rating Models Validation subcommittee, a sub-committee to the Asset and Liability committee and the Risk Committee, is responsible for the approval of the annual rating and scoring model validations, as well as approval of proposals concerning the credit risk model validation framework.

4.6.2 Point-in-time vs. Through-the-cycle

A point-in-time (PIT) rating system uses all currently available obligor-specific and aggregate information to assign obligors to risk buckets. All obligors within a risk grade share roughly the same unstressed PD, and an obligor's rating is expected to change rapidly as its economic prospects change. A through-the-cycle (TTC) rating system uses static and dynamic obligor characteristics but tends not to adjust ratings in response to changes in macroeconomic conditions. The distribution of ratings across obligors will not change significantly over the business cycle, and an obligor's rating is expected to change only when its own dynamic characteristics change.

The rating models Nordea uses for exposure classes corporate and institution exhibits characteristics of both TTC and PIT rating philosophies. For the retail portfolio, Nordea currently employs a set of scoring models which are close to PIT.

4.6.3 Rating and risk grade distribution

4.6.3.1 Rating grade distribution of the IRB institution portfolio

Figure 4.2 shows the rating grade distribution of the IRB institution portfolio. In December 2013, approximately 98% (99%) of the institution exposure was found in the rating grades 4 and higher.

Figure 4.2 Exposure distributed by rating grade, IRB institution



4.6.3.2 Rating grade distribution of the IRB corporate portfolio

Figure 4.3 shows the rating grade distribution of the IRB corporate portfolio. In December 2013, approximately 84% (88%) of the IRB corporate exposure was found in the rating grades 4- and above.

Figure 4.3 Exposure distributed by rating grade, IRB corporate



4.6.3.3 Risk grade distribution of the IRB retail portfolio

Figure 4.4 shows the risk grade distribution of the IRB retail portfolio. As of end 2013, approximately 90% (91%) of the retail exposure was found in the risk grades C- and above.



Figure 4.4 Exposure distributed by risk grade, IRB retail

4.6.4 Rating and risk grade migration

The rating and risk grade distribution changes mainly due to three factors:

- Changes in rating/risk grade for existing customers (pure migration).
- Different rating/risk grade distribution of new customers and customers leaving Nordea, compared to the rating/risk grade distribution of existing customers during the comparison period.
- Increased or decreased exposure per rating/risk grade to existing customers.

Rating migration is affected by macroeconomic development, industry sector developments, changes in business opportunities and development in financial situation of the customers and other company related factors. Risk grade migration is among other things affected by macroeconomic development and customers' repayment capacity.

4.7 Collateral

4.7.1 Loss Given Default

Table 4.13 shows the exposure secured by eligible collateral, guarantees and credit derivatives, split by exposure class. Under the FIRB approach LGD estimates are predefined by legislation. The LGD values for the retail portfolios using IRB approach are based on an internal model, and divided into pools of collateral that are based on historical loss data.

Table 4.13 Exposure secured by collaterals, guarantees and credit derivatives, split by exposure class, 31 December 2013									
			- of which secured by	- of which	Average				
	Original		guarantees and	secured by	weighted				
EURm	exposure	Exposure	credit derivatives	collateral	LGD				
IRB exposure classes									
Institution	17,799	16,914	153	116	32.0 %				
Corporate	69,486	32,684	27,450	7,997	42.7 %				
Retail	34,637	32,954	1,105	29,924	12.6 %				
- of which mortgage	28,790	28,689		28,689	11.0 %				
- of which other retail	4,670	3,283	1,044	593	22.2 %				
- of which SME	1,178	982	61	641	30.1 %				
Other non-credit obligation assets	256	220	1	1	n.a.				
Total IRB approach	122,179	82,773	28,709	38,037					
Standardised exposure classes									
Central government and central banks	40,618	43,511	51						
Regional governments and local authorities	2,688	3,054							
Institution	28,970	47,192							
Corporate	1,528	1,153							
Retail	7,821	4,059	62						
Exposures secured by real estates	2,722	2,659		2,659					
Other ¹	4,712	4,637	2						
Total standardised approach	89,059	106,265	116	2,659					

1) Administrative bodies and non-commercial undertakings, multilateral developments banks, standardised institution, standardised corporate, past due items, short term claims, covered bonds and other items. Associated companies not included in exposure.

4.7.1.1 Guarantees and credit derivatives

The guarantees used as credit risk mitigation are to a large extent issued by central and regional governments in the Nordic countries. Banks and insurance companies are important guarantors of credit risk.

Only eligible providers of guarantees and credit derivatives can be recognised in the standardised and IRB approach for credit risk. All central governments, regional governments and institutions are eligible as well as some multinational development banks and international organisations. Guarantees issued by corporate entities can only be taken into account if their rating corresponds to A– (S&P's rating scale) or better.

Credit derivatives are only used as credit risk protection to a very limited extent in Nordea Bank Finland since the credit portfolio is considered to be well diversified.

4.7.1.2 Collateral distribution

Table 4.14 presents the distribution of collateral used in the capital adequacy calculation process. The table shows real estate to have the major share of eligible collateral items in relative terms.

Table 4.14 Distribution of collateral, 31 December 2013	
Financial collateral	2%
Receivables	2%
Residential real estate	82%
Commercial real estate	8%
Other physical collateral	7%

4.7.1.3 Valuation principles of collateral

A conservative approach with long-term market values taking volatility into account is used as valuation principle for collaterals when defining the maximum collateral ratio. Valuation and hence eligibility of collaterals is based on the following principles:

- Market value is assessed; markets must be liquid, public prices must be available and the collateral is expected to be liquidated within a reasonable time frame.
- A reduction of the collateral value is to be considered if the type, location or character (such as deterioration and obsolescence) of the asset indicates uncertainty regarding the sustainability of the market value. Assessment of the collateral value also reflects the previously experienced volatility of market.
- Forced sale principle: assessment of market value or the collateral value must reflect that realisation of collaterals in a distressed situation is initiated by Nordea.
- No collateral value is to be assigned if a pledge is not legally enforceable and/or if the underlying asset is not adequately insured against damage.

4.8 Estimation and validation of credit risk parameters

Nordea has established an internal process, aimed at ensuring and improving the performance of models, procedures and systems and at ensuring the accuracy of the parameters.

The PD, LGD and CCF parameters are validated annually. The validation includes both a quantitative and a qualitative validation. The quantitative validation includes statistical tests to ensure that the estimates are still valid when new data is added.

The estimation process is linked to the validation since the estimates used for the PD scale are based on Nordea's actual default frequency (ADF).

The PD estimation, and hence the validation, takes into account that the rating models used for corporate and institution customers have a higher degree of TTC than the scoring models used for retail customers. The PD estimates are based on the long-term default experience and adjusted by adding a margin of conservatism between the average PD and the average ADF. This add-on consists of two parts, one that compensates for statistical uncertainty whereas the other constitutes a business cycle adjustment of the rating and scoring models. Table 4.15 shows expected loss, actual gross loss and net loss for the last three years.

Note that the EL will vary over time due to changes in the rating and the collateral coverage distributions, but the average long-term net loss is expected to be in line with the average EL disregarding the fact that EL includes margins for statistical uncertainty and, in the case of LGD, a downturn add-on.

Table 4.15 Expected loss vs. gross loss and net loss Retail household

_	Retail Household					
EURm	Mortgage	Other	Corporate ¹	Institution	Government	Total
2013						
EL	-9	-19	-87	-4	0	-118
Gross loss	-37	-34	-119			-191
Net loss	-12	-8	-33			-53
2012						
EL	-13	-27	-106	-7	-1	-154
Gross loss	-46	-49	-242			-336
Net loss	4	-14	-135			-144
2011						
EL	-15	-35	-105	-10	-1	-166
Gross loss	-30	-58	-188			-275
Net loss	-2	-33	-35			-70

1) Includes SME retail

4.9 Loan portfolio, impaired loans and loan losses

In the tables 4.16-4.19 impaired loans, loan losses and allowances are distributed and stated according to International Financial Reporting Standard (IFRS) as in the Annual Report which differs somewhat from CRD.

4.9.1 Definition and methodology of impairment

Weak and impaired exposure is closely and continuously monitored and reviewed at least on a quarterly basis in terms of current performance, business outlook, future debt service capacity and the possible need for provisions. A need for provisioning is recognised if there is objective evidence, based on loss events or observable data, that there is an impact on the customer's future cash flow to the extent that full repayment is unlikely, collaterals taken into account. Exposures with provision are considered impaired. The size of the provision is equal to the estimated loss, which is the difference between the book value of the outstanding exposure and the discounted value of the future cash flow, including the value of pledged collaterals. Impaired exposures can be either performing or non-performing. Exposures that are past due more than 90 days is automatically regarded as in default, and reported as non-performing and impaired, or not impaired depending on the deemed loss potential.

In addition to individual impairment testing of all individually significant customers, collective impairment testing is performed for groups of customers not identified individually as impaired. Collective impairment is based on the migration of rated and scored customers in the credit portfolio. The assessment of collective impairment relates to both up- and downgrades of customers, as well as new customers entering and those leaving the portfolio. Moreover, customers going to and from default affect the calculation. Collective impairment is assessed quarterly for each legal unit.

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 day. Impairment losses recognised for a group of loans represent an interim step pending the identification of impairment losses for an individual customer.

Table 4.16 Loans and receivables, impaired loans, allowances and provisioning ratios, split by customer type, 31 December 2013

		Immediated	Impaired	Allower cos for		Total
	Loans after	loans before	loans in % of	collectively	Specific	provisioning
EURm	allowances	allowances	receivables	assessed loans	allowances	ratio
To central banks and credit						
institutions	35,767	24	0.07	0	25	102%
- of which central banks	657 25 110	24	0.07	0	25	1029/
- of which credit institutions	35,110	24	0.07	0	25	102%
To the public	113,779	1,984	1.74	125	689	41%
- of which corporate	74,895	1,469	1.96	88	566	44%
Construction and engineering	947	53	5.61	2	18	39%
consumer durables (cars,	855	25	2 90	1	12	52%
Consumer staples (food,	000	25	2.90	1	12	5278
agriculture, etc.)	1,872	19	1.01	1	9	53%
Energy (oil, gas, etc.)	698	2	0.31	0	2	77%
Financial institutions	355	12	3.37	0	4	38%
Health care and pharmaceuticals	805	56	6.94	2	21	40%
Industrial capital goods	1 627	146	8 97	1	73	50%
Industrial commercial services,	1,027		0.07	-		0070
etc.	357	53	14.89	1	23	44%
IT software, hardware and	(21	F1	0.15	0	22	469/
services	631	51	8.15	0	23	40%
Media and leisure	313	45	14.51	3	20	49%
Metals and mining materials	1,103	56	5.03	0	30	55%
building materials, etc.)	1,991	195	9.78	15	100	59%
Other, public and organisations	42,459	36	0.09	11	35	126%
Paper and forest materials	840	1	0.15	2	0	190%
Real estate management and	0 = (0	210	0.51	22	10	2004
investment	9,560	240	2.51	22	48	29%
Retail trade	2,710	194	7.14	1	81	42%
Shipping and offshore	4,073	255	6.27	22	61	32%
Telecommunication equipment	29	4	13.60		2	60%
Telecommunication operators	411	0	0.10	0	0	88%
Transportation	1,454	24	1.66	1	4	23%
utilities (distribution and production)	1 806	1	0.08	1	0	80%
production	1,000	1	0.00	1	0	0078
- of which household	38,156	514	1.35	38	123	31%
Mortgage financing	30,723	275	0.89	9	56	24%
Consumer financing	7,433	239	3.22	28	67	40%
- of which public sector	728					
ł						
Total in banking operations	149,546	2,008	1.81	125	714	42%

				Allowances for		Total
ET ID	Loans after	Impaired loans	Impaired loans	collectively	Specific	provisioning
EUKM	allowances	before allowances	in % of loans	assessed toans	allowances	ratio
Nordic countries	76,190	1,268	1.66	98	482	46%
- of which Denmark	9,842					
- of which Finland	57,874	1,268	2.19	98	482	46%
- of which Norway	125					
- of which Sweden	8,348					
Estonia	3,281	83	2.52	10	23	40%
Latvia	2,760	264	9.56	9	79	33%
Lithuania	2,357	105	4.46	8	38	44%
Poland	129	1	0.82		0	31%
Russia	128					
EU countries other	17,997	13	0.07		7	53%
USA	1,273					
Asia	1,412	251	17.75		60	24%
Latin America	409					
OECD other	303					
Non-OECD other	7,539					
Total	113,779	1,984	1.74	125	689	41%

Table 4.17 Loans to the public, impaired loans, allowances and provisioning ratios, split by geography, 31 December 2013

Table 4.18 Reconciliation of allowance accounts for impaired loans, 2013

Loans and receivables, EURm	Individually assessed	Collectively assessed	Total
Opening balance, 1 Jan 2013	-657	-178	-835
Provisions	-177	-39	-216
Reversals	55	49	104
Changes through the income statement	-122	10	-112
Allowances used to cover write-offs	104		104
Currency translation differences and reclassifications	-39	43	4
Closing balance, 31 Dec 2013	-713	-125	-839

Opening balance, 1 Jan 2012	-576	-236	-812
Provisions	-218	-46	-264
Reversals	42	103	146
Changes through the income statement	-176	58	-118
Allowances used to cover write-offs	92		92
Currency translation differences	3	0	3
Closing balance, 31 Dec 2012	-657	-178	-835

Table 4.19 Loan losses, 2013

EURm	
Loan losses divided by class, net	
Loans and receivables to credit institutions	0
- of which write-offs and provisions	0
- of which reversals and recoveries	0
Loans and receivables to the public	-56
- of which write-offs and provisions	-183
- of which reversals and recoveries	127
Off-balance sheet items	3
- of which write-offs and provisions	-8
- of which reversals and recoveries	11
Total	-53
Specification of loan losses	
Changes of allowance accounts in the balance sheet	-110
- of which loans and receivables	-113
- of which off-balance sheet items	3
Changes directly recognised in the income statement	57
- of which realised loan losses	33
- of which realised recoveries	24
Total	-53

5. Market risk

The market risk taking activities of Nordea Bank Finland are primarily focused on the Nordic and European markets. The total consolidated market risk for Nordea Bank Finland, measured by VaR, was EUR 43m on average in 2013, compared to EUR 31m in 2012. The total market risk, measured by VaR, is primarily driven by interest rate risk.

