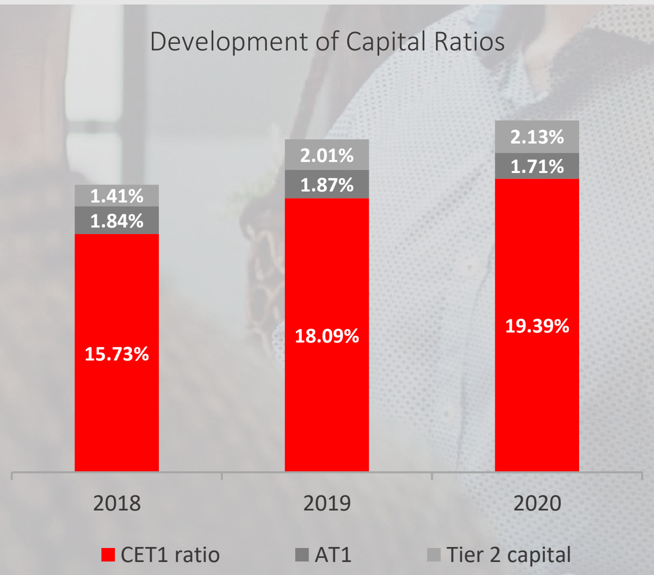
Pillar 3 Report
2020

Santander Consumer Bank at a glance

Highlights in 2020

Key Capital Adequacy Metrics (December 2020)

Risk Weighted Assets (million NOK)	Total Capital Ratio (%)
131 555	23.23
Common Equity Tier 1 Capital Ratio (%)	**Leverage Ratio (%)**
19.39	13.78



Pillar 1 Capital Reporting Methodologies

Credit Risk	Market Risk	Operational Risk
Standardized Approach	Standardized Approach	Basic Indicator Approach
Foundation-IRB	Internal Models	Standardized Approach
Advanced-IRB		Advanced Measurement

Indicate those methods applied by Santander Consumer Bank

Contents

1 Purpose and Scope of Application

The purpose of this report ("**the Pillar 3 report**") is to provide information to the market in order to assess the risk management, risk measurement and capital adequacy of Santander Consumer Bank AS. When including its subsidiary, Santander Consumer Bank AS will be referred to in this document as "SCB", "the Bank" or "SCB Group". When excluding its subsidiary, reference will be made to "SCB AS". SCB is a commercial bank 100% owned by Santander Consumer Finance S.A. in Spain, which is again owned by Banco Santander. This Pillar 3 report covers SCB's operations in Norway, its branches in Sweden and Denmark and its subsidiary in Finland (SCF Oy).

The report meets the information requirements in accordance with the "Regulation on capital requirements and national adaptation of CRR/CRD IV", the Norwegian Finanstilsynet (Norwegian FSA) Circular 5/2018 in "Offentliggjøring av finansiell informasjon – kommisjonsforordninger og anbefalinger fra EBA" and the guidelines issued by the European Banking Authority (EBA) in "Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA-GL-2016-11)". In addition SCB publishes an appendix to the report (see Pillar 3 Appendix) displaying further information on capital adequacy position, terms of capital instruments, leverage ratio calculations, applicable countercyclical buffer calculations and own funds disclosure as recommended in the Norwegian FSA Circular 14/2014 (in "Publishing information regarding own funds") and in the Norwegian FSA Circular 5/2018 mentioned above. The Pillar 3 report is updated annually.

For information on SCB's remuneration policy see SCB's 2020 Annual Report under "*Note 30 – Remuneration*".

2 Santander Consumer Bank AS

SCB is a Nordic commercial bank, operating in Norway, Sweden, Denmark and Finland, with the head office located at Lysaker in Norway. As at 31 December 2020, the Bank had 1355 employees (excluding temporary hired employees) of which 629 worked in Norway, 320 in Sweden, 228 in Denmark and 178 in Finland.

The Bank is a leading consumer finance provider across the Nordic region offering car financing, consumer loans, credit cards and sales financing. The Bank also offers customer deposits in Norway, Sweden and Denmark. Note that, in this document, car financing is referred to as “secured financing” due to collateral in the vehicle while consumer loans, credit card and sales finance are referred to as “unsecured financing” as these loans are without collateral. In addition, the Bank acts as an ancillary insurance mediator for insurance companies[1] in the respective jurisdictions.

SCB aspires to be the leading Nordic consumer finance platform by operating efficiently and working collaboratively. In 2020, the Bank has announced a new Nordic structure to simplify the organization and improve synergies across the Nordic markets in order to continue to be competitive and serve partners and customers in the best way possible.

The year 2020 has also tested our resilience both as a community and indeed as a business. The COVID-19 outbreak had dramatic effects worldwide and even though the Nordic region is better equipped than most at handling the economic effects of the pandemic, we are not immune to the challenges. Measures to combat the spread of the virus were introduced overnight, with Denmark and Norway closing down most of its societies during March 2020, and with Finland following soon after. Sweden has also introduced measures but remained more open than the other countries throughout the year. Various emergency Power Acts and Regulations, Government Guarantee Schemes and Government Crisis Packages were adopted, all seeking to mitigate the negative impacts of the pandemic and the measures implemented to combat the spread of the virus.

Among these measures, regulators have eased overall capital requirements for banks. SCB is governed by Norwegian law and is supervised by the Norwegian Finanstilsynet (Norwegian FSA) and the European Central Bank (ECB) as a Joint Supervisory Team (JST). During 2020, the Bank has experienced substantial changes to its capital requirements but has had a strong capital position through the year.

At year-end 2020, the Group had a solid capital adequacy position with a Common Equity Tier 1 (CET1) ratio of 19.39%, which represents a margin of 6.65%-points above the regulatory requirement. For SCB AS, the CET1-ratio at year-end was

[1] *CNP Santander Insurance Life DAC and CNP Santander Insurance Europe*

19.78%. The strong capital position is due to dividend restrictions encouraged by regulators in light of COVID, reduction in capital requirements during 2020 and equity injection to support the acquisition of Forso Nordic AB (“Forso”). Forso is the captive finance operation for Ford Motor Company in the Nordics with headquarter in Sweden, Gothenburg, with a subsidiary in Finland and branches in Norway and Denmark. The total outstanding portfolio, consisting of auto loans and leasing contracts was approximately 1.3 billion EUR at the transaction date in February 2020.

The Group publishes capital ratios on a transitional rule basis (allowing for a reversal of 70% of IFRS 9 capital impact in 2020) and a fully phased-in basis. Although transitional capital ratios are the official ratios required to meet the minimum capital requirements set forth by regulatory authorities, SCB manages its capital to meet the fully phased-in IFRS 9 capital ratios. For 2021, transitional capital ratios will incorporate a reversal of 50% of the capital impact.

The Bank is an Advanced IRB (A-IRB) bank with approximately one third of its portfolios currently under this approach. The remaining portfolios are under the Standardized Approach, but they are planned to be rolled out under the A-IRB approach in the coming years. The European Banking Authority’s (EBA) introduction of new default definition (NDD) was implemented for IRB portfolios for capital reporting purposes as of November 2020, while the remaining portfolios adopted the NDD in January 2021. The NDD triggers the need to recalibrate the Bank’s IRB models and the Bank plans to submit updated IRB models to the Norwegian FSA for approval during 2021.

3 Risk Management and Control

3.1 Role of the Board of Directors

In accordance with the Norwegian Financial Institutions Act section 13-6, the Board of Directors (“BoD”) shall monitor and manage SCB’s overall risk and regularly assess whether management and control arrangements are tailored to the risk level and scale of SCB’s activities. The BoD has established a risk committee (the “Board Risk Committee” or “BRC”) consisting of three members chosen by and among board members, currently two of the Board’s external directors and one internal director (non-executive), and carrying out the tasks set forth in section 13-6 of the Norwegian Financial Institutions Act and regulations connected thereto. Future information on the BoD sub-committees is outlined in section 3.4.

The Board of Directors instructs senior management to develop and maintain an appropriate, systematic and consistently applied process to determine risk levels, provisions for loan losses and management aligned with the corporate guidelines. More information on SCB Senior Management team can be found in section 3.4.

The Board of Directors adopts and participates in the reassessment of credit authorizations. It also receives relevant reports in the risk area and instigates relevant action to reduce any undesired rise in risk level. It is established in the Credit Policy that BoD shall approve parameter and management limits, as well as any proposed remedial action when facing breach of limits. All breaches of management limits must be reported to the BoD regardless of whether the breach is cured.

3.2 Risk Management and Control

The Bank handles risks under an **Advanced Risk Management (ARM)** program, which is mainly aimed at helping the Bank shift towards advanced management, laying down the foundations to have the best enterprise wide risk management model in the financial industry. Through the annual roll-out of ARM, initiatives are being consolidated, including all strategic projects related to data and reporting, evolving the risk appetite, reinforcing the control environment, strengthening the governance of the risk function, and developing new initiatives such as cyber or model risk management. The program is also helping to reinforce the risk culture which is one of the Bank’s hallmarks. ARM is a holistic risk management program with the following characteristics:

1. It aims **to consolidate the Operating Risk model** with a strong connection to the Bank’s business strategy.
2. It is integrated into the daily narrative of the management, as part of **the risk culture consolidation process**.
3. It is a part of the **objectives and rewards system (Bonus Pool)** of the whole organization.

4. It is **a structured tracking system with a quarterly follow-up** to check on progress. The progress is presented to the Board and Executive Committee.
5. **Availability of an online portal** to record achievements and the evidences that support them.

Lines of Defence Framework

SCB adopts the three lines of defence mechanism for management and control of risk:

- **The business functions or activities that create exposure to a risk are the first line of defence.** The first line of defence is responsible for establishing an appropriate environment for the management of all risks associated with business, for proposing appetite and limit levels, and for implementing the mechanisms to manage the risks and maintain them within risk appetite of the business.
- **The second line of defence consists of the risk control and oversight function and by the compliance function.** This line vouches for effective control of the risks and ensures they are managed in accordance with the level of risk appetite defined.
- **Internal audit is the third line of defence** and as the last layer of control in the Bank regularly assesses the policies, methods, and procedures to ensure they are adequate and are being implemented effectively.

There is a sufficient degree of segregation between the risk control function, the compliance function and the internal audit function, to ensure that their functions are performed and that they have access to the BoD and/or its committees through their heads.

Risk Identification and Assessment

Identifying and evaluating all risks is the first step to controlling and managing risks. The **Risk Map** covers the main risk categories in which SCB has its most significant exposures, current and/or potential.
The key risk types identified in the risk map are:

- **Credit Risk**: risk of financial loss arising from the default or credit quality deterioration of a customer or other third party, to which SCB has provided credit or for which it has assumed a contractual obligation.
- **Liquidity Risk**: risk that SCB does not have enough liquid resources to meet its obligations when they fall due.
- **Structural Risk**: the risk arising from the management of different balance sheet items (i.e. interest rate risk or currency risk).
- **Capital Risk**: the risk of the SCB not having an adequate amount or quality of capital to meet its internal business objectives, regulatory requirements or market expectations.
- **Operational Risk**: the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- **Reputational risk**: risk of losses caused by events that can worsen the public perception of the bank.
- **Model Risk:** the risk of losses arising from inaccurate predictions, causing a bank to make sub-optimal decisions, or from a model being used inappropriately.
- **Strategic Risk**: the risk of loss or damage arising from strategic decisions or their poor implementation, or from an inability to adapt to external developments.

Apart from the risks identified in the risk framework and classified in the risk map, the **Risk Identification and Assessment process** (RIA) also aims to identify and assess all the risks to which the bank is exposed to or could be exposed to in the future. The goal is to define SCB's risk through a quantitative and qualitative evaluation of the relevant risks composed of:

- Risk performance: assesses the current risk exposure and performance through a set of dimensions, metrics and thresholds.
- Control environment: evaluate the level of compliance of the SCB's risk management target operating model, identifying possible gaps and weaknesses.
- Top risks: is a process carried out to allow the early identification of potential threats to the profitability, solvency or strategic objectives of the entity, promoting an effective risk management and mitigation. Top Risks have a three-year horizon, and two sorts of events are considered, depending on their estimated likelihood and/or severity: plausible and tail risk events.

The exercise is conducted semi-annually, with the involvement of 1st, 2nd, and 3rd lines of defence, and with the purpose of monitoring the Bank's risk profile.

Material risks identified in the RIA are incorporated in the Risk Appetite Statement ("RAS").

Risk Appetite

Risk appetite is the maximum level and type of risk that SCB is willing to assume, within its risk capacity, to achieve its strategic objectives and the development of its business plan.

SCB aims to maintain a medium-low risk profile that is predictable. This profile is achieved by means of earnings stability (low P&L volatility), maintaining robust capital and liquidity under both normal and stressed conditions, limiting the impact in earnings and capital base due to concentration on large exposures and individual counterparties, controlling and limiting non-financial risk events (fraud events, operative, technological, legal and regulatory breaches, conduct issues or reputational damage).

The risk appetite is defined by risk limits and alerts for the identified material risks: Credit risk, Liquidity risk, Structural risk, Capital risk, Operational risk, Reputational risk, Model risk and Strategic risk. The limits are set according to their potential impact on 1) Financial results volatility; 2) Solvency levels; 3) Liquidity; 4) Concentration; 5) Non-Financial.

The limits and alerts are set by Risk in cooperation with Financial Management and Compliance and are approved by the BoD. For 2021, the new limits and alerts were approved on 26 January 2021 by the BoD.

All of the metrics are monitored on a monthly basis by the SCB Enterprise Risk Management function and reported at least quarterly to the BoD.

Risk Data Aggregation

In line with Basel Committee on Banking Supervision's standards number 239, the Risk Data Aggregation project ensures that the risk data reported to senior management reflects the basic principles enforced in the regulation: captures all types of risks with appropriate accuracy and timeliness.

During 2020, the Risk Data Quality Reporting System (DQRS) team continued to focus on providing a proper data governance along with the entire data life cycle, robust IT processes and reliable risk reporting. Data quality and traceability controls were set to ensure that risk reports contain accurate granularity and appropriate data sources.

Risk reports contain appropriate balance between data, analysis, and qualitative comments, including forward-looking measures, risk appetite data, limits and emerging risks, and are distributed in due time and form to the senior management.

Strategic Commercial Plan

The Strategic Commercial Plan (SCP) constitutes to be the basic instrument for managing and controlling SCB credit portfolios, defining all the sales strategies, risk policies and the means and infrastructures necessary to meet the annual budget.

Regular monitoring of the SCP will anticipate any undesirable deviations observed with respect to the initial budget and will enable management to identify significant changes to risk, assess their potential impact, and apply any courses of corrective action that may be necessary.

This will also continuously provide management an updated view of the creditworthiness of the portfolios, and identify any key weaknesses in terms of policies, processes and means to help the Bank implement the mitigation mechanisms required.

3.3 Monitoring and Reporting

The main objective of risk monitoring and reporting is to ensure all risk types are managed in conformity with the risk appetite level approved by the Board. For this purpose, an array of different reports has been developed with different contents, audience, and frequencies.

The responsibility for developing risk reports rests with the Risk department, which is also responsible for securing the quality, standards, content, timeliness, and the distribution of risk information. The scheduled risk management information flows via the corporate MIS (Management Information System) reporting tool, which is in use for Risk reporting purposes at the SCB consolidated level internally and towards SCF HQ Risk Area.

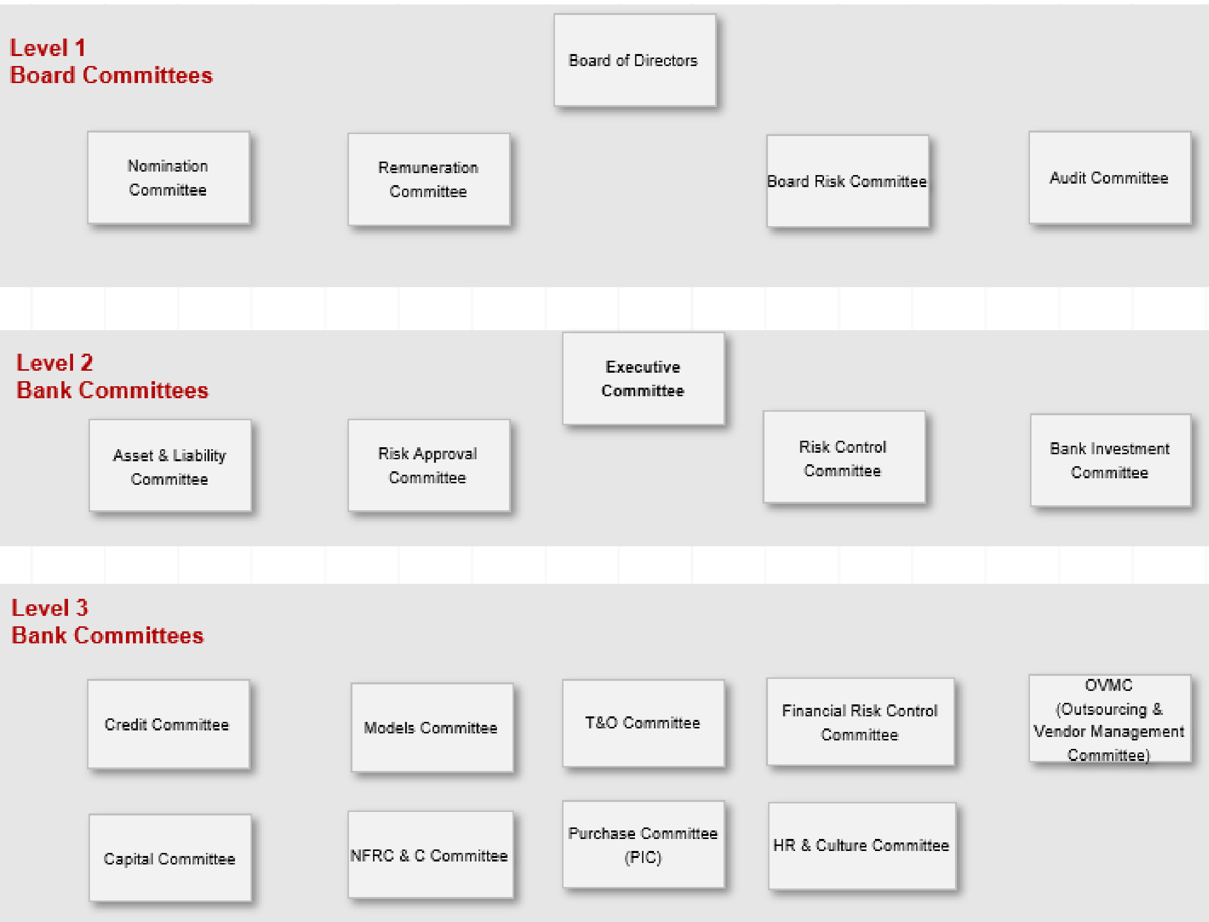
3.4 Internal Control

The BoD has established sub-committees with powers of supervision, information advice and proposals. An overview of the main objectives of the sub-committee is detailed below:

- **Board Risk Committee (BRC):** advise the BoD on current and future risks, risk appetite and risk strategy. This includes ensuring the establishment of appropriate internal control systems and the compliance with laws, ordinances, and internal regulations as well as generally accepted practices or standards.
- **Audit Committee:** review SCB's financial information and internal control systems and serve as the communication channel between the BoD and the external auditor. The committee also supervises the Internal Audit department. Further details on the Internal Audit function are detailed below.
- **Nomination Committee:** oversee the balance, knowledge, diversity, and experience of the BoD and to identify, when applicable, candidates to fill vacant positions in the BoD.
- **Remuneration Committee:** preparation of remunerations decisions to be adopted by the BoD and ensure compliance with and transparency of the remuneration policy.

