Nordea

Year-end Report 2020

Nordea Hypotek AB (publ)

This Year-end Report has not been subject to review by the Company's auditors.

Contents

Layout och produktion: Chimney Group

Year-end Report 2020

The Board of Directors and the President of Nordea Hypotek AB (publ) (corp. id no. 556091–5448), hereby present the Year-end Report for 2020. The company is a wholly owned subsidiary of Nordea Bank Abp (corp. id no. 2858394-9).

Key ratios

	2020 31 Dec	2020 30 Jun	2019 31 Dec	2019 30 Jun	2018 31 Dec
Return on average shareholders equity, %	15.6	13.2	15.9	16.0	19.6
Cost/income ratio, %	22.7	27.5	22.1	23.8	15.6
Loan loss ratio, basis points[1]	1.2	1.9	0,3	0.2	2.7
- of which stage 1	0.5	0.8	0.7	0.0	0.1
- of which stage 2	0.4	0.5	−0.3	0.1	0.2
- of which stage 3	0.3	0.6	0.9	0.1	2.5
Impairment rate (stage 3), net, bps[1]	8.0	8.3	9.8	10.1	9.8
Total allowance ratio (stage 1, 2 and 3), bps[1]	2.1	2.0	1.1	1.1	1.5
Tier 1 capital ratio, %[2]	14.9	15.2	15.8	15.2	15.1

1) Based on IFRS 9.
2) Including profit for the year for the full years 2020, 2019 and 2018. For the half-year periods, the calculation has been made excluding the profit for the period.

Definitions

Return on average shareholders equity, %	Net profit for the year as percentage of equity, quarterly average.
Cost/income ratio, %	Total operating expenses divided by total operating income.
Loan loss ratio, basis points	Net loan losses (annualised) divided by quarterly closing balance of loans to the public (lending).
Impairment rate (stage 3), net, bps	Impaired loans (Stage 3) after allowances divided by total loans measured at amortised cost before allowances.
Total allowance ratio (stage 1, 2 and 3), bps	Total allowances divided by total loans measured at amortised cost before allowances.
Tier 1 capital ratio, %	Tier 1 capital as a percentage of risk-weighted amounts.

Our operations 2020

Operations

The Company operates in the Swedish market and grants loans, primarily long-term in nature, to households, sole business proprietors, municipalities and other legal entities through the Parent Bank's distribution network. The purpose of the lending is primarily to finance properties, tenant-owned apartments, condominiums, agriculture and forestry, and municipal operations. The key emphasis is on financing homes. Collateral consists mainly of mortgages on residential properties and tenant-owned apartments, or municipal guarantees.

Nordea Hypotek entered the COVID-19 crisis with a strong financial position, which has also been maintained. The Company's capital position remains very strong with a Tier 1 capital ratio at the end of the year of 14.9% (15.8), which comfortably exceeds the legal requirement.

Credit quality in Nordea Hypotek's loan portfolio remained very strong in 2020, and we do not see any signs currently of any negative trend in the loan portfolio or heightened default.

The housing market in Sweden

In 2020, Valueguard's price index HOXSWE gained 11.5%. The price increase was greatest for houses, which rose 15.5%, while the increase for apartments was 5.3%. Following the downturn in March and April, as a consequence of the COVID-19 pandemic, the market recovered quickly. In December, the housing market reached yet another all-time high, with prices 7% higher than at the start of the pandemic.

Profit performance in the second half of 2020 compared with the first half of 2020

Operating profit for the second half of 2020 amounted to SEK 3,083m (2,222), which is an increase of 38.8% from the first half of 2020. When comparing profit for the second half of 2020 compared with the first half of 2020, account should mainly be taken of the following major items affecting profit:

- Net interest income amounted to SEK 3,836m (3,256); an increase of 17.8%. The main reason for the increase in net interest income is higher lending volumes and lower funding costs in the second half of 2020.
- The net result from items at fair value improved in the second half of 2020 by SEK 114m from SEK –94m to SEK 20m and is mainly attributable to financial instruments under hedge accounting.
- Net commission income decreased by SEK 22m in the second half of 2020, amounting to SEK –39m (–17) at the end of the period, mainly due to increased commission expense related to funding.
- Operating expenses decreased in the second half of 2020 by SEK 148m, amounting at the end of the period to SEK –716m (–864), which is mainly attributable to the fact that the cost of the resolution fee was taken in the first half of 2020, when Nordea Hypotek received the invoice from the National Debt Office.
- Return on equity, after standard tax, was 15.6% (13.2) at the end of the period.

Profit performance full year 2020 compared with full year 2019

Operating profit amounted to SEK 5,305m (5,242), which is an increase of 1.2 percent from the previous year. When comparing earnings with the previous year, account should mainly be taken of the following major items affecting comparability:

- Net interest income amounted to SEK 7,092m (6,815); an increase of 4.1%. The main reason for the increase in net interest income is higher lending volumes and lower funding costs.
- Net result from items at fair value decreased by SEK 52m, amounting to SEK –74m (–22) at the end of the year. This is chiefly attributable to financial instruments under hedge accounting, which negatively affected the item by SEK 145m, higher premature loan redemption penalties, which had a positive impact on the item in the amount of SEK 7m, and to the repurchase of issued bonds entered at amortised cost, which had a positive effect of SEK 86m on the item.
- Net commission income decreased by SEK 12m, amounting to SEK –56m (–44) at the end of the year, mainly due to increased commission expense related to funding. Operating expenses at the end of the year were SEK 1,580m (1,490), an increase of 6.1% compared to 2019. In 2020, Nordea Hypotek performed a review of the distribution costs that the Company pays to the Parent Company, which chiefly explains the increase in operating expenses compared with the same period last year.
- Return on equity, after standard tax, was 15.6% (15.9).

Lending

Lending performance in the second half of 2020 compared with the first half of 2020

Compared with the first half of 2020, lending to the public increased in the second half by 3.2%, amounting at the end of the year to SEK 619,166m (599,911).

Lending to companies, organisations and municipalities

Compared with the first half of 2020, lending to legal entities increased in the second half by SEK 4,397m (4.0%), amounting at the end of the year to SEK 115,444m (111,047).

Household lending

Compared with the first half of 2020, lending to households increased in the second half by SEK 14,858m (3.0%), amounting at the end of the year to SEK 503,722m (484,864).

Lending performance full year 2020 compared with full year 2019

Lending to the public increased during the year by 6.8% (5.6) to SEK 619,166m (579,773) at year-end.

Lending to companies, organisations and municipalities

Lending to legal entities increased by SEK 9,715m (9.2%) to SEK 115,444m (105,729) at the end of the financial year.

Household lending

Household lending increased by SEK 29,678m (6.3%) to SEK 503,722m (474,044) at year-end.

The volume of loans past due that are not classified as impaired amounted to 0.06% (0.09) for household lending, and to 0.17% (0.33) for corporate lending.

Impaired loans and loan losses

Impaired loans, gross, amounted to SEK 538m (599). Net loan losses amounted to SEK –77m (–18) during the period, and are mainly attributable to increased model-based loan provisions. Realised loan losses, less recoveries of written-off loans and reversed allowances, decreased by SEK 2m during the period, amounting at the end of the year to SEK 6m (8).

The total loan provision increased by SEK 65m compared with 2019, amounting at the end of the year to SEK 131m (66), which ensures that the Company has a substantial provision for future potential loan losses.

It is possible that certain customers will be further affected by the COVID-19 crisis once interest-only arrangements for loans come to an end on 31 August 2021, which might be appreciable for Nordea Hypotek. We will closely monitor developments in credit risk in the sectors affected by COVID-19 and the situation for customers with interest-only arrangements for their loans that will expire after the end of August 2021. These customers are carefully evaluated in line with the normal credit risk assessment.

The management of Nordea Hypotek will take appropriate measures to reduce the provision in line with equivalent loan losses being realised or captured by Nordea Hypotek's models, while at the same time maintaining an appropriate provision as judged by management.

To maintain a sufficient provision in light of the prevailing uncertainty ensuing from the current pandemic, the weight on the negative scenario in our IFRS 9 models was increased to 45% (20) during 2020. The base scenario is maintained as the most probable, with a weight of 50% (60). The macroeconomic scenarios used were largely kept unchanged and remained conservative compared with official forecasts in Sweden. Updates to the scenarios based on the latest economic information did not have any material impact on the level of the provisions.

