

# Handelsbanken

Handelsbanken's risk and capital management – information according to pillar 3



stock	sym	high	low	close	chg	vol	
5.25	5.12	5.16	+0.01	5.12	5.16	+0.01	19751
1.81	1.66	1.71	-0.09	1.66	1.71	-0.09	458
0.38	0.35	0.35	-0.03	0.35	0.35	-0.03	456
2.30	2.18	2.26	+0.05	2.18	2.26	+0.05	34954
7.12	6.89	6.99	-0.06	6.89	6.99	-0.06	5251
5.72	5.47	5.67	+0.22	5.47	5.67	+0.22	



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# Introduction

The purpose of the information in this document is to provide information about risks, risk management and capital adequacy as described in Pillar 3 of the new capital adequacy regulations (Basel II). The requirements are specified in the Swedish Financial Supervisory Authority's directives (FFFS 2007:5).

Svenska Handelsbanken AB (publ)<sup>1</sup> is the parent company in the Handelsbanken Group. In the context of capital adequacy, it is the banking group that is affected by capital requirements and not the whole Group. Thus in this document, information is principally provided for the banking group.

In the banking group, the Group's subsidiaries are fully consolidated, while the associated companies are either fully consolidated or consolidated in accordance with the equity method. The Group's annual report provides information about which subsidiaries exist. Those companies that are not part of the banking group and thus not covered by the capital requirements in the same way as other companies in the Group are shown in the table.

	Corporate identity no.	Domicile
Handelsbanken Liv Försäkrings AB (group)	516401-8284	Stockholm
Handelsbanken Försäkring AB	516401-8326	Stockholm
Svenska Re S.A.	RCS Lux B-32053	Luxembourg
Handelsbanken Skadeförsäkrings AB	516401-6767	Stockholm
Handelsbanken Renting AB	556043-2766	Stockholm

## Risk management

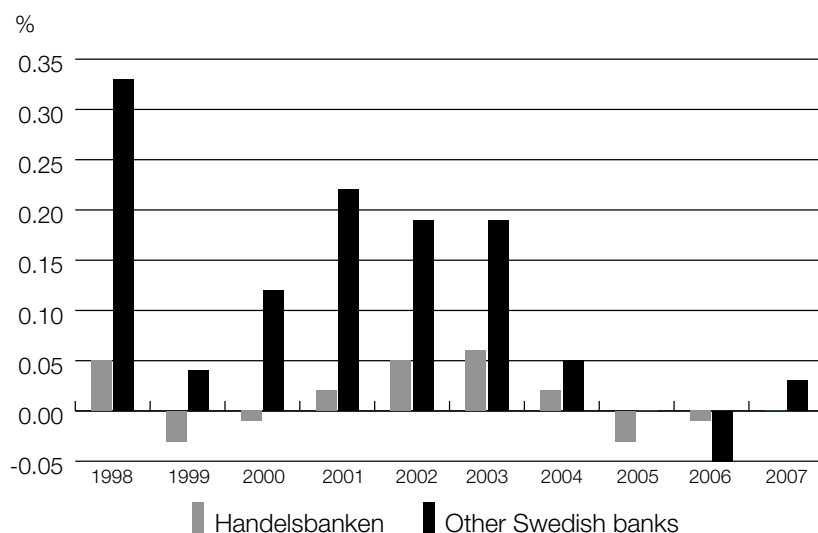
Handelsbanken's ability to manage risks and operate efficient capital management is crucial to the Bank's profitability. Historically, Handelsbanken has low risk appetite, which is reflected in the Bank's low loan losses and its even earnings performance. Handelsbanken's strict approach to risk means that the Bank deliberately avoids high-risk transactions, even if the remuneration is high at that moment in time. This low tolerance of risk applies to all areas in the Group. Market risks in the Bank's operations are mainly taken as one step in meeting customers' short-term investment needs. The Bank is also well-prepared in its way of handling liquidity risks, as illustrated during the market turbulence of 2007. After the sale of SPP, and following risk-reduction measures, the risks in Handelsbanken's insurance operations are also lower than in the past.

The aim of this strict approach to risk is not just to maintain favourable and even earnings performance, but also to be a good business partner for the Bank's customers; this requires sound credit capacity and preparedness – even in troubled times.

<sup>1</sup> Corporate identity no. 502007-7862

The fact that the Bank keeps credit risks on its own books rather than selling them on underlines the Bank's view of customer relationships. This contributes to good risk management and a high level of service. The same principles apply in all countries where Handelsbanken operates and they are guiding principles in the Bank's ongoing international expansion.

### Loan losses as a percentage of lending



Handelsbanken operates in many countries and many different business fields. This entails a variety of risks that are systematically identified, measured and managed. The most significant risk is credit risk.

### Risks in Handelsbanken

	Description:
<b>Credit risk</b>	The risk that an individual borrower cannot fulfil his commitments
<b>Market risk</b>	The risk of price changes in the financial markets
<b>Liquidity risk</b>	The risk that the Bank cannot make its payments when due
<b>Operational risk</b>	The risk of human errors and errors in procedures and systems
<b>Insurance risk</b>	The risk in the outcome of an insurance that depends on the insured party's longevity or health
<b>Business risk</b>	The risk of unexpected changes in financial performance that are not related to loan losses or market risks
<b>Property risk</b>	The risk of changes in prices of the Bank's property holdings

Handelsbanken's risk management aims to ensure that the Bank meets the strict approach to risk that the central board has established. This risk management can be described in terms of four levels:

#### 1. *Business operations*

Handelsbanken's culture is permeated by the responsibility of each bank employee who makes business decisions. The person who best knows the customer and the market conditions is in the best position to assess the risk. The branch responsible for the customer carries the entire risk and manages it. In the Bank's decentralised

organisation, each branch and each unit with profit responsibility is evaluated based on both positive and negative outcomes. One result of this is natural risk limitation and caution in business operations.