5.1 Management, governance and measurement of market risk

Market risk is defined as the risk of value loss in Nordea's holdings and transactions as a result of changes in market rates and parameters that affect the market value, for example changes to interest rates, credit spreads, FX rates, equity prices, commodity prices and option volatilities.

5.1.1 Management of market risk

Nordea Markets and Group Treasury are the key contributors to market risk in the Nordea Group. Nordea Markets is responsible for the customer-driven trading activities, whereas Group Treasury is responsible for funding activities, asset and liability management, liquidity portfolios, pledge/collateral portfolios and investments for Nordea's own account. For all other banking activities, the basic principle is that market risks are transferred to Group Treasury where the risks are managed.

5.1.1.1 Structural market risks

In addition to the immediate change in the market value of Nordea's assets and liabilities that could be caused by a change in financial market variables, a change in interest rates could also affect the net interest income over time. In Nordea this is seen as structural interest income risk (SIIR).

5.1.2 Governance of market risk

Group Risk Management has the responsibility for the development and maintenance of the group-wide market risk framework. The framework defines common management principles and policies for the market risk management in the Nordea Group. These principles and policies are approved by the Group Board of Directors and have been endorsed by the Board of Directors in Nordea Bank Finland. The same reporting and control processes are applied for market risk exposures in both the trading and banking books, on a Nordea Group level as well as in Nordea Bank Finland.

Transparency in the risk management process is central to maintaining risk awareness and a sound risk culture throughout the organisation. This transparency is achieved through:

- A comprehensive Group-wide policy framework, in which responsibilities and objectives are explicitly outlined and in which the risk appetite is clearly defined.
- Clearly defined risk mandates, in terms of limits and restrictions on which instruments may be traded.
- A framework for approval of traded financial instruments and valuation methods that require an elaborate analysis and documentation of the instruments' features and risk factors.
- Proactive information sharing between trading and risk control.
- Timely reporting to senior management on market risk development. The Group CRO receives reporting on the Group's consolidated market risk daily, whereas GEM, the Board of Directors and associated risk committees receive reports on a monthly basis. The Board of Directors in Nordea Bank Finland receives a report of Nordea Bank Finland's consolidated market risk quarterly.

5.1.3 Measurement of market risk

As there is no single risk measure that captures all aspects of market risk, Nordea uses several risk measures including Value-at-Risk (VaR), stressed VaR, stress testing, scenario simulation and other non-statistical risk measures such as basis point values, net open positions and option key figures. In addition, specific simulation-based models are used to capture the default and migration risks from corporate debt, credit derivatives and correlation products in the trading book. These are the Incremental Risk Measure (IRM) and

the Comprehensive Risk Measure (CRM).

5.1.3.1 Value-at-Risk

Nordea calculates VaR using historical simulation. The current portfolio is revaluated using the daily changes in market prices and parameters observed during the last 500 trading days, thus generating a distribution of 499 returns based on empirical data. From this distribution, the expected shortfall method is used to calculate a VaR figure, meaning that the VaR figure is based on the average of the worst outcomes from the distribution. The 1-day VaR figure is subsequently scaled to a 10-day figure. The 10-day VaR figure is used to limit and measure market risk both in the trading book and in the banking book.

Separate VaR figures are calculated for interest rate, credit spread, foreign exchange rate and equity risks. The total VaR includes all these risk categories and allows for diversification among them. The VaR figures include both linear positions and options. The model has been calibrated to generate a 99% VaR figure. This means that the 10-day VaR figure can be interpreted as the loss that will be exceeded in one of hundred 10-day trading periods.

It is important to note that while every effort is made to make the VaR model as realistic as possible, all VaR models are based on assumptions and approximations that have significant effect on the risk figures produced. While historical simulation has the advantage of not being dependent on a specific assumption regarding the distribution of returns, it should be noted that the historical observations of the market variables that are used as input, may not give an adequate description of the behaviour of these variables in the future. The choice of the time period used is also important. While using a longer time period may enhance the model's predictive properties and lead to reduced cyclicality, using a shorter time period increases the model's responsiveness to sudden changes in the volatility of financial markets. Nordea's choice to use the last 500 days of historical data has thus been made with the aim to strike a balance between the pros and cons from using longer or shorter time series in the calculation of VaR.

5.1.3.2 Stressed VaR

Stressed VaR is calculated using a similar methodology as the ordinary VaR measure. However, whereas the ordinary VaR model is based on data from the last 500 days, stressed VaR is based on a specific 250 day period with considerable stress in financial markets. Since the relevant period with stressed markets will depend on the positions currently held in the portfolio, the level of the stressed VaR in relation to the ordinary VaR is monitored continuously. Further analysis may be conducted if deemed necessary, which may lead to a change of the period. The specific period to be used is at least evaluated once every year.

5.1.3.3 Incremental Risk Measure (IRM)

The IRM measures the risk of losses due to the credit migration or default of issuers of tradable corporate debt or credit derivatives held in the trading book. Nordea's IRM model is based on Monte Carlo simulations and measures risk at a 99.9% probability level over a one-year horizon.

5.1.3.4 Comprehensive Risk Measure (CRM)

The CRM measures the total risk related to positions in credit correlation products. This includes the risk of losses due to the credit migration or default of issuers of tradable corporate debt and other risk factors specifically relevant for correlation products. Nordea's CRM model is also based on Monte Carlo simulations and measures risk at a 99.9% probability level over a one-year horizon.

5.1.3.5 Stress testing

Stress tests are used to estimate the possible losses that may occur under extreme market conditions. The main types of stress tests include:

- 1. Subjective stress tests, where the portfolios are exposed to scenarios for financial developments that are deemed particularly relevant at a particular time. The scenarios are inspired by the financial, the macroeconomic or geopolitical situation, or the current composition of the portfolio.
- 2. Sensitivity tests, where rates, prices, and/or volatilities are shifted markedly to emphasize exposure to situations where historical correlations fail to hold. Another sensitivity measure used is the potential

loss stemming from a sudden default of an issuer of a bond or the underlying in a credit default swap.

3. Reversed stress tests. These assess and try to identify the type of events that could lead to losses equal to or greater than a pre-defined level.

Subjective stress tests and sensitivity tests are conducted periodically for the consolidated risk across the banking book and trading book. Reversed stress tests are conducted quarterly for the trading book.

While these stress tests measure the risk over a shorter time horizon, market risk is also a part of Nordea's comprehensive firm-wide ICAAP stress test, which measures the risk over a three-year horizon. For further information on group-wide stress tests, see chapter 9.

5.2 Consolidated market risk for Nordea Bank Finland

The consolidated market risk for Nordea Bank Finland presented in Table 5.1 includes both the trading book and the banking book. The total VaR was EUR 91m at the end of 2013 (EUR 22m at the end of 2012). The increase in total VaR over the year is mainly related to the increase in interest rate VaR, which is a reflection of changed positions and an increased interest rate level. Interest rate VaR was EUR 95m (EUR 13m), with the largest part of the interest rate sensitivity stemming from interest rate positions in EUR, SEK and DKK. The diversification effect between risk categories has decreased significantly. This is to a large extent a consequence of the significant increase in interest rate VaR relative to the other risk categories. Commodity risk was at an insignificant level.

EURm	Measure	31 Dec 2013	2013 high	2013 low	2013 avg	31 Dec 2012
Total risk	VaR	90.5	98.4	16.6	43.0	22.3
- Interest rate risk	VaR	95.0	102.3	16.5	47.1	12.6
- Equity risk	VaR	3.2	4.7	0.1	1.8	2.3
- Credit spread risk	VaR	14.5	21.8	6.1	13.5	11.2
- Foreign exchange risk	VaR	4.2	12.0	2.4	5.2	13.1
Diversification effect		23%	60%	17%	39%	44%

Table 5.1 Consolidated market risk figures for Nordea Bank Finland, 31 December 2013

5.3 Market risk for the trading book

The market risk for the trading book in Nordea Bank Finland is presented in Table 5.2. Total VaR was EUR 38m at the end of 2013 (EUR 22m at the end of 2012). The increase in total VaR over the year is mainly related to the increase in interest rate VaR, which is a reflection of changed positions and an increased interest rate level. Interest rate VaR was EUR 40m (EUR 11m), with the largest part of the interest rate sensitivity stemming from interest rate positions in EUR, SEK and DKK.

Table 5.2 Market risk	(VaR) for the trading	book, 31 December 2013
-----------------------	-----------------------	------------------------

EURm	Measure	31 Dec 2013	2013 high	2013 low	2013 avg	31 Dec 2012
Total risk	VaR	38.3	56.2	11.2	22.7	21.5
- Interest rate risk	VaR	39.8	57.8	9.5	22.5	10.8
- Equity risk	VaR	3.2	4.7	0.1	1.8	2.4
- Credit spread risk	VaR	14.0	21.3	5.9	13.0	10.7
- Foreign exchange risk	VaR	4.1	12.0	2.3	5.1	13.1
Diversification effect		38%	66%	27%	48%	43%
Total stressed VaR	sVaR	78.0	83.4	35.9	49.9	42.9

5.4 Capital requirements for market risk in the trading book (Pillar I)

Market risk in the CRD context contains two categories: general risk and specific risk. General risk is related to changes in overall market prices and specific risk is related to price changes for specific issuers. When calculating the capital requirements for market risk using the internal model approach, general risk is based on VaR with an additional capital charge for stressed VaR, whereas specific risk is based on equity VaR and credit spread VaR with an additional capital charge for incremental risk and comprehensive risk for interest rate risk bearing positions.

Nordea Bank Finland uses the internal model approach to calculate the market risk capital requirements for the predominant part of the trading book. However, for specific interest rate risk relating to mortgage bonds, for specific equity risk relating to structured equity options and for commodity risk, the market risk capital requirements are calculated using the standardised approach. The use of the internal model approach in Nordea Bank Finland is shown in Table 5.3

In addition to positions in the trading book, market risk capital requirements also cover FX risk in the banking book through the standardised approach.

By the end of 2013, RWA and the capital requirements for market risk in the trading book were EUR 8,048m (EUR 4,732m) and EUR 644m (EUR 379m), respectively. The decomposition of the current figures is presented in Table 5.4. RWA was significantly increased during the year as a consequence of increased risk levels in the trading book (mainly interest rate risk) due to the move of exposures from Nordea Bank Denmark as well as increase risk under the internal model approach.

Table 5.3 Methods for calculating capital requirements

	Interest	rate risk	Equity		
	General	Specific	General	Specific	FX risk
Nordea Bank Finland	IA	IA^1	IA	IA1	IA
IA. internal model engrees of					

IA: internal model approach

1) The capital requirement for specific interst rate risk from Danish mortgage bonds and specific equity risk from structured equity options is calculated according to the standardised approach.

	Tradi	ing book, IA	Tradi	ing book, SA	Bank	ing book, SA		Total
EURm	RWA	Capital requirement	RWA	Capital requirement	RWA	Capital requirement	RWA	Capital requirement
Interest rate risk ¹	1,756	140	2,042	163			3,798	304
Equity risk	97	8	306	25			404	32
Foreign exchange risk	235	19			191	15	426	34
Commodity risk			246	20			246	20
Diversification effect	-1,002	-80					-1,002	-80
Stressed VaR	2,751	220					2,751	220
Incremental Risk Charge	1,003	80					1,003	80
Comprehensive Risk Charge	421	34					421	34
Total	5,262	421	2,595	208	191	15	8,048	644

Table 5.4 RWA and capital requirements for market risk, 31 December 2013

1) Interest rate risk in column IA only includes general interest rate risk while column SA includes both general and specific interest rate risk

5.4.1 Backtesting and validation of risk models

Backtesting of the VaR models is conducted daily in accordance with the guidelines laid out by the Basel Committee on Banking Supervision. Backtests are conducted using both hypothetical profit/loss and actual profit/loss (hypothetical profit/loss is the profit/loss that would have been realised if the positions in the portfolio had been held constant during the following trading day). The profit/loss is in the backtest compared to one-day VaR figures. The models used in the calculation of the IRM and the CRM are validated through an assessment of the quantitative and qualitative reasonableness of the various data being modelled (distribution of defaults and credit migrations, dynamics of credit spreads, recovery rates and correlations, etc.). The input parameters are evaluated through a range of methods including sensitivity tests and scenario analysis.

5.5 Interest rate risk in the banking book

Monitoring of the interest rate risk in the banking book is done daily by measuring and monitoring VaR on the banking book and by controlling interest rate sensitivities, which measure the immediate effects of interest rate changes on the economic values of assets, liabilities and off-balance sheet items. As of end 2013, the interest rate VaR in the banking book of Nordea Bank Finland was EUR 60m (EUR 9m at the end of 2012). Table 5.5 shows the net effect on economic value of a parallel shift in rates of up to 200 basis points.