Provisions as judged by management

The management of Nordea Hypotek has chosen to maintain the previous provisions made in June 2020 totalling SEK 32.5m, consisting of a cyclical and structural provision. The purpose of the cyclical provision, which was SEK 17.8m, was to allow for estimated loan losses due to future expected rating downgrades which had not yet been captured by the IFRS 9 models for collective provisions. Furthermore, a structural provision was made of SEK 14.7m, which is to cover the identified development need in our IFRS 9 models for collective provisions.

In December 2020, the management of Nordea Hypotek judged it appropriate to supplement the outcome from the modelled collective provisions with an additional cyclical provision of SEK 2.9m to neutralise the positive outcome of the latest macro scenarios. This is due to the prevailing uncertainty resulting from the current pandemic. In addition, a structural provision of SEK 2.2m was also made to migrate low-scoring risk customers to stage 2 in line with legal requirements.

Foreign exchange risk

The Company's policy is to hedge foreign exchange risk exposure. The Company's foreign exchange exposures are essentially hedged through FX swaps.

Funding

In 2020, all long-term funding, with the exception of subordinated loans, was in the form of covered bonds. A covered bond is a funding instrument, regulated under the Covered Bonds (Issuance) Act (SFS 2003:1223), which gives investors special priority in the event of the borrower's bankruptcy. Covered bonds may only be issued upon special permission from the Swedish FSA and on the basis of high-quality assets. Covered bonds and received credit ratings provide the Company with access to a broader base of funding sources.

In 2020, the Company issued bonds to a nominal value of SEK 122bn (72). The issues take place regularly in existing and new series, with the majority being so-called benchmark bonds. In 2020 the Company held agreements with five banks regarding distribution of the bonds in the benchmark series.

Total outstanding covered bonds at year-end amounted to a nominal SEK 386bn (334). In addition, the Company had outstanding subordinated loans of SEK 10.6 billion (1.65).

Besides long-term funding as above, the Company regularly arranged funding with the Parent Company during the year. At the end of the year the outstanding amount from such funding was SEK 208.2bn (235.9).

Rating

Since June 2006, Nordea Hypotek has been rated Aaa by Moody's Investor Service for the covered bonds that make up the Company's main long-term funding. As of 1 April 2020, Nordea Hypotek only has Moody's rating on the Company's bond programme for covered bonds.

Counterparty risk and exposures

In total, risk-weighted assets for counterparty risk, which is entirely in relation to the Parent Company, were SEK 1,305m (1,328) The majority of counterparty risk is attributable to derivatives.

Derivatives

Derivative instruments primarily pertain to interest payment exchange contracts (rate swaps) and forward currency exchange contracts (FX swaps). The item "Derivative instruments" in the balance sheet recognises derivative contracts at fair value.

Capital adequacy

Since 2014, CRD/CRR (Capital Requirements Directive/Capital Requirements Regulation) applies in the EU. For more information on the capital adequacy, see note 8 "Capital adequacy".

Legal proceedings

There are no outstanding disputes or legal proceedings in which material claims have been lodged against the Company.

Substantial changes after the end of the financial year

Besides the prevailing situation prompted by the pandemic, there have been no other material events after 31 December 2020.

However, there are substantial risks related to the pandemic considering the uncertainty regarding the economic impact it could have in Sweden. Depending on how the pandemic develops ahead, there could be potential negative effects on earnings due to lower net interest income, higher market volatility and reduced business activity, which could have an adverse impact on transaction volumes and customer activity.

Assurance of the Board of Directors

The Year-end Report provides a fair overview of the Company's activities, its financial position and result, and describes material risks and uncertainties assumed by the Company.

Stockholm, 24 February 2021

Per Långsved
Chairman

Peter Dalmalm
Deputy Chair

Maria Härdling
Board member

Marte Kopperstad
Board member

Magnus Montan
Board member

Elisabeth Olin
Board member

Maria Sahlén
Board member

Michael Skytt
Board member

Arvid Krönmark
Chief Executive Officer

Income statement

SEK (000s)	Note	2020 Jul–Dec	2020 Jan–Jun	2019 Jul–Dec	2020 Full year	2019 Full year
Operating income						
Interest income calculated using the effective interest method		4,863,286	4,788,610	4,413,445	9,651,896	8,614,887
Other interest income		12,287	12,809	10,513	25,096	21,193
Negative yield on financial assets		−14,469	−15,252	−20,786	−29,721	−36,320
Interest expense		−1,034,182	−1,535,692	−1,071,701	−2,569,874	−1,920,892
Negative yield on financial liabilities		9,082	5,548	48,462	14,630	136,612
Net interest income		**3,836,004**	**3,256,023**	**3,379,933**	**7,092,027**	**6,815,480**
Fee and commission income		18,679	20,971	20,838	39,650	43,644
Fee and commission expense		−57,489	−38,212	−63,348	−95,701	−87,191
Net fee and commission income		**−38,810**	**−17,241**	**−42,510**	**−56,051**	**−43,547**
Net result from items at fair value		19,958	−94,241	12,640	−74,283	−22,221
Total operating income		**3,817,152**	**3,144,541**	**3,350,063**	**6,961,693**	**6,749,712**
Operating expenses						
General administrative expenses:						
Staff costs		−16,512	−14,632	−14,392	−31,144	−27,702
Other expenses		−699,321	−849,664	−667,107	−1,548,985	−1,461,829
Total operating expenses		**−715,833**	**−864,296**	**−681,499**	**−1,580,129**	**−1,489,531**
Profit before loan losses		**3,101,319**	**2,280,245**	**2,668,564**	**5,381,564**	**5,260,181**
Net loan losses	3	−18,334	−58,438	−12,489	−76,772	−18,346
Operating profit		**3,082,985**	**2,221,807**	**2,656,075**	**5,304,792**	**5,241,835**
Income tax expense		−659,301	−481,175	−569,948	−1,140,476	−1,122,243
Net profit for the period		**2,423,684**	**1,740,632**	**2,086,127**	**4,164,316**	**4,119,592**

Statement of comprehensive income

SEK (000s)	2020 Jul–Dec	2020 Jan–Jun	2019 Jul–Dec	2020 Full year	2019 Full year
Net profit for the period	**2,423,684**	**1,740,632**	**2,086,127**	**4,164,316**	**4,119,592**
Items that may be reclassified subsequently to the income statement					
Cash flow hedges:					
Valuation gains/losses, net of tax	329,279	12,967	−185,238	342,246	224,067
Transferred to the income statement, net of tax	−289,974	−33,326	172,957	−323,300	−228,011
Available for sale investments[1]					
Valuation gains/losses, net of tax	3,734	−4,385	−8,391	−651	13,059
Transferred to the income statement, net of tax	−5,474	5,474	−26	–	–
Other comprehensive income, net of tax	**37,565**	**−19,270**	**−20,698**	**18,295**	**9,115**
Total comprehensive income	**2,461,249**	**1,721,362**	**2,065,429**	**4,182,611**	**4,128,707**

1) Valutation gains/losses related to hedged risks under fair value hedge accounting are accounted for directly in the income statement.

Balance sheet

SEK (000s)	Note	2020 31 Dec	2020 30 Jun	2019 31 Dec
Assets				
Loans to credit institutions	4	4,553,762	3,876,093	5,599,320
Loans to the public	4	619,166,314	599,911,297	579,772,930
Interest-bearing securities		21,057,680	20,981,942	21,103,915
Derivatives		4,566,879	5,674,471	4,566,105
Fair value changes of the hedged items in portfolio hedge of interest rate risk		364,484	522,004	−298,624
Current tax assets		382,250	6	98,274
Other assets		453,585	56	814,019
Prepaid expenses and accrued income		227,095	275,372	357,024
Total assets		**650,772,049**	**631,241,241**	**612,012,963**
Liabilities				
Deposits by credit institutions		208,194,432	219,038,495	235,964,135
Debt securities in issue		403,635,619	375,881,393	340,270,319
Derivatives		877,488	768,859	514,871
Fair value changes of the hedged items in portfolio hedge of interest rate risk		4,077,648	5,117,038	3,168,419
Current tax liabilities		–	175,810	–
Other liabilities		6,647,079	1,304,531	4,777,000
Accrued expenses and prepaid income		195,565	96,862	178,276
Deferred tax liabilities		9,779	300	4,787
Provisions		12,859	8,944	7,440
Subordinated liabilities		1,650,119	1,650,067	1,650,137
Total liabilities		**625,300,588**	**604,042,299**	**586,535,384**
Equity				
Share capital		110,000	110,000	110,000
Fair value reserves		39,821	2,257	21,527
Retained earnings		21,157,324	25,346,053	21,226,460
Net profit for the year		4,164,316	1,740,632	4,119,592
Total equity		**25,471,461**	**27,198,942**	**25,477,579**
Total liabilities and equity		**650,772,049**	**631,241,241**	**612,012,963**