2. *Risk control close to operations*

The responsibility held by those who make business decisions is complemented by checking that no excessive risks are taken in individual transactions or local operations. In lending this means that large loans are limited and assessed in a special credit organisation. Decisions on limits are made at branch, regional or central level, depending on the size of the credit limit. Market risks are subject to equivalent control. It is ascertained that centrally set limits are distributed over various units or groups, and that there is local control to ensure that individual transactions are documented and performed in a way that does not involve unknown risks.

3. *Central risk control*

The third level is the Central Risk Control, which is responsible for identification of the Group’s risks, gauging them, and ensuring that management of these risks complies with the Bank’s low risk tolerance. The responsibilities of Central Risk Control include making sure that well-balanced local risk control is in force, that risks are correctly and uniformly measured and that the Bank’s management receives reports on the risk situation. The significance of strong central risk control has increased following the introduction of internal models for calculation of capital requirements and economic capital.

4. *Capital planning*

If Handelsbanken were to face serious losses despite these risk management measures, the Bank has substantial capital to ensure the Bank’s survival – even in the wake of extreme events. This capital and capital planning thereby constitute the Bank’s fourth level of risk management. The method for calculating economic capital ensures that all risks are considered in a uniform manner when the need for capital is assessed.

In addition to the four levels of risk management, internal and external auditors assess the operation.



Handelsbanken’s effective risk management over many years is illustrated by the fact that the Bank has had lower loan losses than its competitors for a long time. This is mainly attributable to the first two levels. The third level is not new, but was significantly reinforced during the past year. The fourth level was also boosted in analysis of and planning the Bank’s capital requirements. The reinforcement of these functions

is a result of the new capital adequacy regulations that have applied since 1 February 2007 and are based on the Basel II Accord. These new regulations entail increased risk sensitivity in the calculation of capital requirements, which means that the capital requirement will more accurately reflect the Bank's well-established approach to risk. Another consequence is that there are greater demands on capital planning.

The Bank has obtained approval for the basic method in the system of internal risk classification when calculating capital adequacy for credit risk, and is now preparing work towards approval for the advanced method.

## Risk organisation

Handelsbanken's central board is responsible for assessing and monitoring the risks arising in the Group's operations. The central board ratifies policy documents and instructions describing how various risks should be managed and reported. The central board also ratifies the decision structure for credit limits.

At Handelsbanken, the credit process is based on a conviction that a decentralised organisation with local presence ensures high quality in credit decisions. Customer and credit responsibility lies with the branch manager or the employee delegated by the manager at the local branch. Most staff at branches have personal decision limits for credits or credit limits for the customers for whom they have credit responsibility. If there is a need for larger credits, there are regional and central decision levels. The largest credit limits are set by the central board's credit committee. However, no credit application may be processed in the Bank without the recommendation of the branch responsible for the customer.

Decentralisation also means that the documentation that forms the basis for credit decisions is always prepared by the branch responsible for the credit, regardless of whether the decision is to be made at the branch, or at regional or central level. Credit decision documentation includes general and financial information regarding the borrower, and an assessment of the repayment capacity, including ratings and the valuation of collateral, loans and credit terms. For borrowers whose total loans exceed SEK 1m (or SEK 6m for mortgage loans), the credit decision is made in the form of a credit limit. Granted credit limits are valid for a maximum of one year. They are extended after the branch has prepared decision documentation in the same way as for a new loan, and the decision-making process is also the same.

The CFO has the day-to-day responsibility for overall risk assessment. This responsibility entails ensuring that decision documentation regarding risk measurements and limits is prepared, and that there are appropriate information and report systems for this. Independent risk control for the Group's overall risk is carried out by the Central Risk Control department, which is responsible for identifying and checking the Group's risks, and for the models used to measure them, and also for proposing risk reduction measures.

The central board determines the market risk and liquidity risk limits for the entire Group within each type of risk. The limits are then allocated to the various business areas by the group chief executive. In each business area, which has been allocated a

limit, a local risk control unit reports the risk exposure to Central Risk Control and to the business area.

The group chief executive is responsible for the Bank pursuing capital planning which ensures that the Group's supply of capital is secure. The head of the Capital Management department is responsible for measuring available capital and for applying the Group's capital planning policy. This includes responsibility for maintaining the correct level of available capital and the correct proportions of Tier 1 and Tier 2 capital in the capital base.

The Central Treasury has responsibility for group liquidity and funding, and for carrying out such risk management measures as are decided upon by the CFO.

The Central Risk Control department, the Capital Management department and the Central Treasury are all departments within the Central Control and Accounting department. the head of which is the CFO.

## Reporting and follow-up of risk and capital situation

The credit risk situation is reported quarterly to the Central Board in terms of volume growth, non-performing loans, information from the Bank's credit risk models, etc.

In addition to the reporting of loans with provision requirements, which is carried out within the framework of external accounting, defaulting credits are reported regularly, to satisfy the requirements of the internal credit risk model and the calculation of the capital cover requirement. In addition, each branch compiles a quarterly risk report, where it reviews its credit commitments to identify and report credit granted, where the borrower's repayment capacity is impaired and the Bank's collateral is insufficient, or there is a risk that it will be insufficient. The risk is classified as low potential, high potential or probable loss. Normally problems are identified at an early stage and risk-limiting measures are taken before a commitment becomes non-performing. The risk reports are presented quarterly to the boards of the regional banks and subsidiaries and to the central board of the Bank.

The financial risks and limit utilisation for the trading operation, the internal bank, the mortgage business and other operations which carry less market risk, are checked on a daily basis and summarised when necessary (at least weekly). Every month, there is a more detailed follow-up of the market risk and liquidity risk situation before a risk committee chaired by the CFO. Any overdrawn limits are reported to this committee, as well as the current risk situation in the various risk categories and for the Group as a whole. The risk committee's analyses and observations are regularly reported to the group chief executive and the central board of the Bank.

