Nordea Mortgage Bank Plc

Opening balance sheet

1 October 2016

Balance sheet

Euros	Note	Audited opening balance sheet 1 October 2016	Unaudited adjusted opening balance sheet 1 October 2016[2]
Assets			
Cash and balances with central banks[1]		211 126 186,25	211 126 186,25
Loans to credit institutions	2	179 745 292,42	379 745 292,42
Loans to the public	2	24 450 181 270,13	24 450 181 270,13
Derivatives	3	1 037 183 824,99	1 037 183 824,99
Accrued income	4	16 262 624,13	16 262 624,13
Total assets		**25 894 499 197,92**	**26 094 499 197,92**
Liabilities			
Deposits by credit institutions	5	8 700 000 000,00	8 700 000 000,00
Debt securities in issue	6	15 283 690 253,58	15 283 690 253,58
Derivatives	3	21 155 444,62	21 155 444,62
Fair value changes of the hedged items in portfolio hedge of interest rate risk		785 628 977,64	785 628 977,64
Accrued expenses and prepaid income	7	52 209 495,72	52 209 495,72
Subordinated liabilities			200 000 000,00
Total liabilities		**24 842 684 171,56**	**25 042 684 171,56**
Equity			
Share capital		250 000 000,00	250 000 000,00
Other reserves		801 815 026,36	801 815 026,36
Total equity		**1 051 815 026,36**	**1 051 815 026,36**
Total liabilities and equity		**25 894 499 197,92**	**26 094 499 197,92**
Assets pledged as security for own liabilities	8	22 746 065 935,77	22 746 065 935,77
Credit commitments	9	6 528 882,38	6 528 882,38

Other notes
Note 1 Accounting policies
Note 10 Classification of financial instruments

[1] As it was not possible to open an account in the central bank, interest bearing securities having the same nature as deposits from central banks have been transferred in the demerger.
[2] The unaudited adjusted opening balance sheet 1 October shows the balance sheet after Nordea Bank Finland Plc has provided a subordinated loan to Nordea Mortgage Bank Plc. Nordea Mortgage Bank Plc issued a subordinated loan to Nordea Bank Finland Plc. The loan is subordinated to other liabilities. The nominal value and carrying amount of the subordinated loan is EUR 200 million, maturity date 1 October 2026, call date 1 October 2021 and interest rate 3-month EURIBOR + margin 1.42% per annum.

Statement of changes in equity

	Attributable to the shareholders of Nordea Mortgage Bank Plc			
		Other reserves		
Euros	Share capital	Cash flow hedges	Other reserves	**Total equity**
Balance at 1 October 2016	250 000 000,00	1 815 026,36	800 000 000,00	**1 051 815 026,36**

Notes to the balance sheet

Note 1 Accounting policies

1. Basis for presentation

Nordea Mortgage Bank Plc (**"NMB"**, business identity code 2743219-6) was established 1 October 2016 via a demerger from Nordea Bank Finland Plc (business identity code 1680235-8). In connection with the demerger all the assets, liabilities and reserves relating to the covered bond funding business of Nordea Bank Finland Plc were transferred to Nordea Mortgage Bank Plc. All the transferred assets, liabilities and reserves are presented in the opening balance of Nordea Mortgage Bank Plc using the accounting and valuation principles of Nordea Bank Finland Plc.

This special-purpose Nordea Mortgage Bank Plc opening balance sheet and summary of significant accounting policies and other explanatory notes (together **"Opening balance sheet"**) as at 1 October 2016 are prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU. However they are not a complete set of financial statements as defined in IAS 1.10 as the Opening balance sheet omits the statement of comprehensive income, the statement of changes in equity and the statement of the cash flows as well as comparative information. No carve-out financial information has been prepared for the covered bond funding business of Nordea Bank Finland Plc for the historical periods prior to the date of the Opening balance sheet as defined in Commission Regulation (EC) no 211/2007.

Also, certain complementary rules in the Finnish Accounting Act, the Finnish Credit Institutions Act, the Financial Supervision Authority's Regulations and Guidelines and the Decision of the Ministry of Finance on the financial statements and consolidated statements of credit institutions have also been applied. The Opening balance sheet was authorized for issue by Nordea Mortgage Bank Plc on 21 October 2016.