Notes

Statement of changes in equity

SEK (000s)	Restricted equity	Unrestricted equity			
	Share capital[1]	Cash flow hedges	Fair value through other comprehensive income	Retained earnings	Total equity
Balance at 1 Jan 2020	**110,000**	**16,972**	**4,555**	**25,346,052**	**25,477,579**
Net profit for the year	–	–	–	4,164,316	4,164,316
Items that may be reclassified subsequently to the income statement					
Fair value through other comprehensive income:					
Valuation gains/losses, net of tax	–	–	−651	–	−651
Cash flow hedges:					
Valuation gains/losses, net of tax	–	342,246	–	–	342,246
Transferred to the income statement	–	−411,323	–	–	−411,323
Tax on transfers to the income statement	–	88,023	–	–	88,023
Other comprehensive income, net of tax	**–**	**18,946**	**−651**	**–**	**18,295**
Total comprehensive income	**–**	**18,946**	**−651**	**4,164,316**	**4,182,611**
Group contribution paid	–	–	–	−5,329,328	−5,329,328
Tax on Group contribution paid	–	–	–	1,140,476	1,140,476
Share-based payments	–	–	–	123	123
Balance at 31 Dec 2020	**110,000**	**35,918**	**3,904**	**25,321,639**	**25,471,461**

1) Total number of shares registered were 100,000.

SEK (000s)	Restricted equity	Unrestricted equity			
	Share capital[1]	Cash flow hedges	Fair value through other comprehensive income	Retained earnings	Total equity
Balance at 1 Jan 2019	**110,000**	**20,916**	**−8,504**	**24,327,896**	**24,450,308**
Net profit for the year	–	–	–	4,119,592	4,119,592
Items that may be reclassified subsequently to the income statement					
Fair value through other comprehensive income:					
Valuation gains/losses, net of tax	–	–	13,059	–	13,059
Cash flow hedges:					
Valuation gains/losses, net of tax	–	224,067	–	–	224,067
Transferred to the income statement	–	−292,322	–	–	−292,322
Tax on transfers to the income statement	–	64,311	–	–	64,311
Other comprehensvie income, net of tax	**–**	**−3,944**	**13,059**	**–**	**9,115**
Total comprehensive income	**–**	**−3,944**	**13,059**	**4,119,592**	**4,128,707**
Group contribution paid	–	–	–	−3,945,847	−3,945,847
Tax on Group contribution paid	–	–	–	844,411	844,411
Balance at 31 Dec 2019	**110,000**	**16,972**	**4,555**	**25,346,052**	**25,477,579**

1) Total number of shares registered were 100,000.

Cash flow statement

SEK (000s)	2020 Full year	2019 Full year
Operating activities		
Operating profit	5,304,792	5,241,835
Adjustment for items not included in cash flow	−231,263	−405,662
Income taxes paid	−283,976	−347,000
Cash flow from operating activities before changes in operating assets and liabilities	**4,789,553**	**4,489,173**
Changes in operating assets		
Change in treasury bills	−209,718	248,904
Change in loans to the public	−39,471,295	−30,760,940
Change in interest-bearing securities	46,235	−20,354
Change in derivatives, net	548,914	125,423
Change in other assets	360,434	1,984,039
Change in operating liabilities		
Change in deposits by credit institutions	−27,750,000	13,797,000
Change in debt securities in issue	64,099,567	15,776,342
Change in other liabilities	−3,459,248	−6,189,359
Cash flow from operating activities	**−1,045,558**	**−549,772**
Financing activities		
Amortised subordinated liabilities	–	−800,000
Other changes in equity	–	1,650,000
Cash flow from financing activities	**–**	**850,000**
Cash flow for the year	**−1,045,558**	**300,228**
Cash and cash equivalents at beginning of period	5,599,320	5,299,092
Cash and cash equivalents at end of period	4,553,762	5,599,320
Change	**−1,045,558**	**300,228**

Notes to the financial statements

Content

Note 1. Accounting policies

The Year-end Report for Nordea Hypotek AB (publ) are prepared in accordance with the Swedish Annual Accounts Act for Credit Institutions and Securities Companies (1995:1559), the accounting regulations of the Swedish Financial Supervisory Authority (FFFS 2008:25 including amendments), IAS 34 "Interim Financial Reporting" and the accounting recommendation RFR 2 Accounting for legal entities issued by the Swedish Financial Reporting Board. This means that Nordea Hypotek AB (publ) applies International Financial Reporting Standards (IFRS) as endorsed by the European Commission to the extent possible within the framework of Swedish accounting legislation and considering the close tie between financial reporting and taxation.

The disclosures, required in the standards and legislation above, have been included in the notes or in other parts of the Year-end Report.

In all material respects, the accounting policies, basis for calculations and presentation are unchanged from the 2019 Annual Report, with the exception of changed accounting policies and presentation described in the section below, "Changed accounting policies and presentation". For more information see note 1 in the Annual Report 2019.

Changed accounting policies and presentation

The new accounting requirements implemented in 2020 and their effects on Nordea Hypotek's financial statements are described below.

Reclassification of accrued interest on loans

Accrued interest on loans has previously been presented on the line "Prepaid expenses and accrued income" on the balance sheet. As from 2020, accrued income on loans is presented together with the loans on the lines "Loans to credit institutions" and "Loans to the public" on the balance sheet. Comparative figures have been restated accordingly. The impact on the balance sheet can be found in the table below.

	31 Dec 2020		
SEK (000s)	Old policy	Change	New policy
Loans to credit institutions	4,553,762	0	4,553,762
Loans to the public	618,888,246	278,068	619,166,314
Prepaid expenses and accrued income	505,163	–278,068	227,095
	30 Jun 2020		
SEK (000s)	Old policy	Change	New policy
Loans to credit institutions	3,856,201	19,892	3,876,093
Loans to the public	599,631,173	280,124	599,911,297
Prepaid expenses and accrued income	575,388	–300,016	275,372
	31 Dec 2019		
SEK (000s)	Old policy	Change	New policy
Loans to credit institutions	5,578,131	21,189	5,599,320
Loans to the public	579,500,671	272,259	579,772,930
Prepaid expenses and accrued income	650,472	–293,448	357,024

Other amended requirements

The following new and amended standards and interpretations were implemented by Nordea Hypotek 1 January 2020 but have not had any significant impact on the financial statements of Nordea Hypotek:

- Amendments to References to the Conceptual Framework in IFRS Standards.
- Amendments to IAS 1 and IAS 8: Definition of material.

No amendments were made to the Swedish Annual Accounts Act for Credit Institutions and Securities Companies (1995:1559) during the year. Furthermore, the Swedish Financial Reporting Board has issued a notification to amend RFR 2 "Accounting for legal entities", to be applied to financial years starting on or after 1 January 2020 and covering the updates to RFR 2 caused by amendments in updates with respect to the IFRS regulations. These amendments have not had any significant impact on Nordea Hypotek's financial statements. Changes in IFRSs not yet applie.

Interest rate benchmark reform – Phase 2

The IASB has published amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in "Interest Rate Benchmark Reform – Phase 2". Phase 2 of the IBOR reform includes three major areas, hedge accounting, modifications and disclosures. The amendments clarify that hedge accounting does not have to be discontinued just because hedged items and hedging instruments are modified due to the IBOR reform. Hedging relationships (and related documentation) must be amended to reflect modifications to the hedged item, hedging instrument and hedged risk. Any valuation adjustments resulting from the amendments are recognised as part of hedge ineffectiveness.

It is clarified that modifications required as a direct consequence of the IBOR reform and made on an economically equivalent basis are not accounted for as modifications for instruments measured at amortised cost. For such modifications, the effective interest rate is amended in line with the modified cash flows.

The amendments are effective for annual reporting periods beginning on or after 1 January 2021 with earlier application permitted.

The amendments are expected to result in hedge relationships in Nordea Hypotek can continue as before and no material modification gains or losses being recognised. For this reason the amendments are not assessed to have any significant impact on Nordea Hypoteks's financial statements, capital adequacy or large exposures in the period of initial application of the amendments in comparison with the current situation.

Other changes in IFRS

The IASB has published the following new or amended standards that are assessed to have no significant impact on Nordea Hypotek's financial statements, capital adequacy or large exposures in the period of initial application:

- Amendments to IAS 1 Presentation of Financial Statements
- Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets
- Annual improvement 2018–2020

Note 1. Accounting policies, cont.