The capital situation is reported weekly to the head of Capital, based on a short-term capital forecast. In cases where certain thresholds are exceeded, or where, for any other reason, the head of Capital deems it appropriate, the matter is reported on to the group chief executive and the CFO. A summary of the capital situation for the medium and long term is reported quarterly to the capital adequacy committee. A full updating of the forecast takes place quarterly, and when there are significant changes in market conditions.

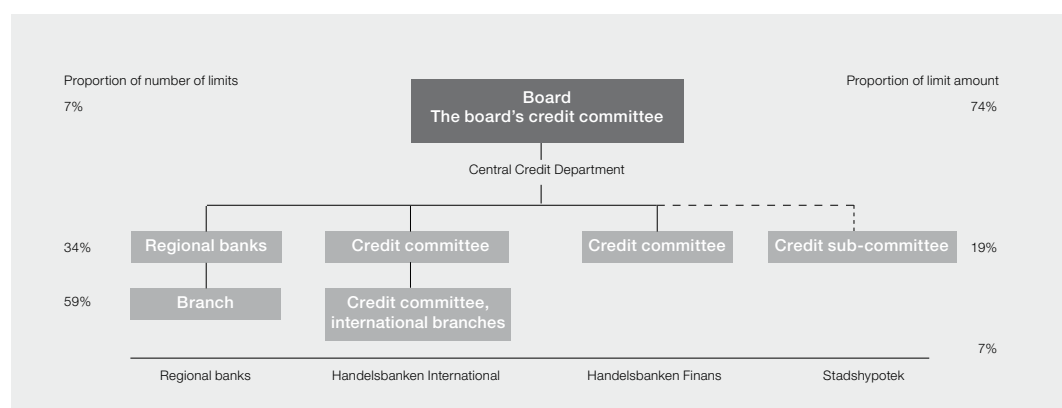
Liquidity risk is reported daily to the Central Risk Control unit, which also compiles a weekly report for the CFO and the head of the Central Treasury. Every month, before each meeting of the central board or when necessary, there is a meeting of the liquidity committee which acts as an advisory unit to the head of the Central Treasury. At this committee meeting, reports are presented on the current liquidity situation, on results of stress tests and a scenario analysis and other information which is relevant for the assessment of the Group's liquidity situation.

## Credit risk

Credit risk is defined as the risk of the Bank facing economic loss because the Bank's counterparties cannot fulfil their contractual commitments.

In the Bank's decentralised organisation, the branch responsible for the customer has complete credit responsibility. The branches maintain ongoing contact with the customer, which gives them in-depth understanding of each individual customer and a continually updated picture of the private customer or the company. This contact also enables the branch to quickly identify any problems and take action. In many cases, this means that the Bank can take action more rapidly – before the problems have become major ones – than had been possible with more centralised management of problematic loans. The branch also holds full economic responsibility for granting the credit. The branch therefore addresses the problems that arise when a customer has repayment difficulties and it bears any loan losses. If necessary, the branch obtains support from the regional head office and central departments. Handelsbanken's working methods mean that all employees whose work involves transactions linked to credit risk acquire a well-established approach to such risks – an approach that forms an important part of the Bank's culture.

### Decision levels for granting credits



The Bank aims to be selective in choosing customers and the borrowers must be of high quality. The quality requirement must never be neglected in order to achieve a high loan volume. Some 97% of the overall limit volume for credit exposures was to customers with a repayment capacity assessed as normal or better than normal, i.e. that they have a risk category between one and five on the Bank's ten-point risk classification scale.



## Measurement of credit risks

In 2005, the Bank applied to the Swedish Financial Supervisory Authority for permission to use an internal ratings based (IRB) approach to credit risk to calculate the capital adequacy requirement and in 2007, permission was granted. The permission applies to the financial company group led by Handelsbanken AB (publ) and the two companies Handelsbanken AB (publ) and Stadshypotek AB (publ).

The Financial Supervisory Authority has approved the Bank's gradual introduction of the approach in accordance with a fixed plan. In addition, the Financial Supervisory Authority has granted time-limited and permanent exceptions from the IRB approach for certain exposures, for which the standardised approach will be used instead. The allowed permanent exception refers to exposures to governments, Sveriges Riksbank (Swedish central bank) and Swedish municipalities. Time-limited exceptions comprise "portfolios of insignificant size" as defined in the Financial Supervisory Authority's regulations and the share exposures held by the Bank at the turn of the year 2007/2008.

For 2007, the Bank has calculated the capital requirement using the IRB approach for some 74% of total risk-weighted assets. The portfolios included in this first part of the implementation plan are mainly Swedish regional banks and part of Regional Bank Norway. Permission from the Financial Supervisory Authority has been obtained for 2008 to include Regional Bank Finland, Handelsbanken Finans in Sweden and Finland, all the Bank's exposures to other banks (exposures to institutions) and a further part of Regional Bank Norway. Moreover, in 2009 most of Regional Bank Denmark and the regional banks in Great Britain, as well as parts of the Handelsbanken International and Handelsbanken Capital Markets business areas will be added.

### Risk classification system

As support for its lending and to assess the capital requirement, the Bank thus also calculates its credit risks in a model. The model assumes that each individual credit will be sorted into a risk class. The Bank's risk classification model has ten steps, where 1 is the lowest risk, 9 the highest and one is for default.

The risk classification system is based on the branch's assessment of each counterparty's repayment capacity. This is determined by the risk of financial strain and resistance to such strain. The methods and classification are based on the rating model that the Bank has applied for three decades. The rating is dynamic; it must be reassessed if there are signs that the counterparty's repayment capacity has changed. The classification is primarily made by the person responsible for granting a credit.

### Exposure classes

The Bank uses different models for calculating credit risk depending on the type of exposure. The overall division into exposure classes, which is mainly governed by the capital adequacy regulatory code, is sovereign, institutional, corporate and retail exposures. Some of these exposure classes have sub-groups where special models are applied. In practice the division into exposure classes is made when a member of staff at a branch or unit responsible for the customer decides which credit rating

template is to be used when assigning the counterparty a rating.