The Opening balance sheet has been prepared for the purpose of presenting the opening balance information in the Covered Bond Programme prospectus in October 2016.

2. Critical judgements and estimation uncertainty

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

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

Critical judgements and estimates are in particular associated with:

- the fair value measurement of certain financial instruments;
- the impairment testing of loans to the public/credit institutions;
- the effectiveness testing of cash flow hedges;
- the translations of assets and liabilities; denominated in foreign currencies; and
- the valuation of deferred tax assets.

Fair value measurement of certain financial instruments

Critical judgements that have a significant impact on the recognised amounts for financial instruments are exercised when determining fair value of OTC derivatives and other financial instruments that lack quoted prices or recently observed market prices. Those judgements relate to the following areas:

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

When determining fair value of financial instruments that lack quoted prices or recently observed market prices there is also a high degree of estimation uncertainty. That estimation uncertainty is mainly a result of the judgement management exercises when:

- selecting an appropriate discount rate for the instrument, and
- determining expected timing of future cash flows from the instruments.

In all of these instances, decisions are based upon professional judgement in accordance with NMB's accounting and valuation policies. In order to ensure proper governance, the Valuation Committee in Nordea Bank AB (publ) reviews on an on-going basis critical judgements that are deemed to have a significant impact on fair value measurements.

Impairment testing of loans to the public/credit institutions
Management is required to exercise critical judgements and estimates when calculating loan impairment allowances on both individually assessed and collectively assessed loans.

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

See also the separate section 10 "Loans to the public/credit institutions".

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

NMB's accounting policies for cash flow hedges are described in section 6 "Hedge accounting".

Translation of assets and liabilities denominated in foreign currencies
NMB's accounting policies covering the translation of assets and liabilities denominated in foreign currencies is described in section 5 "Translation of assets and liabilities denominated in foreign currencies".

3. Recognition of operating income and impairment

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

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

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

Net fee and commission income
NMB's earns commission income from different services provided to its customers. Commission income and commission expenses are normally transaction based and recognised in the period when the services are received.

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

Realised and unrealised gains and losses derive from:

- interest-bearing securities and other interest-related instruments;
- foreign exchange gains/losses; and
- other financial instruments.

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

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

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

Net loan losses
Impairment losses from financial assets classified into the category Loans and receivables (see section 9 “Financial instruments”), in the items “Loans to central banks”, “Loans to credit institutions” and “Loans to the public” on the balance sheet, are reported as ”Net loan losses”. Losses are reported net of any collateral and other credit enhancements. NMB’s accounting policies for the calculation of impairment losses on loans can be found in section 10 “Loans to the public/credit institutions”.

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

4. Recognition and derecognition of financial instruments on the balance sheet

Derivative instruments, quoted securities, debt securities in issue and foreign exchange spot transactions are recognised on and derecognised (reclassified to the items “Other assets” or ”Other liabilities” on the balance sheet between trade date and settlement date) on the trade date. Other financial instruments are recognised on the balance sheet on settlement date.

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

In some cases, NMB enters into transactions where it transfers assets that are recognised on the balance sheet, but retains either all or a portion of risks and rewards from the transferred assets. If all or substantially all risks and rewards are retained, the transferred assets are not derecognised from the balance sheet. If NMB’s counterpart can sell or repledge the transferred assets, the assets are reclassified to the item “Financial instruments pledged as collateral” on the balance sheet. Transfers of assets with retention of all or substantially all risks and rewards include e.g. securities lending agreements and repurchase agreements.

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

5. Translation of assets and liabilities denominated in foreign currencies

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

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

6. Hedge accounting

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

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

There are three forms of hedge accounting:

- fair value hedge accounting;
- cash flow hedge accounting; and
- hedges of net investments.

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

Fair value hedge accounting
Fair value hedge accounting is used when derivatives are hedging changes in fair value of a recognised asset or liability attributable to a specific risk. The risk of changes in fair value of assets and liabilities in NMB’s

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

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

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

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

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

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

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

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

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

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

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

7. Determination of fair value of financial instruments

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

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

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

Whether markets are active or non-active is assessed regularly. The trade frequency and volume are monitored daily.

NMB is predominantly using published price quotations to establish fair value for items disclosed under the balance sheet item Interest-bearing securities.