Critical judgements and estimation uncertainty

Nordea Hypotek has applied significant critical judgements in the preparation of the Annual Report 2020 due to significant uncertainty concerning the potential long-term impact of COVID-19 on Nordea Hypotek's financial statements. Areas particularly important were the fair value measurement of certain financial instruments and impairment testing of loans to the public/credit institutions.

Critical judgements was applied when determining the fair value of financial instruments that lack quoted prices or recently observed market prices. In all of these instances, decisions are based on professional judgement in accordance with Nordea Hypotek's accounting and valuation policies. More information on financial instruments held at fair value on Nordea Hypotek's balance sheet can be found in Note 6.

Critical judgement was also applied in the assessment of when loans have experienced a significant change in credit risk (staging) and in the application of macro scenarios when estimating the change in expected credit losses. More information on the impairment testing of loans to the public/credit institutions can be found in note 1 in the Annual Report 2019". Information on sensitivities to rating and scoring migrations can be found in the section "Sensitivities" in Note 4.

Note 2. Segment reporting

Reportable segment

Brief description of the business segments:

- Personal Banking helps Nordea Hypotek's private customers through various channels with financing real estate for housing purposes.
- Business Banking consists of Business Banking and Business Banking Direct which also works with a relationship-based service model with a customer-centric value offering for our corporate customers.
- Group Treasury & ALM (TALM) is responsible for Nordea's treasury operations and asset and liability management, including liquidity, capital, structural and strategic market risks on the balance sheet.
- Other operating segments mainly refer to Large Corporates & Institutions, which is responsible for lending to large corporate customers.

Group functions and earnings that are not entirely assigned to any of the operating segments are shown separately as reconciling items in the table below.

Operating segments

	Personal Banking		Business Banking		Group Treasury & Asset & Liability management		Other operating segments		Total operating segments		Reconciliation		Total	
Income statement, SEKm	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**
Net interest income	7,696	6,994	1,451	1,305	–2,420	–1,801	126	132	6,853	6,630	239	185	7,092	6,815
Net fee and commission income	36	40	3	4	–31	–33	–64	–54	–56	–43	–	–	–56	–43
Net result from items at fair value	32	28	4	1	–110	–51	0	0	–74	–22	–	–	–74	–22
Total operating income	**7,764**	**7,062**	**1,458**	**1,310**	**–2,561**	**–1,885**	**62**	**78**	**6,723**	**6,565**	**239**	**185**	**6,962**	**6,750**
Other expenses	–	0	0	0	–	–	–1,580	–1,490	–1,580	–1,490	–	–	–1,580	–1,490
Total operating expenses	**–**	**0**	**0**	**0**	**–**	**–**	**–1,580**	**–1,490**	**–1,580**	**–1,490**	**–**	**–**	**–1,580**	**–1,490**
Net loan losses	–62	–16	–5	2	–	–	–10	–4	–77	–18	0	–	–77	–18
Operating profit	**7,702**	**7,046**	**1,453**	**1,312**	**–2,561**	**–1,885**	**–1,528**	**–1,416**	**5,066**	**5,057**	**239**	**185**	**5,305**	**5,242**
Balance sheet, SEKm														
Loans to the public	465,808	441,369	128,817	117,613	–	–	24,541	20,788	619,166	579,770	0	3	619,166	579,773
Other assets	–	–	0	–	31,206	32,122	380	98	31,586	32,220	20	20	31,606	32,240
Total assets	**465,808**	**441,369**	**128,817**	**117,613**	**31,206**	**32,122**	**24,921**	**20,886**	**650,752**	**611,990**	**20**	**23**	**650,772**	**612,013**
Total liabilities	**1**	**0**	**0**	**0**	**619,722**	**582,380**	**184**	**209**	**619,907**	**582,590**	**5,394**	**3,946**	**625,301**	**586,535**
Equity	465,807	441,369	128,817	117,613	–588,516	–550,258	24,737	20,677	30,845	29,400	–5,374	–3,923	25,471	25,478
Total liabilities and equity	**465,808**	**441,369**	**128,817**	**117,613**	**31,206**	**32,122**	**24,921**	**20,886**	**650,752**	**611,990**	**20**	**23**	**650,772**	**612,013**

Reconciliation between total operating segments and financial statements

	2020		2019	
SEKm	**Operating profit**	**Total assets**	**Operating profit**	**Total assets**
Total operating segments	5,066	650,752	5,057	611,990
Group functions and unallocated items	239	20	185	23
Total	**5,305**	**650,772**	**5,242**	**612,013**

Note 3. Net loan losses

SEK (000s)	2020 Jul–Dec	2020 Jan–Jun	2019 Jul–Dec	2020 Full year	2019 Full year
Net loan losses, stage 1	−5,681	−24,793	−8,499	−30,474	−9,643
Net loan losses, stage 2	−11,751	−15,280	6,059	−27,031	4,293
Net loan losses, non-defaulted	**−17,432**	**−40,073**	**−2,440**	**−57,505**	**−5,350**
Stage 3, defaulted					
Net loan losses, individually assessed, collectively calculated	2,166	−15,498	−4,048	−13,332	−4,576
Realised loan losses	−3,832	−3,242	−6,621	−7,074	−32,252
Decrease of provisions to cover realised loan losses	–	–	–	–	18,700
Recoveries on previously realised loan losses	764	375	620	1,139	1,082
Reversals of provisions	–	–	–	–	4,050
Net loan losses, defaulted	**−902**	**−18,365**	**−10,049**	**−19,267**	**−12,996**
Net loan losses	**−18,334**	**−58,438**	**−12,489**	**−76,772**	**−18,346**

Key ratios

	2020 31 Dec	2020 30 Jun	2019 31 Dec	2019 30 Jun
Loan loss ratio, basis points[1]	1.2	1.9	0,3	0.2
- of which stage 1	0.5	0.8	0.7	0.0
- of which stage 2	0.4	0.5	−0.3	0.1
- of which stage 3	0.3	0.6	0.9	0.1

1) Based on IFRS 9.

Note 4. Loans and impairment

SEKm	2020 31 Dec	2020 30 Jun	2019 31 Dec
Loans measured to amortised cost, not impaired (stage 1 and 2)	623,313	603,369	584,839
Impaired loans (stage 3)	538	538	599
- of which servicing	47	89	104
- of which non-servicing	491	449	495
Loans before allowances	**623,851**	**603,907**	**585,438**
- of which credit institutions	4,554	3,876	5,599
Allowances for individually assessed loans (stage 3)	−36	−39	−23
- of which servicing	−2	−6	−4
- of which non-servicing	−34	−33	−19
Allowances for collectively assessed loans (stage 1 and 2)	−95	−81	−43
Allowances	**−131**	**−119**	**−66**
- of which credit institutions	–	–	–
Loans carrying amount	**623,720**	**603,787**	**585,372**

Note 4. Loans and impairment, cont.

Movement of allowance accounts for loans measured at amortised cost

SEKm	Stage 1	Stage 2	Stage 3	Total
Balance at 1 Jan 2020	**–20**	**–22**	**–23**	**–65**
Changes due to origination and acquisition	–17	–6	–1	–24
Changes due to transfers from stage 1 to stage 2	0	–28	–	–28
Changes due to transfers from stage 1 to stage 3	0	–	–12	–12
Changes due to transfers from stage 2 to stage 1	–1	11	–	10
Changes due to transfers from stage 2 to stage 3	–	1	–5	–4
Changes due to transfers from stage 3 to stage 1	0	–	3	3
Changes due to transfers from stage 3 to stage 2	–	–1	3	2
Changes due to credit risk without stage transfer	–10	–7	–7	–24
Changes due to repayments and disposals	3	3	5	11
Closing balance at 31 Dec 2020	**–45**	**–49**	**–37**	**–131**

SEKm	Stage 1	Stage 2	Stage 3	Total
Balance at 1 Jan 2020	**–20**	**–22**	**–23**	**–65**
Changes due to origination and acquisition	–10	0	–1	–11
Changes due to transfers from stage 1 to stage 2	1	–20	0	–19
Changes due to transfers from stage 1 to stage 3	0	0	–6	–6
Changes due to transfers from stage 2 to stage 1	–1	9	0	8
Changes due to transfers from stage 2 to stage 3	0	1	–6	–5
Changes due to transfers from stage 3 to stage 1	0	0	1	1
Changes due to transfers from stage 3 to stage 2	0	–1	4	3
Changes due to credit risk without stage transfer	–14	–5	–12	–31
Changes due to repayments and disposals	1	1	3	6
Closing balance at 30 Jun 2020	**–43**	**–38**	**–38**	**–119**