Sovereign exposures refer to exposures to governments, central banks and government agencies. Exposures to institutions refer to exposures to counterparties defined as banks and other credit institutions and certain securities companies. In 2007 the capital requirement for exposures to governments and institutions was calculated in accordance with the old capital adequacy rules (Basel I). For 2008 the Bank has received approval for an internal model for exposures to institutions.

Retail exposures include both exposures to private individuals and exposures to sole traders, where the total exposure within the Group does not exceed SEK 5m. Also included are companies that are legal persons with a maximum turnover of SEK 50m, where the total exposure within the Group does not exceed SEK 5m (excluding housing loans). Retail exposures are subdivided into two groups; real estate credit and other retail exposures.

Corporate exposures refer to exposures to non-financial companies, consisting of legal persons with a total exposure within the Group in excess of SEK 5m or where the company's turnover is more than SEK 50m, and sole traders with a total exposure for the Group in excess of SEK 5m. Apart from ordinary non-financial companies the exposure class includes insurance companies, co-operative apartment associations and exposure in the form of "special financing".

Equity exposures refer to the Bank's holdings of shares that are not included in the trading book. In 2007 the capital requirement for equity exposures was calculated in accordance with the old capital adequacy rules (Basel I).

## Risk classification methods

For corporate exposures the internal rating assigned by the credit organisation for each counterparty is translated directly into a risk grade. A certain average probability of default (PD) is calculated for each risk grade. Standardised values prescribed by the regulatory code are applied to loss given default (LGD) for corporate exposures. The standardised value that may be used is regulated by the collateral provided for a certain exposure.

For retail exposures the risk classification is also based on the internal rating assigned to all credit customers. The rating is not directly translated into a risk grade as it is for corporate exposures; instead the various exposures are sorted into a number of smaller groups, depending on certain factors such as non-payment records, number of borrowers etc. An average probability of default has been calculated for each of the smaller groups, which are then assigned to one of the ten risk grades according to the result of that calculation. Different models are used for exposures to private individuals and small businesses, but the principle is the same.

Loss given default (LGD) for retail exposures is not prescribed by the regulatory code; the Bank uses its own calculations. Different values are used for the two subdivisions of retail exposures; real estate exposures and other exposures. Different values are applied to real estate exposures depending on the loan to value ratio of the exposure. For other exposures the LGD value is determined by factors that may depend on the collateral, the product etc.

For all exposure classes a certain probability of default (PD) has been calculated for each of the risk grades. Probability of default is based on calculations of the historical percentage of default for different types of exposure. Default is defined as a counterparty being more than 90 days late with a payment, or an assessment having been made prior to this that the counterparty will be unable to pay according to the contract. The average probability of default is then adjusted by a safety margin and a business cycle adjustment factor. The safety margin is intended to ensure that the probability of default is not underestimated. The business cycle adjustment factor takes into account the fact that the estimated probability of default can be expected to vary due to the business cycle. The probability of default used for risk weighting therefore needs to be adjusted in relation to where in the business cycle the Bank's borrowers were in the period on which the calculations are based.

When the exposure at default is to be calculated, certain adjustments are made to the book exposure. This applies predominantly to various types of commitments where exposure may increase without any active decision on the part of the Bank. Examples of this are credit promises or revolving credit, where the Bank agrees with the customer that the customer may borrow up to a certain amount in the future. This type of commitment constitutes a credit risk and must be subject to capital adequacy rules, even if they do not currently constitute a book exposure. Normally this means that instead of the actual exposure, the credit granted is used, adjusted using a conversion factor (CF). For corporate exposures the conversion factors are determined by the regulatory code, while for retail exposures the Bank uses its own calculated conversion factors. Here it is the product referred to that mainly governs the conversion factor, but other factors may also be of relevance.

To sum up, for each credit exposure at the Bank a risk weight is calculated. This is calculated through probability of default (PD) and how large the loss will be if the counterparty defaults (LGD). The risk weight is then multiplied by the exposure at default (EAD) which leads to a risk-weighted exposure amount. The capital requirement is eight per cent of this risk-weighted exposure amount. The Bank calculates PD for companies and private individuals on the basis of its own loss history. For private individuals and small companies, EAD and LGD are also calculated on the basis of the loss history.

## Risk classification in practice

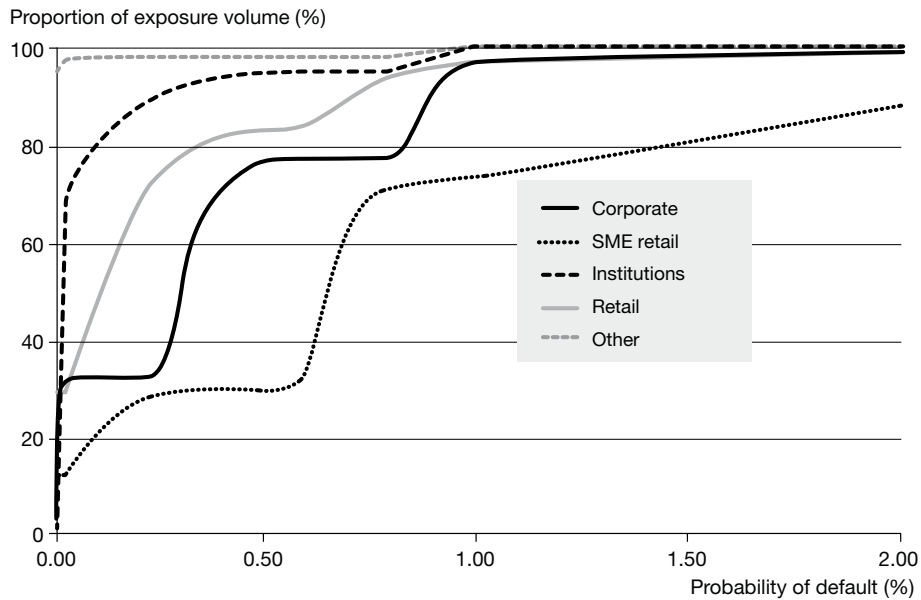
The risk measurements are used to price risk in each individual transaction and to calculate economic capital and capital requirements. New credits that are judged to involve higher than normal risk are refused, irrespective of price. The method used means that the Bank's historical losses – which are low – have a direct impact on risk calculations and capital requirement.