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

Valuation models are designed to apply observable market prices and rates as input whenever possible, but can also make use of unobservable model parameters. NMB is predominantly using valuation techniques to establish the fair value for interest-bearing securities (when quoted prices in an active market are not available) and derivatives (OTC-derivatives).

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

The valuation models applied by NMB 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 a Model Risk Management Committee and all models are reviewed on a regular basis.

8. Cash and balances with central banks

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

- the central bank is domiciled in the country where the institution is established, and
- the balance is readily available at any time.

9. Financial instruments

Classification of financial instruments

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

All financial assets and liabilities are initially measured at fair value. The classification of financial instruments into different categories forms the basis for how each instrument is subsequently measured on the balance sheet and how changes in its value are recognised.

Loans and receivables

Loans and receivables are non-derivative financial assets, with fixed or determinable payments, that are not quoted in an active market. These assets and their impairment are further described in the separate section 10 “Loans to the public/credit institutions”.

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

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

The sub-category Held for trading mainly contains derivative instruments that are held for trading purposes and interest-bearing securities.

Other financial liabilities
Other financial liabilities are measured at amortised cost. Interest on Other financial liabilities is recognised in the item “Interest expense” in the income statement.

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

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

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

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

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

Loans to the public/credit institutions

Financial instruments classified as “Loans to the public/credit institutions” (including loans to central banks) on the balance sheet and into the category Loans and receivables are measured at amortised cost (see also the separate section 5 “Recognition and derecognition of financial instruments on the balance sheet”).

NMB monitors loans on a continuous basis. Loans attached to individual customers or groups of customers are identified as impaired if the impairment tests indicate an objective evidence of impairment.

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

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

Impairment test of collectively assessed loans
Loans not impaired on an individual basis are collectively tested for impairment. These loans are grouped on the basis of similar credit risk characteristics that are indicative of the debtors´ ability to pay all amounts due according to the contractual terms. NMB monitors its portfolio through rating migrations, the credit decision and annual review process supplemented by quarterly risk reviews. Through these processes NMB identifies loss events indicating incurred losses in a group. A loss event is an event resulting in a deterioration of the expected future cash flows. Only loss events incurred up to the reporting date are included when performing the assessment of the group.

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

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

Personal customers and small corporate customers are monitored through scoring models. These are based mostly on historical data, as default rates and loss rates given a default, and experienced judgement performed by management.

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

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

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

If the impairment loss is not regarded as final, the impairment loss is accounted for on an allowance account representing the accumulated impairment losses. Changes in the credit risk and accumulated impairment losses are accounted for as changes in the allowance account and as ”Net loan losses” in the income statement (see also section 3 “Recognition of operating income and impairment”).

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

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

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

10. Taxes

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

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

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

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

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

11. Employee benefits

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

Short-term benefits
Short term benefits consist mainly of fixed and variable salary. Both fixed and variable salaries are expensed in the period when the employees have performed services to NMB. NMB has also issued a share-based payment programmes, which is further described in section 15 “Share-based payment”.

Post-employment benefits
Pension plans
NMB has defined contribution pension plans only. NMB’s defined contribution arrangements hold no pension liability for NMB.

Pension costs
Obligations for defined contribution pension plans are recognised as an expense as the employee renders services to the entity and the contribution payable in exchange for that service becomes due.

12. Equity

Other reserves
Other reserves comprise income and expenses, net after tax effects, which are reported in equity through other comprehensive income. These reserves include fair value reserves for cash flow hedges as well as a reserve for translation differences.

Retained earnings
Retained earnings comprise undistributed profits from previous years.

13. Credit commitments

The contractual amount of irrevocable credit commitments is recognised off-balance sheet in the item “Credit commitments”.

14. Share-based payment

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

Related party transactions

NMB defines related parties as:

- shareholder with significant influence;
- group undertakings;
- key management personnel, and
- other related parties.

All transactions with related parties are made on an arm’s length basis, apart from loans granted to employees.

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

Nordea Group undertakings
Nordea Group undertakings means the subsidiaries of the parent company Nordea Bank AB (publ) (Corp. reg. no. 516406-0120).