The figure below illustrates how SCB's corporate governance is structured. It identifies the allocation of authority and responsibilities and how decision-making and reporting lines between the shareholder, the BoD, management, and Internal Audit are arranged.

Figure 3.4.1: SCB Governance Structure Overview

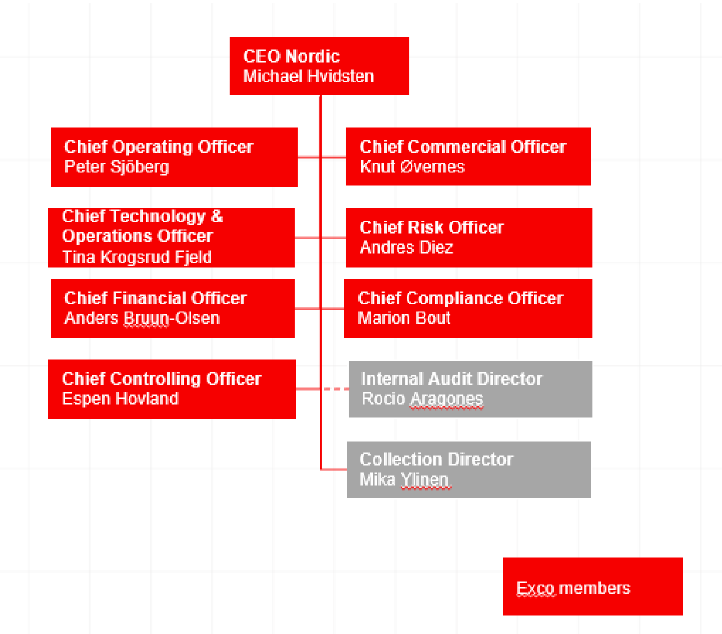


SCB operates with a pan-Nordic management structure, consisting of the CEO and heads of the different functions (departments).

Figure 3.4.2 shows the management structure as per December 2020. Members of the senior management marked in red constitute the Bank's Executive Committee (ExCo). ExCo is responsible for:

- Draft, review and revise SCB's strategy and propose to the Board for approval
- Review and recommend revision of SCB's long-term strategic plan, three-year business, financial plan and annual budget, and validating it before sending to the Board for approval.
- Ensure execution of the bank's strategy and value creation for the bank.
- Monitor the SCB's strategic, financial and operational performance, and decide on corrective actions where needed, propose corrective actions or Board approval when required
- Monitor SCB's commercial performance, decide on corrective actions where needed, propose corrective actions or Board approval when required.
- Review and revise SCB's operating model and governance structure, recommend for Board approval when required
- Monitor and ensure that the bank is managed in accordance within regulations and Santander frameworks.
- Provide monthly updates to the Board via the CEO Update
- Act as SCB Special Situation Management Committee, conducting and monitoring the management of events of any kind (financial or of an operational/reputational nature) which may result in a severe deterioration of the SCB liquidity and/or solvency levels, and compromise the development of its activity.

Figure 3.4.2: SCB Senior Management



Internal Control Framework

The internal control framework within SCB is based on: (1) the Santander Internal Control Framework, (2) the requirements of The Sarbanes-Oxley Act (SOX), (3) the Committee of Sponsoring Organizations of the Treadway Commission Framework (COSO) and (4) the local requirements by Nordic regulators. The Santander Internal Control Framework sets the foundations for the Internal Control function in SCB and the internal control methodology.

4 Capital Adequacy

4.1 Capital Management Governance

Governance and responsibilities related to capital management are outlined in the Bank's Capital Framework and Policy documents. The objective of the Capital Management governance framework is to ensure adequate solvency levels, regulatory compliance and efficient use of capital.

The BoD have the ultimate responsibility for the solvency and capital adequacy of the bank. Capital management decisions requiring BoD approval must be approved and recommended by the Capital Committee before being recommended to the BoD. Certain items may also need to be reviewed in the Board Risk Committee before being presented to the Board. Capital management decisions will include those relating to capital adequacy, capital targets, capital composition, capital plan, dividend policy and capital contingency plans. The Capital Committee consist of members of senior management (the Chief Financial Officer, Chief Risk Officer and the Chief Controlling Officer) who have voting power and representatives from Risk, Financial Management and Financial Control who have an advisory role.

The BoD approves target capital ratios, at least on an annual basis. Capital positions and forecasts are presented to the BoD on a regular basis. Capital reporting to the Norwegian FSA is approved by the Capital Committee before submission. Any dividends proposed by the BoD, must be finally approved in the SCB General Meeting.

Increase and reduction of capital is subject to the approval of the BoD and the general meeting of SCB (either directly or through a power of attorney). Corporate authority to issue subordinated debt lies with the General Meeting of SCB (although such authority may be delegated to the BoD through a power of attorney). All other debt issuances (including senior non-preferred debt) may be authorized by the BoD or any other person(s) authorized by the BoD. In case of repayment of hybrid capital and subordinated debt, approval by the BoD or any other person(s) authorized by the BoD will be sufficient.

Dividend Policy

The Bank has a formal dividend policy that was approved by the BoD in 2019. The dividend policy states that *"As a reference criterion, the pay-out ratio shall, over time, be at least 50%. However, the policy will be adapted to SCB's specific circumstances".* SCB will assess its capital position prior to every potential dividend payment to ensure sufficient capitalization to cover all risks as well as all regulatory requirements.

On December 18th, 2020 the European Systemic Risk Board (ESRB) issued a new recommendation on national authorities to request banks and insurers to apply caution in distributing profits until 30 September 2021. In January 2021, the Ministry of Finance communicated that there still is an unusual level of uncertainty due to the pandemic, and banks may as a consequence of this and measures implemented to combat the spread of the virus, over time incur significant credit losses. However, provided that great caution is applied, and certain thresholds not exceeded, well-capitalized banks should be able to distribute some of their profits in 2021.

In light of the widespread financial turmoil caused by the Covid-19 pandemic, the Board has not proposed any dividend distribution from the financial year 2019 or 2020 in the general meeting in February 2021.

4.2 Capital Requirements

SCB is supervised by the Norwegian FSA and has to comply with the capital requirements for banks in Norway. Norwegian banks are subject to ongoing capital adequacy requirements, which implement EU Directives and Regulations based on the Basel III regime. In line with the recommendations of the Basel Committee on Banking Supervision (the Basel Committee), the regulatory approach in the Financial Undertakings Act is divided into three pillars:

- **Pillar 1:** Minimum regulatory capital of 8% of risk-weighted assets: banks shall, at all times, satisfy capital adequacy requirements reflecting credit risk, operational risk and market risk.

- **Pillar 2:** Assessment of overall capital needs and individual supervisory review: banks must have a process for assessing their overall capital adequacy in relation to their risk profile and strategy for maintaining their capital levels – the Internal Capital Adequacy Assessment Process or ICAAP. The regulator evaluates the ICAAP and, following completion of the Supervisory Review and Evaluation Process (SREP), publishes the Pillar 2 requirement (P2R) for the bank. In addition, the Norwegian FSA will assess SCB's own stress test performed in ICAAP and other stress tests conducted by other regulators (European Banking Authority and International Monetary Fund) to communicate Norwegian FSA's expectations of a Pillar 2 guidance (P2G) over and above the overall capital requirement.

- **Pillar 3:** Disclosure of information: banks are required to disclose relevant information on their activities, risk profile and capital situation to the market.

The table below outlines the evolution of capital requirements for SCB Group as per December 2020 and 2021 (expected). During 2020, the Bank has experienced substantial changes to its capital requirements but has had a strong capital position through the year. The year 2020 started with an increase in capital requirements due to both increased Pillar 2 and countercyclical buffer requirements (CCyB). As a result of this increase in capital requirements and the acquisition of Forso AB ("Forso"), no dividend was proposed from the year 2019 in the general meeting in the first quarter. To support the acquisition of Forso, the Bank also received new equity of 2 billion NOK by its owner in February 2020.

During 2020, changes in regulatory requirements driven by the COVID-19 pandemic have decreased the overall capital requirements for the Group. In March 2020, regulators across Europe reduced the CCyB as a result of the pandemic. In Norway the CCyB was reduced from 2.5% to 1%, while in the other Nordic countries, the CCyB was reduced to 0%. Later in December 2020, the Norwegian Ministry of Finance confirmed amendments to the systemic risk buffer (SRB) requirement from 3% to 4.5% from year-end 2020 allowing banks to use buffer requirements in the jurisdictions where they operate. With operations in Sweden, Denmark and Finland with an SRB of 0%, the changes resulted in lower capital requirements for SCB.

The Board of Directors did not propose any dividend distribution for 2020 in light of the communication by the Ministry of Finance 20th of January 2021, where they urged banks to refrain from dividend payments until 30th of September 2021 due to uncertainty related to the COVID-19 pandemic.

Going forward, the expectation is that the CCyB will gradually return to pre-COVID levels once the COVID situation improves. Furthermore, in the spring of 2019, EU adopted what is collectively called the "Banking Package" or the "Risk Reduction Package", including changes to EU's capital requirement legislation and the Bank Recovery and Resolution Directive, CRR II, CRD V and BRRD II, entering into force in the EU from June of 2021. The legislation is EEA relevant and is expected to be included in the EEA agreement, and therefore the Norwegian Ministry of Finance asked the Norwegian FSA to establish and take lead on a working group to review the Norwegian implementation. On 9 October 2020, the FSA submitted their results of their review as well as a proposal for the Norwegian implementation

The regulatory changes in the Banking Package include minimum requirements for leverage ratio, requirement for NSFR, narrowing of the supervisory authorities ability to conclude on Pillar 2 requirement for systemic risk, and greater flexibility for national authorities to implement measures to deal with various forms for systemic risk, including increased capital buffers. In addition, the so-called "SME Discount" will be continued and expanded. The Banking Package furthermore include additional rules on how the crisis management authority shall determine how much of the MREL[2] requirements are to be met with subordinated debt. The Banking Package must be implemented in Norwegian law through incorporation and will apply as Norwegian law with EEA adoption or special Norwegian rules. It is expected that the Banking Package is incorporated in Norwegian Law during 2021 or 2022.

[2] *Minimum requirement for own funds and eligible liabilities*

Table 4.2.1: SCB Capital Requirements December 2020 and Expected December 2021

December 2020	Capital Requirement (%)	December 2021E	Capital Requirement (%)
CET1		**CET1**	
Minimum requirement	4.5 %	Minimum requirement	4.5 %
Capital Conservation Buffer	2.5 %	Capital Conservation Buffer	2.5 %
Systemic Risk Buffer [2]	1.2 %	Systemic Risk Buffer [2]	1.2 %
Countercyclical Buffer (CCB) [1]	0.3 %	Countercyclical Buffer (CCB) [1]	0.3 %
Total Pillar 1 requirement	**8.4 %**	**Total Pillar 1 requirement**	**8.4 %**
Pillar 2 requirement (P2R)	3.3 %	Pillar 2 requirement (P2R)	3.3 %
Pillar 2 Guidance (P2G)	1.0 %	Pillar 2 Guidance (P2G)	1.0 %
Total CET1 requirement	**12.7 %**	**Total CET1 requirement**	**12.7 %**
Tier1 (T1)		**Tier1 (T1)**	
Additional T1 requirement	1.5 %	Additional T1 requirement	1.5 %
Total T1 requirement	**14.2 %**	**Total T1 requirement**	**14.2 %**
Tier2 (T2)		**Tier2 (T2)**	
Additional T2 requirement	2.0 %	Additional T2 requirement	2.0 %
Total T2 requirement	**16.2 %**	**Total T2 requirement**	**16.2 %**
Leverage Ratio (LR)		**Leverage Ratio (LR)**	
Minimum leverage requirement	3.0 %	Minimum leverage requirement	3.0 %
Buffer requirement for non-SIFI banks	2.0 %	Buffer requirement for non-SIFI banks	2.0 %
Total LR requirement	**5.0 %**	**Total LR requirement**	**5.0 %**

[1] *Based on local CCB req. Dec20: NO 1%, SE 0%, DK 0%, FI 0%*
[2] *Based on local SRB req. Dec20: NO 4.5%, SE 0%, DK 0%, FI 0%*

[1] *Based on local CCB req. Dec20: NO 1%, SE 0%, DK 0%, FI 0%*
[2] *Based on local SRB req. Dec20: NO 4.5%, SE 0%, DK 0%, FI 0%*

Pillar 1 Requirements

The minimum capital adequacy requirement of 8% shall consist of at least 4.5% Common Equity Tier 1 capital (CET1 capital), at least 1.5% of Additional Tier 1 capital (T1 capital) and the remaining 2.0% may consist of subordinated capital instruments (T2 capital). In addition, banking institutions are subject to various regulatory buffer requirements referred to as combined buffer requirements (CBR) which must be met with CET1 capital. Per 31 December 2020, the Bank's CBR consisted of a 2.5% capital conservation buffer, a 1.2% systemic risk buffer and a 0.3% countercyclical buffer (CCyB) which is calculated as a weighted average of country specific CCyBs in accordance with CRD IV Article 140.

Systemic important financial institutions should hold an additional 2% buffer of CET1 capital. However, SCB is not considered a systemic important financial institution ("SIFI") and therefore, has no SIFI buffer requirement.

In summary, the Pillar 1 CET1 capital requirement for SCB Group was 8.4% per 31 December 2020.

Pillar 2 Requirements

SCB conducts, at least annually, an ICAAP which is used as one input to determine the Bank's Pillar 2 capital requirement. Several departments are involved in the ICAAP process including Financial Management, Risk, Financial Control, Legal and Compliance & Conduct and IT Risk. Stress scenarios, as well as outcomes of various analysis in the ICAAP report are reviewed and approved by the Capital Committee. In addition, all analysis and governance processes leading to the ICAAP report is reviewed by Internal Audit.

Thereafter, the ICAAP is reviewed by the Risk Control Committee and the Board Risk Committee, which gives its recommendations to the Board of Directors. Finally, the ICAAP is reviewed and approved by the Board of Directors prior to submission to the Norwegian FSA.

In December 2020, the Bank received feedback from the Norwegian FSA on the annual Supervisory Review and Evaluation Process (SREP). In light of the COVID-19 pandemic, the FSA performed a pragmatic assessment and maintained their previous decision communicated in December 2019: Pillar 2 requirement (P2R) of 3.3% limited to a minimum of that at least 4 billion NOK, and Pillar 2 Guidance (P2G) of 1.0% for the Group.

Pillar 3 Requirements

This Pillar 3 report is updated at least annually in conjunction with the Annual report, as outlined in the Capital Framework approved by the BoD. The report meets the information requirements in accordance with the "Regulation on capital requirements and national adaptation of CRR/CRD IV", the NFSA Circular 5/2018 "Offentliggjøring av finansiell informasjon – kommisjonsforordninger og anbefalinger fra EBA" and the guidelines issued by the European Banking Authority (EBA) in "Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA-GL-2016-11)". In addition, the Bank publishes an appendix to the report (see Pillar 3 Appendix), where terms of capital instruments, capital & own funds, leverage ratio, countercyclical buffer requirements and credit exposures are disclosed in accordance with the NFSA Circular 14/2014 in "Publishing information regarding own funds" and the NFSA Circular 5/2018 mentioned above.

The senior management members of the Capital Committee, consisting of the Chief Risk Officer, the Chief Controlling Officer and the Chief Financial Officer, as voting members, approve the content of the Pillar 3 report.

Internal Audit assesses the quality of the disclosure of information about the bank's capitalization, risk profile and management and control of risk.

Leverage Ratio Requirements

In addition to the Pillar 1 and Pillar 2 capital requirements, banks are required to adhere to leverage ratio requirements. The leverage ratio is calculated in accordance with CRR Article 429 i.e., Tier 1 capital and total exposures (on and off-balance sheet). Since 30 June 2017, the Norwegian FSA has set a minimum leverage ratio requirement of 3%, a mandatory buffer of 2% for all banks and a 1% buffer for SIFI banks. SCB must comply with a leverage ratio requirement of 5%.