The diagram shows how the credit portfolio is split into differing PD value per counterparty category.<sup>2</sup> The PD value is expressed as a percentage where a PD value of 0.5% statistically means that 1 borrower out of 200 is expected to default within one year. At the year-end, 75% of the corporate exposures had been set a PD value of 0.5% or less. In reality however, not many of the defaulting loans cause losses for the Bank. In most cases there is collateral for the exposure and the default does

<sup>2</sup> The diagrams in this section refer to all exposures where the Bank performs calculations according to the credit risk model, that is not only exposures approved by the Swedish Financial Supervisory Authority.

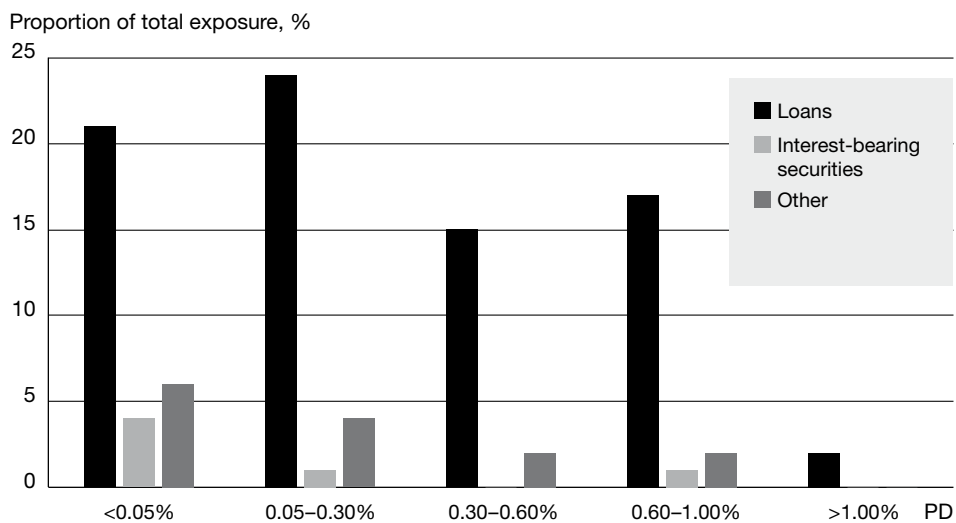
not exclude the possibility of the counterparty starting to pay again. In addition the PD values set have significant margins in the form of business cycle and safety adjustments. The business cycle adjustments are based on the Bank's default history between 1985 and 2006.

### Accumulated proportion of exposure volume and risk of default per counterparty category

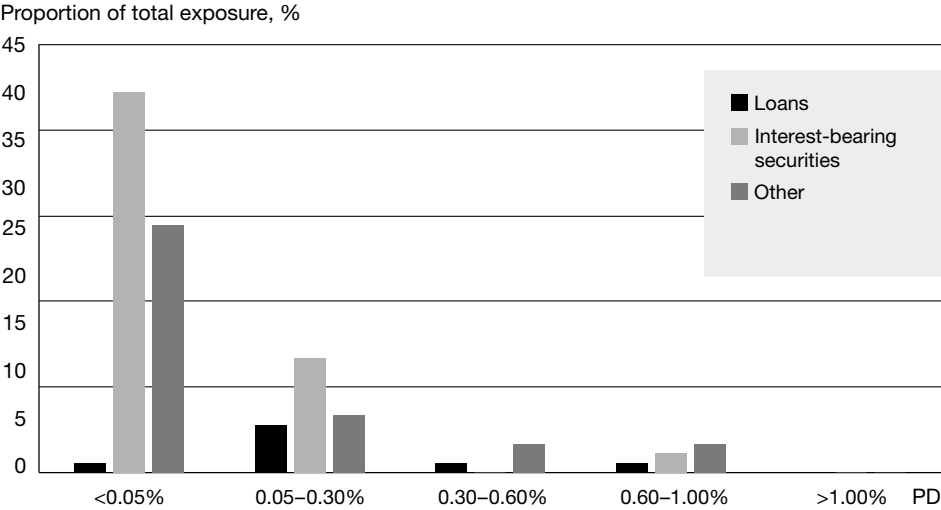


For the Corporate and Institutions counterparty categories the below diagrams show how exposure is distributed between bonds and other interest-bearing securities, and loans and other exposures respectively. Instead of showing the cumulative exposure distributed between the different PD values, as in the above diagrams, these two diagrams show how the exposures are distributed between different PD intervals. Exposures within a certain interval are shown in terms of the distribution between loans, interest-bearing securities and other types of exposure. Other exposures are for example derivatives, guarantees and credit promises.