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

Key management personnel
Key management personnel include the following positions:

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

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

Risk, Liquidity and Capital management

Management principles and control
Nordea Mortgage Bank Plc is fully integrated into the Nordea Group's risk and capital management, where appropriate, and for this reason it is described herein how this area is dealt with at Nordea Group.

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

The Group Board approves the credit instructions in which the powers-to-act for all major credit committees in the organisation are included. These authorisations vary for different decision-making levels, mainly in terms of size of limits, and are also dependent on the internal risk categorization of customers. The Group Board also decides on the limits for market and liquidity risk in the Group.

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

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 in Group Executive Management (GEM) decides on the Group's earnings volatility measurement framework(s) and targets for these, such as the Structural Interest Income Risk (SIIR).

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 (ALCO), chaired by the Group Chief Operating Officer (COO), prepares issues of major importance concerning the Group's financial operations and balance sheet risks either for decision by the CEO in GEM or for recommendation by the CEO in GEM and for decision by the Group Board.

- 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. Further, within the scope of resolutions adopted by the Board of Directors, the Risk Committee decides on the allocation of the market risk limits and liquidity risk limits to the risk-taking units. 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 subcommittees for its work and decision-making within specific risk areas. Minutes of the meetings in sub-committees are distributed to the members of the Risk Committee.

- The Group Executive Management Credit Committee (GEM CC) is chaired by the CEO and the Executive Credit Committee (ECC) is 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 customer limits. Credit risk limits are granted as individual limits for customers or consolidated customer groups and as industry limits for certain defined industries.

Governance of Risk Management
Group Risk Management and Group Compliance is the second line of defence. The flow of risk related information from the business areas and the group functions to the Board of Directors passes through Risk Committee and Board Risk Committee (BRIC). Group Compliance reports to the Board of Directors through Board Audit Committee (BAC).

Group Risk Management is organised in divisions covering all risk types except compliance risk. The divisions are: Group Credit Risk, Group Credit & Financial Reporting Control, Group Market and Counterparty Credit Risk, Group Operational Risk, Recovery and Resolution Planning and Group Strategic Risk Management and Analysis. The flow of information starts with the divisions that monitor and analyse information on the respective risk type. The risks are presented and discussed in the Risk Committee and sub committees. Information on risk is then brought to BRIC where risk issues are being discussed and prepared before presented to Board of Directors.

Group Compliance is organised in divisions covering all compliance risk types, with compliance divisions allocated to each Business Area. The purpose of Group Compliance is to add value to the Nordea Group and its stakeholders by providing an independent view on compliance to rules and regulations applicable to the Group, and by contributing to an effective and efficient compliance risk management.

Risk appetite

Risk appetite within the Nordea Group is defined as the level and nature of risk that the bank is willing to take in order to pursue the articulated strategy on behalf of shareholders, and is defined by constraints reflecting the views of shareholders, debt holders, regulators and other stakeholders.

The Board of Directors of Nordea Bank AB (publ) is ultimately responsible for the overall risk appetite of the Group and for setting the principles for how risk appetite is managed. The Board Risk Committee assists the Board of Directors in fulfilling these responsibilities by reviewing the development of the risk profile in relation to the risk appetite and by making recommendations regarding changes to the Group’s risk appetite.

Nordea’s risk appetite framework is based on explicit top-down risk appetite statements ensuring comprehensive coverage of key risks faced by the Group. These statements collectively define the boundaries for Nordea’s risk-taking activities and will also help identify areas with scope for additional risk taking. The statements are approved by the Board of Directors, and set the basis for a new risk reporting structure. Moreover, the framework supports management decision processes, such as planning and target setting.

The risk appetite framework considers key risks relevant to Nordea’s business activities and on an aggregate level is represented in terms of credit risk, market risk, operational risk, solvency, compliance/ non-negotiable risks and liquidity risk.

The risk appetite framework is further presented in the Capital and Risk Management Report (Pillar III report).

Monitoring and reporting

The control environment is based on the principles for segregation of duties and independence. Monitoring and reporting of risk are conducted on a daily basis for market and liquidity risk and on a monthly and quarterly basis for credit and operational risk.

Risk reporting including reporting the development of REA (Risk Exposure Amount) is regularly made to the GEM and the Board of Directors. Group Internal Audit (GIA) makes an independent evaluation of the processes regarding the risk and capital management in accordance with the annual audit plan.