Recovery Plan and Minimum Requirements for Own Funds and Eligible Liabilities

In previous years, the Bank has been covered under its parent's company Recovery Plan. However, during the fourth quarter of 2020, the Bank prepared a draft Recovery Plan for the first time at the request of SCB's consolidated supervisor, the Norwegian FSA, based on applicable Norwegian regulations and guidelines[3]. By draft, the Norwegian FSA expected SCB to deliver a plan with all required chapters highlighted in Circular 10/2019 but not necessarily with all details and depth required for a full version. The purpose of a Recovery plan is to define critical functions (for society) of the bank and set out recovery measures that the Bank could adopt to restore its financial position in case of a severe distress. The draft Recovery Plan was approved by SCB's Board of Directors on November 25th, 2020 and subsequently submitted to the Norwegian FSA.

A bank's Recovery Plan will be the foundation for the Minimum Requirement for own funds and Eligible Liabilities (MREL) so that banks have sufficient capital and convertible debt to handle crisis without the use of public funds. In December 2019, the NFSA published MREL requirements for eight Norwegian Banks and in December 2020, the Norwegian FSA published MREL requirements for additional six Norwegian Banks. SCB has not received MREL requirements by Norwegian FSA. The question of whether SCB will be subject to MREL requirements as a standalone Norwegian bank or covered by the MREL requirements for Banco Santander (as the resolution entity), has not been resolved. MREL debt will in any event be internal debt provided by the parent company.

4.3 Capital Position per December 2020

SCB Group possesses a robust capital adequacy position. As at 31 December 2020, the CET1 capital ratio stood at 19.39% on a phased-in IFRS9 basis and 19.19% on a fully phased-in IFRS 9 basis, representing a significant buffer above the minimum regulatory requirement. Although official reporting to the Norwegian FSA is with transitional rules for IFRS 9 impact, the Bank manages its capital on a fully phased IFRS 9 basis. In addition, the Group called two subordinated loans of 250 million NOK each and refinanced with a new loan of 500 million NOK in December 2020, ensuring Total-Capital ratios are met going forward.

[3] *Circular 10/2019 issued by the Norwegian FSA on "Finanstilsynets retningslinjer for gjenopprettingsplaner" outlines the requirements and expectations for Bank's recovery plans. Requirements laid out in the Circular takes into account and must be read in conjunction with relevant EU documentation, including EBA/GL/2014/06, EBA/GL/2015/02, EBA/Rec/2017/02, Commission Delegated Regulation (EU) 2019/348.*

The Board of Directors refrained from proposing dividend from 2019 to the general meeting that took place in January 2020 and proposed to increase the equity with 2 billion NOK. The new equity was paid by the owner Santander Consumer Finance S.A. on 28 February 2020, further strengthening the capital position of the Bank. Furthermore, the Board of Directors refrained from proposing dividends from 2020 to the general meeting in February 2021 in light of the communication by the Ministry of Finance as previously mentioned.

The Bank's leverage ratio was 13.78% (SCB AS: 15.07%) as at 31 December 2020, significantly above the 5% regulatory requirement. The Table below details SCB Group's surplus of capital vs. regulatory capital requirements in 2020. For more information on capital adequacy, please refer to "Note 9 – Capital Adequacy" in the 2020 Annual Report.

Table 4.3.1: SCB Capital Adequacy vs. Regulatory Requirements as at 31 December 2020

Composition of SCB's capital adequacy requirements	**2020**	
	%	**NOK m**
Minimum CET1 requirement	4.5	5 907
Systemic Buffer	1.2	1 549
Counter cyclical buffer	0.3	341
Capital conservation buffer	2.5	3 282
Pillar 2 requirement	3.3	4 332
Pillar 2 guidance	1.0	1 313
CET1 requirement	**12.7**	**16 724**
Additional Tier 1	1.5	1 969
Tier 1 requirement	**14.2**	**18 694**
Tier 2	2.0	2 626
Total Capital requirement	**16.2**	**21 319**
SCB CET1	**19.2**	**25 191**
- Surplus of CET1	*6.5*	*8 467*
SCB Tier 1	**20.9**	**27 441**
- Surplus of Tier 1	*6.7*	*8 743*
SCB Total Capital	**23.0**	**30 234**
- Surplus of Total capital	*6.8*	*8 914*

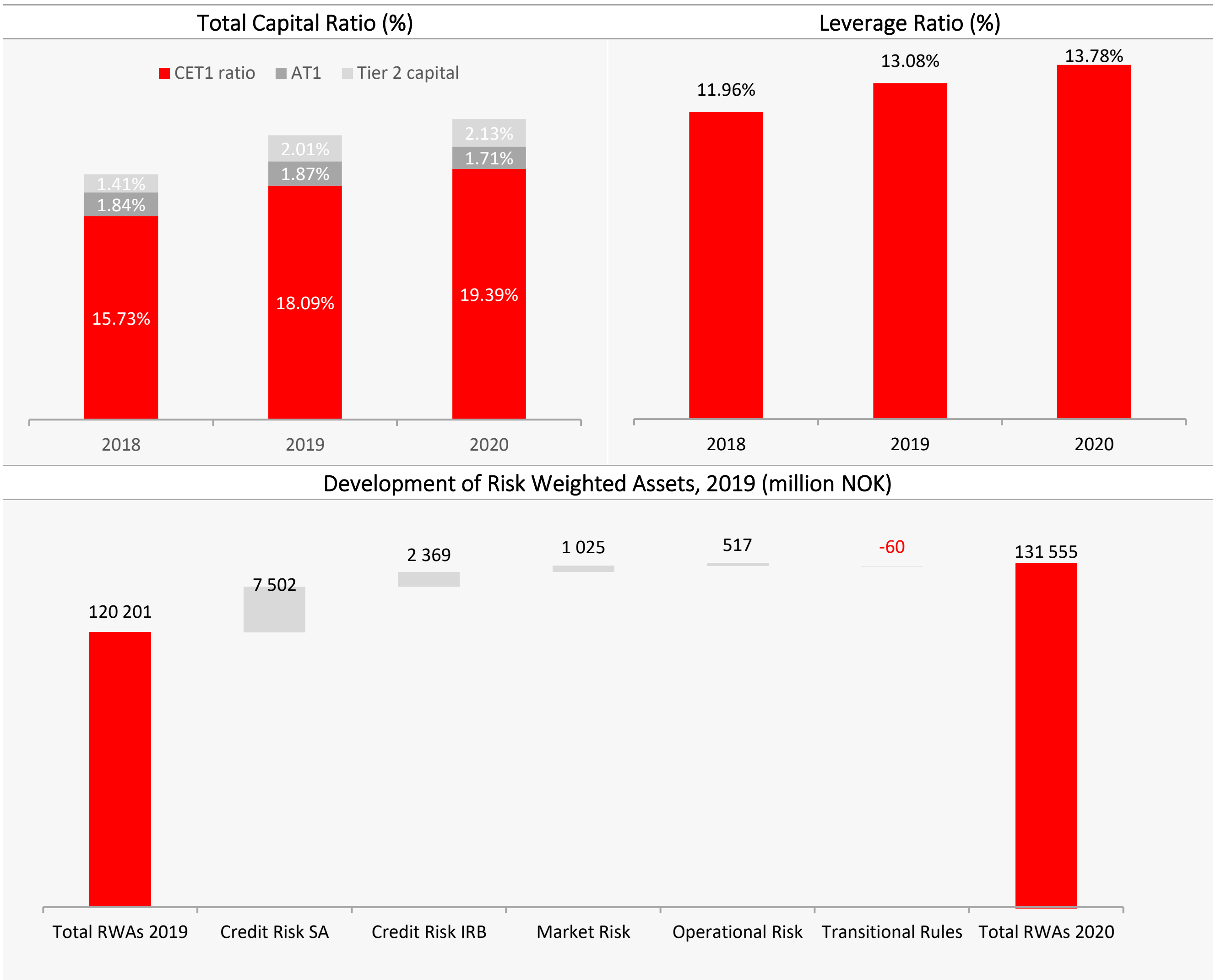
SCB uses both the Standardized approach and A-IRB approach for calculating risk weighted assets (RWAs) for credit risk, the Standardized method for calculating market risk and the Basic Indicator Approach for operational risk. The Bank's RWAs are used as the basis for calculating the combined buffer requirements. For 2020, RWAs increased by 11 354 million NOK to 131 555 million NOK driven by Retail and Corporate exposures under Standard Approach and by Retail exposures under IRB. As can be seen from the figure below, the majority of the Bank's RWA are related to retail customer loans under both the Standardized approach and under the A-IRB approach.

Table 4.3.2: SCB Group Risk Weighted Assets as at 31 December 2020

Risk Weighted Assets ("RWAs")	**2019**	**2020**
Standardised Approach		
Regional Governments	64	73
Institutions	694	988
Corporates	8 713	11 180
Retail	54 028	59 065
Default	1 496	1 209
Covered Bonds	385	100
Other	3 763	4 030
Total Standardised Approach	69 143	76 645
Internal Ratings Based Approach		
IRB	35 495	37 864
Total IRB Approach	35 495	37 864
Market Risk	1 463	2 472
Operational Risk	13 730	14 247
CVA	30	46
Total RWAs	**119 861**	**131 275**
IFRA 9 Transitional Adjustment	340	280
Total RWAs (After IFRS9 transitional rule)	**120 201**	**131 555**

The figure below depicts the development of the Bank's key capital adequacy metrics.

Figure 4.3.1: SCB Group Development of Key Capital Adequacy Metrics



The Pillar 3 appendix and *"Note 9 - Capital Adequacy"* in the 2020 Annual Report, discloses more information on SCB's capital adequacy position and requirements.

5 Counterparty Risk

The Bank defines counterparty credit risk as defined in Article 272 of CRR: "*Risk that the counterparty to the transaction could default before the final settlement of the transaction cash flows*".

Transactions within the scope of counterparty credit risk in the Bank are cross currency swaps and interest rate swaps. These types of derivatives are used to hedge currency and interest rate risk related to funding transactions. All the Bank's derivatives have signed collateral agreements with the counterparty with bilateral daily collateral posting.

The Bank holds derivatives for hedging purposes only and capital required for these transactions represent a very small share of total capital requirements - counterparty credit risk is thus not considered a significant risk for the Bank.

6 Credit Risk

SCB defines credit risk as “the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms.”

SCB business is mostly focused on auto financing (auto loan, leasing, subscription, and stock finance) and unsecured products (consumer loans, credit cards and sales finance). Due to the type of business performed, credit risk is the most significant risk in SCB.

6.1 Strategy and Policies

The Bank’s strategy and risk policies contain diversification requirements and therefore, SCB’s credit portfolio must possess a diversified composition with regard to customers, business sectors, geographical areas and market segments.

SCB establishes the frameworks and general guidelines for all lending and credit-granting activities in the Nordic countries in the Nordic Retail Credit Policy and Nordic Wholesale Credit Policy. The objective of these policies is to ensure a customer portfolio with a satisfactory risk profile and with good profitability in a long-term perspective.

6.2 Credit Risk Monitoring and Reporting

In order to fulfil SCB’s ambitions on credit quality and portfolio composition, the Bank has put in place information systems supported by analytical techniques that measure and report credit risk on both individual and portfolio levels throughout the credit risk cycle.

While retail products are monitored through an aggregated/portfolio view, wholesale clients are monitored at an individual basis. The Wholesale customers are assigned an internal rating based on the rating model developed based on guidelines from Banco Santander, which will then derive an individual Probability of Default within 12 months (PD). The model considers the Bank’s internal knowledge and expertise as well as an objective assessment of the customers financial and management structure.

In order to monitor the retail and wholesale businesses, the Bank has a quarterly monitoring of the Strategic Commercial Plan. The commercial functions are responsible for performing regular monitoring of the degree of execution of the commercial strategies. The Risk function is responsible for monitoring the degree of execution of the risk strategy, the credit admission and portfolio management policies of the recovery strategies. In the event of deviations from the Bank’s objectives, the responsible functions will propose the appropriate corrective action plans. Each function will be responsible for managing the approval of these actions in the corresponding governance bodies.

6.3 Admissions and Monitoring of Standardized and Non-Standardized Risk

To ensure business policy and practices are aligned with product features and characteristics, and with the needs of the Bank's customers, SCB divides its portfolios into two main segments:

- **Retail Credit Risk:** applicable to the part of the portfolio which follows a standard, highly automated credit approval process primarily based on system-generated decisions. It does not warrant individualized treatment of clients as the risk is well diversified, and each individual client has a low total exposure. Retail Risk clients includes private persons, as well as sole proprietorships and small and medium-sized enterprises (“SME”) companies without a permanently assigned risk analyst.
- **Wholesale Credit Risk or “Non-standardized risk”:** applicable to customers who, due to their volume of risk exposure or type of risk exposure with SCB, are permanently assigned to a risk analyst with a tailored and

individualized credit approval process. Banco Santander's standard criterion is to assign analysts to companies with exposures over 0.5 million EUR. As SCB is comprised of four units with separate currencies, that criterion is converted into the four currencies in the respective local credit policies: 5 million NOK, 5 million DKK, 5 million SEK and 0.5 million EUR in Norway, Denmark, Sweden and Finland, respectively. If the customer has stock finance as a product, regardless of the exposure size, the customer is included in the wholesale portfolio.

Credit Scorecards

The main credit risk management tool for the retail portfolio in the Bank is based on the use of scorecards. Admission and behavioural scorecards have been developed and implemented for all retail portfolios (except Denmark Auto SME and Credit Cards). The purpose of the admission scorecards is to distinguish between customers based on their creditworthiness, whilst behavioural scorecards monitor the customer's credit behaviour over time. Upon scoring, the customer is assigned a Probability of Default (PD) bucket which is used for risk monitoring purposes and in capital calculations under Advanced Internal Ratings Based (A-IRB). In addition, the scoring models are used also as main segmentation drivers in the Bank’s IFRS9 PD estimation models for Expected Credit Loss (ECL) calculation purposes. All implemented scorecards are monitored quarterly for their performance i.e. stability, accuracy and predictability to ensure they work as intended. The goal is to ensure that portfolio delinquency rate is within acceptable limits by adjusting the score limits in line with the risk appetite of the Bank. In addition to performance monitoring, overall model risk level is also periodically monitored by senior management at SCB.

Internal Rating Model

The non-standardized customers in the Bank are composed of large and/or complex exposures evaluated individually by a risk analyst and are not scored by the retail scorecards. BoD delegates autority to approve credit risk proposals to the CEO which further delegates authority to different levels in the organization depending on size of the exposure, rating, profitability and more. Credit risk approvals above certain thresholds are presented in the Credit Approval Committee (CAC) or the Risk Approval Committee (RACO) and approved by the CCO and CEO respectively. An internal rating model developed centrally in Banco Santander (SCB’s ultimate parent) is implemented in all units. This involved risk analysts reviewing all wholesale clients and setting a rating score, following the Santander Rating scale. Ratings from the Santander Internal Rating model method will result in an individual PD by wholesale exposure.

6.4 Credit Risk Profile

SCB’s credit portfolio has a diversified risk composition with regards to single customers, business sectors, geographical areas and market segments. The Bank operates in four different countries and the consumer lending business is composed of the following products:

- **Auto & Leisure** – Loans and financial services provided to private customers, corporates and car dealers. The distribution is performed via dealers, cross sale from other products and online.
- **Direct unsecured consumer loans** are distributed via brokers, cross sale and online channel.
- **Sales Finance / Durables** are revolving products in Norway and Sweden and close-end products in Denmark and Finland, distributed via stores, cross sale and online.
- **Credit Cards** is a revolving product distributed in Norway, Sweden and Denmark via stores, cross sales, online and portfolio management.

SCB’s gross outstanding loans increased from 166 billion NOK to 182 billion NOK between December 2019 and December 2020. The main drivers for the increase are the outstanding Forso portfolio of 5.8 billion NOK, growth in the portfolios of 4.3 billion NOK, and the weakening of the NOK increasing the impact of translation of loans in other currencies of 5.9 billion NOK. As the figures below shows, the growth was driven by continuous growth in auto portfolios and less so for the unsecured portfolios which saw a significant reduction in new sales when compared to 2019 impacted by regulatory changes and mobility restrictions and lockdowns due to COVID-19.