EURm	+200 bp	+100 bp	+50 bp	-50 bp	-100 bp	-200 bp
EUR	-136.8	-68.6	-34.3	34.4	68.9	137.7
USD	38.6	19.3	9.7	-9.7	-19.3	-38.6
CHF	-4.8	-2.4	-1.2	1.2	2.4	4.8
SEK	-2.2	-1.1	-0.5	0.5	1.1	2.2
DKK	-1.9	-0.9	-0.5	0.5	0.9	1.9
Total	-105.1	-52.7	-26.4	26.5	53.0	105.9

Table 5.5 Interest rate sensitivities for the banking book, instantaneous interest rate movements, 31 December 2013

The totals are netted and include currencies not specified.

5.6 Structural Interest Income Risk

Structural Interest Income Risk (SIIR) is the amount Nordea's accumulated net interest income would change during the next 12 months if all interest rates were to change by one percentage point. SIIR reflects the mismatch in the balance sheet items and the off-balance sheet items when the interest rate repricing periods, volumes or reference rates of assets, liabilities and derivatives do not correspond exactly.

Nordea's SIIR management is based on policy statements resulting in different SIIR measures and organisational procedures. Policy statements focus on optimising financial structure, balanced risk taking and reliable earnings growth, identification of all significant sources of SIIR, measurement under stressful market conditions and adequate public information. Group Treasury has the responsibility for the operational management of SIIR.

5.6.1 SIIR measurement methods

Nordea's SIIR is measured through dynamic simulations by calculating several net interest income scenarios and comparing the difference between these scenarios. Several interest rate scenarios are applied, but the basic measures for SIIR are the two scenarios (increasing rates and decreasing rates). These scenarios measure the effect on Nordea's net interest income for a 12 month period of a one percentage point change in all interest rates (as shown in Table 5.6, which also covers repricing gaps over 12 months). The balance sheet and margins on assets and liabilities are assumed to be constant over time. Main elements of the customer behaviour and Nordea's decision-making process concerning Nordea's own rates are however taken into account.

Table 5.6 Repricing gap analysis, scenario of a one percentage point increase in all rates, 31 December 2013

		Interest Rate Fixing Period							
EURm	Group balance sheet	Within 3 months	3-6 months	6-12 months	1-2 years	2-5 years	>5 years	Non- repricing	Total
Interest-bearing assets	224,338	124,001	10,492	8,614	3 <i>,</i> 596	4,770	2,089	70,776	224,338
Non-interest bearing assets	80,423	0	0	0	0	0	0	80,423	80,423
Total assets	304,761	124,001	10,492	8,614	3,596	4,770	2,089	151,199	304,761
Interest-bearing liabilities	207,895	102,650	17,013	4,014	2,122	5,347	4,680	72,070	207,895
Non-interest bearing liabilities	96,866	0	0	0	0	0	0	96,866	96,866
Total liabilities and equity	304,761	102,650	17,013	4,014	2,122	5,347	4,680	168,936	304,761
Off-balance sheet items, net		-9,596	6,028	-3,057	702	1,911	3,573		
Exposure		11,755	-493	1,542	2,176	1,335	983	-17,736	
Cumulative exposure			11,261	12,804	14,979	16,314	17,297	-440	
SIIR impact of increasing interest rates for t	he year 2014	100	2						

Impact ¹	103	-2	4
Cumulative SIIR impact	103	101	104

1) Impact is calculated based on +100bps change on exposure

5.6.2 SIIR analysis

At the end of the year, the SIIR for increasing market rates in Nordea Bank Finland was EUR 104m (EUR 121m) and the SIIR for decreasing market rates was EUR -59m (EUR -75m). These figures imply that net interest income would increase if interest rates rise and decrease if interest rates fall.

5.7 Equity risk in the banking book

In Table 5.7, the equity holdings in the banking book are grouped based on the intention of the holding. All equities in the table are carried at fair value. The portfolio of illiquid alternative investments (private equity funds) is included with a fair value of EUR 4m (EUR 6m).

Table 5.7 Equity holdings in the banking book, 31 December 2013

EURm	Book value	Fair value	Unrealised gains/losses ³	Realised gains/losses ³	Capital requirement
Investment portfolio1	11	11	-2	0	1
Other ²	4	4	0	6	0
Total	15	15	-2	6	1
 Of which listed equity holdings Of which listed equity holdings 	0 0				

2) Of which listed equity holdings
 3) Result for 2013

5.8 Determination of fair value of financial instruments

Fair value is defined in IFRS 13 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The best evidence of fair value is the existence of published price quotations in an active market and when such prices exist they are used for the assignment of fair value. Published price quotations are predominantly used to establish fair value for items disclosed under the following balance sheet items:

- Treasury bills
- Interest-bearing securities
- Shares
- Listed derivatives
- Debt securities in issue (issued mortgage bonds in Nordea Kredit Realkreditaktieselskab)

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. Valuation techniques can range from simple discounted cash flow analysis to complex option pricing models. These are designed to apply observable market prices and rates as input whenever possible, but can also make use of unobservable model parameters. Nordea uses valuation techniques to establish fair value for OTC derivatives and for securities and shares for which quoted prices in an active market are not available.

The calculation of fair value using valuation techniques is supplemented by a portfolio adjustment for uncertainties associated with the model assumptions and uncertainties associated with the portfolio's counterparty credit risk and liquidity risk.

If non-observable data has a significant impact on the valuation, the instrument cannot be recognised initially at fair value and any upfront gains are therefore deferred and amortised over the contractual life of the contract.

The valuation models applied by Nordea 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 Group Risk Management and all models are reviewed regularly.

The valuation framework is a joint responsibility between the Group CFO and the Group CRO. The Group Valuation Committee, a sub-committee of the Risk Committee consisting of senior management representatives from Group Finance, Group Risk Management and the control organisations in the business divisions, serves as an oversight committee and supports the CFO and CRO on different issues in relation to the framework, including standards for valuation and processes for valuation and valuation control.

5.8.1 Compliance with requirements applicable to exposure in the trading book

The CRD outlines requirements for systems and controls. These systems and controls must be of sufficient quality to provide prudent and reliable valuation estimates. Nordea complies in all material aspects with these requirements. Overall valuation principles and processes are governed by the valuation policy which is developed and maintained by the Group Valuation Committee. The product control organisations in the individual business units are responsible for performing valuation controls in accordance with the policies and instructions. The quality control framework is assessed by relevant Group functions as well as by Group Internal Audit on an ongoing basis.

Nordea's set-up for valuation adjustments is designed to be compliant with the requirements in IFRS 13. Requirements in the CRD that are not supported by IFRS 13 are therefore not implemented. Nordea incorporates counterparty credit risk in OTC derivatives, bid/ask spreads and where judged relevant, also model risk.

6. Operational risk

Operational risk is inherent in all activities performed by Nordea Bank Finland. Nordea Bank Finland is included in the Nordea Group's processes for operational risk management.

6.1 Management, governance and measurement of operational risk

Operational risk is 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. Operational risk includes compliance risk, which means the risk of business not being conducted according to legal and regulatory requirements, market standards and business ethics, thereby jeopardising customers' best interest, other stakeholders' trust and increasing the risk of regulatory sanctions, financial loss or damage to the reputation and confidence in Nordea.

Operational risk also includes legal risk, which is the risk that Nordea suffers damage due to a deficient or incorrect legal assessment. Operational risk is inherent in all activities within the organisation, in outsourced activities and in all interactions with external parties.

6.1.1 Management of operational risk

The Policy for Internal Control and Risk Management in Nordea states that the management of risks includes all activities aiming at identifying, measuring, assessing, monitoring and controlling risks as well as measures to limit and mitigate consequences of the risks. Management of risks is proactive, emphasising training and risk awareness.

An important part of operational and compliance risk management is protecting Nordea from being used for the purpose of money laundering and terrorist financing. Therefore Nordea has strict processes concerning customer identification and verification, customer acceptance, monitoring of customer relations, record keeping, detection and reporting of suspicious activities and transactions and employee training to ensure adequate awareness.

Operational risks are managed based on common principles established for Nordea. A common operating model and key processes are set forth in the Nordea Operational Risk Policy.

6.1.2 Governance of operational risk

Group Risk Management is responsible for developing and maintaining the framework for managing operational and compliance risks, and for supporting the business organisation in their implementation of the framework. Information security, physical security, crime prevention as well as educational and training activities are important components when managing operational risks.

Managing operational risk is part of management's responsibilities. In order to manage these risks, a common set of standards and a sound risk management culture is aimed at the objective to follow best practice regarding market conduct and ethical standards in all business activities.

The key principle for the management of operational risks in Nordea is the three lines of defence where the first line of defence is represented by the business organisation. Group Operational Risk and Compliance represents the second line of defence and has defined a common set of standards (Group Directives, processes and reporting) in order to manage operational risks. The network of risk and compliance officers (RCOs) ensures the implementation and roll-out of the common standards by advising the business organisation on how to manage operational and compliance risks and by monitoring and reporting on them. The RCOs work together with the business but are part of second line of defence. Group Internal Audit, representing the third line of defence, provides assurance to the Board of Directors on the risk management, control and governance processes.

A new operating model for operational risk management was established in 2013 and ensures both the independence of the risk and compliance officers and strengthens the cooperation between first and second line of defence. An Operational Risk and Compliance Committee, a sub-committee to the Group's Risk Committee, has been established and the main duties of the committee is to prepare proposals for the Risk Committee on framework, planning and policies and to approve activity plans and various risk assessments. The committee is chaired by the Chief Operational Risk Officer.

Improvements of anti-money laundering processes and routines have been a focus area since 2012 and in 2013 a Group-wide AML programme was established with a programme management office responsible for reporting on progress within the various AML related projects and initiatives across the Group.

A Group-wide BCM programme was also established during 2013 in order to improve the current BCM framework and it will run for three years. The programme includes several work streams, including a review of the existing operating model and governance structure, creation and verification of a Business Impact Analysis model and process, development of crisis management framework and improvement of governing policies.

Nordea uses external risk transfer in the form of insurance, including re-insurance, to cover certain aspects of crime risk and professional liability, including the liability of directors and officers. The Nordea Group furthermore uses insurance for travel, property and general liability purposes.

6.1.3 Measurement of operational risk

6.1.3.1 Key processes

Risk and control self-assessment

The risk and control self-assessment (RCSA) process puts focus on identifying key risks as well as ensuring fulfilment of requirements specified in Nordea Group directives.

The RCSA process is executed in the operational and compliance risk system where an operational risk library is used. The risk library is used for several processes which enables comparison of data across the processes. The division management assesses the risks in the risk library and estimate which risks are relevant for their organisation. The risks are identified both through top-down division management involvement and through bottom-up analysis of result from control questions as well as existing information from processes, e.g. incident reporting, scenario analysis, quality and risk analyses, and product approvals. Upon identification of the risks, the estimated impact of risk materialisation is assessed and the mitigating actions are identified. The mitigating actions related to the most critical risks are followed up in the Group's risk appetite reporting. Mitigating actions to critical risks in Finland are followed up separately in the local Finnish risk appetite reporting.

The purpose of the RCSA is to identify, assess and prioritise operational risks as well as plan mitigating actions for prioritised risks and it provides for an overview of the overall risk picture. The results are used as input to the annual Operational and compliance risk map. Furthermore, the purpose of the control assessment part of the RCSA is to verify whether Nordea adequately fulfils minimum legal requirements as specified in the Nordea Group Directives as well as to ensure a sufficient level of internal control in Nordea. The time period for answering (end of April – beginning of September) aims at providing time for actions to be taken by the business to correct substandard matters, making the process an active tool for improvement rather than merely a status report.

Incident reporting

Incidents and security weaknesses are dealt with immediately in order to minimise damage. Upon detection of an incident, handling of the incident has first priority. The unit manager is responsible for the proper handling, documentation and reporting of the incidents and any quality deficiencies in the unit.

Incident reporting is a Group-wide process which is performed in the operational and compliance risk system by the risk and compliance officer in order to ensure consistent quality in the process. Nordea's operational risk library is used for categorising all incidents and the taxonomy reflects the Operational Riskdata eXchange Association's (ORX) reporting requirements. Nordea joined ORX in 2010 and since Q2 2011, Nordea delivers risk loss data on a quarterly basis to ORX.

The threshold levels for incidents are EUR 1,000 for minor incidents and EUR 20,000 for major incidents. Incidents with no direct financial loss are reported if there is a reputational, regulatory, process or other impact to it. Aggregated incident information is included in regular risk reports to the Risk Committee, GEM, the Board Risk Committee and the Board of Directors, and key observations are included in the Operational and compliance risk map and the semi-annual compliance report.

Other processes

Nordea has developed more task-specific risk management processes in three key areas; product approvals, business continuity and ad hoc changes.

The purpose of the product approval process is to ensure common requirements and documentation in respect of new products as well as material changes to existing products.

Business continuity management covers the broad scope from the procedures for handling incidents in the organisation via escalation procedures to crisis management on Nordea Group level. As most service chains are supported by IT applications, disaster recovery plans for technical infrastructure and IT systems constitute the core of the business continuity management in Nordea.

The quality and risk analysis (QRA) is used to analyse risk and quality aspects related to changes on case by case basis, for example new programmes or projects, significant changes to organisations, processes, systems and procedures. Conducting a QRA is mandatory as part of the product approval process.

The Group-wide Scenario Analysis process aims to put focus on extreme operational risks. The objective of the process is to challenge and extend the Group's present understanding of its operational risk landscape as well as evaluate the potential financial impact of certain risks. The process has been run since 2012 and Nordea aims to further integrate this process in the existing RCSA process.

The two awareness programmes, one targeting senior management and one group-wide, which were introduced in 2011 will continue during 2014 with updated existing modules as well as launch of new topics. Modules about preventing bribery and corruption and AML, counter-terrorist financing and sanctions risk management has been run during 2013 and they were both part of the Group-wide programme Both programmes were mandatory and aimed to set the tone at the top and to increase the awareness of operational and compliance risk-related threats and challenges throughout the organisation. The next module which is about Operational Risk, will be launched in early 2014.