Risk management

Credit Risk management

Group Risk Management is responsible for the credit process framework and 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. 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 Board of Directors, credit risk limits are approved by decision-making authorities on different levels in the organisation. The risk categorization of the customer and the exposure decide the level at which the decision will be made. Responsibility for a credit exposure lies with the relevant customer responsible unit. Customers are risk categorized by a rating or score in accordance with Nordea Group’s rating and scoring guidelines.

Credit risk definition and identification

Credit risk is defined as the risk of loss if counterparts fail to fulfil their agreed obligations and the pledged collateral does not cover the existing claims. Credit risk stems mainly from various forms of lending, but also from guarantees and documentary credits, counterparty credit risk in derivative contracts, transfer risk attributable to the transfer of money from another country and settlement risk. For monitoring the distribution of a portfolio, improving the risk management and defining a common strategy towards specific industries there are specific industry credit principles and policies in place establishing requirements and caps.

Credit risk mitigation

Credit risk mitigation is an inherent part of the credit decision process. In every credit decision and review, the valuation of collaterals is considered as well as the adequacy of covenants and other risk mitigations. Pledging of collateral is the main credit risk mitigation technique. In corporate exposures, the main collateral types are real estate mortgages, floating charges and leasing objects. Collateral coverage is higher for exposures to financially weaker customers than for those who are financially strong. Regarding 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 limited extent. Covenants in credit agreements are an important complement to both secured and unsecured exposures. Most exposures of substantial size and complexity include appropriate covenants. Financial covenants are designed to react to early warning signs and are carefully monitored.

Individual and collective assessment of impairment

Throughout the process of identifying and mitigating credit impairments, Nordea continuously reviews the quality of the credit exposures. Weak and impaired exposures are closely and continuously monitored and reviewed at least on a quarterly basis in terms of current performance, business outlook, future debt service capacity and the possible need for provisions.

A provision is recognised if there is objective evidence based on loss events and observable data that the customer's future cash flow is weakened to the extent that full repayment is unlikely, pledged collateral included. Exposures with provisions are considered as impaired. The size of the provision is equal to the estimated loss being the difference between the book value of the outstanding exposure and the discounted value of the future cash flow, including the value of pledged collateral. Impaired exposures can be either performing or non-performing. Exposures that have been past due more than 90 days are by definition regarded as defaulted and non-performing, and reported as impaired or not impaired depending on the deemed loss potential.

Forbearance is negotiated terms or restructuring due to borrowers' financial stress. The intention with granting forbearance for a limited period of time is to ensure full repayment of the outstanding debt. Examples of negotiated terms are changes in amortization profile, repayment schedule, customer margin as well as ease of financial covenants. Forbearance is undertaken on a selective and individual basis and followed by impairment testing. Loan loss provisions are recognized if necessary. Forborne rated customers without impairment charges are fully covered by either collateral and/or the net present value of future cash flows.

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

Counterparty credit risk

Counterparty credit risk is the risk that Nordea's counterpart in a FX, interest, commodity, equity or credit 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.

Market risk

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

Nordea Markets, Group Treasury & Asset & Liability Management (ALM) are the key contributors to market risk in the Nordea Group. Nordea Markets is responsible for the customer driven trading activities, Group Treasury & ALM is responsible for funding activities and investments for Nordea's own account, asset and liability management, liquidity portfolios and pledge/collateral account portfolios. For all other banking activities market risks are transferred to Group Treasury & ALM.

Measurement of market 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 a loss that will be exceeded in one of a 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 a 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 of using longer or shorter time series in the calculation of VaR.

Structural Interest Income Risk
SIIR is the amount by which 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 mismatches 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 Group's SIIR management is based on policy statements resulting in different SIIR measures, and organisational procedures.

Policy statements focus on optimising the 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 & ALM has the responsibility for the operational management of SIIR.

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, where reference rates are floored at zero) measuring the effect on Nordea's net interest income for a 12-month period of a one percentage point increase, respectively decrease, in all interest rates. The balance sheet is assumed to be constant over time, however main elements of customer behaviour and Nordea's decision-making process concerning Nordea's own rates are taken into account.