Figure 6.4.1: Gross Outstanding by Country

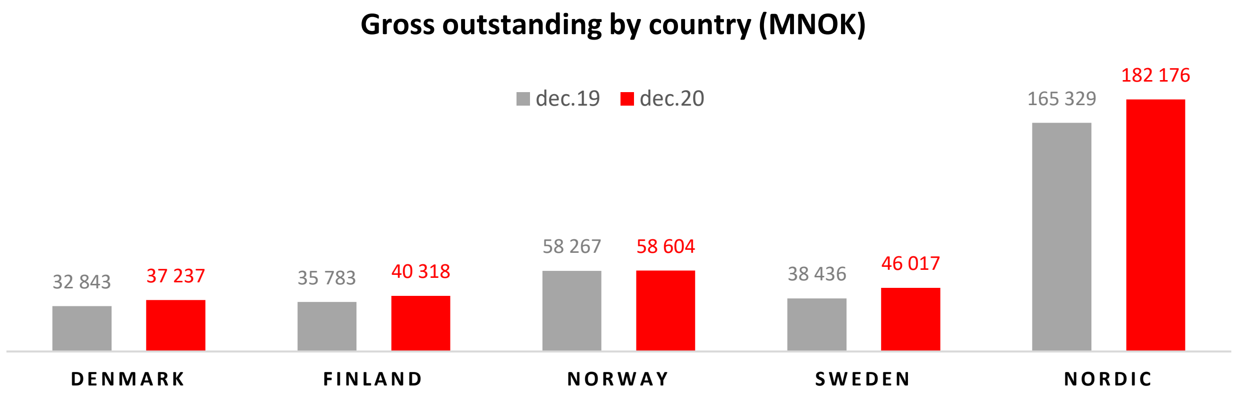
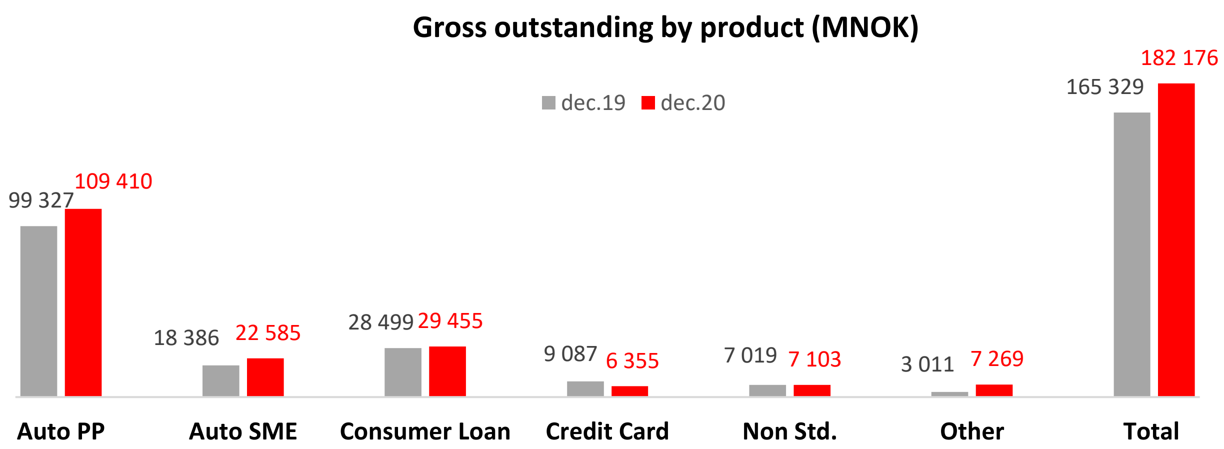
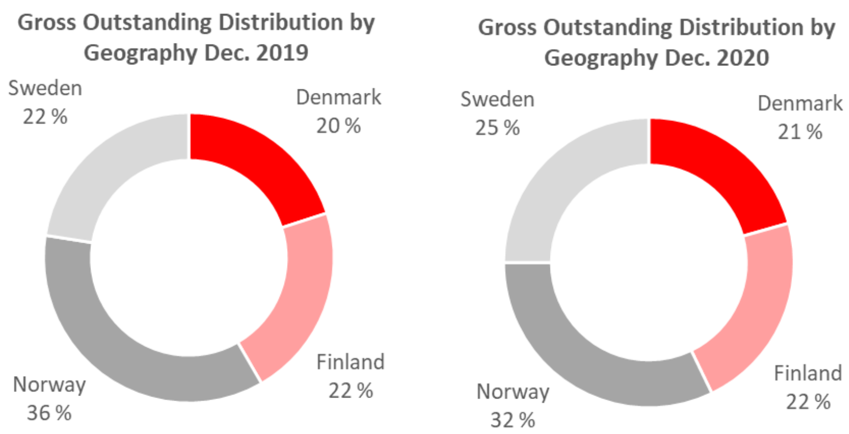


Figure 6.4.2: Gross Outstading by Product



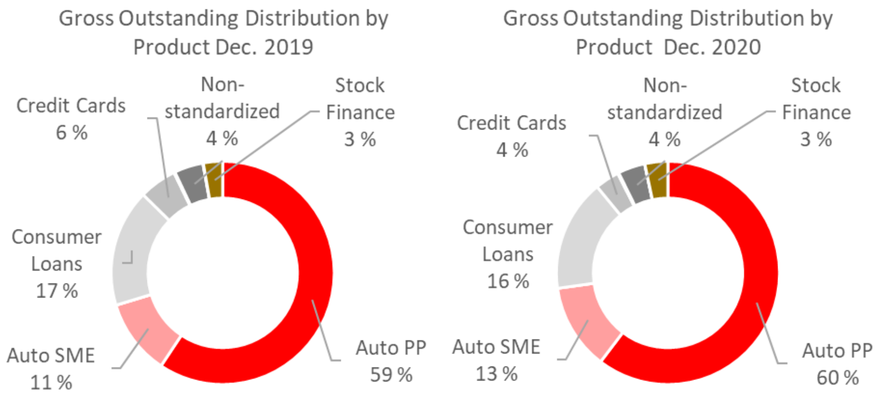
The figures below show the country break-down for December 2020 and December 2019. Compared to 2019, the asset distribution per country has remained fairly stable. The 2 %-points of the relative drop in Norway is driven by the depreciation of the NOK over the course of 2020, thus increasing the share of the other currencies measured in NOK. Current distribution is well-balanced, in line with the business strategy.

Figure 6.4.3: Gross Outstanding Distribution by Geographies



SCB’s product mix is displayed below. As of December 2020, Auto Private Persons (Auto PP) continues to be the largest portfolio of the Bank, and Consumer Loans the second largest. Auto PP Norway accounts for the largest part of the Auto PP portfolio.

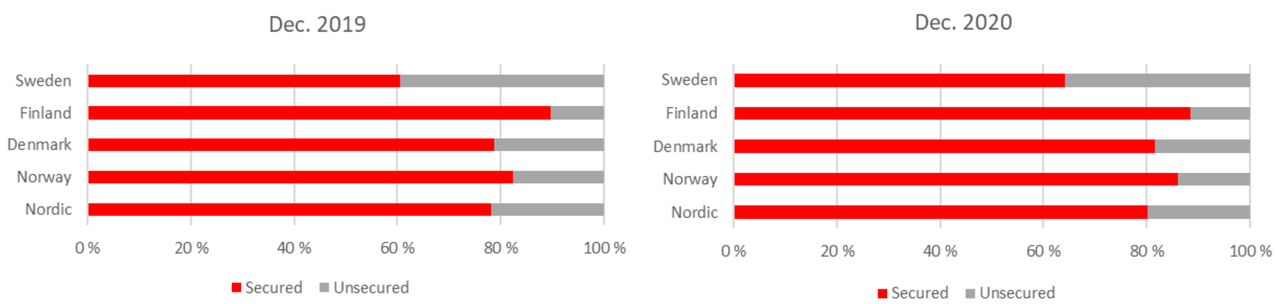
Figure 6.4.4: Gross Outstanding Distribution by Product



The relative share of secured loans (auto) relative to unsecured loans is continuing to grow and was per December 2020 constituting 80% of gross outstanding loans at consolidated level. Auto PP in Norway, Sweden and Finland, are IRB portfolios and represent the biggest portfolios in each country.

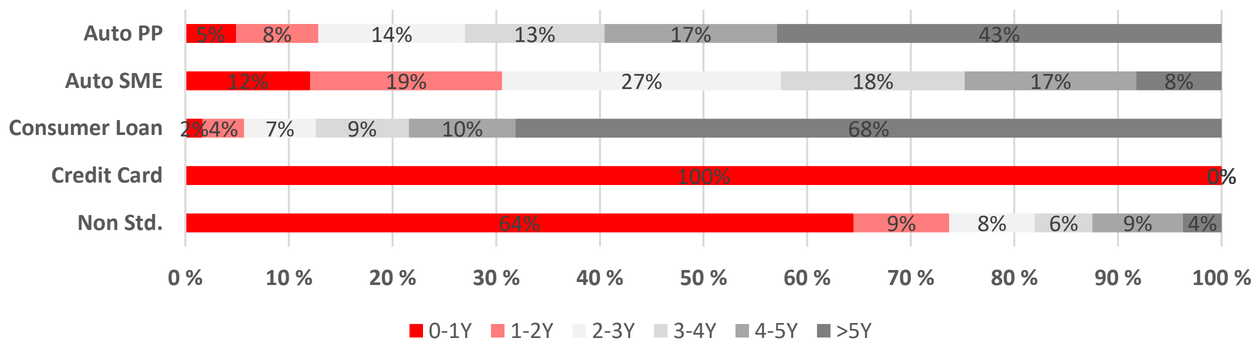
Figure 6.4.5 shows the split between secured and unsecured portfolio per country and at consolidated level for December 2019 and December 2020. As can be seen from the figure, the share of secured portfolios at the Nordic level has increased following the Forso aquisition. Year-to-Year (“YoY”) the secured portfolio share increased by 2%-points.

Figure 6.4.5: Gross Outstanding Distribution by Secured and Unsecured Portfolios



The figure below shows the distribution of gross outstanding by different residual maturity buckets.

Figure 6.4.6: Gross Outstanding Distribution by Maturity Buckets as per December 2020



The table below details the risk-weighted asset density of its exposures. As can be seen, the average risk weight of the Bank's exposures is c. 60%. As will be detailed in the following section, the Bank reports its credit exposures under the Standardized and Advanced Internal Ratings Based Approach ("A-IRB").

Table 6.4.1: Overview of Gross Exposures, Exposures as Default and RWAs as at 31 December 2020

million NOK	Gross Total Exposure	Total EAD	Total RWA	RWA Density (RWA/EAD)	Capital Required
Regional and Governments	10 580	10 580	73	0,7 %	6
Institutions	8 167	8 167	988	12,1 %	79
Corporates	19 349	11 449	11 180	97,7 %	894
Retail (Standardised approach)	108 170	82 951	59 065	71,2 %	4 725
Retail (A-IRB approach)	80 665	80 665	37 864	46,9 %	3 029
Exposures in Default	3 526	1 209	1 209	100,0 %	97
Covered Bonds	997	997	100	10,0 %	8
Other Exposures	3 640	3 640	4 030	110,7 %	322
Total Credit Risk	**235 093**	**199 657**	**114 509**	**57,4 %**	**9 161**

6.5 SCB's Application of Credit Risk Methodologies

SCB uses both the Standardized Approach and the Advanced-IRB Approach to calculate its capital requirements for credit risk.

- Standardized Approach: general risk weights are prescribed in the Capital Requirements Regulation (CRR) for each exposure type to determine credit risk RWA amounts.
- Advanced-IRB Approach (A-IRB): banks use their own estimated risk parameters – Probability of Default, Loss Given Default and Exposure at Default – to determine credit risk RWA amounts. There are numerous and very stringent requirements that banks must adhere to be able to report under A-IRB.

SCB considers the implementation of the A-IRB approach to be strategically important and a key business driver for sustainable growth and future competitiveness. The operational benefits of A-IRB are related to improved client information, increased accuracy of models, improved scoring, processes, and routines and in general improved risk management practice of the Bank. Greater information regarding the Bank's adoption and use of A-IRB is detailed in Section 6.8.

6.6 Key Terminology: Credit Risk Metrics and IRB Parameters

The information below describes many important terms used to describe credit risk across the Bank's credit portfolio. These terms will be used throughout the remainder of this chapter.

Non-Performing Loans, Impairments and Write-offs

The Bank's definition of the default, write-off and loan loss reserves is detailed below:

- **Default:** a default is deemed to have occurred when it is considered that the obligor is unlikely to pay for objective reasons (i.e. bankruptcy) or is more than 90 days past due (in line with CRR Art. 178(1)). Defaults are also referred to as non-performing loans. The European Banking Authority's (EBA) introduction of new default definition (NDD) was implemented for IRB portfolios for capital reporting purposes as of November 2020, while the remaining portfolios adopted the NDD in January 2021. The NDD triggers the need to recalibrate the Bank's IRB portfolios.

- **Write-off**: credit obligation is written-off and removed from on-balance sheet exposure according to accounting standards, which states "financial assets are written off once the entity has no reasonable expectation of recovering a financial asset in its entirety or party thereof". SCB uses indicators such as days past due, expected cash flows and collateral to determine write-offs. In 4Q 2018, SCB's Board of Directors approved a change in write-off policy for its unsecured portfolios in Sweden, Denmark, and Finland. In Q2 2019, the board approved the same policy for Norway. The revised policy dictates that, in order for an exposure to be written-off, it must meet the criteria of being more than 720 days past due (DPD) as opposed to 180 DPD as was previously applicable.
- **Loan Loss Reserves (LLR):** represents management's best estimates of losses for accounting purposes incurred in the Bank's loan portfolio at the balance sheet date. Since January 2018, the Bank amended its accounting policy from IAS 39 to IFRS 9. As a result, LLR are classified across Stage 1, Stage 2 and Stage 3.
    - **Stage 1:** Effectively compares to what was a "collective impairment" under IAS 39.
    - **Stage 2:** Exposures that have exhibited a substantial increase in credit risk (SICR), determined by the change in PD vs. the PD at origination.
    - **Stage 3:** defaulted exposures and compares to specific write-downs.

SCB has a model for calculated the Expected Credit Loss (ECL), in which all exposures are divided into the aforementioned stages. The impairment calculation for Stage 1 and Stage 2 is provided by models that estimate future losses based on forecasts of future economic development. The Bank is planning to change the default definition also for its IFRS9 models used to calculate defaults for accounting purposes to be aligned with New Default Definition (NDD) and HQ methodology.

IRB Parameters

In order to measure the credit risk of an exposure for capital requirement purposes, Expected Loss and Unexpected Loss needs to be determined. Unexpected Loss relates to the very high but improbable level of losses not considered recurring but must be absorbed by capital. For expected loss, SCB determines Probability of Default, Loss Given Default, and Exposure at Default in order to derive an exposure's Expected Loss.

- **Probability of Default (PD):** probability that a given customer will default on their credit exposure within the next 12 months. The PD used for regulatory capital is Through-the-Cycle (TTC) i.e., long term. A default is deemed to have occurred when either there exists reasonable doubt whether there will be a repayment or when a customer is more than 90 days past due on their credit obligation. Defaulted exposures are automatically assigned a PD of 100%. Calculation of PD is done based on the Bank's historical information.
- **Loss Given Default (LGD):** indicates how much the Bank expects to lose in the event of a default. For the purpose of regulatory capital, LGD is calculated based on a downturn economic cycle. In the calculation for LGD, customer collateral, future cash flows and other relevant factors are incorporated.
- **Exposure at Default (EAD):** the value of debt at the time of default.

The parameters and associated metrics include Expected and Unexpected Loss and are to be used not only for regulatory purposes but also for internal credit risk management. In SCB, the internal credit risk parameter estimates are used in a verity of management tools, including pre-classifications, profitability calculations (Return on Risk Weighted Asset), stress testing, and scenario analyses. The results are subsequently reported to senior management through various internal committees.

6.7 SCB Credit Performance

The Group's Credit Risk profile remained relatively stable for 2020, in line with business strategy. The secured auto portfolio saw an increase due to the Forso auto portfolio integration. The consolidated Non-Performing Loans (NPL) Ratio ended at 2.73% (1.34% for Secured and 8.35% for Unsecured portfolios) in Q4 2020, compared to 2.60% in Q4 2019 (1.32% for Secured and 7.26% for Unsecured). The increase in NPL for the unsecured portfolios was primarily driven by the changes in write-off policies effective from 2019 and the COVID-19 situation in 2020. Additionally, the 720 DPD policy was implemented in Norway in 2019 for the auto loan product increasing slightly the NPL ratio for secured portfolios.

NPL ratio is the amount of NPL relative to gross outstanding loans and identifies the quantum of gross outstanding loans >90 DPD, but not written-off, relative to total gross outstanding loans. The NPL ratio is not a risk metric which is useful to compare credit quality between financial institutions since the level of NPLs will depend on the financial institutions write-off policy. A stable NPL ratio is, however, a good indication that the financial institution's credit quality has not increased. The figures below show the 2020 evolution of total gross outstanding exposure (in million NOK) and NPL ratio at consolidated level. As can be seen, the NPL ratio has remained relatively stable ranging from 2.7% to 3.2%. The slow upward trend can be explained by the change in write-off policy implemented across countries explained under "write-off" in section 6.6. Note also that NPL sales were performed in June 2019 and June 2020 decreasing the NPL ratio.

Figure 6.7.1: Gross Outstanding Loans vs. NPL

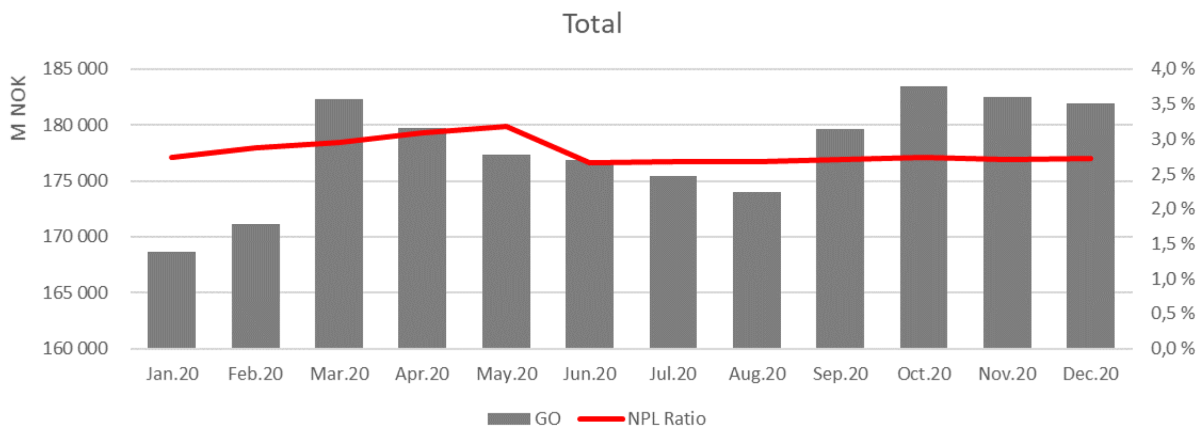


Table 6.7.1 below shows the development in the NPL ratio, divided into the secured (auto) and the unsecured portfolio, during 2018, 2019 and 2020. From December 2018, the NPL ratio has been increasing slowly for the unsecured portfolio in line with the write-off policy.