SEKm	Stage 1	Stage 2	Stage 3	Total
Balance at 1 Jan 2019	**–14**	**–27**	**–41**	**–82**
Changes due to origination and acquisition	–9	–1	–2	–12
Changes due to transfers from stage 1 to stage 2	0	–13	–	–13
Changes due to transfers from stage 1 to stage 3	0	–	–7	–7
Changes due to transfers from stage 2 to stage 1	0	14	–	14
Changes due to transfers from stage 2 to stage 3	–	1	–5	–4
Changes due to transfers from stage 3 to stage 1	0	–	1	1
Changes due to transfers from stage 3 to stage 2	–	–1	3	2
Changes due to credit risk without stage transfer	1	1	4	6
Changes due to repayments and disposals	3	4	5	12
Write-off through decrease in allowance account	–	–	19	19
Changes due to changes in credit risk without stage transfer	–1	–1	0	–2
Closing balance at 31 Dec 2019	**–20**	**–23**	**–23**	**–66**

Key ratios

	2020 31 Dec	2020 30 Jun	2019 31 Dec
Impairment rate, (stage 3), gross[1], basis points	8.6	8.9	10.2
Impairment rate, (stage), net[2]	8.0	8.3	9.8
Total allowance rate (stage 1, 2 and 3)[3], basis points	2.1	2.0	1.1
Allowances in relation to impaired loans (stage 3)[4], %	6.8	7.2	3.9
Allowances in relation to loans stage 1 and 2[5], basis points	1.5	1.3	0.7

1) Impaired loans (stage 3) before allowances divided by total loans, measured at amortised cost, before allowances.
2) Impaired loans (stage 3) after allowances divided by total loans, measured at amortised cost, before allowances.
3) Total allowances divided by total loans, measured at amorised cost, before allowances.
4) Allowances for impaired loans (stage 3) divided by impaired loans measured at amortised cost (stage 3), before allowances.
5) Allowances for performing loans (stage 2) divided by performing loans measured at amortised cost (stage 1 and 2), before allowances.

Note 4. Loans and impairment, cont.

Forbearance

Forbearance refers to eased terms or restructuring of credit terms and conditions due to the borrower experiencing financial difficulties. The intention of granting forbearance for a limited period of time is to ensure full repayment of the outstanding debt. Examples of eased terms are changes in amortisation profile, repayment schedule, customer margin or eased financial covenants. Forbearance is undertaken on an individual basis, according to internal guidelines, and followed by impairment testing. Forborne exposures can be performing or non-performing. Loan loss provisions are recognised if necessary. Customers with forbearance measures are transferred to stage 2, unless already identified as credit impaired (stage 3).

On 13 March 2020 Nordea announced that it would offer COVID-19 instalment-free periods in all Nordic countries to those mortgage and car finance household customers and SMEs who were experiencing temporary liquidity problems due to the COVID-19 situation. Nordea did not register COVID-19 instalment-free periods as forbearance, and consequently did not automatically transfer the exposures to stage 2, due to the temporary nature of the instalment-free periods and as interest continued to accrue. On 1 October 2020 Nordea ended all temporary amendments to the credit risk framework and returned to the normal forbearance registration procedures, while still continuing to support customers through the crisis.

The carrying amounts of loans for which Nordea Hypotek had granted interest-only periods due to COVID-19 was, at the end of December 2020, SEK 76bn, which equals 12% of the loan portfolio.

Sensitivities

One important factor in estimating expected credit losses in accordance with IFRS 9 is to assess what constitutes a significant increase in credit risk. To understand the sensitivities for these relative triggers Nordea Hypotek has by using models calculated provisions based on two different scenarios:

	Scenario 1	Scenario 2
Retail portfolios		
Relavtive threshold	50 %	150 %
Absolute threshold, 12 month	35 basic points	55 basic points
Absolute threshold, remaining maturity	250 basic points	350 basic points
Notch	1 less	1 more
Other customers portfolios		
Relativt threshold	100 %	200 %
Absolute threshold, 12 month	15 basic points	25 basic points
Absolute threshold, remaining maturity	350 basic points	450 basic points
Notch	1 less	1 more

The provisions would have increased by SEK 4.1m in scenario 1 and decreased by SEK 3.1m in scenario 2.

The provisions are sensitive to rating migration ecen if triggers are not reached. The table below shows the impact on provisions from a one notch downgrade on all exposures. It includes both the impact of the higher risk for all exposures as well as the impact of transferring from Stage 1 to Stage 2 for those exposures that reach the trigger.

Sensitivities

	31 Dec 2020	
SEKm	Model based provisions	Provisions if one notch downgrade
Personal Banking	61.4	88.6
Business Banking	12.8	21.6
Large Corporates & Institutions	0.7	1.3
Other	5.3	7.5
Total	**80.2**	**119.0**

	31 Dec 2019	
SEKm	Model based provisions	Provisions if one notch downgrade
Personal Banking	48.2	70.9
Business Banking	7.8	13.1
Large Corporates & Institutions	0.2	0.3
Övrigt	2.3	3.5
Total	**58.5**	**87.8**

Forward-looking information

Forward-looking information is used both for assessing significant increases in credit risk and the calculation of expected credit losses. Nordea Hypotek uses three macroeconomic scenarios: a baseline scenario, a favourable scenario and an adverse scenario. For the fourth quarter of 2020, the scenarios have been weighted into the final expected credit losses (ECL) using baseline 50%, adverse 45% and favourable 5% (baseline 60%, adverse 20% and favourable 20% at year-end 2019). The weight on the adverse scenario was increased in the third quarter of 2020 to give more weight to the downside risks surrounding the expiry of customer support measures and the continuation of the pandemic. The baseline scenario was still maintained as the most probable one.

The macroeconomic scenarios are provided by Group Risk and Compliance (GRC) in Nordea, based on the Oxford Economics Model. The forecast is a combination of modelling and expert judgement, subject to thorough checks and quality control processes. The model has been built to give a good description of the historical relationships between economic variables and to capture the key linkages between those variables. The forecast period in the model is ten years, and for periods beyond, a long-term average is used in the ECL calculations.

The macroeconomic scenarios reflect Nordea Hypotek's view of how the COVID-19 virus and lockdowns will potentially impact the economic outlook. The scenarios also reflect the macroeconomic effects of government and central bank support measures. When developing the scenarios, Nordea Hypotek took into account projections from Nordic governments and central banks, Nordea Research and the ECB's macroeconomic forecasts for the euro area.

Following one of the largest contractions in output since the Second World War, the Swedish economy experienced a significant recovery of activity in Q3 2020. Although the economic recovery during the second half of 2020 appeared to be relatively strong, growth in 2021 is predicted to be slow, as the outlook is still clouded by a very high level of uncertainty. Thus, the resurgence of the COVID-19 pandemic in the

Note 4. Loans and impairment, cont.

autumn of 2020 with renewed and widespread lockdowns in most of Europe poses a threat to the export dependent countries like Sweden.

The high level of uncertainty also weighs on business investments. On the other hand, the eventual roll-out of vaccines, and the willingness of the Swedish government to extend special support measures for sectors hit by lockdowns, point to a continued but modest recovery in the baseline. This implies that economic output in Sweden does not return to the pre-pandemic levels before 2022. The significant loss of output will continue to weigh on labour markets leading to an additional rise in unemployment in 2021. The rise in unemployment and the impact on consumer confidence are also expected to weigh on housing markets in spite of the strong price increases seen in 2020 and the low level of interest rates.

The adjustments to model-based provisions amount to SEK 51m, including management judgements amounting to SEK 38m and corrections of SEK 13m. This management judgement covers projected loan losses not yet covered by the IFRS 9 model. The cyclical reserve amounted to SEK 21m at the end of 2020 and identified issues in the IFRS 9 model to be later covered in model updates (structural reserve) amounted to SEK 17m at the end of 2020.

The estimation of the cyclical reserve was largely unchanged in the fourth quarter of 2020 compared with the third quarter of 2020. One important source of information in the estimation of the cyclical reserve is the internal stress testing model, adjusted for the impact of government support schemes. For the retail portfolio, the most important public sector actions have been the various forms of labour market support schemes, which have significantly decreased the expected defaults and losses amongst households. Due to the wide scope of these schemes, Nordea Hypotek decreased the modelled development of new defaults originally predicted by the internal stress testing models, leading to lower predicted loan losses. These models are based on historical observations and correlations. Thus, they are not capable of replicating the impact of the current government support schemes.