Operational risk
Operational risk is defined as the risk of direct or indirect loss, or damaged reputation, resulting from inadequate or failed internal processes, from people and systems, or from external events. Operational risk includes legal risk and is inherent in all activities within the organisation, in outsourced activities and in all interactions with external parties.

Managing operational risk is part of the management's responsibilities. The operational risks are monitored through regular risk assessment procedures and a systematic, quality and risk focused management of changes. Development of new products, services, activities as well as processes and systems shall be risk assessed. Identified risk elements and consequences of risk events are mitigated with, inter alia, up to date Business Continuity Plans as well as Group Crisis Management and Communication plans ensuring a good contingency preparedness in all business plans and crisis management structures. External risk transfer is used in the form of insurance, including reinsurance, to cover certain aspects of crime risk and professional liability, including the liability of directors and officers. Nordea furthermore uses insurance for travel, property and general liability purposes.

The key principle for the management of Operational risks is the three lines of defence. The first line of defence is represented by the Business Areas and Group Functions who are responsible for their own daily risk management and for operating their business within limits for risk exposure and in accordance with decided framework for internal control and risk management at the first line of defence. The control function Group Operational Risk, in Group Risk Management is in the second line of defence and is responsible for activities such as independently monitoring, controlling and reporting on issues related to key risks. Group Internal Audit performs audits and provides assurance to stakeholders on internal controls and risk management processes in the third line of defence.

The key process for management of operational risks is the annual Operational Risk Assessment process. The process includes the risk and control self-assessment (RCSA) and the scenario analysis, and puts focus on both the risks on a divisional and unit level threatening its daily activities and the risks which could cause extreme financial losses or other significant impacts to Nordea as well as ensuring fulfilment of requirements specified in Group directives. The risks are identified both through top-down and through bottom-up analysis of results obtained from control questions as well as existing information from processes, such as incident reporting, scenario analysis, quality and risk analyses as well as product approvals. The timing of this process is synchronised with the annual planning process to be able to ensure adequate input to the Group's overall prioritisations.

Compliance risk

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

The key principle for the management of Compliance risk is the three lines of defence. The first line of defence represented by the Business Areas and Group Functions are risk owners, and are responsible for their own daily risk management and control of compliance risks. Management on all levels are responsible for operating their business within defined limits for risk exposure and in accordance with decided directives, instructions and risk management processes, and for implementing and executing Group level and Business Area level instructions and guidelines.

Group Compliance is the second line of defence risk control function in the Group, coordinating, facilitating and overseeing the effectiveness and integrity of the Group's compliance risk management. Group Compliance provides an independent view on compliance to relevant rules and regulations, to a large degree based on carried out monitoring activities. Furthermore, Group Compliance also advises and supports the first line on ways to effectively and efficiently handle compliance obligations. Group Internal Audit performs audits and provides assurance to stakeholders on internal controls and risk management processes in the third line of defence.

To specifically address the deficiencies in this area Nordea has established a Financial Crime Change Programme, which is a holistic approach to develop a group-wide and sustainable standard for the prevention of financial crime.

However, broader change activities aimed to strengthen the general compliance framework in Nordea has accelerated significantly. Initiatives are targeted both towards strengthening the regulatory implementation capability in the first line as well as strengthening Group Compliance to ensure the second line role is carried out in accordance with regulatory and internal requirements.

Liquidity risk management

Management principles and control

Group Treasury & ALM is responsible for pursuing 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. Furthermore, Group Treasury & ALM, together with Group Market and Counterparty Credit Risk, develops the liquidity management and risk frameworks, which consist of policies, instructions and guidelines for the Group as well as the principles for pricing liquidity risk.

The Board of Directors defines the liquidity risk appetite by setting limits for applied liquidity risk measures. The most central measure is survival horizon, which defines the risk appetite by setting the minimum survival of one month under institution-specific and market-wide stress scenarios with limited mitigation actions.

Liquidity risk management

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. Nordea's liquidity management and strategy are 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 the Group's 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 the Group's four domestic markets in the form of a strong and stable retail customer base and a variety of funding programmes. Funding programmes are both short-term (US Commercial Papers, European Commercial Papers, Commercial Papers, 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. Stress testing framework also includes the survival horizon metric, which represents a combined liquidity risk scenario (idiosyncratic and market-wide stress).