6.1.3.2 Key reports

Operational and compliance risk map

The results from RCSA process and the identification of top risks represent the main input to the Operational and compliance risk map. In the first part of the report, the Group's overall risk picture is illustrated in a dashboard including the RCSA results from scenario analysis process and Group loss data as well as an assessment of the development of each risk category in the Group's operational risk library. The second part of the report supplies a risk overview for each of the Business Areas in the Group with a business area specific dashboard together with a more detailed information on individual risks. The report is used as input to the Group's annual planning process in order to ensure adequate resource allocation to the planned mitigating actions. Mitigating actions are followed up on a quarterly basis within the risk appetite framework with detailed descriptions of the current development status. The Operational and compliance risk map is submitted to the Risk Committee, GEM, the Board Risk Committee and the Board of Directors on an annual basis. A local operational and compliance risk map is submitted to Nordea Bank Finland.

Semi-annual compliance report

Semi-annual reporting on operational and compliance risks is done based on input from risk and compliance officers in the business. The risk and compliance officers are asked to make their own reflections on the division's future challenges, improvements and his/her own ability to work independently. Reporting also contains specific, ad hoc themes, focusing on areas that are relevant at current. The semi-annual Nordea Group compliance report is based on the risk and compliance officers' reports as well as Group Risk Management's own observations and analysis of key compliance risks, incident reporting and other relevant data. Local compliance report is sent to the Board of Directors of Nordea Bank Finland.

6.2 Capital requirements for operational risk

The capital requirements for operational risk is calculated according to the standardised approach, in which all of the institution's activities are divided into eight standardised business lines and a defined beta coefficient is multiplied by the gross income for each business line. Nordea Bank Finland's capital requirements for operational risk for 2013 amounts to EUR 405m (EUR 408m). The capital requirements for operational risk are updated on a yearly basis.

7. Securitisation and credit derivatives

Nordea's role in securitisation has been limited to that of being a sponsor of various schemes together with some limited trading on credit derivatives as described below. Nordea has not participated in securitisation as originator and hence has not transferred loans or their risk outside of Nordea.

7.1 Introduction to securitisation and credit derivatives trading

The CRD defines securitisation as a scheme where the credit risk of underlying exposures is converted into marketable securities so that payments from these securities depend on the performance of the underlying exposures and a subordination scheme exists for determining how losses are distributed among investors to these securities. In a traditional securitisation, the ownership of these assets is transferred to a special purpose entity (SPE), which in turn issues securities backed by these assets. In synthetic securitisation, ownership of these assets does not change, however the credit risk is still transferred to the investor through the use of credit derivatives.

Banks can play several roles in securitisations. First, they can act as originators by having assets they themselves originated as underlying exposures. Second, they can act as sponsors in which role they establish and manage securitisations of assets from third party entities. Third, in their credit trading activity banks can themselves invest in these securities or create these exposures in credit derivatives markets.

Nordea has to date not acted as originator in securitisations. However, Nordea has sponsored various securitisation schemes which are described in the following section. Nordea is also acting as an intermediary in the credit derivatives market, especially in Nordic names. In addition to becoming exposed to the credit risk of a single entity, credit derivatives trading often involves buying and selling protection for collateralised debt obligation (CDO) tranches. These can be characterised as credit risk related financial products, the risk of which depends on the risk of a portfolio of single entities ('a reference portfolio') as well as the subordination. Subordination defines the level of defaults in the reference portfolio after which further defaults will create a credit loss for the investor in the CDO tranche. Because hedging CDO tranches always involves a view on how the correlation between the credit risk of single names evolves it has been customary to talk about correlation trading in this context. The market risk created by Nordea's correlation trading is described in further default in section 7.3.

7.2 Traditional securitisations where Nordea acts as sponsor

Nordea sponsors a limited number of SPEs. These SPEs have been established to facilitate or secure customer transactions, either to enable investments in structured credit products, or with the purpose of supporting trade receivable or account payable securitisation for Nordea corporate customers. At year-end 2013, Nordea is sponsoring the SPEs presented in Table 7.1.

The decision to sponsor these SPEs has been made by senior management. The SPEs are monitored centrally to ensure appropriate purpose and governance. Nordea's role in these transactions has included acting as arranger, account bank, swap/FX counterparty, administrator, calculation agent and/or CP dealer.

In accordance with IFRS, Nordea does not consolidate SPEs' assets and liabilities beyond its control. In determining whether Nordea controls an SPE or not, Nordea makes judgements about risks and rewards from the SPE and assesses its ability to make operational decisions for the SPE. Nordea consolidates all SPEs where it retains the majority of the risks and rewards. For the SPEs that are not consolidated, the rationale is that Nordea does not have any significant risks nor rewards on these assets and liabilities.

The SPEs in Table 7.1 are not consolidated for capital adequacy purposes. Instead, loans and loan commitments to the SPEs are included in the banking book and capital requirements are calculated in accordance with the rules described in chapter 4. Bonds and notes issued by the SPE and held by Nordea as well as credit derivative transactions between Nordea and the SPE are reported in the trading book. Nordea has been approved to calculate the general and specific market risk of these transactions under the VaR model. The counterparty credit risk of credit derivative transactions is calculated in accordance with the current exposure method.

		-	Accounting		Nordea's	
EURm		Duration	treatment	Book	investment ¹	Total assets
Viking ABCP Conduit	Receivables Securitisation	< 5 years	Consolidated	Banking	131	159
Total					131	159

Table 7.1 Special purpose entities where Nordea is the sponsor, 31 December 2013

1) Includes all assets towards SPEs (such as bonds, subordinated loans and drawn credit facilities)

7.2.1 Entities issuing structured credit products

Nordea gives investors an opportunity to invest in different types of structured credit products, such as structured Credit-Linked Notes (CLNs) and Collateralised Mortgage Obligations.

In example the Kalmar Structured Finance A/S (Kalmar) was established to allow customers to invest in structured products in the global credit markets. Nordea sells protection in the credit derivative market by entering into a portfolio CDO. At the same time, Nordea purchases protection under similar terms from Kalmar which issues CLNs to investors. In this process the investors end up bearing the credit risk of the underlying portfolio. In case of credit losses in the underlying portfolio the collateral given by the investors in connection with the CLN is reduced. The total notional outstanding CLNs in this category were reduced to zero (EUR 23m) at year-end 2013.

7.2.2 Securitisations of customer assets

The Viking ABCP Conduit (Viking) was established with the purpose of supporting trade receivable or accounts payable securitisations to core Nordic customers. The SPEs purchase trade receivables (the only asset class purchased) and fund the purchases either by issuing commercial paper via the established assetbacked commercial paper programme or by drawing on the liquidity facilities. Nordea has provided liquidity facilities of maximum EUR 1,646m at year end 2013 (EUR 1,691m) out of which EUR 1,369m (EUR 1,230m) had been utilised. Nordea Bank Finland has provided liquidity facilities of maximum EUR 188m at year end 2013 (EUR 288m) out of which EUR 130m (EUR 117m) were utilised.

Nordea's risks are limited to its holding of CPs issued by Viking and to the drawings under the liquidity facilities provided by Nordea to the SPEs. First loss protection is provided by the originators of the assets and/or from additional external credit enhancement such as the purchase of credit protection from a credit insurance policy, depending on the nature of the SPE and the quality of the purchased assets. When deciding if Nordea should arrange a new transaction, and in providing the liquidity facilities, Nordea uses the same approach as if it was to provide liquidity directly to the underlying customer.

There was no outstanding commercial paper issue at year end 2013. The liquidity facility results in an RWA of EUR 665m (EUR 614m) for Nordea, which is included within the credit risk framework of Nordea's banking book. The RWA for Nordea Bank Finland was EUR 50m (EUR 45m).

7.3 Credit derivatives trading

Nordea acts as an intermediary in the credit derivatives market, especially in Nordic names. Nordea also uses credit derivatives to hedge positions in corporate bonds and synthetic CDOs.

When Nordea sells protection in a CDO transaction, it carries the risk of losses in the reference portfolio if a credit event occurs. When Nordea buys protection in a CDO transaction, any losses in the reference portfolio triggered by a credit event are then carried by the seller of protection.

Credit derivatives transactions create counterparty credit risk in similar manner to other derivative transactions. Counterparties in these transactions are typically subject to a financial collateral agreement, where the exposure is covered daily by collateral placements. Table 7.2 and Table 7.3 list the total outstanding notional of credit default swaps and CDOs at the end of 2013, split by bought and sold positions. CDO valuations are subject to fair value adjustments for model risk. These fair value adjustments are recognised in the income statement. In the Nordea Group, the credit derivative portfolio is part of Nordea Bank Finland Plc.

The risk positions in correlation trading are integrated in Nordea's consolidated market risk management and are as such subject to:

- Limits, including VaR, jump-to-default and correlation risk limits
- The product and transaction approval process

The capital requirement for the comprehensive risk charge specific to the correlation book amounted to EUR 33.7m (39.1m) as of end of 2013 for Nordea Bank Finland.

Table 7.2 Credit default swaps (CDSs), 31 December 2013

EURm	Total gross notional sold	Total gross notional bought
Single name CDS: Investment grade	14,994	15,650
Single name CDS: Non-Investment grade	3,877	4,329
Multi-name CDS: Investment grade indices	6,780	6,846
Multi-name CDS: Non-investment grade indices	4,220	3,747
Total	29,871	30,572

As of December 31, all CDS positions were part of the trading book.

Table 7.3 Collateralised debt obligations (CDOs) - Exposure (excl. NLP)¹, 31 December 2013

	Bought	
Notionals EURm	protection	Sold protection
CDOs, gross	1,266	1,587
Hedged exposures	965	966
CDOs, net ²	301 ³	621 ⁴
Of which:		
- Equity	57	102
- Mezzanine	108	306
- Senior	136	213

1) First-To-Default swaps are not classified as CDOs and are therefore not included in the table. Net bought protection amounts to EUR 47m (EUR 214m) and net sold protection to EUR 18m (EUR 50m). Both bought and sold protection are, to the predominant part, investment grade.

2) Net exposure disregards exposure where bought and sold tranches are completely identical in terms of reference pool attachment, detachment, maturity and currency.

3) Of which investment grade EUR 150m (EUR 349m) and sub-investment grade EUR 151m (EUR 42m).

4) Of which investment grade EUR 326m (EUR 769m), sub-investment grade EUR 286m (EUR 101m) and not rated EUR 0m (EUR 0m).

8. Liquidity risk and funding

During 2013, Nordea Bank Finland continued to benefit from its focus on prudent liquidity risk management, in terms of maintaining a diversified and strong funding base. Nordea had access to all relevant financial markets and was able to actively use all of its funding programmes.

8.1 Management, governance and measurement of liquidity risk

Liquidity risk is the risk of being able to meet liquidity commitments only at increased cost or, ultimately, being unable to meet obligations as they fall due.

8.1.1 Management of liquidity risk

Nordea's liquidity management and strategy is based on policy statements resulting in various liquidity risk measures, limits and organisational procedures.

Policy statements stipulate that Nordea's liquidity management reflects a conservative attitude towards liquidity risk. Nordea strives to diversify its sources of funding and seeks to establish and maintain relationships with investors in order to ensure market access. A broad and diversified funding structure is reflected by the strong presence in Nordea's four domestic markets in the form of a strong and stable retail customer base and the variety of funding programmes. Funding programmes are both short-term (US commercial paper, European commercial paper, commercial paper, Certificates of Deposits) and long-term (covered bonds, European medium-term notes, medium term notes) and cover a range of currencies.

Nordea's liquidity risk management includes stress testing and a business continuity plan for liquidity management. Stress testing is defined as the evaluation of potential effects on a bank's liquidity situation under a set of exceptional but plausible events. The stress testing framework also includes survival horizon metrics (see below), which represents a combined liquidity risk scenario (idiosyncratic and market-wide stress).

8.1.2 Governance of liquidity risk

Group Treasury is responsible for pursuing the Nordea's liquidity strategy, managing the liquidity in Nordea and for compliance with the group-wide limits set by the Board of Directors and the Risk Committee. Group Treasury develops the liquidity risk management frameworks, which consist of policies, instructions and guidelines for the Group as well as the principles for pricing liquidity risk.

8.1.3 Measurement of liquidity risk

The liquidity risk management focuses on both short-term liquidity risk and long-term structural liquidity risk. In order to manage short-term funding positions, Nordea measures the funding gap risk, which expresses the expected maximum accumulated need for raising liquidity in the course of the next 30 days. Cash flows from both on-balance sheet and off-balance sheet items are included. Funding gap risk is measured and limited for each currency and as a figure for all currencies combined. The limit for all currencies combined is set by the Board of Directors.

To ensure funding in situations where Nordea is in urgent need of cash and the normal funding sources do not suffice, Nordea holds a liquidity buffer. The buffer minimum level is set by the Board of Directors. The liquidity buffer consists of central bank eligible high-grade liquid securities held by Group Treasury that can be readily sold or used as collateral in funding operations.

During 2011, the survival horizon metric was introduced. The metric is composed of a liquidity buffer and funding gap risk cash flows, and includes expected behavioural cash flows from contingent liquidity drivers. Survival horizon defines the short-term liquidity risk appetite of the Nordea Group and expresses the excess liquidity after a 30-day period without access to market funding. The Board of Directors has set the limit for minimum survival without access to market funding to 30 days.

The structural liquidity risk of Nordea is measured and limited by the Board of Directors through the net balance of stable funding (NBSF), which is defined as the difference between stable liabilities and stable assets. These liabilities primarily comprise retail deposits, bank deposits and bonds with a remaining term to

maturity of more than 12 months, as well as shareholders' equity, while stable assets primarily comprise retail loans, other loans with a remaining term to maturity longer than 12 months and committed facilities. The CEO in GEM has set as a target that the NBSF should be positive, which means that stable assets must be funded by stable liabilities.