The stress test model-based scenario simulations were used to challenge the internal bottom-up loan loss forecasts by the business areas, which helped Nordea Hypotek to ensure that the loan loss projections were sufficiently conservative. The cyclical reserve decided on by management aims to adjust the outcome in the IFRS 9 models so that it comprises the range of expected losses rather than the top range of the projections.

Scenarios and provisions

31 Dec 2020		2021	2022	2023	Un-weighted ECL SEKm	Probability weight	Model based provisions SEKm	Individual provisions SEKm	Total provisions SEKm
Favourable scenario	GDP growth, %	4.1	2.1	2.3					
	Unemployment, %	8.3	7.7	6.8	66	5%			
	Change in household consumption, %	2.4	2.2	2.3					
	Change in house prices, %	−2.8	−0.3	2.7					
Base scenario	GDP growth, %	1.8	5.0	3.0					
	Unemployment, %	10.0	8.1	7.3	74	50%	80	51	131
	Change in household consumption, %	0.1	5.2	2.7					
	Change in house prices, %	−3.5	−0.1	1.6					
Adverse scenario	GDP growth, %	−2.3	3.8	3.7					
	Unemployment, %	11.5	11.1	10.2	89	45%			
	Change in household consumption, %	−3.2	2.9	2.3					
	Change in house prices, %	−13,5	−11.1	3.8					

31 Dec 2019		2020	2021	2022	Un-weighted ECL SEKm	Probability weight	Model based provisions SEKm	Individual provisions SEKm	Total provisions SEKm
Favourable scenario	GDP growth, %	1.7	2.7	2.6					
	Unemployment, %	6.7	6.3	5.7	57	20%			
	Change in household consumption, %	1.8	2.6	2.1					
	Change in house prices, %	1.1	2.6	3.3					
Base scenario	GDP growth, %	1.4	1.9	2.3					
	Unemployment, %	6.9	6.7	6.3	58	60%	58	8	66
	Change in household consumption, %	1.4	2.0	2.2					
	Change in house prices, %	1.1	2.4	2.9					
Adverse scenario	GDP growth, %	1.1	1.3	1.7					
	Unemployment, %	6.9	7.0	7.1	60	20%			
	Change in household consumption, %	1.0	1.6	2.9					
	Change in house prices, %	1.0	1.8	2.9					

Note 5. Classification of financial instruments

Assets

SEKm	Amortised cost (AC)	Financial assets at fair value through profit or loss (FVPL)	Fair value through other comprehensive income (FVOCI)	Non-financial assets	Total
		Mandatorily			
Loans to credit institutions	4,554	–	–	–	4,554
Loans to the public	619,166	–	–	–	619,166
Interest-bearing securities	–	9,975	11,083	–	21,058
Derivatives	–	4,567	–	–	4,567
Fair value changes of the hedged items in portfolio hedge of interest rate risk	364	–	–	–	364
Current tax assets	–	–	–	382	382
Other assets	454	–	–	–	454
Prepaid expenses and accrued income	207	–	–	20	227
Total 31 Dec 2020	**624,745**	**14,542**	**11,083**	**402**	**650,772**
Total 31 Dec 2019	**586,245**	**15,282**	**10,388**	**98**	**612,013**

Liabilities

SEKm	Amortised cost (AC)	Financial assets at fair value through profit or loss (FVPL)	Non-financial assets	Total
		Mandatorily		
Deposits by credit institutions	208,194	–	–	208,194
Debt securities in issue	403,636	–	–	403,636
Derivatives	–	877	–	877
Fair value changes of the hedged items in portfolio hedge of interest rate risk	4,078	–	–	4,078
Other liabilities	6,641	–	6	6,647
Accrued expenses and prepaid income	174	–	22	196
Deferred tax liabilities	–	–	10	10
Provisions	–	–	13	13
Subordinated liabilities	1,650	–	–	1,650
Total 31 Dec 2020	**624,373**	**877**	**51**	**625,301**
Total 31 Dec 2019	**585,978**	**515**	**42**	**586,535**

Enforceable master netting agreements and similar arrangements

The fact that financial instruments are being accounted for on a gross basis on the balance sheet, would not imply that the financial instruments are not subject to master netting agreements or similar arrangements. Generally financial instruments (derivatives and repos), would be subject to master netting agreements, and as a consequence Nordea Hypotek would be allowed to benefit from netting both in the ordinary course of business and in the case of default towards its counter parties, in any calculations involving counterparty credit risk.

Note 6. Assets and liabilities at fair value

Fair value of financial assets and liabilities

SEKm	31 Dec 2020 Carrying amount	31 Dec 2020 Fair value	31 Dec 2019 Carrying amount	31 Dec 2019 Fair value
Financial assets				
Loans	624,084	660,953	585,074	603,045
Interest-bearing securities	21,058	21,058	21,104	21,104
Derivatives	4,567	4,567	4,566	4,566
Other assets	454	454	814	814
Prepaid expenses and accrued income	207	207	357	357
Total	**650,370**	**687,239**	**611,915**	**629,886**
Financial liabilities				
Deposits and debt instruments	617,558	613,721	581,053	583,645
Derivatives	877	877	515	515
Other liabilities	6,641	6,641	4,774	4,774
Accrued expenses and prepaid income	174	174	151	151
Total	**625,250**	**621,413**	**586,493**	**589,085**

Assets and liabilities held at fair value on the balance sheet

31 Dec 2020, SEKm	Quoted prices in active markets for the same instrument (Level 1)	Valuation technique using observable data (Level 2)	Valuation technique using non-observable data (Level 3)	Total
Assets at fair value on the balance sheet[1]				
Interest-bearing securities	454[2]	20,604	–	21,058
Derivatives	–	4,566	1	4,567
Total	454	**25,170**	1	**25,625**
Liabilities at fair value on the balance sheet[1]				
Derivatives	–	877	–	877
Total	–	**877**	–	**877**

1) All items are measured at fair value on a recurring basis at the end of each reporting period.
2) During the second half of 2020, there was a move of one bond from Level 2 to Level 1 of SEK 454m. This bond is now regarded as actively traded.

31 Dec 2019, SEKm	Quoted prices in active markets for the same instrument (Level 1)	Valuation technique using observable data (Level 2)	Valuation technique using non-observable data (Level 3)	Total
Assets at fair value on the balance sheet[1]				
Interest-bearing securities	–	21,104	–	21,104
Derivatives	–	4,566	–	4,566
Total	–	**25,670**	–	**25,670**
Liabilities at fair value on the balance sheet[1]				
Derivatives	–	515	–	515
Total	–	**515**	–	**515**

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

Determination of fair values for items measured at fair value on the balance sheet

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

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

Level 2 in the fair value hierarchy consists of assets and liabilities that do not have directly quoted market prices available from active markets. The fair values are based on quoted

Note 6. Assets and liabilities at fair value, cont.

prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in markets that are not active. Alternatively, the fair values are estimated using valuation techniques or valuation models based on market prices or inputs prevailing at the balance sheet date and where any unobservable inputs have had an insignificant impact on the fair values. This is the case for shorter-term interest rate caps in liquid currencies.

Level 3 in the fair value hierarchy consists of those types of assets and liabilities for which fair values cannot be obtained directly from quoted market prices or indirectly using valuation techniques or models supported by observable market-prices or rates. This
is the case for longer-term interest rate caps in less liquid currencies.

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

For interest-bearing securities the categorisation into the three levels are based on the internal pricing methodology. These instruments can either be directly quoted in active markets (Level 1) or measured using a methodology giving a quote based on observable inputs (Level 2). Level 3 bonds are characterised by illiquidity.

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

The valuation processes for fair value measurements

Financial instruments

The valuation process in Nordea Hypotek consists of several steps. The first step is to determine the end of day (EOD) marking of mid-prices. It is the responsibility of the business areas to determine correct prices used for the valuation process. These prices are either internally marked prices set by a trading unit or externally sourced prices. The valuation prices and valuation approaches are then controlled and tested by a valuation control function within the 1st line of defence, which is independent from the risk taking units in the front office. The cornerstone in the control process is the independent price verification (IPV). The IPV test comprises verification of the correctness of valuations by comparing the prices to independently sourced data. The result of the IPV is analysed and any findings are escalated as appropriate. The verification of the correctness of prices and inputs is as minimum carried out on a monthly basis and is for many products carried out daily. Third-party information, such as broker quotes and pricing services, is used as benchmark data in the verification. The quality of the benchmark data is assessed on a regular basis.