Liquidity risk measurement methods

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 total figure for all currencies combined. The total figure for all currencies combined is limited 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 & ALM that can be readily sold or used as collateral in funding operations.

During 2011, the survival horizon metric was introduced. It is conceptually similar to the Basel and EU Liquidity Coverage Ratio. 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 Group and expresses the excess liquidity after a 30-day period without access to market funding. The Board of Directors has set a limit for minimum survival without access to market funding during 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 it as a target that the NBSF should be positive, which means that stable assets must be funded by stable liabilities.

Capital management

Nordea strives to be efficient in its use of capital and therefore actively manages its balance sheet with respect to assets, liabilities and risks. The goal is to enhance returns to shareholders while maintaining a prudent capital structure.

Capital governance

The Board of Directors decides ultimately on the targets for capital ratios and the capital policy in Nordea, while the CEO in GEM decides on the overall framework of capital management. The ability to meet targets and to maintain minimum capital requirements is reviewed regularly within the Asset and Liability Committee (ALCO) and the Risk Committee.

Minimum capital requirements

Risk exposure amount (REA) is calculated in accordance with the requirements in the CRD. Nordea uses the advanced IRB approach for corporate exposures in the Nordic region and the retail IRB approach for the majority of the retail exposures in Finland.

For operational risk NMB applies the standardised approach.

Internal capital requirement
Nordea bases its internal capital requirements under the Internal Capital Adequacy Assessment Process (ICAAP) on risks defined by the CRD and risks internally defined under Pillar II. The following major risk types are included in the internal capital requirement: credit risk, market risk and operational risk. Additionally, interest rate risk in the banking book, risk in Nordea's sponsored defined benefit pension plans, real estate risk and concentration risk are explicitly accounted for.

In addition to calculating risk capital for its various risk types, Nordea 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, along with potential management interventions, in Nordea's internal capital requirements as buffers for economic stress. The internal capital requirement is a key component of Nordea's capital ratio target setting.

The ICAAP also describes Nordea's management, mitigation and measurement of material risks and assesses the adequacy of internal capital by defining internal capital requirements reflecting the risk of the institution. Regulatory buffers were introduced with the implementation of CRD IV.

Economic Capital (EC)
Nordea's Economic Capital model is based on the same risk components as the ICAAP but also includes risks in the insurance businesses. EC is calculated for the conglomerate whereas the ICAAP, which is governed by the CRD, covers only the financial group. EC is aligned to CET1 capitalisation requirements in accordance to CRD IV. Additional capital items were introduced in the EC during 2014 to reduce the gap between legal equity and allocated capital.

Economic Profit (EP)
Nordea uses EP as one of its financial performance indicators. EP is calculated as risk-adjusted profit less the cost of equity. The risk-adjusted profit and EP are measures to support performance management and shareholder value creation. In investment decisions and customer relationships, EP drives and supports the operational decision-making process in Nordea. The EP model also captures both growth and return. EC and expected losses (EL) are inputs in the EP framework.

Expected losses (EL)
EL reflects the normalised loss level of an individual credit exposure over a business cycle as well as various portfolios. During 2015 there were no changes to the EL framework apart from the regular update of parameters based on the latest validations.

EL is a more stable measure than actual losses, but it will vary with the business cycle as a consequence of shifts in the repayment capacity (PD dimension) and collateral coverage (LGD dimension) distributions.

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

Additional Tier 1 and Tier 2 capital consist mostly of undated and dated subordinated loans, respectively. Holdings of other financial sector entities' subordinated loans are deducted from the corresponding tier.

Note 2 Loans and impairment

EURm	Central banks and credit institutions 1 Oct 2016	The public 1 Oct 2016	Total 1 Oct 2016
Loans, not impaired	180	24 462	24 642
Loans before allowances	**180**	**24 462**	**24 642**
Allowances for collectively assessed impaired loans	-	-12	-12
Allowances	**-**	**-12**	**-12**
Loans, carrying amount	**180**	**24 450**	**24 630**