8.2 Liquidity risk and funding analysis

The short-term liquidity risk remained at moderate levels throughout 2013. The average funding gap risk, i.e. the average expected need for raising liquidity in the course of the next 30 days, was EUR +3.8bn (EUR – 2.2bn). Nordea Bank Finland's liquidity buffer range was EUR 14.5 - 17.3bn (EUR 12.5 - 15.9bn) throughout 2013 with an average buffer size of EUR 16.6bn (EUR 14.5bn). Nordea Bank Finland's liquidity buffer is highly liquid, consisting of only central bank eligible securities held by Group Treasury. Survival horizon was in the range EUR +4.0bn – 17.3bn (EUR +0.0 – 19.1bn) throughout 2013 with an average of EUR 10.4bn (EUR 8.1bn). The target of maintaining a positive NBSF was been comfortably achieved throughout 2013, with a yearly average NBSF of EUR 20.1bn (EUR 20.9bn).

9. ICAAP and internal capital requirement

The internal capital adequacy assessment process aims to ensure that the bank keeps sufficient available capital to cover all risks taken over a foreseeable future, including during periods of stress. The level of capital needs to be adequate from an internal perspective as well as from the perspective of regulators, as well as market participants.

9.1 ICAAP

The purpose of the Internal Capital Adequacy Assessment Process (ICAAP) is 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 requirement 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 the Finnish FSA, rating agencies and other external stakeholders with respect to capital management, measurement and mitigation techniques used.

The capital ratios and capital forecasts for Nordea Bank Finland are regularly monitored by Group Corporate Center. The current capital situation and forecasts are reported to the ALCO, Risk Committee, GEM and the Board of Directors. On an annual basis the capital requirements and adequacy are thoroughly reviewed and documented in Nordea Bank Finland's ICAAP report, which ultimately is decided and signed off by the Board of Directors.

9.1.1 Capital planning and capital policy

The capital planning process is intended to ensure that the Nordea Group and its legal entities have sufficient capital to meet minimum regulatory requirements, support its credit rating, growth and strategic options. The process includes a forecast of the capital development (e.g. the Pillar I and Pillar II capital requirements), the available capital (e.g. core tier 1, tier 1 and tier 2 capital) as well as the impact of new regulations. The capital planning is based on key components of Nordea's rolling financial forecast, which includes lending volume growth by customer segment and country as well as forecasts of net profit including assumptions of future loan losses. The capital planning process also considers forecasts of the state of the economy to reflect the future impact of credit risk migration on the capital situation of Nordea Bank Finland Group. An active capital planning process ensures that Nordea is prepared to make necessary capital arrangements regardless the state of the economy and the introduction of new capital adequacy regulations.

ALCO is responsible for evaluating and deciding on capitalisation and prepares proposals for decision by the CEO in GEM when needed.

9.1.2 Conclusion of ICAAP and SREP

Nordea Bank Finland'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 2014, Nordea Bank Finland will continue to closely follow the development of the new capital requirement regime as well as maintain its open dialogue with the Finnish FSA.

9.2 Internal capital requirements

Nordea Bank Finland bases its internal capital requirements under the ICAAP on its internally identified risks, which consists of both Pillar I and Pillar II risks. In effect, the internal capital requirement is a combination of risks defined by the CRD and risks defined by quantitative models under Pillar II. The following risk types are included under Pillar II:

- Business risk is the earnings volatility inherent in all business due to changes in the economic and competitive environment. Business risk is calculated based on the observed volatility in historical profit and loss that is attributed to business risk.
- Interest rate risk in the banking book consists of exposures deriving from the balance sheet (mainly lending to public and deposits from public) and from Group Treasury's investment and liquidity portfolios. The interest rate risk is measured in several ways on a daily basis and in accordance with the financial supervisory authorities' requirements.
- Pension risk is included in the market risk framework and includes equity risk, interest rate risk and FX risk in the Nordea-sponsored defined benefit pension plans.
- Real estate risk consists of exposure to owned and leased properties and is included in the market risk framework.
- Concentration risk is the credit risk related to the degree of diversification in the credit portfolio and includes both single name concentration risk and sector/geography concentration risk.

Liquidity risk is a Pillar II risk, however it is not included in the capital framework, instead it is mitigated through active management of liquidity. Liquidity risk is the risk of being able to meet liquidity commitments only at increased costs, or ultimately, being unable to meet obligations as they fall due. The liquidity risk management focuses on both short-term liquidity risk and long-term structural liquidity risk.

In addition to calculating risk capital for its various risk types, Nordea Bank Finland conducts a comprehensive capital adequacy stress test to analyse the effects of a series of global and local shock scenarios. The results of the stress tests are considered in Nordea Bank Finland's internal capital requirements as buffers for economic stress.

By considering the stress test results in the assessment of internal capital requirements, the pro-cyclical effects inherent in the risk-adjusted capital calculations of the economic capital and IRB approaches are addressed. Regulatory buffers are introduced with the implementation of CRD IV. This might lead to higher capitalisation requirements than what is determined in the internal capital requirement. Should the regulatory capital requirement come to exceed the internal capital requirement, additional capital will be held to meet regulatory requirements with a margin

9.2.1 Economic capital (EC)

EC is input in the EP framework which is calculated as risk adjusted profit less cost of equity. EP drives and supports the operational decision making process in Nordea to support performance management and shareholder value creation.

Nordea's Economic Capital model is based on the same risk components as the ICAAP. Pillar II closes the gap between regulatory capital and EC by improving the risk sensitivity of regulatory capital measurement. EC was during 2013 further aligned to core tier 1 capitalisation requirements anticipated in forthcoming regulation. For 2014, additional capital items will be introduced in the EC to reduce the gap between legal equity and allocated capital.

As of end 2013 the total EC for Nordea Bank Finland equals EUR 7.0bn (EUR 7.0bn as of 2012, restated). Figure 9.1 shows the economic capital distributed by risk type. Notably, credit risk accounts for 71 % of the total EC.

Figure 9.1 EC distributed by risk type



9.2.2 Stress testing governance and framework

Stress testing governance and framework are important due to the vital role of capital for Nordea's management and profitability. Thus an adequate governance structure is required for the stress testing process. Key responsibilities include Group Executive Management (GEM) and the legal entity boards engagement in the internal assessment of capital (ICAAP) stress testing. In addition, the Executive Management of Group Risk Management (GREM) and the Asset and Liability Committee/Risk Committee review in details the stress test performed and potential implications for future capital.

Capital adequacy stress testing is carried out annually during the first quarter, using end-of-year data. Ad hoc stress testing may be carried out throughout the year when necessary. In order to determine the adequacy of capital for the Nordea Group throughout the scenarios, Key financial targets , which are stated in Nordea's capital policy, are also considered. As long as the capital policy is fulfilled during the scenarios, the adequacy of existing capital can be supported.

The key measure for determining the stress test impact is the core tier 1 ratio and how it develops during the scenarios. The stress test capital impact is defined as the percentage drop in core tier 1 ratio in the most stressed year. The impact is then analysed in relation to capital policy, regulatory buffers and internal capital requirements.

9.2.2.1 Stress tests performed

During 2013, Nordea Bank Finland performed internal stress tests in order to evaluate general effects of an economic downturn as well as effects for specifically identified segments or high risk areas. In addition to the internal stress tests, the Nordea Group and Nordea Bank Finland was subject to stress tests and capital review exercises performed by financial supervisors and central banks.

As part of the ICAAP and the capital planning process, firm-wide stress tests are used as an important risk management tool in order to determine how severe unexpected changes in the business and macro environment will affect the capital need. The stress tests reveal how the capital need varies during a stress scenario, where the income statements, balance sheet, regulatory capital requirements, EC and capital ratios are impacted.

In addition to the firm-wide stress tests which cover all risks defined in the EC framework, Nordea Bank Finland performs ad hoc stress test and sensitivity analysis of various risk parameters and risk factors on a need-by-need basis. The Nordea Group has also carried out reverse stress tests of various recovery environments in relation to the development of the recovery and resolution plan.

Nordea Bank Finland continuously refines its stress testing methodologies and practises to ensure a forward-looking element.

The general stress test process is divided into the following three steps:

- Scenario development and translation
- Calculation
- Analysis and reporting.

These steps are described further in the sections following.

9.2.2.2 Scenario development and translation

The annual ICAAP stress test is based on three-year macroeconomic scenarios for each Nordic and Baltic country and the scenarios are designed to replicate shocks that are particularly relevant for the existing portfolio. Stress scenarios are designed by experts within the Nordea Economic Research division. Nordea also uses its rolling financial forecast for complementary assumptions of the base case. The difference between the stressed scenarios and the base case scenario is used to determine the stress effect and the additional capital need.

While the annual stress test is based on comprehensive macroeconomic scenario which involves estimates of several macroeconomic factors, the ad hoc stress tests are based on direct estimates of risk parameter changes or based on a few macroeconomic variables. This enables senior management to easily define scenarios and evaluate the effect of them in capital planning.

After a scenario is developed, the effects on risk drivers are translated and the risk and financial parameters are simulated. Advanced models in combination with expert judgment from Business Areas are used in order to determine the effect of the scenario.

As an example, in the annual stress test, the scenario is translated into an impact on the parameters listed in Table 9.1.

Parameter	Impact
Volumes	Lending volumes are dependent on lending growth specified in the scenario and on inflow to default and loss provisions. Deposit volumes are given directly by the RFF.
Margins	Corporate lending margins are country and rating specific and therefore sensitive to rating migrations. Retail margins are country specific and split by mortgage lending and other lending. Defaulted (but performing) customers are assigned a lower margin. Deposit margins are given by the RFF.
Net interest income	Net interest income figures are adjusted according to the change in volume and margins for deposits and lending, as well as increased funding cost (see below).
Funding cost	Changes in funding costs are derived from the assumption of Nordea being down-rated. The increased funding cost, due to a lower rating, reduces net interest income.
Net fee and commission income	Net fee and commission income is calculated according to product mix. Commission income is assumed to follow market movements and is adjusted according to changes in the stock index, whereas other items are adjusted according to changes in GDP.
Operating expenses	Operating expenses are assumed to be constant except for variable salary expenses, which are adjusted according to changes in net profit the previous year.
Loan losses	Loan losses are calculated based on a bottom-up, EL-based model. The EL-calculations are carried out on stressed rating distributions, stressed point in time PD curves and stressed LGD values (see below). The model covers both collective and specific provisions. The loan loss model consists of two components that cover losses related to (i) a general macroeconomic scenario and (ii) industry specific and idiosyncratic loss events.
P/L effect of Operational- and Market Risk	Stressed losses related to operational risk and market risk are calculated using assumed loss distributions and correlations between the risk types.
Rating/Scoring migration	For corporate customers, rating migrations are calculated on customer level based on stressing their financial statements for each year and scenario. For retail and bank customers, rating/scoring migrations are calculated based on central macro-economic variables per year and scenario.
Probability of default	Stressed PD values are calculated on customer level based on the stressed rating/scoring migrations (see above). For loan loss calculations point in time PDs are used. The point in time PDs are dependent on the severity of the macroeconomic scenario. In addition the PDs contain an add-on factor to reflect industry specific and idiosyncratic risk.
Collateral values	The collateral coverage is stressed by moving parts of the exposure from secured to unsecured, resulting in an increase in average weighted LGD.
Risk weighted assets (RWA)	Credit risk RWA is calculated on customer/exposure level based on stressed PDs and LGDs. RWA is also dependent on changes in volumes (EAD) which are a function of lending growth and inflow to default.

Table 9.1 Parameters in the annual stress test

9.2.2.3 Calculation

The stressed figures and parameters from the scenario are used to calculate the effects on the regulatory capital requirements, the EC and the financial statements. The regulatory capital is calculated for the credit risk, market risk and operational risk according to the CRD with regards to the IRB approaches used. The calculations for each risk type are aggregated into total capital requirement figures.

Stressed figures for loan losses are calculated bottom-up, based on stressed rating migrations and collateral values. Stressed point-in-time PDs that are functions of the downturn scenario, are used in the calculation of loan losses. The loan loss calculation also covers idiosyncratic losses related to the exposure to single customers and industries. The loan loss model covers both specific and collective provisions. Together with net profit and dividend from the stressed financial statements are used to calculate the effect on the capital base components. The capital base is set in relation to the regulatory capital or EC in order to calculate the effect on capital ratios during a stress scenario. Figure 9.2 shows the calculation process used in the stress test framework.



Figure 9.2 Calculation process

9.2.2.4 Analysis and reporting

The first level of reporting in Nordea is the ALCO and the Risk Committee, which review the details of the stress tests and implications on future capital need. The results, showing the implications of the stress tests on the adequacy of existing capital are distributed to the executive management and the Board of Directors.

The results of the stress tests should support senior management's understanding of the implications of the current capital strategy given potential market shocks. Based on this information senior management is able to ensure that the Group holds enough capital against potential economic downturns and other stress events. Business Area involvement in defining and assessing the stress tests is seen as important in order to increase the risk awareness throughout the organisation and the understanding of the relation between capital requirements and exposure to material risks.

The outcome of the stress tests demonstrates how Nordea Bank Finlands's loan loss and capital ratios will change during a stress scenario. The outcome is then analysed in order to decide the capital need during a downturn period and to ensure that Nordea Bank Finland is well capitalised.

10. Capital base

The capital base grew slightly for Nordea Bank Finland in 2013 and the quality of the capital base remains strong. Core tier 1 capital, considered capital of the highest quality, comprises 95% of the Nordea Bank Finland's capital base.