The valuation adjustment at portfolio level and the deferrals of day 1 P/L on Level 3 trades are calculated and reported on a monthly basis. The actual assessment of instruments in the fair value hierarchy is performed on a continuous basis.

Specialised teams within the unit Balance Sheet Risk Control (BSRC) are responsible for overseeing and independently assessing the valuations performed by the 1st line of defence. These teams are responsible for 2nd line of defence oversight for valuations, with independent reporting responsibilities towards the CRO and the BAC.

Loans

The fair value of "Loans to credit institutions" and "Loans to the public" have been estimated by discounting the expected future cash flows with an assumed customer interest rate that would have been used on the market if the loans had been issued at the time of the measurement. The assumed customer interest rate is calculated as the benchmark interest rate plus the average margin on new lending in Personal Banking, Commercial & Business Banking and Large Corporates & Institutions respectively.

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

Interest bearing-securities

The fair value is SEK 20,604m categorised in Level 2 and SEK 454m is categorised in Level 1 in the fair value hierarchy.

Other assets and prepaid expenses and accrued income

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

Deposits and debt instruments

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

Other liabilities and accrued expenses and prepaid income

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

Note 7. Commitments

SEK (000s) (nom. Amount)	31 Dec 2020	30 Dec 2020	31 Dec 2019
Credit commitments	73,677,181	67,997,173	52,062,075

Note 8. Capital adequacy

New regulations

In June 2019, the 'Banking package' containing revisions to the BRRD, the CRD and the CRR was adopted. The revised directives (BRRD II, CRD V) need to be implemented in Swedish legislation before entering into force, whilst the revised regulation (CRR II) became directly applicable. The majority of changes in CRR II does however enter into force two years later, i.e. in June 2021.

The revisions include a review of the Minimum Requirement for own funds and Eligible Liabilities (MREL), a review of the market risk requirements (Fundamental Review of the Trading Book, FRTB), the introduction of a binding Net Stable Funding Ratio (NSFR), the introduction of a strict leverage ratio requirement of 3% to be met by Tier 1 capital and amendments to the Pillar 2 and macroprudential framework.

The new European Covered Bond Directive and Regulation have been finalised. The Directive entered into force on 8 January 2020, the national transposition period will last until 8 July 2021 and national measures shall be applied starting at the latest from 8 July 2022. The Regulation will apply only from 8 July 2022, in parallel with the deadline for the national measures of the Directive.

The Swedish FSA has implemented a temporary risk weight floor for residential mortgages of 25%. The floor was implemented with effect from 31 December 2018 and was in December 2020 decided to be prolonged to also be applicable during 2021.

On 28 January 2020, the Swedish FSA decided to impose average risk weight floors for commercial real estates in Sweden, applicable to banks with IRB permission. The floors are set to 35% for exposures to commercial property corporates and 25% for residential property companies. The floors will be included within Pillar 2 where the add-on will be the difference between the actual average risk weight and the floor.

Regulatory changes related to COVID-19.

On 16 March, the Swedish FSA communicated that they will temporarily allow banks to fall below the liquidity coverage ratio (LCR) for individual currencies and total currencies due to COVID-19. On the same day, the Swedish FSA also decided to set the countercyclical capital buffer (CCyB) to 0% with immediate effect. The buffer was previously at 2.5%. The Swedish FSA is also stated the new buffer rate will not be changed for at least the next twelve months, meaning that any subsequent increase will not go into effect earlier than March 2022.

On 26 June, a so called 'quick-fix' was implemented in EU with the intention to ensure that banks can continue to lend money to support the economy and help mitigate the significant economic impact of the COVID-19. The package includes a few targeted "quick fix" amendments to the CRR with the intention to maximise the ability of banks to lend and absorb losses related to COVID-19. Among the changes, the quick-fix implements an extended SME factor and changed treatment of software at an earlier date then earlier decided.

Due to economic uncertainty and the current pandemic, on 18 December 2020 Finansinspektionen communicated that they expect Swedish banks to be restrictive with dividends and share buybacks until 30 September 2021. However, this does not affect Nordea Hypotek's possibility of paying, as usual, an internal dividend for the 2020 financial year to its parent company Nordea Bank Abp.

Finalised Basel III framework ("Basel IV")

Basel III is a global regulatory framework on bank capital adequacy, stress testing, and liquidity risk. In December 2017, the finalised Basel III framework, often called the Basel IV package, was published. The Basel IV package was supposed to be implemented in 2022, but was postponed until 2023 due to COVID-19, and includes revisions to credit risk, market risk, operational risk, credit valuation adjustment (CVA) risk, leverage ratio and introduces a new output floor.

The output floor is to be set at 72.5% of the standardised approaches on an aggregate level, meaning that the capital requirement under the floor will be 72.5% of the total Pillar 1 REA calculated with the standardised approaches for credit, market and operational risk. The floor will be phased in, starting with 50% from 2023 to be fully implemented at 72.5% from 1 January 2028.

Before being applicable to Nordea Hypotek, the Basel IV package needs to be implemented into EU regulations and will therefore be subject to negotiations between the European Commission, Council and Parliament, which might change the implementation and potentially also the timetable. It is expected that the Commission will publish its proposal in mid-2021 after which negotiations in the Council and Parliament will begin.

Note 8. Capital adequacy, cont.

These figures are according to part 8 of CRR, in Sweden implemented in FFFS 2014:12. For more information on the leverage ratio disclosure requirement, please see the interim disclosure required by regulation (CRR article 433 and 437).

Summary of items included in own funds

SEKm	31 Dec 2020[2]	31 Dec 2019[2]
Calculation of own funds		
Equity in the consolidated situation	25,471	25,478
Proposed/actual dividend	–	–
Common Equity Tier 1 capital before regulatory adjustments	**25,471**	**25,478**
Deferred tax assets	–	–
Intangible assets	–	–
IRB provisions shortfall (–)	–71	–102
Pension assets in excess of related liabilities[1]	–10	–8
Other items, net	–42	–28
Total regulatory adjustments to Common Equity Tier 1 capital	–123	–138
Common Equity Tier 1 capital (net after deduction)	**25,348**	**25,340**
Additional Tier 1 capital before regulatory adjustments	–	–
Total regulatory adjustments to Additional Tier 1 capital	–	–
Additional Tier 1 capital	–	–
Tier 1 capital (net after deduction)	**25,348**	**25,340**
Tier 2 capital before regulatory adjustments	1,650	1,650
IRB provisions excess (+)	37	22
Pension assets in excess of related liabilities	–	–
Other items, net	–	–
Total regulatory adjustments to Tier 2 capital	37	22
Tier 2 capital	1,687	1,672
Own funds (net after deduction)[1]	**27,035**	**27,012**

1) Based on conditional FSA approval.

2) Including profit of the period.

Own Funds, excluding profit

SEKm	31 Dec 2020	31 Dec 2019
Common Equity Tier 1 capital, excluding profit	21,181	21,208
Total Own Funds, excluding profit	22,868	22,879

Note 8. Capital adequacy, cont.

Minimum capital requirement and REA

SEKm	31 Dec 2020 Minimum Capital requirement	31 Dec 2020 REA	31 Dec 2019 Minimum Capital requirement	31 Dec 2019 REA
Credit risk	**3,065**	**38,318**	**3,035**	**37,939**
- of which counterparty credit risk	104	1,305	106	1,328
IRB	2,876	35,951	2,826	35,328
- sovereign	–	–	–	–
- corporate	1,258	15,727	1,347	16,836
- advanced	1,258	15,727	1,347	16,836
- foundation	–	–	–	–
- institutions	56	698	55	695
- retail	1,562	19,526	1,395	17,440
- secured by immovable property collateral	1,495	18,686	1,340	16,748
- other retail	67	840	55	692
- other	–	–	29	357
Standardised	189	2,367	209	2,611
- central governments or central banks	1	15	–	–
- regional governments or local authorities	–	–	–	–
- public sector entities	–	–	–	–
- multilateral development banks	–	–	–	–
- international organisations	–	–	–	–
- institutions	188	2,352	209	2,611
- corporate	–	–	–	–
- retail	–	–	–	–
- secured by mortgages on immovable properties	–	–	–	–
- in default	–	–	–	–
- associated with particularly high risk	–	–	–	–
- covered bonds	–	–	–	–
- institutions and corporates with a short-term credit assessment	–	–	–	–
- collective investments undertakings (CIU)	–	–	–	–
- equity	–	–	–	–
- other items	–	–	–	–
Credit Value Adjustment Risk	**–**	**–**	**–**	**–**
Market risk	**–**	**–**	**–**	**–**
- trading book, Internal Approach				
- trading book, Standardised Approach	–	–	–	–
- banking book, Standardised Approach	–	–	–	–
Operational risk	**916**	**11,450**	**956**	**11,949**
Standardised	916	11,450	956	11,949
Additional risk exposure amount related to Finnish RW floor due to Article 458 CRR	–	–	–	–
Additional risk exposure amount related to Swedish RW floor due to Article 458 CRR	9,634	120,419	8,825	110,318
Additional risk exposure amount due to Article 3 CRR	**–**	**–**	**–**	**–**
Total	**13,615**	**170,187**	**12,816**	**160,206**

Note 8. Capital adequacy, cont.