Table 6.7.1: NPL Ratio Developments per Type of Portfolio

NPL ratio	Dec-18	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Secured	1.12%	1.32%	1.43%	1.52%	1.40%	1.34%
Unsecured	5.34%	7.26%	8.46%	6.96%	7.66%	8.35%
Nordic	**2.03%**	**2.60%**	**2.96%**	**2.66%**	**2.70%**	**2.73%**

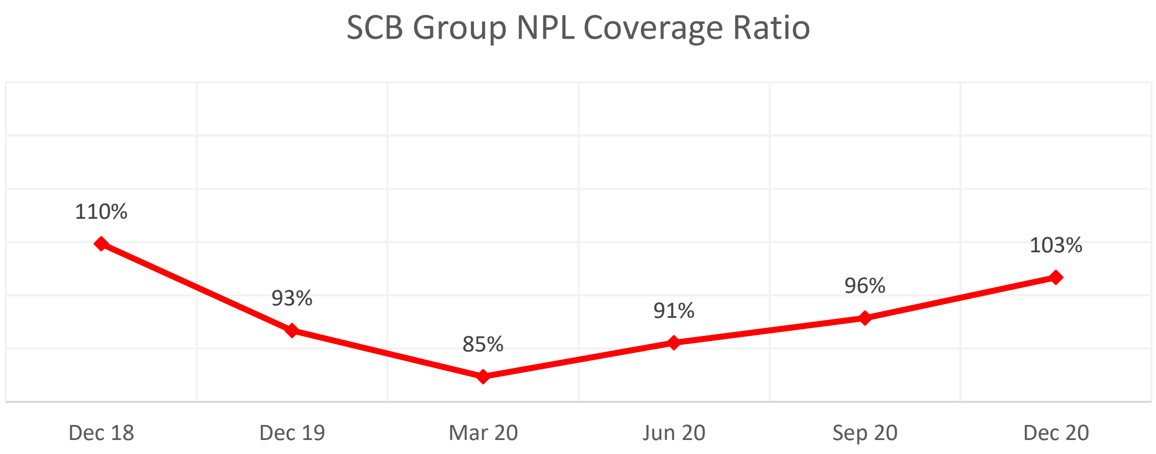
The table below shows the NPL ratio development for the same period per country, indicating a good loan quality in all countries. Norway has the highest NPL ratio, mainly due to a higher share of credit cards than in the other countries.

Table 6.7.2: NPL Ratio Developments per Country

NPL ratio	Dec-18	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Denmark	1.45%	2.64%	3.05%	3.07%	3.00%	2.88%
Finland	0.90%	1.34%	1.55%	1.65%	1.59%	1.67%
Norway	3.46%	3.77%	4.37%	4.03%	3.56%	3.81%
Sweden	1.34%	2.01%	2.36%	1.45%	1.86%	2.17%
Nordic	**2.03%**	**2.60%**	**2.96%**	**2.66%**	**2.70%**	**2.73%**

NPL coverage is defined as Loan Loss Reserve set by the Bank divided by NPLs. NPL coverage is an important metric to consider because as it identifies the amount of loan loss provisions already set aside to cover those exposures considered non-performing. The figure below demonstrates SCB's prudency in its approach to provisioning.

Figure 6.7.2: Coverage Ratio Development



6.8 SCB Credit Risk under A-IRB Approach

Approved IRB portfolios

In December 2015, SCB received approval from the Bank of Spain and the Norwegian FSA, to report under IRB for the Auto PP portfolios in Norway, Sweden and Finland. The stability of the parameters and the underlying data for all the portfolios performance were monitored closely before the IRB approval.

The figure below displays the EAD, Risk Weighted Assets, and risk weights of the existing IRB portfolios (the "wave-1 portfolios"). During 2020, EAD and RWA has grown, while the risk weight remained stable.

Figure 6.8.1: EAD, RWA and Average RW

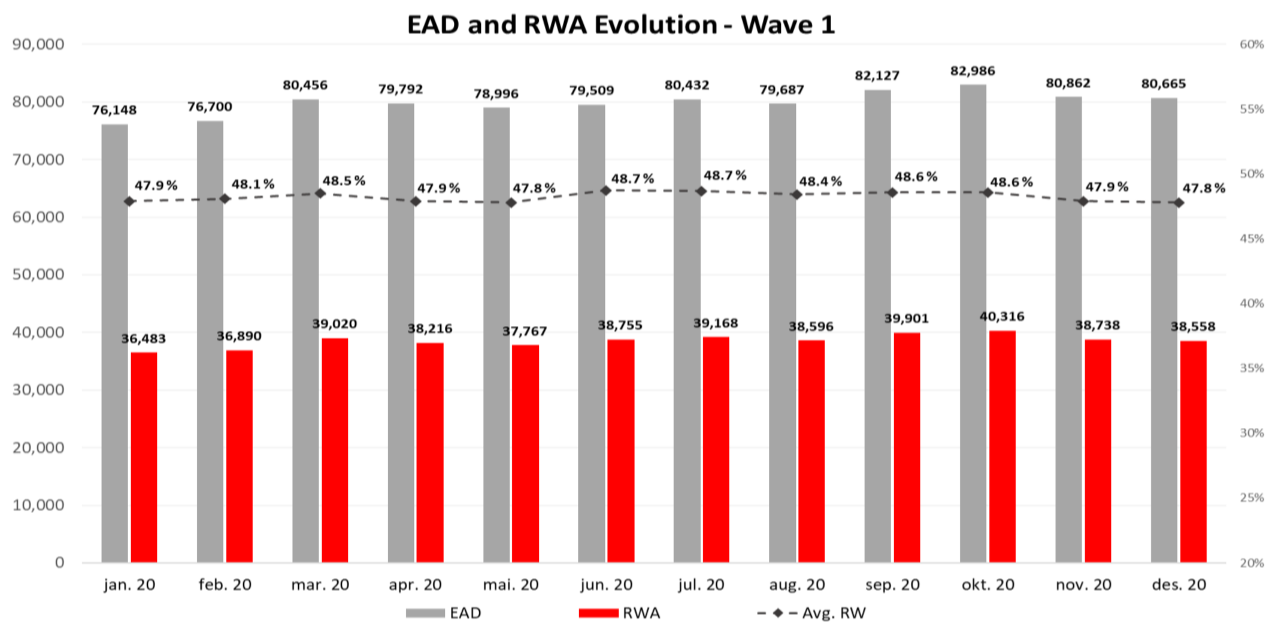


Table 6.8.1 below provides RWA and parameter details (data as of Dec 2020) for all wave 1 portfolios currently under the IRB approach. This follows a quantitative study suggested by the Basel Committee on Banking Supervision (BCBS) in table CR6 of the document 'Revised Pillar 3 disclosure requirements', of January 2015. Since SCB IRB portfolios consist of installment loans without any assigned credit limit, CCF columns have not been reported. As can be seen from the table the RWA density for the combined portfolios was 47.8% per December 2020.

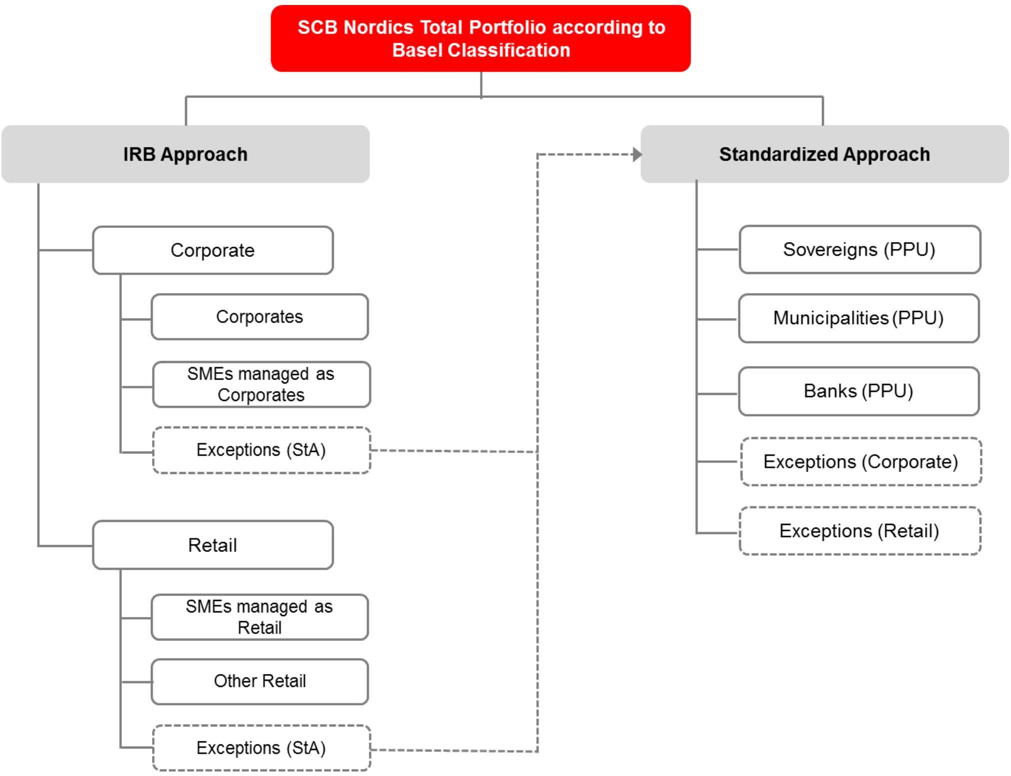
Table 6.8.1: Parameter Details for IRB portfolios as at 31 December 2020

PD_Bucket	EAD	Average PD	Average LGD	# Obligors	Average Maturity	RW [4]	RWA Density	EL	Provisions
[0.25-0.50)	9 982 746 812	0.26 %	38.21 %	55 042	3.54	1 796 807 781	18.00 %	9 137 900	45 909 738
[0.50-0.75)	10 353 430 795	0.63 %	36.85 %	63 917	3.39	3 130 007 709	30.23 %	22 764 610	51 562 258
[0.75-2.50)	45 004 996 630	1.18 %	46.73 %	306 726	3.21	22 620 756 288	50.26 %	231 637 106	214 110 112
[2.50-10.00)	9 548 111 577	4.38 %	48.41 %	69 116	3.19	6 769 911 014	70.90 %	191 750 817	73 628 859
[10.00-100.00)	4 338 829 553	26.52 %	39.22 %	29 818	3.20	4 041 842 305	93.16 %	432 330 158	146 738 018
PD 100	1 436 729 354	100.00 %	40.63 %	11 168	2.69	198 244 233	13.80 %	544 191 659	489 643 765
Total	**80 664 844 721**	**4.50 %**	**44.09 %**	**535 787**	**3.26**	**38 557 569 330**	**47.80 %**	**1 431 812 250**	**1 021 592 751**

IRB Roll-Out Plan

The figure below provides an overview of the Basel II approach by segments and what portfolios the Bank plans to have under the IRB approach and the Standard approach going forward. As can be seen from the figure, some portfolios will remain under the standard approach based on the underlying obligor and the materiality of the portfolio as agreed with the regulator.

Figure 6.8.2: SCB Portfolios by Basel Approach

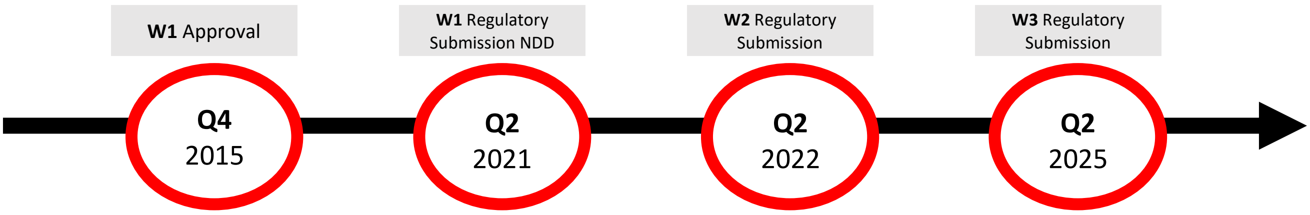


[4] *The reported RWA were calculated taking into account an SME factor (equivalent to 76.19%) for the corresponding section of the portfolio.*

SCB has a three "wave" approach for the roll out of the portfolios under IRB approach. The details for the roll out are provided in the figure below. Wave 1 was approved for IRB in December 2015 and constituted the Auto Private Person in Norway, Finland and Sweden and are thus used for assessing regulatory capital requirements today. The European Banking Authority's (EBA) introduction of new default definition (NDD) was implemented for IRB portfolios for capital reporting purposes as of November 2020, while the remaining portfolios will adopt the NDD in January 2021. Due to the change in default definition for capital reporting purposes, SCB is required to recalibrate its IRB portfolios and plan to submit updated IRB models under wave 1 to the regulators during 2021. Submission of further portfolios to apply the IRB approach is planned for 2022 ("wave 2") and 2025 ("wave 3") respectively.

Figure 6.8.3: IRB Rollout Calendar

The new IRB rollout calendar is displayed in figure below.



IRB Regulatory Limits

In order to measure any significant variation within the portfolio and ensure the stability, management and regulatory limits are established on key risk performance indicators every year per country and product.

For A-IRB portfolios, limits are set on following performance indicators:

- Risk Weight for total portfolio
- Expected Loss (EL) for total portfolio
- Probability of Default (PD) for non-defaulted portfolio
- Downturn Loss Given Default (LGD)
- Risk Weight (RW) for New business volume for the month
- Expected Loss (EL) for New business volume for the month
- Portfolio Worsening (%)

These limits are reviewed by and delivered to relevant stakeholders (i.e., Modelling team, Internal Validation team, model owners and portfolio managers) on a monthly basis, with any point of attention clarified and managed if necessary. The limits are established every year based on the past performance and the Budget for that year. Limits are set for all dimensions including new business volume and existing portfolio outstanding. Per December 2020, , all IRB KPI's were within the pre stablished limits set by the Board.

Credit Risk Mitigation

In the regulatory capital calculation, credit risk mitigation techniques affect the value of the risk parameters used for the calculation of capital. The identification and valuation of the collateral and/or guarantees associated with the contracts is essential. This process of mitigation is undertaken provided that the validity of the collateral and/or guarantee has been checked and they are considered eligible to be applied. Under the IRB approach, the presence of collateral impacts on the final value of the LGD used in the calculation of capital.

For LGD estimations on its IRB portfolios, SCB uses vehicles pledged as collaterals in form of other physical collaterals following the requirements specified under CRR article 199.1(c).

IRB Model Governance

A fundamental part of the process implementing A-IRB models is to establish robust control and review mechanisms by Internal Validation and Internal Audit. This to ensure effective monitoring, validation and documentation of the capital models and their integration into risk management. The governance model involves different levels of control structured around three lines of defence with an organizational structure and independent, clearly defined functions:

- Model owners, model users, model developers and model implementers (1st LoD) have responsibility for the primary management of model risk, which arises from their activities.
- Internal validation (IV) and Model Risk Control (2nd LoD) functions comprehensively oversee, independently validate, asses, and control model risk management.
- Internal Audit function (3rd LoD) is involved in all stages of the model lifecycle and they oversee all other functions

This governance model meets the regulatory requirements for IRB models:

1. Existence of a strong governance model.
2. Existence, separation and independence of the Risk Control and Supervision, Internal Validation and Internal Audit areas.
3. Independent annual reviews by Internal Validation and Internal Audit (also at Banco Santander level)
4. Communication processes with Management which ensure all associated risks are reported.

Model Validation

Independent validation of models before implementation is not only a regulatory requirement in certain cases, but also a key feature for proper management and control of model risk. Within the Group, a specialist unit in Banco Santander, completely independent of both developers and users, draws up a technical opinion of the suitability of internal models to their purposes, and sets out conclusions concerning their robustness, utility and effectiveness (initial validation). The intensity varies depending on the importance of the model and the modification of the model. IRB models are viewed as highly important models as they are used for regulatory capital estimation. The validation function also performs recurrent validation after the models are put in use, based on their performance, ensuring an updated evaluation of the model risk level.

During validation, 5 different dimensions of the model are assessed, including data, IT environment, model foundations, model performance and use, and governance. The validation opinion for each dimension and overall for the model is detailed in a validation report and summarized in the Model Risk Rating (MRR) of the model on a scale of 1 to 5, where 1 is low model risk, 2 is moderate-low, 3 is moderate, 4 is moderate high and 5 is high. In addition to the model risk rating (MRR), the validation function issues recommendations, tied to model weaknesses, categorized by relevance and relative impact on model risk implied by the model. They are followed up on a regular basis by the model risk function and model owners to ensure action plans are set and fulfilled.

Once the validation is finished, a consistency check process is carried out in order to provide homogeneity and consistency to the validation process and outcome. Through this process, the validation conclusions are challenged by a different group of validators.

Model Monitoring

A model is designed and built based on certain information and circumstances, which may change over time. Models are subject to regular performance monitoring to ensure they are correctly functioning. As a consequence of the monitoring, the model may be modified or retired (decommissioned).