### Proportion of exposure distributed by exposure category, corporate



**Proportion of exposure distributed by exposure category, institutions**

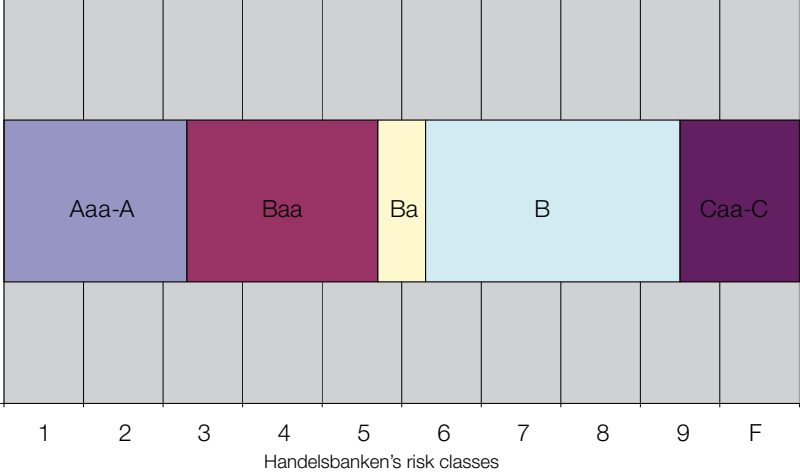


**Comparisons with external ratings**

The Bank’s risk categories are not directly comparable with the ratings applied by external credit rating agencies. The agencies’ ratings do not correspond to a direct classification of the probability of the counterparty defaulting, as the Bank’s risk classification does. In addition, the rating agencies vary in the extent to which they factor in the seriousness of the losses that default can lead to. Nor is the time horizon within which creditworthiness is assessed always the same for banks as it is for the rating agencies.

Nor do the Bank’s risk categories reflect a uniform scale, whereby a certain risk category always corresponds to a certain probability of default (PD). This is because different PD scales are applied to different parts of the credit portfolio, and also the PD values change over time, depending on business cycle adjustment factors and developments in the model.

With some allowance for the above-mentioned differences, the Bank’s risk classification can still be compared diagrammatically with the ratings that the agencies use. The figure below is an assessment of how the Bank’s risk classification of companies relates to Moody’s rating of companies. The assessment is based on the actual default frequency for Handelsbanken’s and Moody’s customers, and also on a comparison of the rating of counterparties with a credit rating from both Moody’s and Handelsbanken.



## Quality assurance of the credit risk model

The Bank carries out a detailed annual review of its risk classification system. The review checks firstly that the internal ratings on which the Bank's risk classification is based are applied in a consistent, high-quality, appropriate manner (assessment) and secondly that the statistical models that are used measure risk satisfactorily (validation).

The purpose of evaluating internal ratings is to ensure that they function well as the central factor in the risk classification of the Bank's counterparties. For example, this includes evaluating whether the ratings reflect the risk in the counterparty, that customers are assessed equally, regardless of where in the bank the rating takes place, that the rules for rating are followed, that ratings are updated, etc. The evaluation may highlight ratings in certain parts of the bank or for certain types of counterparty, with measures being taken to remedy any deficiencies. Such measures may include more frequent, specifically targeted follow-up action, changes to rating instructions or adaptations to models.

The statistical models and risk measurements on which these are based are validated at least once a year. The aim of this validation is to check that the risk classification system has successfully measured the risk in the PD, LGD and CF risk dimensions. Above all, the validation aims to evaluate whether the outcomes observed over the preceding year confirm that the models applied by the Bank are working as intended. To achieve this, a number of statistical tests are used which have pre-defined threshold values, so that if there are deficiencies in the models, clear signals are given. The validation may necessitate changes to models, correction of risk measurements or revision of instructions.

The results of the evaluations and validations are reported to the central board of the Bank.

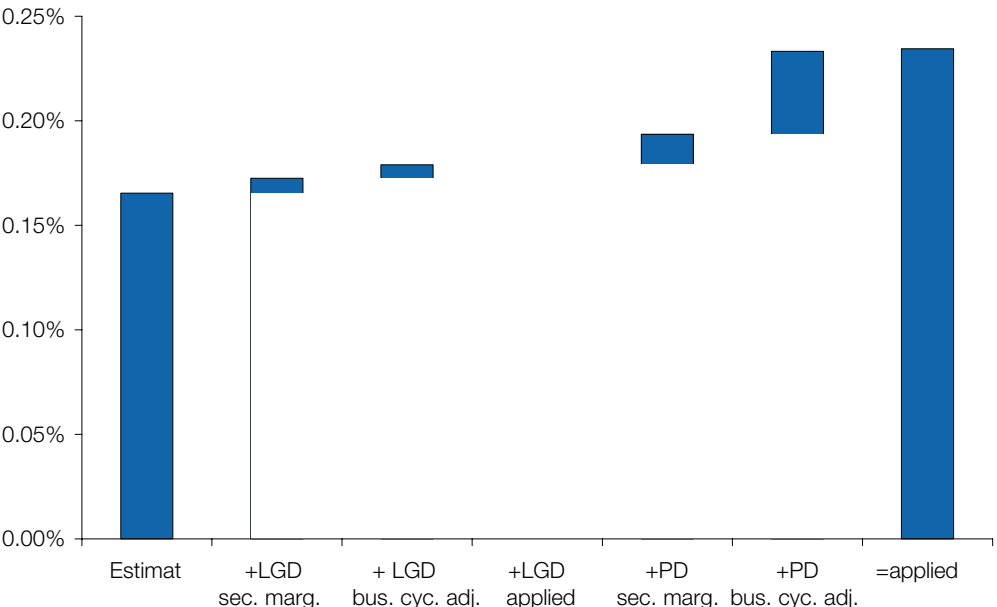
The table below shows the values applied for 2007 (predictions) for the various dimensions of risk. Loan losses (gross, i.e. without write-backs) are also shown so that a comparison can be made between the losses the model implies and the actual losses the Bank has had for these exposures during 2007.

	EL			PD		LGD	
	Prediction excl. defaults	Prediction incl. defaults	Gross loan losses	Prediction	Outcome 2006	Prediction	Outcome 2006
<b>Corporate</b>	0.15%	0.26%	0.06%	0.63%	0.39%	–	–
<b>Household, property</b>	–	0.05%	0.00%	0.38%	0.30%	12%	1%
<b>Household, other</b>	–	0.94%	0.48%	1.89%	1.60%	41%	34%
<b>All</b>	0.12%	0.23%	0.05%	0.63%	0.44%	17%	6%

For expected loss (EL), the total expected loss is shown for the exposures in appro-

ved IRB models, broken down by exposure class. When EL is calculated, it is possible to include defaulted exposures – these will be set a high EL value since the PD is 100% – or to exclude them. The table shows EL both including and excluding defaulted exposures. For PD and LGD, the average PD and LGD values for the approved exposures are shown – firstly the average value used and secondly the outcomes for the respective parameters in 2006. The average figures are weighted in terms of volumes of exposure. The PD values shown here are those applied in the capital adequacy report, that is both security margins and the business cycle adjustment factor affect the PD values.