Minimum Capital Requirement & Capital Buffers

			Capital buffers			
Percentage	Minimum Capital requirement	Pillar II requirements[1]	CCoB	CCyB	Capital Buffers total[2]	Total requirement
Common Equity Tier 1 capital	4.5	0	2.5	0.0	2.5	7.0
Tier 1 capital	6.0	0	2.5	0.0	2.5	8.5
Own funds	8.0	0	2.5	0.0	2.5	10.5
SEKm						
Common Equity Tier 1 capital	7,658	0	4,255	1	4,256	11,915
Tier 1 capital	10,211	0	4,255	1	4,256	14,467
Own funds	13,615	0	4,255	1	4,256	17,871

1) In line with Finansinspektionens position communicated in FI ref. 14-6258 the authority has not made a formal decision on a specific own funds requirement for Nordea Hypotek AB. In the 2019 SREP, the supervisor has informed Nordea Hypotek AB of its supervisory capital assessment where pillar 2 is approxiamterly 1.75 % in own funds requirement.

2) Nordea Hypotek AB is not subject to any SRB or SII capital buffers requirements.

Common Equity Tier 1 available to meet Capital Buffers

Percentage points of REA	31 Dec 2020[1]	31 Dec 2019[1]
Common Equity Tier 1 capital	7.9	8.9

1) Including profit of the period.

Capital ratios

Percentage	31 Dec 2020	31 Dec 2019
Common Equity Tier 1 capital ratio, including profit	14.9	15.8
Tier 1 capital ratio, including profit	14.9	15.8
Total capital ratio, including profit	15.9	16.9
Common Equity Tier 1 capital ratio, excluding profit	12.4	13.2
Tier 1 capital ratio, excluding profit	12.4	13.2
Total capital ratio, excluding profit	**13.4**	**14.3**

Leverage Ratio

Percentage	31 Dec 2020[1]	31 Dec 2019[1]
Tier 1 capital, transitional definition, SEKm	25,348	25,340
Leverage ratio exposure, SEKm	667,053	624,208
Leverage ratio, percentage	3.8	4.1

1) Including profit of the period.

Note 8. Capital adequacy, cont.

Credit risk exposures for which internal models are used, split by rating grade

SEKm	On-balance exposure, SEKm	Off-balance exposure, SEKm	Exposure value (EAD), SEKm[1]	of which EAD for off-balance, SEKm	Exposure-weighted average risk weight, %:
Corporate, foundation IRB:					
- rating grades 6	–	–	–	–	–
- rating grades 5	–	–	–	–	–
- rating grades 4	–	–	–	–	–
- rating grades 3	–	–	–	–	–
- rating grades 2	–	–	–	–	–
- rating grades 1	–	–	–	–	–
- unrated	–	–	–	–	–
- defaulted	–	–	–	–	–
Corporate, advanced IRB:	**107,327**	**–**	**102,820**	**–**	**15.3**
- rating grades 6	65,599	–	64,707	–	5.5
- rating grades 5	13,149	–	11,189	–	19.5
- rating grades 4	26,226	–	24,633	–	36.5
- rating grades 3	2,136	–	2,094	–	39.8
- rating grades 2	56	–	56	–	50.9
- rating grades 1	43	–	41	–	62.4
- unrated	**92**	–	74	–	77.8
- defaulted	**26**	–	26	–	224.8
Institutions, foundation IRB:	**9,892**	**–**	**9,892**	**–**	**7.1**
- rating grades 6	**9,036**	–	9,036	–	6.8
- rating grades 5	**856**	–	856	–	10.2
- rating grades 4	–	–	–	–	–
- rating grades 3	**–**	**–**	**–**	**–**	**–**
- rating grades 2	–	–	–	–	–
- rating grades 1	–	–	–	–	–
- unrated	–	–	–	–	–
- defaulted	–	–	–	–	–
Retail, of which secured by real estate:	**492,024**	**73,677**	**565,701**	**73,677**	**3.3**
- scoring grades A	434,828	65,107	499,935	65,107	2.2
- scoring grades B	33,732	5,096	38,829	5,096	5.6
- scoring grades C	16,191	2,501	18,692	2,501	12.4
- scoring grades D	4,524	689	5,213	689	21.5
- scoring grades E	879	139	1,017	139	36.7
- scoring grades F	955	145	1,100	145	58.6
- not scored	229	–	229	–	63.0
- defaulted	686	–	686	–	124.2
Retail, of which other retail:	**12,457**	**–**	**12,450**	**–**	**6.7**
- scoring grades A	10,137	–	10,137	–	4.3
- scoring grades B	1,097	–	1,096	–	9.9
- scoring grades C	903	–	899	–	18.8
- scoring grades D	182	–	181	–	24.2
- scoring grades E	71	–	70	–	26.1
- scoring grades F	35	–	34	–	41.4
- not scored	11	–	11	–	46.3
- defaulted	21	–	22	–	226.6
Other non credit-obligation assets:					

1) Includes EAD for on-balance, off-balance, derivatives and securities financing.

Nordea Hypotek does not have the following IRB exposure classes: equity exposures, central governments and central banks and also qualifying revolving retail.

Note 9. Related-party transactions

The information below is presented from a Nordea Hypotek perspective, meaning that the information show the effect from related party transationcs on the Nordea Hypotek figures.

Balance sheet

	Nordea Group companies		
SEK (000s)	31 Dec 2020	30 Jun 2020	31 Dec 2019
Assets			
Loans to credit institutions	4,553,762	3,876,093	5,599,320
Loans to the public	–	–	–
Derivatives	4,559,286	5,729,635	4,598,794
Other assets	453,585	0	813,788
Prepaid expenses and accrued income	227,095	19,892	21,189
Total assets	**9,793,728**	**9,625,620**	**11,033,091**
Liabilities			
Deposits by credit institutions	208,194,432	219,038,495	235,964,135
Debt securities in issue	67,536,271	31,394,594	5,454,130
Deivatives	839,654	771,484	507,046
Other liabilities	6,641,707	1,303,956	4,775,261
Prepaid income and accured expenses	165,943	68,659	140,747
Subordinated liabilities	1,650,119	1,650,067	1,650,137
Total liabilities	**285,028,126**	**254,227,255**	**248,491,456**

Income statement

	Nordea Group companies		
SEK (000s)	2020 Full year	2020 Jan–Jun	2019 Full year
Interest income	205,779	159,423	101,152
Interest expense	488,695	–23,275	1,296,526
Net fee and commission income	–68,846	–26,371	–54,410
Net result from items at fair value	222,766	1,022,418	–159,147
General administrative expenses:			
- Other expenses	–1,280,031	–605,854	–1,057,404
Total	**–431,637**	**526,341**	**126,717**

Note 10. Risks and uncertainties

Credit risk is the most significant risk exposure for the Company. The Company is also exposed to market risk, liquidity risk and operational risk, including legal risks. These risks are inherent in the Company's business operations and are acceptable to a certain level. Risk limits have been set by the Board of Directors in the risk appetite, and cover all material risks to which the Company is exposed. The risk appetite is updated no later than 22 February 2021.

Nordea Hypotek entered the COVID-19 crisis with a strong financial position, which the Company has managed to maintain. The underlying operations have remained strong and the Company has allowed for increased future credit losses in its provisioning. Realised credit losses have not changed compared with pre-crisis levels. However, there are significant risks related to the pandemic given the uncertainty of the economic impact in Sweden. Depending on future developments, potential adverse impacts on income could arise due to lower net interest income, higher market volatility and reduced business activity impacting transaction volumes and customer activity.

There are no outstanding disputes or legal proceedings in which material claims have been lodged against the Company.

Upcoming publications

Nordea Hypotek's Annual Report for the financial year 2020, which includes the Audited Financial Statements, the Board of Directors' Report and the Corporate Governance Statement, will be published on 5 March 2021 by way of a stock exchange release and will also be available at www.nordea.com.

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