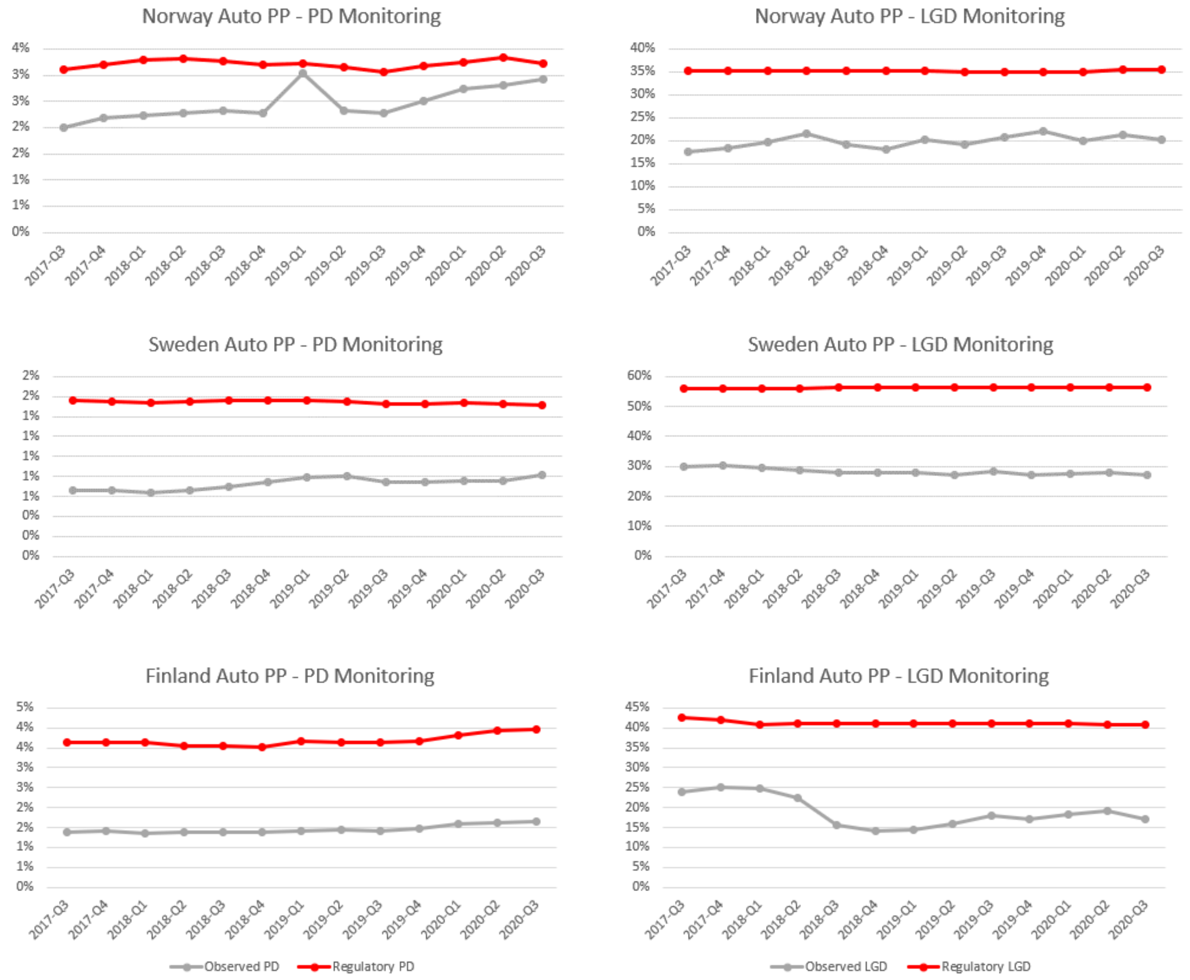
The model owner and model developer are in charge of performance monitoring of the models in use according to corporate standards including measures of stability, calibration and performance. The frequency of monitoring will vary depending on model uses, data availability and other factors. The monitoring results are presented to the relevant governance bodies.

Back-testing of IRB parameters

SCB has a comprehensive back-testing framework to test the IRB parameters validity on a quarterly basis. The aim of the PD back-test is to compare the regulatory PD used for calculating capital requirements with actual PD point-in-time (PD PIT). The purpose of this exercise is to assess the predictive power of the IRB models.

In order to manage model risk for the PD’s and LGD’s used for capital requirement calculation, SCB group has set up validation processes to monitor the quality of the models on an ongoing basis. Back-testing is a key quantitative validation tool in which predicted PD’s and LGD’s are compared with observed PD’s and LGD’s. Timely detection of inadequate performance of the PD's and LGD's is crucial since they are used in the capital requirement calculation, and back-testing is thus conducted on a regular basis.

Figure 6.8.4: Back-testing of IRB portfolios



As can be observed from the graphs above, the PDs PIT for the A-IRB portfolios are below the predicted measurements used in capital requirement calculation. This indicates that the calculation is sufficiently conservative. The peak in Q1-2019 in the PDs PIT in Norway is driven by a data issue in the score distribution. Levels were back again to actual average from the next quarter. The divergence in the observed LGD's in Sweden and Finland can be explained by corrections in recovery movements in Finland and the phasing out of an old portfolio with very high LGD levels in Sweden. In addition, higher BDS amounts (Bad Debt Sales) contributed to the decrease in observed LGDs.

For each portfolio, regulatory PD buckets, representing different PD levels, are established. For each of these, the average PD assigned is compared with the observed default frequency (ODF). To observe defaults, outstanding loans that were not in default at a reference date is selected, and the rate of new defaults among these outstanding loans over the subsequent 12-month period is observed.

The regulatory PD is a through-the-cycle (TTC) PD, i.e. a long-term average that is not tied to any particular point in the cycle. However, the default frequency is observed at a given point in time (2020). Given their different characteristics, the comparison between the two figures does not constitute a precise control of the regulatory PD, but it does serve to assess the size of the cyclical adjustment used in the calculation of the regulatory (TTC) PD.

ODF is also compared with the point-in-time (PIT) PD, which is influenced by the cyclicality. This allows the slope of the PD curve to be compared with the delinquency observed in each rating category. The graphs below illustrate that the TTC PD is consistently higher than observed defaults for the vast majority of rating categories.

Figure 6.8.5: Norway A-IRB: Observed default frequency by PD bucket and PD rate

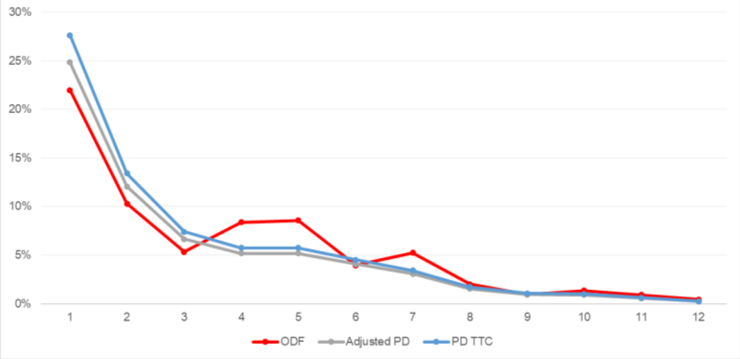


Figure 6.8.6: Sweden A-IRB: Observed default frequency by PD bucket and PD rate

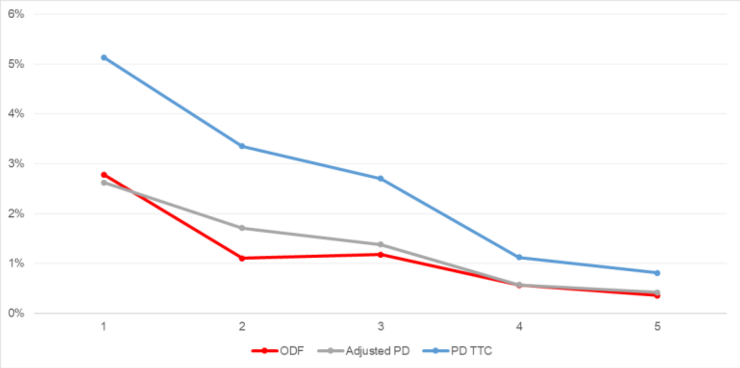
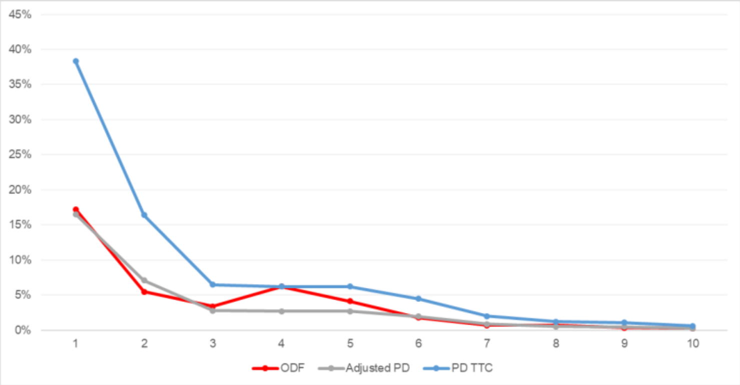


Figure 6.8.7: Finland A-IRB: Observed default frequency by PD bucket and PD rate



In addition to the above analysis, Figures 6.8.5 to 6.8.7 give an overview of the back-testing exercise through the disclosure table CR9 as per EBA/GL/2016/11. In general, it is observed that the PD assigned to IRB portfolios for capital requirement is conservative when compared with average defaults over the last 5 years. This observation is in line with economic cycle development in the respective countries.

The figure below gives an overview of the back-testing exercise. As it can be seen, there is no major difference between the average exposure-weighted PD and the simple average (arithmetic average) in each bucket, indicating that the different transactions are fairly uniform with regards to exposure. The following columns are divided into two, which contain the number of obligors (or transactions in the case of retail) at two different dates: September 2019 and September 2020. The intention is to detect customers/transactions migrating between PD buckets, though sometimes the migration is due to a recalibration of regulatory models rather than to the dynamics of the rating system. For all models it can be observed that the distribution of obligors is fairly similar in these 2 years, meaning no significant rating migration and that portfolio quality is stable.

From the back-testing point of view, average historical default rate is very important, as it averages the default rates experienced in each of the past five years for each PD bucket. Comparing this column with columns weighted average PD and simple average PD gives an idea of how well our regulatory PD matches the actual experience over the medium term.

In general, it is observed that the PD assigned to IRB portfolios for capital requirement is conservative when compared with average defaults over the last 5 years. This observation is in line with economic cycle development in the respective countries. In order to measure any significant variation within the portfolio and ensure the stability, management and regulatory limits are established on key risk performance indicators every year per country and product.

Table 6.8.8: Back Testing IRB Parameters as at 3 September 2020

	sep-20	sep-20	sep-20	sep-20	sep-19	sep-20	sep19-sep20	
					Number of obligors			
Nordics	**PD range**	**External rating equivalent**	**Weighted average PD**	**Arithmetic average PD by obligors**	**End of previous year**	**End of the year**	**Defaulted obligors in the year**	**Average historical annual default rate**
Nordics - Norway Auto Individuals	**0.00 to < 0.15**	**AAA to BBB+**						
	0.00 to < 0.10							
	0.10 to < 0.15							
	0.15 to < 0.25	**BBB+ to BBB**						
	0.25 to < 0.50	**BBB to BB+**	**0.26%**	**0.26%**	**54,316**	**54,171**	**150**	**0.29%**
	0.50 to < 0.75	**BB+ to BB**	**0.63%**	**0.63%**	**47,315**	**46,898**	**285**	**0.65%**
	0.75 to < 2.50	**BB to B+**	**1.33%**	**1.38%**	**67,199**	**66,815**	**783**	**1.01%**
	0.75 to < 1.75		1.33%	1.38%	67,199	66,815	783	1.01%
	1.75 to < 2.5							
	2.50 to < 10.00	**B+ to B-**	**5.84%**	**5.90%**	**16,608**	**15,363**	**648**	**3.95%**
	2.5 to < 5.00		4.24%	4.23%	7,529	7,041	258	3.51%
	5.00 to < 10.00		7.30%	7.32%	9,079	8,322	390	4.60%
	10.00 to < 100.00	**B- to C**	**25.23%**	**25.31%**	**17,600**	**18,318**	**2,721**	**21.46%**
	10.00 to < 20.00		13.39%	13.39%	6,322	5,896	553	7.63%
	20.00 to < 30.00		27.62%	27.62%	10,107	10,420	2,074	15.10%
	30.00 to < 100.00		48.38%	48.38%	1,171	2,002	94	41.65%
	100.00 (default)	**D**	**100.00%**	**100.00%**	**4,203**	**5,265**	**5**	
Nordics - Sweden Auto Individuals	**0.00 to < 0.15**	**AAA to BBB+**						
	0.00 to < 0.10							
	0.10 to < 0.15							
	0.15 to < 0.25	**BBB+ to BBB**						
	0.25 to < 0.50	**BBB to BB+**						
	0.50 to < 0.75	**BB+ to BB**						
	0.75 to < 2.50	**BB to B+**	**0.85%**	**0.85%**	**126,141**	**130,068**	**459**	**0.41%**
	0.75 to < 1.75		0.85%	0.85%	126,141	130,068	459	0.41%
	1.75 to < 2.5							
	2.50 to < 10.00	**B+ to B-**	**3.37%**	**3.38%**	**34,896**	**34,615**	**488**	**1.40%**
	2.5 to < 5.00		2.77%	2.77%	25,789	25,741	263	0.95%
	5.00 to < 10.00		5.14%	5.14%	9,107	8,874	225	2.32%
	10.00 to < 100.00	**B- to C**	**67.47%**	**67.21%**	**494**	**466**	**194**	**54.47%**
	10.00 to < 20.00							
	20.00 to < 30.00							
	30.00 to < 100.00		67.47%	67.21%	494	466	194	54.47%
	100.00 (default)	**D**	**100.00%**	**100.00%**	**412**	**420**	**0**	
Nordics - Finland Auto Individuals	**0.00 to < 0.15**	**AAA to BBB+**						
	0.00 to < 0.10							
	0.10 to < 0.15							
	0.15 to < 0.25	**BBB+ to BBB**						
	0.25 to < 0.50	**BBB to BB+**						
	0.50 to < 0.75	**BB+ to BB**	**0.62%**	**0.62%**	**18,725**	**16,904**	**49**	**0.19%**
	0.75 to < 2.50	**BB to B+**	**1.37%**	**1.42%**	**118,730**	**112,884**	**559**	**0.53%**
	0.75 to < 1.75		1.11%	1.11%	85,375	80,432	340	0.47%
	1.75 to < 2.5		2.20%	2.20%	33,355	32,452	219	0.64%
	2.50 to < 10.00	**B+ to B-**	**4.94%**	**4.95%**	**21,038**	**20,989**	**480**	**2.63%**
	2.5 to < 5.00		4.48%	4.48%	16,386	15,660	274	1.46%
	5.00 to < 10.00		6.32%	6.34%	4,652	5,329	206	3.22%
	10.00 to < 100.00	**B- to C**	**28.52%**	**28.58%**	**14,554**	**14,994**	**1,532**	**22.11%**
	10.00 to < 20.00		16.40%	16.40%	7,797	7,377	407	4.38%
	20.00 to < 30.00							
	30.00 to < 100.00		40.51%	40.38%	6,757	7,617	1,125	30.97%
	100.00 (default)	**D**	**100.00%**	**100.00%**	**1,408**	**1,321**	**0**	

7 Market Risk

Market risk is the potential loss of value in assets and liabilities due to changes in the market prices such as foreign exchange and interest rates. SCB's strategy is not to actively assume market risk other than what results directly from the Bank's operations. For SCB, market risk can be split into the following categories:

- **Currency risk**: risk of loss resulting from changes in foreign exchange rates. The key metric is the open exposure amount in the relevant currencies
- **Interest rate risk**: risk of loss resulting from changes in interest rates. The key metrics are Net Interest Margin (NIM) and Market Value of Equity (MVE) sensitivities
- **Credit spread risk**: risk of loss as a result of changes in credit spreads

Market risk is managed by the Financial Management Division and controlled by the Risk Division.

As alluded to above, SCB's strategy is not to take on market risk beyond what results directly from our normal business operations in the four countries where SCB is present. The Bank is exposed to currency risk because it operates in four different countries with different currencies and through its use of international funding markets. The Bank has interest rate risk to the extent there is a mismatch between interest rate exposure on the asset side and liability side. SCB does not have an active trading portfolio or positions in securities and commodities but does possess a liquidity portfolio consisting of High-Quality Liquid Assets (HQLAs) where the intention is to hold the bonds to maturity. HQLAs comprises, amongst others, marketable securities backed by sovereigns and central banks and covered bonds.

7.1 Governance of Market Risk

SCB maintains two documents directly relating to Market Risk that are approved by the BoD. The high-level Structural Risk Model document outlines all requirements of the Bank's Market Risk organization and governance, and the more specific Liquidity and Market Risk Policy document details how these requirements are fulfilled. In addition, the Risk Appetite Model forms the foundation of the Bank's Market Risk limit structure.

The Bank maintains a balance sheet composition that ensures that the market risk is managed at prudent levels and within established limits, as detailed in the Liquidity and Market Risk Policy.

SCB's Risk Appetite statement (RAS) contains the Bank's risk appetite limits for Market Risk. In addition, the Bank has a set of Management limits, subject to annual review and approval by the Risk Approval Committee, which encompasses more metrics and stricter limits than the RAS. As per the governance structure specified in the Liquidity and Market Risk policy of the Bank, the limits are monitored by the Risk Control Committee and the Board Risk Committee. The Bank maintains limits for interest rate risk and currency risk but not for share risk, property risk, CVA risk or spread risk since the Bank has very limited exposure to these risks.

7.2 Currency Risk

SCB operates in four countries – Norway, Sweden, Denmark and Finland - with four different currencies. The Bank is to strive for a composition of the balance sheet that minimizes currency risk by ensuring that the assets and liabilities are primarily denominated in the same currency. When raising funding such as Euro Medium Term Notes ("EMTN") or Asset Backed Securities ("ABS") through international debt markets, the Bank closes any open position through the use of derivatives.