The ‘expected loss’ as presented here does not represent the most likely loss level for the Bank. This is because a number of adjustments are made to the value calculated using the Bank’s IRB model. The main aim of these adjustments is to ensure that the Bank’s internal model does not underestimate the actual risk. The diagram below shows how these adjustments affect the calculated value for expected losses. The diagram shows EL for all IRB-approved exposures, including defaulted exposures.



The first column shows the observed EL value, that is EL based on the outright estimate of PD and LGD, which is 0.17 %. The next column shows how EL is affected when the security margins, business cycle adjustments and regulatory floor levels are introduced. The purpose of the safety margin is to ensure that the probability of default is not underestimated because the statistical data on which the models are based is not sufficiently comprehensive. The business cycle adjustment takes into account the fact that the estimated probability of default and the loss can be expected to vary due to the business cycle. The probability of default used for risk weighting therefore needs to be adjusted in relation to where in the business cycle the Bank’s borrowers were in the period on which the calculations are based. LGD applied refers to adjustments for the floor regulations which exist but where there is currently no such effect.

The above diagram includes the capital requirement for defaulted credits. If these are excluded the outright estimate of EL is 0.06%, which can be compared with the applied values which lead to an EL of 0.12%. EL excluding defaulted exposures is

the most probable level for the Bank's losses, based on calculations with the aid of the Bank's internal credit risk model. In addition, this figure is considerably closer to the Bank's net loan loss level for 2007, namely 0.0%.

In addition to assessments and validation, the internal auditing department also carries out an important part of the quality control. This department regularly examines (at least once a year) the risk classification system and its usage.

## Collateral

When Handelsbanken assesses the credit risk of a specific customer, the assessment must start with the borrower's repayment capacity. According to the Bank's credit policy, weak repayment capacity can never be accepted because good collateral has been offered to the Bank. Collateral may, however, substantially reduce the Bank's loss if the borrower cannot fulfil his commitments towards the Bank. Credits must therefore normally be adequately secured. This applies to mortgage loans to private individuals and loans to property companies. It also applies to securities lending, factoring, leasing agreements and many other types of financing.

Credit without collateral mainly consists of small loans to private individuals and loans to large companies with very sound repayment capacity. In the latter case, special loan conditions are drawn up that entitle the Bank to renegotiate or terminate the agreement if the borrower's repayment capacity deteriorates.

Since collateral is not generally used until a borrower faces serious repayment difficulties, the valuation of collateral is focused on its expected value in the case of insolvency. The value of certain types of asset may change considerably from the period before and the time of a forced sale.

A large part of lending to credit institutions consists of reverse repos. A reverse repo is a repurchase transaction in which the Bank buys interest-bearing securities or equities under the agreement that the security will be resold to the seller at a specific price on a specific date. Handelsbanken regards reverse repos as secured lending.

The Bank buys credit derivatives to hedge the credit risk in loan receivables to a very limited degree.

### Loans to the public, collateral

SEK m	2006	2007
Residential property <sup>1)</sup>	682,357	607,966
Agricultural property	15,328	14,334
Other property	106,056	88,128
Governments, municipalities and county councils	64,605	95,221
Floating charges on assets	18,464	17,767
Guarantees	22,903	17,912
Unsecured	221,075	138,440
Other collateral	162,200	120,770
<b>Loans to the public</b>	<b>1,292,988</b>	<b>1,100,538</b>

<sup>1)</sup> Including ownership housing co-operatives.



## Credit risk protection which reduces the capital requirement

The information in this section concerns capital requirement-reducing credit risk protection for exposures that are IRB-approved. The Bank's other exposures have capital cover in accordance with Basel I. For these exposures, credit risk protection means a reduction of capital requirement in a different, much more limited respect, than for exposures with capital cover according to Basel II. Therefore, the effects of the credit risk protection are illustrated mainly for the approved corporate and household exposures.

The Bank may receive types of collateral other than those that are considered eligible under the capital adequacy regulations. Corporate mortgages (floating charges on assets) are an example of such collateral. Another example is collateral in the form of a real estate mortgage supplemented with a guarantee, in which case, only one of these is used in the capital adequacy calculation.

For capital adequacy calculation of corporate exposures, collateral on property corresponds to approx. 25% of the reported exposure amount. The corresponding figures for guarantees and other collateral are 3% each. The remaining exposure amount is included in the capital adequacy calculation as unprotected exposure.

For household exposures, collateral on the property – mainly residential – corresponds to around 85% of the reported exposure amount. Of the remaining exposure amount, roughly two percentage points are categorised as having some form of collateral, while the remaining 13 percentage points are set an LGD value due to other terms. These terms are chiefly determined by factors such as type of borrower, type of credit or number of borrowers.

Handelsbanken has established procedures to fulfil the requirements contained in the regulations in terms of valuation of eligible collateral. These specify who/which body may update the valuation, how this is to be carried out, and the fact that it must be up-to-date.

For corporate exposures in Sweden and Norway, where there is eligible collateral, the capital requirement is reduced through an adjustment of either the PD or the LGD. The PD is adjusted in cases where there are approved protection providers, for example the issuer of a guarantee, with a lower PD value than the borrower. For most other types of collateral, the LGD is adjusted to the values specified by the regulations for each type.

In cases where an approved collateral value for the capital adequacy calculation does not cover the total exposure, a unique capital requirement is calculated for each collateral. A corresponding calculation is also carried out for the unprotected part of the exposure.