10.1 Capital base definition

Capital for regulatory purposes, the capital base, is determined in accordance with the CRD and the Finnish legislation and is based on equity as reported under applicable accounting standards in the balance sheet. Only capital contributed by companies within the Financial Group and by the consolidated accounts can be included in the capital base. Items included in the capital base should without restrictions or time constraints be available for the institution to cover risk and absorb potential losses.

The size of the capital base must as a minimum correspond to the sum of the capital requirements for credit, market and operational risks, in accordance with the pillar I requirements.

The capital base, referred to as own funds in the CRD, is the sum of tier 1 capital (referred to as original own funds in the CRD) and tier 2 capital (referred to as additional own funds in the CRD) net after deductions.

Tier 1 capital consists of both core tier 1 capital (paid-in shareholder capital and retained earnings) and other tier 1 (undated subordinated debt). The tier 2 capital consists mostly of dated/undated subordinated loans. A summary of items included in the capital base is available in Table 10.1. Below is a detailed description of the items included in the capital base.

10.2 Core tier 1 capital and tier 1 capital

Core tier 1 capital is defined as eligible capital including eligible reserves, net of regulatory required deductions made directly to core tier 1 capital. The capital recognised as core tier 1 capital holds the ultimate characteristics for loss absorbance defined from a "going concern" perspective and are the most subordinated claim in the event of liquidation. Tier 1 capital is defined as core tier 1 capital and capital of the same or close to the character of eligible capital and eligible reserves. Tier 1 capital can include a limited component of undated subordinated capital loans.

10.2.1 Eligible capital and eligible reserves

Eligible capital is the share capital contributed by shareholders, including the share premium paid. Eligible reserves consist primarily of retained earnings, other reserves, minority interest and income from current year. Retained earnings are earnings from previous years reported via the income statement. Other reserves are related to revaluation and translation reserves referred to acquisitions and associated companies under the equity method. The equity interests of minority shareholdings in companies that are fully consolidated in the Financial Group are also included. Positive income from current year is included as eligible capital after verification by the external auditors, however negative income must be deducted. Repurchased own shares or own shares temporary included in trading portfolios are deducted from eligible reserves.

10.2.2 Tier 1 instruments subject to limits

The inclusion of undated subordinated capital loans in tier 1 capital is restricted and repurchase can normally not take place until five years after the loan was originally issued. Undated subordinated loans may be repaid only upon decision by the Board of Directors in Nordea Bank Finland and with the permission of the Finnish FSA. Further, there are restrictions related to step-up conditions, order of priority, interest payments under constraint conditions and the level of amount that can be part of tier 1 capital.

Currently, there are no undated subordinated capital loans included in the tier 1 capital of Nordea Bank Finland.

Table 10.1 Summary of items included in capital base, 31 December 2013

EURm	31 December 2013	31 December 2012
Tier 1 capital		
Paid-up capital	2,319	2,319
Share premium	598	598
Eligible capital	2,918	2,918
Reserves	5,759	5,194
Minority interests	1	4
Income from current year	828	1,185
Eligible reserves	6,587	6,383
Core tier 1 capital (before deductions)	9,505	9,301
Subordinated capital loans	0	0
Proposed/actual dividend	-750	-625
Deferred tax assets	-5	-16
Intangible assets	-100	-108
Deductions for investments in credit institutions	-2	-1
IRB provisions shortfall (-)	-118	-207
Other items, net	-100	-98
Deductions	-1,075	-1,055
Tier 1 capital (net after deduction)	8,430	8,246
- of which subordinated capital		
- of which core tier 1 capital (net of deductions)	8,430	8,246
Tier 2 capital		
Undated subordinated loans	537	556
Dated subordinated loans		
Other additional own funds	17	13
Tier 2 capital (before deductions)	555	569
Deductions for investments in credit institutions	-2	-1
IRB provisions shortfall (-)		-207
Deductions -119		-208
Tier 2 capital (net after deductions)	435	362
Capital base	8,866	8,607

10.2.3 Deductions from tier 1 capital

10.2.3.1 Proposed/actual dividend

In relation to income for the period, the corresponding dividend should be deducted. The amount deducted from tier 1 capital is based on the dividend proposed by the Board of Directors of Nordea Bank Finland to be decided at the annual general meeting of Nordea Bank Finland's shareholders.

10.2.3.2 Deferred tax assets

In accordance with local legal requirements deferred tax assets have been deducted from the tier 1 capital. The deducted amount is calculated based on accounting standards relevant for the individual companies included in the finacial group.

10.2.3.3 Intangible assets

The significant part of deducted intangible assets contains assets related to IT software and development.

10.2.3.4 Deductions for investments in credit institutions

The institutions should in its capital base deduct for equity holdings and some other types of contributions to institutions that are not consolidated into the Financial Group (in Nordea Bank Finland foremost associated companies). 50% should be deducted from tier 1 capital and 50% should be deducted from tier 2 capital.

10.2.3.5 IRB provisions shortfall

In accordance with Finnish legislation, the differences between actual IRB provision made for the related exposure and expected loss are adjusted for in the capital base. The negative difference (when the expected loss amount is larger than the provision amount) is defined as a shortfall. By the end of 2013, the expected loss was EUR 965m and the IRB shortfall equalled EUR 235m. According to the rules in the CRD, the shortfall amount is to be deducted equally from tier 1 capital and tier 2 capital. A positive difference (provisions exceeding expected loss) can be included in tier 2 capital subject to certain limitations (maximum 0.6% of IRB RWA). For the purpose of the CRD transition rules calculations of the shortfall is under Finnish regulation deducted from the RWA to be neutralised in a Basel I perspective.

10.2.3.6 Cash flow hedges

Recognised changes in the value of equity arising from cash flow hedges are not eligible for inclusion in the capital base.

10.2.3.7 Other deductions

Surplus net value of pension plans for employees should under certain circumstances be deducted from tier 1 capital. At the end of 2013 the surplus values of the plans reached EUR 100m.

10.3 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.

10.3.1 Tier 2 – Subordinated loans

Tier 2 capital consists mainly of subordinated debt. Tier 2 capital includes two different types of subordinated loan capital; undated loans and dated loans. According to the regulation, tier 2 capital may not exceed tier 1 capital and dated tier 2 loans may not exceed 50% of tier 1 capital. The limits are set net of deductions.

The basic principle for subordinated debt in the capital base is the order of priority in case of a default or bankruptcy situation. Under such conditions, the holder of the subordinated loan would be repaid after other creditors, but before shareholders. The share of outstanding loan amount possible to include in the tier 2 capital related to dated loans is reduced if the remaining maturity is less than five years. Outstanding amount in the specific issue is deducted by 20% for each year.

As of year-end 2013 Nordea Bank Finland held EUR 537m in undated subordinated loans.

10.3.2 Other tier 2 capital

Other additional funds consists of adjustment to valuation differences in available for-sale equities transferred to core additional own funds. Unrealised gains from equity holdings classified as available for-sale securities can according to regulation only be included in tier 2 capital. Nordea has no significant holdings in this category and therefore only has a minor impact in tier 2 capital from such items.

10.3.3 Deductions from tier 2 capital

10.3.3.1 Deductions for investments in credit institutions

The institutions should in its capital base deduct for equity holdings and some other types of contributions to institutions that are not consolidated into the Financial Group (in Nordea Bank Finland foremost associated companies). The regulation stipulates 50% to be deducted from tier 1 capital and 50% to be deducted from tier 2 capital.

10.3.3.2 IRB provisions excess (+) / shortfall

The differences between EL and provisions made for the related exposure are adjusted for in the tier 2 capital. See section 10.2.3 for further explanation.

11. New regulations

The final version of the Capital Requirement Directive IV (CRD IV) and Capital Requirement Regulation (CRR) for the European financial market was published in June 2013. The Directive will be implemented through national law within all EU member states during 2014, pending on national processes, while the Regulation will become applicable in all EU countries from 1 January 2014 directly through the European process.

11.1 Forthcoming regulatory framework

The changes for financial institutions in the regulatory area related to capital and risk are extensive. In addition to the CRD IV/CRR, other closely related regulations are also emerging. These include a new framework for dealing with bank failure (crisis management), a proposal for a Banking Union (including the already agreed single supervisory mechanism and the single resolution mechanism), a review regarding treatment of the trading book from the Basel Committee on Banking Supervision (Fundamental review of the Trading Book), a potential proposal regarding a structural reform primarily related to trading activities as well as changes to accounting regulation that will have an effect on capital and risk. Furthermore, data and reporting requirements for banks are expected to increase substantially.

11.2 Basel III and the CRD IV/CRR

In December 2010, the Basel Committee on Banking Supervision (BCBS) issued rules of new global regulatory standards on credit institutions capital adequacy, leverage and liquidity, collectively referred to as Basel III. These standards have now been transposed to European legislation through the CRD IV/CRR.

CRD IV/CRR include several key initiatives which change the current requirements that have been in effect since 2007. The regulation requires higher capitalisation levels and better quality of capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk based requirement, measures to promote the build-up of capital that can be drawn in periods of stress and the introduction of liquidity standards.

CRD IV/CRR will consist of a Directive and a Regulation:

- The Directive, CRD IV, covers areas such as authorisation of banks, principles for prudential supervision including Pillar II rules, corporate governance, capital buffers, sanctions and remuneration.
- The Regulation, CRR, contains detailed requirements covering own funds, capital requirements for credit risk, market risk and operational risk, large exposures, liquidity, leverage ratios, and disclosure requirements.

The CRR is intended to set a single rule book for all banks in the EU, avoiding diverging national rules. However, the on-going national implementation of the Directive and of the national options possible in the CRR shows that there will be differences between different countries.

The EBA, with its objective to play a leading role in the creation of the single rule book for the EU banking system, issues binding technical standards for banks. More than 100 binding technical standards are expected due to CRD IV/CRR, of which a large number were issued for consultation already during 2012 and 2013.

11.2.1 Capital regulation

11.2.1.1 Own funds

The CRR includes a revised definition of own funds, intending to increase the quality of capital, hence create better loss-absorbing capacity. Own funds is the sum of tier 1 capital and tier 2 capital. Tier 1 capital consists of common equity tier 1 capital (paid-in shareholder capital and retained earnings) and additional tier 1 (undated subordinated debt). Tier 2 capital consists predominantly of dated/undated subordinated loans. In common terms, tier 1 capital can absorb losses without an institution being required to close down it business activities, and tier 2 capital can absorb losses in the event of a winding-up and so provides a lesser degree of

protection to depositors. The requirements for inclusion of instruments in common equity tier 1 (CET1) are stricter and the details have also been further regulated by technical standards from the EBA. Also, the CRR applies deductions mainly to CET1 (under the previous framework, important deductions have been applied to other parts of own funds as well).

According to the CRR the changes should gradually be phased-in until 2024. However, the CRR also opens up for local regulators to phase in deductions faster. The required features of capital instruments to be eligible as additional tier 1 and tier 2 capital will also be stricter. For example, instruments with incentives to redeem (e.g. step-up clauses) will not be eligible. Instruments that do not contain the required features should be gradually phased-out until 2022. The regulation opens up for local regulators to phase out instruments that are not fully compliant faster.

11.2.1.2 Regulatory minimum capital requirements

CRR requires banks to comply with the following minimum capital ratios:

- Common equity tier 1 capital ratio of 4.5%
- Tier 1 capital ratio of 6%
- Capital ratio of 8%

The minimum CET1 capital ratio and the minimum tier 1 capital ratio should be gradually phased-in until 2015. Again, the framework opens up for faster implementation by national regulators.

11.2.1.3 Capital buffers

CRD IV introduces a number of capital buffer requirements. The capital buffers are expressed in relation to RWA and represent additional capital to be held on top of the minimum regulatory requirements. The levels and the phasing-in of the buffer requirements are subject to national discretion.

A mandatory capital conservation buffer of 2.5% to be met with CET1 will be established above regulatory minimum requirements. Further, a countercyclical capital buffer is implemented as an extension of the capital conservation buffer, which will be developed in national jurisdictions when excess credit growth is judged to be associated with a build-up of system wide risk. The countercyclical capital buffer should also be met with CET1 and the institution specific buffer will be in the range of 0-2.5%. Supervisory authorities shall also require that globally important institutions (G-SIIs) hold buffers of additionally 1-3.5% CET1. In addition, the CRD IV allows for a systemic risk buffer (SRB) to be added as well as a buffer for other systemically important institutions (O-SIIs). These buffers should be seen in conjunction with the other buffers and should also be met with CET1. The O-SII buffer can be set up to 2% and the SRB can be set up to 3% for a banks all exposures and up to 5% for a bank's domestic exposures. Breaching these buffer requirements will restrict banks' capital distribution, such as the payment of dividends.

11.2.2 Risk-weighted assets (RWA)

RWA will mainly be affected by additional requirements related to counterparty credit risk, the introduction of an asset correlation factor for exposures towards financial institutions and a multiplication factor for exposures to SMEs. Several countries are also discussing the introduction of higher risk weights or other restrictions on mortgage lending.

For banks calculating RWA according to the IRB approach, a risk-weight floor was previously in place, stipulating that RWA should not be less than 80% of the RWA calculated under Basel I. This floor was expected to end December 2012 however CRR extends these transition rules until 31 December 2017.

11.2.2.1 Counterparty credit risk

The largest change to the calculation of RWA relates to the changes made to the calculation of counterparty credit risk. The changes are mainly made in the introduction of a capital charge for credit valuation adjustment risk (CVA risk) and a capital charge for exposures to central counterparties (CCPs).

The CVA risk mirrors that the value of a financial instrument may not be realised due to the default of the counterparty. The basis of the capital charge is to hold capital against potential mark-to-market losses associated with deterioration in the creditworthiness of a counterparty. The capital charge can be determined according to two methods: the advanced and the standardised. The advanced method should be implemented

if the bank has both IMM approval for counterparty credit risk and a specific interest rate VaR approval, hence Nordea is to use the advanced method for applicable portfolios.