The Banks routines ensure that the currency exposure is continuously monitored and controlled. On a monthly basis, an FX Exposure Report is produced covering all currencies. The Bank operates with management limits for currency risk. The limits are set for each currency and for the total foreign currency exposure; both for SCB AS and SCB Group. Financial

Management proposes the limits to the Risk Department, which assesses the proposal and, subject to review, submits it to the Risk Approval Committee (RACO) for approval. Per December 2020, the Bank had a net EUR position of the equivalent of 1 994 million NOK. The EUR position stems from net assets built up through retained earnings in the Finnish subsidiary, SCF Oy.

7.3 Interest Rate Risk

Interest rate risk is the risk of reduced earnings or reduction in the economic value of the equity due to changes in market interest rates. SCB aims to achieve a balance sheet composition that minimizes the interest rate risk by balancing the total weighted interest term for both assets and liabilities. The Bank is only exposed to interest rate risk that follows directly from the Bank's operations, as does not actively take on interest rate risk.

The strategy of managing interest rate risk involves the use of variable/ fixed rate intragroup loans, interest rate derivatives and variable/fixed rate customer deposits. The interest rate gap positions for all significant currencies are monitored and reported monthly. The Bank also calculates the six interest rate risk scenarios as described by the Basel committee in interest rate risk in the banking book (IRRBB). In addition, a sensitivity analysis and a forecast of future interest rate risk is performed.

The Financial Management department (risk taker), proposes interest rate risk limits to the Risk department, which assesses the proposal and submits it to the BoD for final approval. Limits must be reviewed annually for each of the following metrics:

- **Net Interest Margin (NIM) sensitivity**: The sensitivity of the NIM is a measure of the difference between the return on assets and the financial cost of the liabilities over a 12-month horizon. The impact is measured as the worst effect on NIM of +/-25, 50, 75 and 100 bps parallel movement in the interest rate curves
- **Economic Value or Market Value of Equity (MVE) sensitivity**: The sensitivity of MVE is a measure, which complements the sensitivity of NIM. It measures the implicit interest rate risk in the MVE from a variation in interest rates (worst of +/-25, 50, 75 and 100 bps parallel movement in the interest rate curves) on the Bank's financial assets and liabilities.

The interest rate is calculated in the internally developed Asset and Liability Model by distributing all interest rate sensitive assets and liabilities into tenor buckets and then calculating the MVE and NIM sensitivities. The assets and liabilities are assigned re-pricing maturities following certain assumptions that are regularly reviewed. The assumptions include the behavioural aspects of non-maturity deposits that do not have contractual maturity and the re-pricing criteria of the loan portfolio that are contractually neither fixed nor floating rate products. The repricing distribution for non-maturity deposits is based on a run off assumption (exponential distribution), whose parameters are estimated based on historical deposits data. For the loan portfolio, the repricing distribution is based on a prepayment model, which is governed by a Constant Prepayment Rate, estimated by each business unit. The table below shows the NIM and MVE sensitivities per currency per year-end 2020.

Table 7.3.1: Interest Rate Risk per December 2020

Interest rate schock bps	+100	+75	+50	+25	-25	-50	-75	-100
NIM exposure per 31.12.2020, million NOK								
Exposure in NOK	151	113	76	38	-38	-76	-114	**-116**
Exposure in SEK	**-53**	-33	-27	-5	4	25	28	37
Exposure in DKK	**-36**	-35	-34	-51	50	98	144	178
Exposure in EUR	2	2	1	1	-10	**-10**	-10	-10

Interest rate schock bps	+100	+75	+50	+25	-25	-50	-75	-100
MVE exposure per 31.12.2020, million NOK								
Exposure in NOK	**-120**	-90	-60	-30	30	59	87	87
Exposure in SEK	**-79**	-45	-39	-4	5	40	46	79
Exposure in DKK	-62	-63	-63	**-88**	88	176	265	353
Exposure in EUR	91	69	46	24	-25	**-26**	-26	-26

7.4 Credit Spread Risk

Credit spread risk is defined as the risk of changes in market value of securities or any credit derivatives resulting from an overall change in credit spreads. SCB's strategy is not to take on any credit risk in excess of what follows directly from the operations of the Bank.

Credit spread risk in the bank is managed through strict policy mandates setting the structure of our liquidity bond portfolio. Only the highest quality bonds are allowed with maturities of up to 1 year for fixed rate bonds and 3 years for floating rate bonds. The bond portfolio is also classified as "Hold to collect" following the IFRS9 definitions which means that SCB is holding the bond portfolio to maturity and not making profit or loss from market changes. This results in a very low and stable credit spread risk, defined as non-material. The Bank monitors the credit spread risk on a weekly basis by monitoring changes in the market value of the bond portfolio but has not established limits towards it based on a low materiality. SCB believes this is covered by LCR limits and liquidity stress test limits; should the credit spread risk materialize, it will decrease the value of the bond portfolio for the LCR and liquidity stress test horizon calculation. The value of the liquidity bond portfolio per 31 December 2020 was 10 514 million NOK.

7.5 Capital Requirements for Market Risk

The Bank's market risk capital requirements are calculated in accordance with capital adequacy regulations under CRD IV and CRR regulations. The approach to calculate market risk regulatory capital can be either the internal model approach or the standardized approach. SCB reports according to the standardized approach for market risk. The table below depicts SCB's Pillar 1 market risk capital over the previous three financial years.

Table 7.5.1: SCB Group Pillar 1 Market Risk Capital (million NOK)

SCB Pillar 1 Market Risk	2018	2019	2020
Interest Rate Risk	-	-	-
Currency Risk	118	117	198
CVA Risk	8	2	4
Total	126	119	202

The capital requirement for interest rate risk in 2020 was determined to be zero given that the Bank, through its balance sheet structure, runs minimal interest rate risk. The capital requirement for currency risk for 2020 was 198 million NOK due to the total net currency position exceeding 2% of total own funds. The net currency position mainly derives from equity position in the Finnish subsidiary SCF Oy. CVA risk is minimal due to the net mark-to-market value of derivates and thus results in a minor Pillar 1 capital charge of 4 million NOK.

8 Exposure to Securitisation Positions

Securitization risk is, for SCB, defined as a reversal of capital relief obtained through securitization, which would result in an immediate and substantial increase in required capital.

To date none of the securitization transactions executed by SCB and its subsidiary has resulted in a reduction in capital for SCB[5]. The intention of the securitization programs has been primarily to provide access to the international debt capital markets and potentially to access the liquidity provided by Central Banks to ensure functional credit and money markets.

Securitization programs have been implemented across the four Nordic units over the past nine years and serve as an integral part of the Bank's funding strategy. The Bank has completed 19 securitization funding transactions: seven

[5] *SCF HQ utilized the significant risk transfer obtained for three transactions launched in 2019 and 2020 to reduce their risk-weighted assets, with a corresponding reduction in capital.*

transactions with Norwegian collateral, nine from its Finnish subsidiary, two transactions from the Swedish branch (including a warehouse structure) and one from the Danish branch. Total external funding raised equals approximately 14.5 billion NOK and 2.8 billion EUR (swapped to NOK) from the Norwegian business, 4.85 billion EUR from Finland, 17.4 billion SEK from Sweden and 4.2 billion DKK from Denmark.

Out of the 19 funding transactions completed, 12 have been wound down, with full payment to external investors.

SCB closed one transaction in 2020. This was the ninth Kimi transaction out of the Finnish subsidiary. The transaction was issued in the public ABS markets.

The Committee on Finance and Economic Affairs in the Norwegian parliament is currently reviewing a proposal to implement the Securitization Regulation into Norwegian law. The Securitization Regulation came into law in the EU in 2019 and it is now expected that it will come into the EEA (EØS) agreement in 2021. This new regulation will allow Norwegian banks to issue traditional securitizations and obtain capital relief. If implemented, SCB will assess whether it will utilize the new regulation for capital relief at local level.

9 Non-Financial Risks

Non-financial risk in the Bank captures risks within the following areas:

- Operational Risk according to Basel II, including compliance, conduct and legal risk
- Cyber and Technology Risk
- Reputational Risk

SCB is currently applying the Basic Indicator Approach for calculating the Bank's capital requirement for operational risk under Pillar I in accordance with the Basel capital adequacy framework.

9.1 Framework

SCB's Non-Financial Risk Framework is based on Banco Santander governance and framework for Operational Risk. One of the objectives with this framework is to ensure that the Bank is operating within the given risk appetite limits. To be able to monitor and manage the risk appetite limits, all relevant operational risk events need to be detected, reported, monitored, and managed. Therefore, SCB's operational risk model consists of seven main processes, which all are interlinked to each other.

All of the main processes use the Corporate tool Heracles. Heracles is a holistic operational risk and internal control governance system, which uses standardized processes and taxonomies. This methodology and system ensure a high standard of the management of operational risk and internal control processes in addition to a consistent report of data across all SCB units.

Internal control processes consist of the following:

- **Event loss reporting**: This event loss reporting process includes the identification and assessment of events as well as consolidation, aggregation, calculation, development of mitigation plans/activities for and the reporting of events that have occurred or could potentially occur. In order to assure that all functions are covered by the operational risk reporting process, and that the procedures are followed, a number of 1LoD (first line of defence) operational risk coordinators have been appointed by 1LoD management. They safeguard the operational risk loss processes and act as a promotor for operational risk processes within the Bank.
- **Risk and Control Self-Assessment (RCSA)**: RCSA is a yearly risk assessment process identifying and evaluating potential risks and controls to proactively prevent risks from materializing. It is based on a bottom-up approach and 1LoD risk owners and control owners in the whole business take part in the assessment workshops. Conduct risks (Basel IV Client, Product and Business Practices) are assessed in the Conduct Risk Assessment and included in

the RCSA workshops in order to assess the residual risk and is considered in the Operational Risks Statements. The purpose of the process is to identify the biggest operational risks with their associated controls as foundation for the final inherent and residual risk assessment. After consolidation and ranking of risks, the outcome is presented in management committees for either acceptance or decisions regarding mitigation actions. In 2020, the RCSA process has been aligned with the Internal Control Model certification process (Convergence 2020 initiative).

- **Scenario analysis**: Scenario analysis is an operational risk instrument that identifies relevant risks (low frequency, high severity) within the organization, establishes action plans and aims to reduce the probability and/or severity of the scenario should it occur.
- **Internal Control Model**: The internal control framework within SCB is based on the internal control methodology of Grupo Santander, as well as requirements and frameworks set by international and local organizations and regulators. The requirements of The Sarbanes Oxley Act (SOX), the Committee of Sponsoring Organizations of the Treadway Commission Framework (COSO) and the local requirements by Nordic regulators are included in the Santander Internal Control Framework, which in turn sets the foundations for the Internal Control function in SCB and the internal control methodology.
- **Action Drivers and Mitigating Actions**: Action Drivers and Mitigating Actions are tools for recording issues and mitigation plans. More specifically, Action Driver is a problem to be solved (deficiency/issue) and Mitigating Action is the action plan to solve the issue. Both require 1LoD to name an owner and timeline by which the issue has to be fixed. There is a monthly monitoring process in place, coordinated by 2LoD.
- **Special Situations Management Framework**: The Company has adopted a framework for special situations (financial and/or operational/reputational severe events). Under this framework, the Company has established a Special Situations Management Policy which establishes identification, classification, governance and management protocols for special situations. It furthermore outlines the different action plans the Bank has established to handle different types of special situations.
- **Business Continuity Management (BCM)**: In the BCM program, plans are defined to quickly recover a system or a process exposed to a major event or a disaster. In the potential event of an activation of a BCM plan, the event will also be a part of the event loss management and reporting process.
- **Operational Risk Indicators (ORIs)**: The use of different metrics, or key risk indicators, is an important tool for detecting and remediating potential risks before they are materialized. The ORIs are based on corporate methodology but adapted to local conditions and needs.

Reporting in Risk Committees and Other forums: Operational risk reporting is managed in the corporate tool Heracles. The reports based on Heracles data are presented in various Risk Committees depending on the type or severity of the potential or materialized event or assessment.

9.2 Governance

Based upon SCB Corporate guidelines, the Bank has adapted and established a Nordic model, appropriate policies and procedures, which describe the non-financial risk management hereunder operational risk management, cyber and technology, compliance and conduct.

The governance includes several risk committees that operate with the objective to assure that the senior management team, including the Board, are updated with relevant non-financial risks and ongoing activities. The committees provide oversight of the risk and control management, and when applicable makes recommendations or agree on corrective actions regarding low and medium risks and for high and critical risks escalated to the Non-Financial Risk Control and Compliance Committee.

9.3 Operational Risk

Operational risk is defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events." It includes events that may arise due to legal or regulatory risk, compliance and conduct risk, model risk and IT risk.

To ensure that the Bank operates within the BoD approved risk appetite, an operational loss risk appetite is set at least annually which requires the BoD approval. The main risk appetite metric is "Operational risk losses" / "Gross Margin". Ongoing BoD meetings monitors the data related to operational loss risk appetite.

Operational Loss Budget: In 2020, the Bank defined its operational risk loss budgets for 2021. For assessing and setting of the operational risk loss budget, the Bank uses the seven Basel categories for the classification of losses. The Non-Financial Risk & Compliance Committee reviews the budget.

The budget is monitored by the second line on a monthly basis and reported to management committees[6.] Specific general ledger operational risk accounts, both at local and corporate level, has been set for this purpose.

9.4 Cyber & Technology Risk

When considering the current state of the threat landscape, the 2020 cyber and technology risk level of SCB is rated as largely unchanged from 2019. To describe the state of Cyber Security and IT Risk in SCB, the Bank present and combine two views:

Externally, the Bank sees the same as most other financial institutions in the Nordics (as compared with the Nordic Financial CERT quarterly threat reports). The bank continues to see phishing attempts, and in some cases, observations believed to be targeted attempts (spear phishing). However, there are not registered any security incidents resulting from these attempts and the Bank continues to have a high focus on employee training to recognize phishing attempts. The Bank has established operational risk indicators associated with employee behaviour in phishing simulations, and these have thresholds and targets. The Bank has not registered any significant DDoS (distributed denial-of-services) attacks, or attempts. Even so, new technological capabilities are introduced to protect against both volumetric and protocol-based denial of service attacks in 2020.

The way of working has changed in 2020 due to the pandemic. Employees have mainly been working from home since March 2020 and the risks related to this situation have been monitored closely during the entire year. Even with the new way of working, attacker's methods have not changed dramatically compared to previous years.

Internally, the bank continues to see the risk of employees unintentionally harming systems or data, causing disruption of products and services. The bank also acknowledges the risk of employees performing fraudulent activities in day-today business, yet not seeing an increased risk in 2020. In order to internalize risks from current threat landscape the bank has evolved and is nearing the end of a change journey which began in 2018 to unify the country branches into One Nordic Bank. Along this journey the Bank maintains a focus on the technology risks associated with organizational and technology changes, and communications regarding the cyber security policies and capabilities have been an important driver to maintain consistency and lead improvements.

The bank has in 2020 increased number of reporting indicators associated with technology and cyber security risk in order to evaluate current capabilities against the threat landscape. Through established metrics, technology risk is measured on a monthly basis. These metrics are collected from the first line of defence and validated by the second line of defence and are all associated with thresholds and targets. Any deviations from the targets are followed up on with structured mitigation plans.

[6] *Non-Financial Risk Control and Compliance Committee, Risk Control Committee, Board Risk Committee and BoD meeting.*

In 2019, SCB adopted a number of services aimed at strengthening cyber security in 2020; including Web Application Firewalls, improved vulnerability discovery tools, and improved tools to manage identities and accesses, both for normal users and privileged users. In addition, as the OneIT project continues to harmonize IT and infrastructure deliveries across the Nordics, security continues to be involved both in technology decisions and in the change process in order to ensure that technology risk is managed appropriately.

9.5 Model Risk

SCB defines model as a system, approach or quantitative method that applies statistical, economic, financial, or mathematical theories, techniques, and assumptions to process input data into quantitative estimates. The definition of a model also covers quantitative approaches whose inputs are, partially, or wholly qualitative or based on expert judgment, provided that the output is quantitative in nature.

SCB uses models to support decision making, financial and regulatory reporting, and to provide predictive information in a number of business functions, such as credit risk management, market risk management, capital estimation and stress testing, and asset/liability management, among others.

Usage of models entails exposure to model risk, which is defined as the potential for adverse consequences from decisions based on incorrect, inadequate or misused model outputs and reports, including the opportunity cost of lacking adequate models. Model development, implementation and use can all be potential sources of model risk. Regardless of the source, model risk may be reflected in the risks associated with the activity it supports. It can lead to financial loss, poor business or strategic decision-making, or damage to SCB’s reputation

To support this process, SCB has defined clear frameworks, policies and guidelines for establishing common general principles for the management and control of model risk, aligned with internal regulations within the Santander Group. The processes established within model risk management with respect to A-IRB rating systems, aim to implement the regulatory expectations set out in Delegated Regulation (EU) No 2015/942 amending Delegated Regulation (EU) No 529/2014, supplementing Regulation (EU) No 575/2013, Finanstilsynet’s circular 3/2015 and CRR/CRD IV, where applicable.

Model Validation
Independent validation of models before implementation is not only a regulatory requirement in certain cases, but also a key feature for proper management and control of model risk. Within the Group, a specialist unit outside SCB, completely independent of both developers and users, draws up a technical opinion of the suitability of internal models to their purposes, and sets out conclusions concerning their robustness, utility and effectiveness (initial validation). The intensity varies depending on the model tier, importance of the modification and it is higher, aligned with regulatory requirements, when the model is used for regulatory capital estimation. The validation function also performs recurrent validation after the models are in use, based on their performance, ensuring an updated evaluation of the model risk level they carry. The frequency and depth is also based on the same factors and considers regulatory requirements in the case of models part of the IRB rating system.