Note 3 Derivatives and hedge accounting

	Fair value		
1 Oct 2016, EURm	Positive	Negative	Total nom. amount
Derivatives held for trading			
Interest rate derivatives			
Other	109	21	8 739
Total	109	21	8 739
Total derivatives held for trading	**109**	**21**	**8 739**
Derivatives used for hedge accounting			
Interest rate derivatives	884	0	14 965
Foreign exchange derivatives	44	-	147
Total derivatives used for hedge accounting	**928**	**0**	**15 112**
- of which cash flow hedges	2	-	147
- of which fair value hedges	926	0	14 965
Total derivatives	**1 037**	**21**	**23 851**

Note 4 Prepaid expenses and accrued income

EURm	1 Oct 2016
Accrued interest income	16
Total	**16**

Note 5 Deposits by credit institutions

EURm	1 Oct 2016
Banks	8 700
Total	**8 700**

Note 6 Debt securities issue

EURm	1 Oct 2016
Covered bonds	15 284
Total	**15 284**

Note 7 Accrued expenses and prepaid income

EURm	1 Oct 2016
Prepaid income	52
Total	**52**

Note 8 Assets pledged as security for own liabilities

EURm	1 Oct 2016
Loans to the public	22 746
Total	**22 746**

The above pledges pertain to the following liabilities

Debt securities in issue	15 284
Total	**15 284**

Note 9 Commitments

EURm	1 Oct 2016
Loan commitments	7
Total	**7**

Note 10 Classification of financial instruments

1 Oct 2016, EURm	Loans and receivables	Held to maturity	Financial assets at fair value through profit or loss: Held for trading	Financial assets at fair value through profit or loss: Designated at fair value through profit or loss	Derivatives used for hedging	Available for sale	Non-financial assets and associates	Total
Assets								
Cash and balances with central banks	211	-	-	-	-	-	-	211
Loans to credit institutions	180	-	-	-	-	-	-	180
Loans to the public	24 450	-	-	-	-	-	-	24 450
Derivatives	-	-	109	-	928	-	-	1 037
Prepaid expenses and accrued income	16	-	-	-	-	-	-	16
Total	**24 857**	**-**	**109**	**-**	**928**	**-**	**-**	**25 894**

1 Oct 2016, EURm	Financial liabilities at fair value through profit or loss: Held for trading	Financial liabilities at fair value through profit or loss: Designated at fair value through profit or loss	Derivatives used for hedging	Other financial liabilities	Non-financial liabilities	Total
Liabilities						
Deposits by credit institutions	-	-	-	8 700	-	8 700
Debt securities in issue	-	-	-	15 284	-	15 284
Derivatives	21	-	0	-	-	21
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	786	-	786
Accrued expenses and prepaid income	-	-	-	52	-	52
Total	**21**	**-**	**0**	**24 822**	**-**	**24 843**

Signatures of the Board of Directors and Chief Executive Officer

Helsinki, 21 October 2016

Topi Manner

Hanna-Maria Heikkinen

Riikka Laine-Tolonen

Nina Luomanen

Ola Littorin

Jussi Mekkonen

Thomas Miller
Chief Executive Officer

pwc

Independent Auditor's Report

To the Board of Directors of Nordea Mortgage Bank Plc

We have audited the opening balance sheet of Nordea Mortgage Bank Plc as at 1 October 2016 and a summary of significant accounting policies and other explanatory information (together the "balance sheet").

Responsibility of the Board of Directors and the Managing Director for the balance sheet

The Board of Directors and the Managing Director are responsible for the preparation of balance sheet that gives a true and fair view in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The Board of Directors is responsible for the appropriate arrangement of the control of the company's accounts and finances, and the Managing Director shall see to it that the accounts of the company are in compliance with the law and that its financial affairs have been arranged in a reliable manner.

Auditor's Responsibility

Our responsibility is to express an opinion on the balance sheet based on our audit. The Auditing Act requires that we comply with the requirements of professional ethics. We conducted our audit in accordance with good auditing practice in Finland. Good auditing practice requires that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the balance sheet. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the balance sheet that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the balance sheet.

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

Opinion

In our opinion, the balance sheet gives a true and fair view of the financial position of Nordea Mortgage Bank Plc as at 1 October 2016 in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Emphasis of Matter

Without modifying our opinion, we draw to user's attention that the balance sheet does not comprise a full set of financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Helsinki 25 October 2016

PricewaterhouseCoopers Oy
Authorised Public Accountants

Jukka Wahlroos
Authorised Public Accountant (KHT)

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