Exposures to CCPs will be subject to a capital requirement. A CCP is an entity that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer. The size of the capital requirement will depend on the type of exposure and whether the CCP is qualified or not.

11.2.2.2 Asset correlation factor

The CRR introduces an asset correlation factor of 1.25% when calculating RWA for exposures to large regulated financial entities that are subject to prudential supervision and whose assets are greater than or equal to EUR 70bn. Unregulated financial entities with relevant activities are also affected. The motivation for the introduction of an asset correlation factor is that correlation within these segments is substantial.

11.2.2.3 Risk weight for small and medium sized entities (SMEs)

In order to encourage lending to SMEs, the risk weights for SMEs will be reduced. The capital requirement for credit risk for exposures to SMEs shall be multiplied with the factor 0,7619. The definition includes exposures in both the standardised and IRB approaches in the exposure classes retail, corporate and secured by real estate. The annual turnover for the SME must be below EUR 50m and the total amount owed (for the group of connected clients) shall not exceed EUR 1.5m excluding claims secured by residential real estate

11.2.3 Leverage ratio

The CRR introduces a non-risk based measure, the leverage ratio, in order to limit an excessive build-up of leverage on credit institutions' balance sheets and thus helps in containing the cyclicality of lending. The impact of the ratio will be monitored with an aim to migrate to a binding measure in 2018, based on appropriate review and calibration. The leverage ratio will be calculated as the tier 1 capital divided by the exposure (on-balance and off-balance sheet exposures, with adjustments for certain items such as derivatives and securities financing transactions).

In January 2014, the BCBS published the leverage ratio framework. The final version is more in line with CRR compared to the consultation paper that was issued during summer 2013.

11.2.4 Liquidity regulations

The objective of the liquidity reform is to improve the banking sector's ability to absorb liquidity shocks arising from financial and economic stress, thus reducing the risk of spill-over from the financial sector to the real economy. In CRD IV/CRR two new quantitative liquidity standards have been introduced: liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). LCR requires that a bank shall hold liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of 30 days. NSFR requires that a bank shall ensure that long term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions. CRD IV/CRR does not contain detailed rules for NSFR. BCBS published detailed proposals for NSFR in 2010 and changed proposals on 12 January 2014. According to the Basel proposals, a bank' Available Stable Funding (ASF) shall be at least equal to its Required Stable Funding (RSF). ASF and RSF are determined by pre-specified factors. Both LCR and NSFR will be subject to an observation period in CRD IV/CRR. After the observation period, LCR will be phased-in from January 2015 (60% in 2015, 70% in 2016, 80% in 2017, 100% in 2018) while NSFR might be introduced as a minimum standard by 2018.

11.2.5 Reporting requirements

The EBA has by mandate in the CRR developed Implementing Technical Standards related to supervisory reporting requirements. The harmonisation of the reporting is part of the intention in building the single rule book in Europe, with the particular aim of specifying uniform formats, frequencies and dates of prudential reporting as well as IT solutions to be applied by credit institutions and investment firms in the EU. The requirements cover capital adequacy ("Corep"), financial reporting ("Finrep") and liquidity. The new

reporting requirements have required additional data gathering, extensive IT implementations and changes to reporting templates. The new Corep reporting will be mandatory when the CRR comes into force.

11.2.6 Implementation of CRD IV/CRR

As mentioned, CRD IV needs to be implemented into national laws and regulations before entering into force. The CRR will however enter into force at 1 January 2014 in all EU countries. Within CRR there are a number of national options that can be implemented into national legislation/regulation should the national authorities choose to do so and during the autumn and winter a number of consultations on national implementation of CRD IV/CRR has been issued. The final decisions about the usage of national options in Finland are available during year 2014 as those will be reconsidered within the implementation of the SSM framework.

CRD IV will be implemented by a new act on credit institutions, expected to enter into force 1 July 2014. The draft government bill for the new act was issued for comments in October 2013. The draft includes new requirements on governance and risk management in credit institutions. It is also suggested that the countercyclical capital buffer (up to 2.5% CET1) and a capital conservation buffer (2.5 % CET1) will be applicable from 1 January 2015 and that a buffer requirement for systemically important institutions of 2 % CET1 will be applicable from 1 January 2016. It is currently not clear how the definition of the systemically important institutions will be made.

Part of the national options given in CRR will be regulated within the new Finnish Credit Institution Act. The old regulation will be applied connected to those options until the new law is in force.

The usage of macro-prudential tools and implementation of systemic risk buffer are under consideration.

11.3 Crisis management and Recovery and Resolution

During 2011, the FSB published "Key Attributes of Effective Resolution Regimes for Financial Institutions". The Bank Recovery and Resolution Directive (BRRD) is the EU implementation of the FSB guidelines, and were finally agreed upon in December 2013. The Banking Union regulation, parts of which is currently being drafted, implements the BRRD for the Eurozone (and potential opt-in) countries, and introduces single standards for resolution banks. On an overall level these regulations address how to maintain financial stability through reducing the systemic impact of failing financial institutions. A central political aim is to minimize the intrinsic public financial support to the banking system during large scale financial crises, while avoiding critical disruptions in the financial markets and infrastructures.

The BRRD outlines the tools and powers available to the relevant authorities in the EU, which are aimed at both preventing bank defaults, as well as handling banks in crises, while maintaining financial stability.

11.3.1 Recovery and Resolution Plan

In November every year, the FSB and the Basel Committee identifies global systemically important banks. The November 2013 report lists 29 institutions and Nordea was for the second time identified as the only institution in the Nordic region.

Global systemically important institutions are required to submit recovery plans aimed at establishing recovery planning processes to reduce the probability of default, while authorities are required to establish credible and operational resolution plans.

11.4 Banking union

In the early autumn of 2012, the EU Commission presented a proposal to move to a full banking union in the Euro zone. In December 2013 the Parliament and the Council ensured, by key legislation, that the European Central Bank (ECB) will be responsible for the supervision of banks in the framework of the Single Supervisory Mechanism (SSM). This is the first effective step in creating the banking union. A banking union can be defined as a fully integrated bank regulatory and supervisory system within a federal structure. National supervisors will however continue to play an important role in preparing and implementing the ECB's decisions.

For increasing consistency and efficiency of supervisory practises the EBA will continue to develop the single rule book applicable to all 27 member states. It will also ensure that regular stress-tests are carried out to assess the resilience of European banks.

The SSM, as agreed by the Parliament and the Council, also establishes rules on the governance and responsibility of the ECB which should ensure a separation between its tasks as a supervisor and its monetary policy functions.

For banks active in several countries, both inside and outside the Eurozone, existing home/host supervisor coordination procedures will continue to exist as they do today.

11.5 Separation of trading activities

In February 2012, the EU Commission established a high-level expert group (HLEG) with the task to assess whether additional reforms on the structure of individual banks should be considered. The HLEG answer to the task was presented in a report in October 2012 and suggested mandatory separation of proprietary trading and other high-risk trading activities from the normal banking activities. The main purpose would be to separate certain particularly risky parts of financial activities from deposit taking activities within a banking group. The underlying objective is to make deposit taking banks safer and less connected to trading activities. Risky financial activities are defined as proprietary trading and all securities or derivatives incurred in the process of market-making as well as exposures towards hedge funds, private equity investments and structured investment vehicles.

During 2013 the Commission has been working on a legislative proposal and an impact study with the aim of presenting the proposal early 2014.

11.6 Trading book review

In October 2013, BCBS published the second consultative document on a fundamental review of the trading book. The aim is to strengthen the resilience to markets risks due to observed weaknesses during the crisis. The review sets out a potential definition of the scope of the trading book and also proposes to strengthen the relationship between the standardised and internal model-based approaches.

11.7 Accounting standards

There are other regulations under consideration and implementation, which require close monitoring and assessment of the impact. New accounting rules and the proposal for a tax on financial transactions are two examples.

Nordea's accounting policies, which follow IFRS, are under significant change. Nordea's assessment is that the most important changes are related to Financial Instruments (IFRS 9), Insurance Contracts (IFRS 4) and Leasing (IAS 17), although other changes might/will also significantly impact Nordea. The finalisation dates and effective dates for these standards are still pending.

12. Remuneration

Nordea has clear remuneration policies, instructions and processes, securing sound remuneration structures throughout the organisation.

12.1 The Board Remuneration Committee

The Board Remuneration Committee is responsible for preparing and presenting proposals to the Board of Directors on remuneration issues. This includes proposals regarding the Nordea Remuneration Policy and supplementing instructions, guidelines for remuneration to the executive officers to be decided by the Annual General Meeting as well as the remuneration for the Group CEO, the Group Chief Audit Executive and also Group Compliance Officer and Head of Group Credit Control. At least annually, the Committee follows up on the application of the Nordea Remuneration Policy and supplementing instructions through an independent review by Group Internal Audit.

12.2 Remuneration risk analysis

New regulations require financial institutions to establish a remuneration policy and to conduct a risk analysis in respect of the policy. Nordea's risk analysis includes risks related to the governance and structure of the remuneration schemes, goal setting and measurement of results, as well as fraud and reputation. Mitigating actions are furthermore described. The main focus in the analysis is on the variable remuneration elements.

12.2.1 Effective and balanced risk management

Nordea Remuneration Policy and its underlying instructions, systems, schemes and processes are aligned with and support efficient risk management. The risk of excessive risk taking is limited by:

- Ensuring that the Remuneration Policy, instructions and systems etc. are approved at the relevant organisational level, supported by analyses of potential financial as well as non-financial consequences.
- Having a "Steering Committee for updating Nordea's implementation of internal and local remuneration instructions" with representatives from the business, Group Legal and Group Operational Risk and Compliance to support Group Executive Management in these issues.
- Having clear governance and approval processes for all remuneration components, including the grandparent principle and involvement of control functions, and by having most remuneration paid as fixed compensation.
- Requiring that the main variable remuneration components are based on a pre-determined set of well-defined financial as well as non-financial success criteria, including Nordea Group criteria.
- Having divisional Bonus pools mainly defined by a share of divisional Economic Profit.

Risks related to the remuneration schemes and processes governed by the Remuneration Policy exist and will continue to exist going forward. Nordea applies a wide range of processes, tools and control activities to manage the risks, including the involvement of relevant risk and control functions, and thereby reduces potential negative effects.

12.2.2 The governance and structure of the remuneration schemes

A range of new regulations as well as recommendations on best market practices have been issued in respect of the structure of variable remuneration elements on the back of the financial crisis. Nordea aims at developing the structure of variable remuneration elements on a continuous basis in order to meet own needs, regulatory requirements, and such best market practices. The schemes are considered to take these factors satisfactorily into account. In the second half of 2009 Nordea engaged external consultants from Oliver Wyman to perform a review of key issues in respect of bonus structures, principles, and levels. Although certain changes and improvements were recommended, the review concluded that Nordea has reasonably well-structured bonus schemes, measured against new international guidelines. The gaps identified were addressed by Nordea. In autumn 2010, a follow-up review was conducted, concluding a need for a shift in the balance between variable and fixed compensation due to new regulations

In second half of 2012 Oliver Wyman was again engaged to review Bonus structures in the light of regulatory and market development and expected future changes. No regulatory gaps were identified but Nordea addressed proposed Bonus structure calibrations.

Even well-structured remuneration policies and variable remuneration schemes can be counterproductive if the goals and performance criteria are ill-designed. Nordea pays due attention to these risks by conducting a broadly based strategy process on an annual basis and reflecting this process in the decision on financial targets, risk limits and Group key performance indicators (KPIs). Group KPIs furthermore include both financial and non-financial targets.

12.2.3 Performance measurement and control defines remunerations

Measuring results and achievements correctly and consistently is, and will continue to be, a challenge. Good systems and processes for performance measurement are important for fair and equal treatment of employees under variable remuneration schemes. This applies to both quantitative and qualitative criteria. Nordea meets this challenge by undertaking continuous improvements in the financial reporting processes as well as having clear governance and approval processes, including the grandparent principle. When assessing goal and target fulfilment, discretionary judgment is furthermore applied in addition to absolute outcome.

There is always a risk of fraudulent actions by one or more employees. This means that there is a risk of e.g. manipulating results. Nordea mitigates this risk by means of its internal control framework which is based on the control environment, and includes the following elements: Values and management culture, goal orientation and follow-up, a clear and transparent organisational structure, segregation of duties, the four-eye principle, quality and efficiency of internal communication and an independent evaluation process.

12.2.4 Annual review of all remuneration schemes

Nordea meets reputational challenges by performing an annual review of all remuneration schemes, aiming at having competitive remuneration schemes, while at the same time ensuring that these schemes are based on the Group's business strategies and goals. Nordea also meets the challenge by disclosing relevant information in terms of policies and principles, specific schemes, amount in respect of variable remuneration in the Group, as well as total compensation to executive management and the Board of Directors.

12.3 Bonus schemes risk analysis

Bonus schemes are only offered to selected groups of employees employed in specific businesses areas or units approved by the Board of Directors. Nordea pays bonuses linked to performance where both divisional bonus pools and individual allocations are being explicitly based on defined performance measures. Divisional financial performance is measured as risk-adjusted profits, explicitly incorporating capital and funding costs, and is adjusted for multi-period revenue effects and minimum required profit. In the event of weak or negative overall results for the Nordea Group, bonus pools can be adjusted downwards at the discretion of the Board of Directors. As such, individual compensation is determined based on detailed performance evaluations covering a range of financial and non-financial factors.

Inappropriate individual bonuses are prevented through both caps on the percentage of risk-adjusted profit that can be paid out, as well as individual caps. Nordea has introduced deferral programmes for the staff in the risk analysis, defined as Identified Staff.