During validation, 5 different dimensions of the model are assessed, including data, IT environment, model foundations, model performance and use, and governance. The validation opinion for each dimension and overall for the model is detailed in a validation report and summarized in the Model Risk Rating (MRR) of the model on a scale of 1 to 5, where 1 is low model risk, 2 is moderate-low, 3 is moderate, 4 is moderate high and 5 is high. In addition to the model risk rating (MRR), the validation function issues recommendations, tied to model weaknesses, categorized by relevance and relative impact on model risk implied by the model. They are followed up on a regular basis by the model risk function and model owners to ensure action plans are set and fulfilled.

Once the validation is finished, a consistency check process is carried out in order to provide homogeneity and consistency to the validation process and outcome. Through this process, the validation conclusions are challenged by a different group of validators.

9.6 Compliance and Conduct Risk

Compliance Risk is defined as a risk of legal and regulatory sanctions, financial loss or damage to the reputation of the Bank arising from the Bank or its directors, officers and employees not adhering to applicable laws, rules, regulations, and internal policies. The Bank's Compliance and Conduct Program covers the following risk taxonomies, Regulatory Compliance Risk, Anti-Money Laundering and Countering Terrorism Financing Framework Risk, Product Governance and Customer Protection Risk as well as Reputational Risk.

The Bank has adopted the three lines of defence mechanism with first line of defence as responsible for the risk management and control of the compliance risk. To oversee the compliance processes in the Bank and to secure that management and the Board of Directors are provided with independent information regarding the compliance status in the business, SCB has an independent Compliance and Conduct function in second line of defence. The Compliance and Conduct function promotes adherence to rules, supervisory requirements, principles of good conduct and values by acting as a second line of defence – establishing standards, challenging, advising and reporting – in the interest of employees, customers, shareholders and the wider community. The function performs independent assessments by performing independent risk-based monitoring, controls, testing, and thematic reviews. Annual risk assessment forms the risk-based approach of the Compliance and Conduct function activities, and the prioritizing between the activities is concluded in the Annual Compliance Plan.

The Bank is continuously keeping high focus on ensuring that it is not being used for any illegal activities and that the Bank is complying with, and have focus on, all applicable financial crime regulations and mitigating actions. During 2020, the Bank has initiated several measures to reduce the financial crime risk and further develop a robust financial crime prevention program with supporting IT systems. In 2020 the "Financial Crime Prevention Unit" was established, including clear mandates, roles and responsibilities and sufficient resources. During 2020, the Compliance and Conduct function has performed risk-based testing as part of the AML/CTF control program.

The Bank has a "new product approval process" in place to ensure that the compliance and conduct risk is mitigated in the design and development of new and significantly changed products and services. In addition the compliance function is planning to further improve and develop the compliance commercialization program to ensure that costumers are treated fairly throughout all stages of the customer lifecycle and that products at all times are suitable to meet customer requirements under the applicable market conditions.

Compliance with GDPR requirements continues to be a high focus area in the Bank. Several improvements have been implemented in 2020, including clarifying roles and responsibilities within different functions, assigning ownership, clarifying the dependencies between key roles and updating relevant policies and procedures accordingly. To improve the GDPR framework and to ensure sufficient resources and knowledge in the business, the Bank has established a Data Privacy Officer in first line of defence. In addition, a new control framework has been implemented within first and second line of defence.

Clear roles, extensive expertise and a strong culture of compliance are the central elements of the Bank's compliance management. The "One Bank" initiative, which aims to improve and centralize the IT structure, governance processes and the organizational set-up of the bank, is an important measure to meet the challenges the Bank is facing in the rapidly changing and increasingly complex regulatory environment and financial services industry. A total of 14 initiatives were completed under the One Bank initiative during 2020. In 2021, 15 initiatives are in progress.

To ensure proper implementation of new and changed regulations and to be able to give the Management an adequate risk picture of the regulatory implementation status, the bank has during 2020 further improved and clarified the process for monitoring the implementation of regulation.

The Groups General Code of Conduct is applicable to all employees and members of the Board and sets the ethics principles and rules of conduct by which all activities of the Group's should be governed, and therefore comprises the central component of the Santander Group's Compliance Programme. All employees are required to complete a mandatory training in the Code of Conduct to ensure proper knowledge and awareness of the ethical principles.

The Group has two whistleblowing channels, one for internal purposes, and one for its supplier relationships. Reporting should be made on improper conduct that is believed illegal or which violates the Group's Code of Conduct and policies. Employees are free to report their concerns anonymously to the Compliance and Conduct function and employees who report such concerns in good faith are protected from retaliation.

9.7 Capital Requirements for Non-Financial Risk

SCB applies the Basic Indicator Approach (BIA) for calculating its capital requirement for non-financial risk. Under the BIA, the RWA's for operational risk are calculated as a percentage (alpha) of the three-year average gross income amount multiplied by 12.5. This alpha is given by article 315 (1) of the CRR and is currently 15%. The table below details the Bank's BIA calculation for 2020.

Table 9.7.1: SCB Application of Basic Indicator Approach (NOK million)

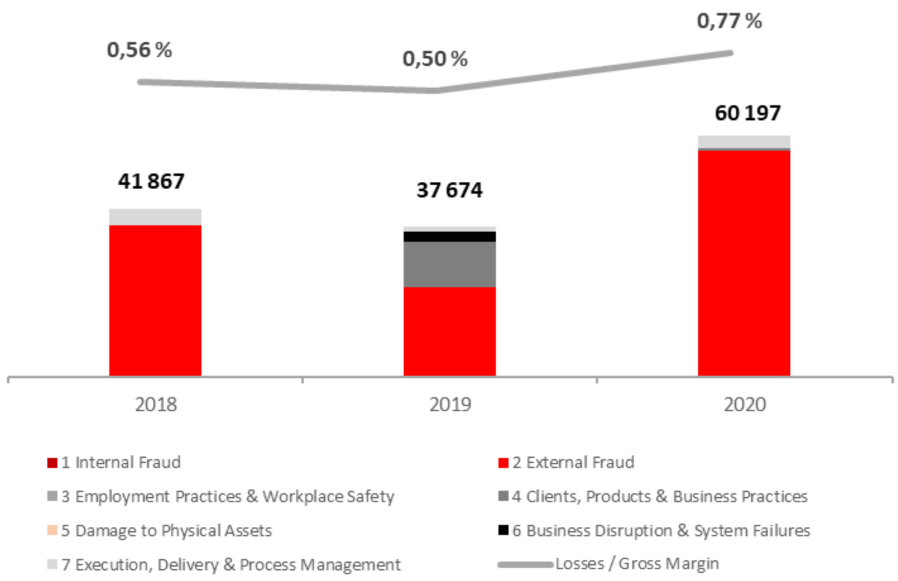
Basic Indicator Approach	2018	2019	2020
SCB Gross Margin	7 384	7 595	7 816
3-year average Gross Margin			7 598
15% BIA Capital Charge			1 139
RWA			**14 247**

9.8 Operational Loss Performance in 2020

As detailed above, the Bank held 1 139 million NOK of operational risk capital under Pillar 1 whilst operational losses amounted to 60.1 million NOK in 2020. External fraud events constitute the majority of the operational risk losses. The number of detected operational risk events are considered stable.

The figure below identified SCB operational losses by category over the three previous years. As can be seen, External fraud accounted for the majority of the operational losses.

Figure 9.8.1: Operational Losses by Basel Category (NOK 000s)



10 Liquidity Risk

Liquidity Risk is the risk that an entity becomes unable to meet its obligations as they fall due because of an inability to liquidate assets or obtain adequate funding.

Liquidity risk management in the Bank aims to ensure sufficient funds to support daily operations, a balance between weighted average life of the assets and liabilities, diversified funding sources and sufficient amount of liquidity reserves across all four currencies in order to survive a stress scenario.

The key ratios for assessing liquidity risk are the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).

- The **LCR** is established as a metric to measure short-term liquidity risk. This ratio indicates the short-term resilience of the entity's liquidity risk profile, ensuring that there are sufficient high-quality liquid assets to withstand an event of combined systemic and global stress over a period of 30 calendar days. SCB calculates this ratio on an ongoing basis and reports on a monthly basis according to CRD IV. Since September 2017, the Bank is now also compliant with the change to the specific Norwegian legislations regarding LCR, so to meet the requirements not only on a consolidated level, but also per significant currency. For the Bank the significant currencies are NOK, SEK, DKK and EUR. As at December 31st, 2020, LCR was 239% at consolidated level, 130% in NOK, 175% in SEK, 1095% in DKK and 284% in EUR.

- The **NSFR** is the long-term funding ratio which compares the structural funding needs to the entity's stable funding sources. This ratio requires the banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. SCB calculates this ratio on a quarterly basis according to CRD IV. From June 2021 onwards SCB will start to report NSFR monthly internally. Aditionally, SCB is continuously improving its NSFR forecasting model to ensure continued compliance with NSFR metrics once implemented in regulation. As of December 31st, 2020, the Bank's NSFR was 111%.

10.1 Diversification of Funding Sources

SCB's objective is to maintain a well-diversified funding composition and within that, to reduce its reliance on funding from the parent company. As of December 31st, 2020, the Bank had a self-funding ratio of 82%[7], up from 80% in 2019.

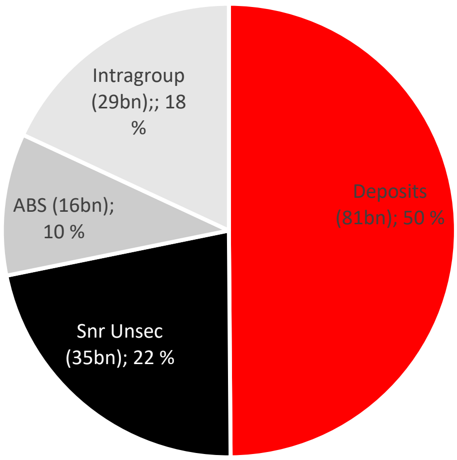
The Bank is raising funds through the following sources:

- Customer deposits in Norway, Sweden and Denmark. The customer deposit products are demand deposits, fixed rate deposits and notification products
- Secured funding in the Nordic countries (Asset Backed Securities)
- Senior Unsecured funding in the local Nordic markets and in international markets
- Intragroup funding from the parent company
- Repo capabilities with Nordic counterparties

[7] *Calculated as a proportion of senior debt, excluding equity and subordinated debt.*

The figure below shows the funding composition on a consolidated Nordic level as of December 31st, 2020.

Figure 10.1.1: Funding Composition as of December 31st 2020 (numbers in NOK)



The main source of funding for SCB comes from customer funds (50%). In addition to deposits, SCB also funds itself through intragroup loans from SCF (18%). Senior unsecured funding (22%) has also increased in importance over the last few years. However, in 2020 the Senior Unsecured portfolio was reduced by 2 billion NOKn compared to 2019. This was due to the lower issuance level in 2020 resulting from high spreads related to COVID-19 unrest in the financial markets. This funding was primarily replaced by deposit growth. In addition to the aforementioned, the Bank is still raising secured funding through Asset Backed Securities ("ABS") in the Finnish subsidiary (10%). SCB has also entered into GMRA[8] agreements with Bank counterparties, to allow for short term repo funding.

SCB is still reliant on SCF for around 18% of its funding. As the Bank has issued more debt directly in the wholesale markets and deposit balances have grown, the utilization of intragroup funding has primarily been used for the short-term funding needs of SCB. This is an effective and flexible tool for SCB compared to many of the local peers. The Bank also continues to be more and more active in the Repo market for short term funding needs. As these markets continue to develop in the local Nordic currencies, we see improved liquidity across all currencies.

10.2 Liquidity Portfolio

The Bank's liquidity reserve portfolio consists of government bonds issued by European countries with rating from AA- to AAA, AAA rated covered bonds and AAA rated supranational bonds. All qualify as Level 1 securities under the LCR rules and are defined as High Quality Liquid Assets ("HQLA"). SCB maintains a portfolio which is obliged to exceed the liquidity flows in each significant currency according to ratios set by the Norwegian FSA. The Bank has also defined several internal threshold levels above the regulatory requirement in order to minimize operational risk and ensure that the liquidity buffer is of sufficient size.

In addition to holding bonds, SCB utilizes central bank deposits for covering its liquid asset needs. During 2020 the Bank utilized F-deposit facility provided by Norges bank as well as deposit facility provided by Riksbanken.
SCB does not have a trading book and the bonds in the liquidity portfolio are under normal circumstances held to maturity. The Bank's policy only allows for the purchase of bonds with a maximum 3-year maturity if floating coupon and 380 days maturity if fixed rate, limiting the impact on market value of any change in the discount rate.

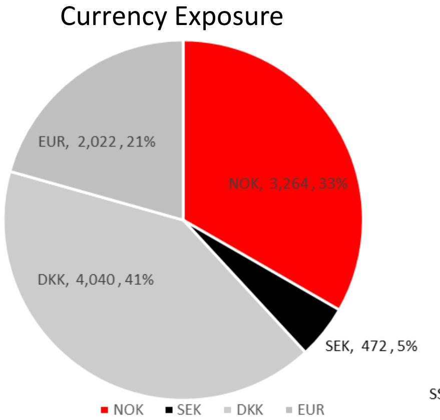
[8] *A Global Master Repurchase Agreement is a model legal agreement designed for parties conducting repo transactions.*

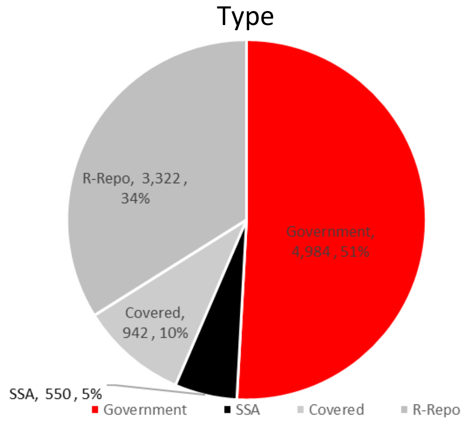
Due to Volcker regulations, the Bank will only buy bonds with a residual maturity above 70 days. In order to manage very short-term needs in the portfolio, SCB has entered into GMRA agreements with Nordic counterparties to allow for reverse repo transactions. This has proved a valuable tool for the Bank.

Valuation of the Bank's HQLAs and LCR reporting is conducted on a daily basis. The bond portfolio is well diversified in terms of country/currency, issuer, instrument type and issue. The short average duration of the portfolio also limits the inherent credit risk. The Minimum Liquidity Buffer level is calculated monthly, based on the internal stress tests, and adjusted for specific transactions after the last run of the stress test. The buffer composition and size are calculated daily and measured against the minimum liquidity buffer.

The Bank will always hold most of the NOK & SEK denominated portfolio with the respective Central Banks, to ensure availability of overnight liquidity, if needed. However, in 2020 SCB utilized Riksbanken deposit facility directly, instead of holding SEK denominated bonds leading to lower share of SEK denominated papers in the bond portfolio. As of year-end 2020, SCB had 3.2 billion SEK deposited in Swedish central bank. Below is an overview of the HQLA Bond portfolio (notional, including reverse repos, excluding central bank deposits) allocations in million NOK as of end December 2020:

Figure 10.2.1: Overview of the HQLA allocations (MNOK per December 31st 2020)[9]





10.3 Asset Encumbrance

The asset encumbrance ratio is calculated and reported on a quarterly basis. As of December 2020, the main source of asset encumbrance in the Bank are Auto Asset Backed Securities (ABS) issued and retained or placed in the market. In addition, the Bank has pledged reserve fund amounts in the Special Purpose Vehicles of respective ABS transactions, which together with customer payment amounts due to the SPVs amounted to 806 million NOK at year-end.

Table 10.3.1: Summary of F 32.01 - Assets of reporting institution -Dec. 20 (NOK '000)

Total Encumbered Assets	**17 995 118**
Loans on demand	965 806
Retained asset-backed securities issued	1 810 098
Sold asset-backet securities issued	15 2019 215
Total Non-Encumbered Assets	**180 896 871**
Loans on demand	9 940 922
Debt securities	6 813 554
Loans and advances other than loans on demand	159 233 480
Other assets	4 908 916
Asset Encumbrance Ratio	**9.05%**

[9] *"SSA» refers to Sovereigns, Supranational and Agencies*

No new true sale ABS transactions have been issued in Sweden, Denmark or Norway since 2015, with only SCF Oy issuing Finnish transactions annually. This has led to a decline in the encumbrance ratio, which is expected to remain well below the management limit going forward.

10.4 Liquidity Management and Governance

The Risk Appetite Framework defines the Bank's risk appetite limit for liquidity risk. The currently approved risk appetite limits for liquidity risk in SCB address NSFR, LCR and Liquidity Survival Horizon (form of stress scenario).

All three metrics are considered primary metrics in the Risk Appetite Statement, and risk excess has to be communicated to the Board of Directors. The Risk Appetite metrics are reported to the BoD in every meeting, at least on a quarterly basis. Metrics are also monitored by the Board Risk Committee and the Risk Control Committee.

SCB also has a set of management limits on additional liquidity risk metrics including, amongst others, asset encumbrance, intraday liquidity limits and intragroup limits. The management limits must be reviewed annually and must be approved by the Risk Approval Committee. The management limit metrics covered in the risk appetite statement must also be approved by the BoD, as detailed in the SCB governance structure.

These limits are being managed by the Treasury and Analysis department and controlled by the Market Risk department on a monthly basis, and some on a daily basis. Breach of any management limits are reported to the relevant controlling committees in SCB.

10.5 Liquidity Stress Tests

SCB maintains a Liquidity Stress Test model, which is run on a monthly basis. The liquidity stress test of the Bank complies with regulatory requirements and is used both as a tool for measuring liquidity risk and for managing funding and liquid assets.

The liquidity stress test results are presented to Senior Management on a quarterly basis and to the BoD on a semi-annual basis. The objective of the liquidity stress test is to ensure that the Bank has sufficient liquidity to survive a given period under defined stress scenarios. The stress test is used as part of the liquidity risk management of the Bank.