Care is taken to ensure that control and compliance staff employed in divisions with bonus schemes are competitively rewarded although not eligible for bonus.

The Board of Directors decides on new or revised bonus schemes and the outcome of divisional bonus pools by proposal from Board Remuneration Committee. Group Executive Management is responsible for the implementation of the agreed bonus schemes. Nordea also applies a stringent process to ensure that

compensation for individuals does not encourage excessive risk-taking behaviour. To supplement the division-level assessment, there is an approval process for significant bonuses to individuals, with the CEO's approval required for bonuses exceeding a predetermined level.

12.4 Additional disclosures on remuneration

Additional disclosures on remuneration under Nordic FSAs' regulations and general guidelines are published in the Annual Report and in a separate report on Nordea's web site (www.nordea.com) in due time before the Annual General Meeting of shareholders.

13. Appendix

13.1 General description of Pillar I, II and III

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 II) drawn up by the Basel Committee on Banking Supervision. Within the EU, the capital adequacy requirements are outlined in the CRD III.

Over the years, amendments have been made to the first version of the CRD regulation. CRD II and CRD III were implemented at the end of 2010 and 2011and strengthened the large exposure regime, increased the quality of the capital base and added stricter securitisation regulation. The final version of the Capital Requirement Directive (CRD IV) and Capital Requirement Regulation (CRR), which was published in June 2013, require higher capitalisation levels and better quality of capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk based requirement, measures to promote the build-up of capital that can be drawn in periods of stress and the introduction of liquidity standards. The Directive will be implemented through national law within all EU countries during 2014, while the Regulation will become applicable in all EU countries from 1 January 2014.

The Basel II framework is built on three pillars:

- Pillar I requirements for the calculation of RWA and capital requirements
- Pillar II rules for the Supervisory Review Process (SRP), including the ICAAP
- Pillar III rules for the disclosure on risk and capital management, including capital adequacy

13.1.1 Pillar I

Pillar I relates to the estimation, management and reporting of minimum capital requirements for credit risk, market risk, and operational risk. Banks can apply more or less sophisticated methods to calculate their RWA. More risk-sensitive models to estimate credit risk, market risk or operational risk require approval from the supervisory authorities.

There are three approaches for reporting capital requirements for credit risk in the CRD:

- 1. The standardised approach (SA), where calculation of credit risk is close to Basel I regulation, except an additional possibility to use external ratings for counterparties and a wider use of financial collateral. RWA is calculated by multiplying the exposure with a risk weight factor dependent on the external rating and exposure class.
- 2. The Foundation IRB (FIRB) calculation for credit risk is based on the internal rating and PD for each counterpart and fixed (supervisory) estimates for LGD, CCF and maturity.
- 3. The Advanced IRB (AIRB) calculations are based on internal estimates for PD, LGD, CCF and maturity. For the Retail IRB approach (RIRB), maturity is not included in the calculations.

Pillar I also encompasses the design, implementation, validation, oversight and performance of the credit risk classification systems.

13.1.2 Pillar II

Pillar II or the Supervisory Review Process (SRP), comprises two processes:

- the Internal Capital Adequacy Assessment Process (ICAAP); and
- the Supervisory Review and Evaluation Process (SREP).

The SRP is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes, to support the risks taken. The SRP also encourages institutions to develop and employ better risk management techniques in monitoring and measuring risk in addition to the credit risk, market risk and operational risk in the CRD. The ICAAP allows banks to review their risk management policies and capital positions relative to the risk they take. In the ICAAP, the institution ensures it has sufficient available capital to meet regulatory and internal capital requirements, also during periods of economic or financial stress. The ICAAP covers all components of risk management, from daily risk

management of material risk to the more strategic capital management of the Group and its legal entities. The SREP constitutes the supervisory review of the institutions' capital management and the assessment of their internal controls and governance.

Other risk types, which are not covered by the minimum capital requirements according to Pillar I, are typically liquidity risk, business risk, interest rate risk in the banking book, pension risk, real estate risk and concentration risk. These are covered either by capital or risk management and mitigation processes under Pillar II. In the calculation of economic capital (EC), Pillar II risks as well as risk in the life insurance operations are included. Liquidity risk is not included in the EC framework, but instead mitigated through the active management of liquidity. For further information on Pillar II, please see chapter 10.

13.1.3 Pillar III

The CRD also stipulates how and when institutions should make disclosures on capital and risk management. The disclosure should follow the requirements according to Pillar III. The main requirements are:

- Description of the Group structure and overall risk and capital management
- Regulatory capital requirements and the capital base
- Credit risk, including RWA calculations and loan losses
- Market risk
- Operational risk
- Liquidity risk
- Remuneration policy

13.2 IRB approach

Nordea is approved to use the IRB approach for the exposure classes institution, corporate, retail and other non-credit obligation assets. For the remaining exposure classes, Nordea used the standardised approach in 2013. Following is a description of what exposures are included in the different exposure classes.

13.2.1 IRB exposure classes

13.2.1.1 Institution exposure

Exposure to credit institutions and investment firms is classified as exposure to institutions. In addition, exposure to regional governments, local authorities and multilateral development banks is classified as exposure to institutions unless it is treated as exposure to sovereigns according to regulations issued by the authorities.

13.2.1.2 Corporate exposure

Exposure that does not fall into any of the other exposure classes is classified as corporate exposure. The corporate exposure class contains exposure that is rated in accordance with Nordea's guidelines for rating.

13.2.1.3 Retail exposure

Exposure to SMEs (with an exposure of less than EUR 250k¹) and private individuals are included in the retail exposure class and defined in accordance with Nordea's internal guidelines for scoring.

13.2.1.4 Other non-credit obligation assets

Assets that do not require any performance from any counterparty are classified as non-credit obligation assets.

13.2.2 Calculation of RWA in IRB approach

The calculation of EAD in Nordea differs between approaches but is also depending on the exposure classes within the IRB approach.

¹ EUR 100k in Baltic countries and Poland.

The FIRB approach is used for calculating the minimum capital requirements for exposure to institutions and corporate customers. Input parameters are Nordea's internal estimate of PD while LGD, EAD and maturity are set by the supervisory authorities.

Internal estimates of PD, LGD and EAD are used in the retail IRB approach. Retail IRB risk parameters differ from the AIRB risk parameters in two respects; first, the asset correlation assumptions are different and second, the retail IRB risk weight functions do not include maturity adjustments.

13.2.2.1 Exposure at default (EAD)

EAD is an estimate of the total exposure to the customer at the time of default. For on-balance sheet items, EAD is normally the same as the booked value, such as the market value or utilisation. For off-balance exposures, a CCF is multiplied with the amount to estimate how much of the exposure will be drawn at default.

13.2.2.2 Probability of default (PD)

PD means the likelihood of default of a counterpart and represents the long-term average of yearly default rates. The internal credit risk classification models provide an estimate of the repayment capacity of the counterpart. The internal risk classification scale consists of 18 grades for non-defaulted customers and three grades for defaulted customers. All customers with the same risk classification are expected to have the same repayment capacity; independent of the customers' industry, size, etc.

13.2.2.3 Loss given default (LGD)

The LGD measures the economic loss that can be expected if a customer defaults. The regulatory capital requirements are dependent on LGD.

For the FIRB institution and corporate exposure classes, LGD values are fixed by the supervisory authorities. The LGD values in the retail IRB approach are based on internal estimates. Nordea uses LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. The LGD pools are based on collateral types, country and customer type.

LGD values in the AIRB approach are calculated using similar internal calculations as for the retail IRB portfolio.

13.2.2.4 Credit risk mitigation

RWA and exposures are reduced by the application of credit risk mitigation techniques. Only certain types of collateral and some issuers of guarantees are eligible to reduce RWA and hence the capital requirement. Furthermore, the collateral management process and the terms in the collateral agreements have to fulfil the minimum requirements (such as procedures for monitoring of market values as well as insurance and legal certainty) stipulated in the capital adequacy regulations. Collateral items and guarantees which do fulfil the minimum capital requirements are defined as eligible collateral.

Nordea uses a wide variety of risk mitigation techniques in different markets which contribute to risk diversification and credit protection.

13.2.2.5 Maturity

For exposure calculated under the FIRB approach, maturity is set to standard values in the RWA calculation formula based on the estimates set by the financial supervisory authorities. The maturity parameter is set to 2.5 years for the exposure types on-balance sheet items, off-balance sheet items and derivatives. For securities financing the maturity parameter is set to 0.5 years. Under the RIRB approach, maturity is not included in the RWA calculation.

13.3 Standardised approach

13.3.1 Standardised exposure classes

13.3.1.1 Central governments and central banks

Exposure to central governments and central banks is treated as low risk if the counterparty is within the member states and/or has a high rating.

13.3.1.2 Regional governments and local authorities

Exposure to regional governments and local authorities is treated as exposure to the central government in whose jurisdiction they are established if there is no differences in risk weight between the government and the local authority (with the exception of Norway, where a risk weight of 20% is applied).

13.3.1.3 Institution exposure

Exposure to institutions is assigned a risk weight by an eligible rating agency depending on the credit quality steps of the central government in the jurisdiction (although risk weight cannot be lower than 20%). Specific rules determined how to treat an exposure where no rating exists. The rating cannot be lower than that of the central government in the jurisdiction of the institution.

13.3.1.4 Corporate exposure

Exposure to corporates rated by an eligible rating agency is assigned a risk weight between 20% and 150%. Exposure without rating agency rating is assigned a risk weight of 100%.

13.3.1.5 Retail exposure

Retail exposure is assigned a risk weight of 75%.

13.3.1.6 *Exposure secured by real estate*

Exposure secured by mortgages on residential real estate is assigned a risk weight of 35%². The risk weight is only reduced for the part of the exposure that is fully secured. Exposure that is secured by commercial real estate is subject to national discretions and the regulation differs between the Nordic countries.

13.3.1.7 Other

Additional exposure classes exist within the standardised approach, such as:

- Exposure to public sector entities
- Exposure to multilateral development banks
- Exposure to named international organisations
- Exposures in default
- High risk exposures
- Equity exposures
- Past due items
- Short-term claims.

13.3.2 Calculation of RWA in the standardised approach

The standardised approach remains in use for some portfolios. The standardised approach is the least sophisticated of the capital calculation approaches. The risk weights in the standardised approach are set by the supervisory authorities and are based on external rating and exposure class. Some exposure classes are derived from the type of counterparty while others are based on asset type, product type, collateral type or exposure size. The EAD of an on-balance sheet exposure in the standardised approach is measured net of value adjustments such as provisions. Off-balance sheet exposure is converted into EAD using a CCF set by the FSAs. Derivative contracts and securities financing have an EAD that is the same amount as the exposure.

² Except for Polish exposures secured by real estate denominated in foreign currency, which have a risk weight of 100% according to local regulations.

List of abbreviations

ADF	Actual Default Frequency
AIRB	Advanced Internal Ratings Based
ALCO	Asset and Liability Committee
AML	Anti-money laundering
AR	Annual Report
BCBS	Basel Committee on Banking Supervision
BCM	Business Continuity Management
BEM	Banks and emerging markets
BRRD	Bank Recovery and Resolution Directive
CCF	Credit Conversion Factor
CCO	Chief Credit Officer
CCP	Central Counterparties
CCR	Counterparty credit risk
CDO	Collateralised Debt Obligation
CDS	Credit Default Swap
CEM	Current Exposure Method
CET1	Common equity tier 1
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIB	Corporate and Institutional Banking
CLN	Credit-Linked Notes
CLS	Continuous Linked Settlement
СР	Commercial Paper
CRD	The EU's Capital Requirements Directive
CRM	Comprehensive Risk Measure
CRO	Chief Risk Officer
CRR	Capital Requirement Regulation
CVA	Credit Valuation Adjustment
EAD	Exposure at Default
EBA	European Banking Authority
EC	Economic capital
ECC	Executive Credit Committee
EL	Expected Loss
EP	Economic profit
ERAT	Environmental Risk Assessment Tool
EU	European Union
FIRB	Foundation Internal Rating Based
	approach
FSA	Financial Supervisory Authority
FSB	Financial Stability Board
FX	Foreign exchange
G-SII	Global systemically important institutions
GCCR	Group Credit Committee Retail Banking
GCCW	Group Credit Committee Wholesale
	Banking

GDP	Gross Domestic Product
GEM	Group Executive Management
GEM CC	Group Executive Management Credit
	Committee
GICS	Global Industries Classification Standard
HLEG	High-level expert group
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment
	Process
IFRS	International Financial Reporting Standard
IMM	Internal Model Method
IRB	Internal Rating Based approach
IRM	Incremental Risk Measure
KPI	Key performance indicators
LCR	Liquidity Coverage Ratio
LGD	Loss given default
NBSF	Net Balance of Stable Funding
NLP	Nordea Life & Pensions
NSFR	Net Stable Funding Ratio
O-SII	Other systemically important institutions
OTC	Over-the-counter
ORX	Operational Riskdata eXchange
	Association
P/L	Profit and Loss
PD	Probability of default
PIT	Point-in-time
QRA	Quality and Risk Analysis
RCSA	Risk and Control Self-Assessment
RCO	Risk and Compliance Officer
RWA	Risk-weighted assets
S&P	Standard & Poor's
SA	Standardised approach
SIIR	Structural Interest Income Risk
SME	Small and medium-sized enterprises
SOO	Shipping, oil and offshore
SPE	Special Purpose Entity
SPRAT	Social and Political Risk Assessment Tool
SREP	Supervisory Review and Evaluation
	Process
SRP	Supervisory Review Process
SSM	Single Supervisory Mechanism
TTC	Through-the-cycle
VaR	Value-at-Risk