For household exposure, risk reduction takes place by the exposures being categorised into various groups, depending on the collateral which covers them. For private individuals in Sweden with collateral in the form of a house or second home, the LGD per exposure is calculated using a model based on the loan-to-value ratio.

To establish the LGD for other household exposures, private individuals and small companies in Sweden, categorisation into various segments takes place. The LGD value is then obtained for each segment. This categorisation takes into account the type of credit, number of borrowers and collateral, etc. Collateral is divided up into real estate, other collateral and unprotected exposures.

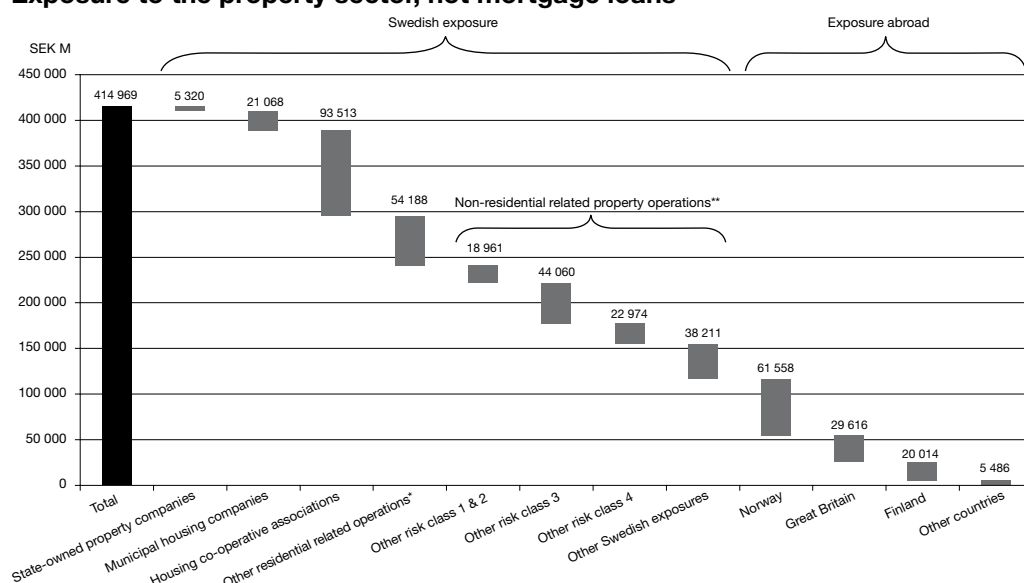
## Credit risk concentrations

Handelsbanken branches focus strongly on establishing long-term relationships with good customers who have good creditworthiness. If a branch identifies a good customer, the branch should be able to do business with this customer, irrespective of whether the Bank as a whole has major exposure to the business sector that the customer represents. In granting credit the Bank thereby has no built-in restriction to relatively extensive exposures in individual sectors. This does not, however, prevent the Bank from monitoring and calculating concentration risks continually for various business sectors, geographic areas or individual major exposures. Concentration risks are detected in the Bank's calculation of economic capital for credit risks and in the stress tests conducted in the overall capital assessment. This ensures that Handelsbanken has sufficient capital taking into account concentration risks. If the concentration risks are judged to be excessive, the Bank has the opportunity and capacity to lessen them using various risk reduction measures.

Handelsbanken has considerable lending operations, besides mortgage loans, in which property is used as collateral (SEK 415bn). The predominant proportion of this lending is to government-owned property companies, municipal housing companies, housing co-operatives and other housing-related operations where the borrowers have very good creditworthiness (risk class 1-4). Within the category of non-residential property operations, customers have sound net operating income and a robust cash flow. Thus a large part of lending to the property sector is to companies with a very low probability of default.

The diagram below shows the Bank's exposures to the property sector. The exposure is expressed as EAD – exposure at default – according to the capital adequacy regulations.

### Exposure to the property sector, not mortgage loans



\*Property companies which finance multi-family dwellings

\*\*Property companies which finance other types of property (offices, shops, industrial property etc) or which have a mixed property portfolio

## Counterparty risk

Counterparty risks arise when Handelsbanken has entered into derivative contracts with a counterparty for instruments such as futures, swaps or options. Counterparty risk is regarded as a credit risk, where the market value of the contract determines the size of the exposure. If the contract has a positive value, the default of the counterparty means a loss for the Bank – in the same way as for a loan.

The size of counterparty exposures is restricted through credit limitation in the regular credit process. The size of the exposures may vary substantially due to fluctuations in the price of the underlying asset. Due to this risk of an increase in exposure, supplements are added to the value of the exposure in question. The supplements are calculated using templates that depend on the type of contract and its time to maturity. The exposures are calculated and followed up daily.

Counterparty risks arise particularly in transactions with other banks, but the Bank also performs transactions with other counterparties.

In calculating Economic Capital (EC), counterparty exposures are taken into account based on the exposure amounts stipulated by the capital adequacy regulations. These credit exposures are then treated in the same way as other credit exposures in calculating EC for credit risks. In addition to derivatives, the capital adequacy regulations treat both repurchase transactions and equity loans as counterparty risks. In the Bank's internal capital calculation model, these transaction types are treated equivalently. The Bank applies the mark to market method to calculate the exposure amount for counterparty risks for capital adequacy.

The counterparty risk in over-the-counter (OTC) derivatives is reduced through netting agreements, which involve setting off positive values against negative values in all derivative transactions with the same counterparty. Handelsbanken's policy is to sign netting agreements with all counterparties. The exposure values that are netted are the market values, plus the aforementioned supplements for a possible increase in exposures.

The netting agreements are increasingly supplemented with collateral agreements which further reduces the credit risk. Such agreements are in the form of a Credit Support Annex to the ISDA, and regulate the collateral for counterparty exposures in OTC derivatives. Cash is the primary collateral for these transactions, but government instruments are also used. As only cash and government instruments are accepted as collateral, special attention does not need to be paid to the risk of correlation between the counterparty's creditworthiness and the value of the collateral (the wrong-way risk). The high proportion of cash also limits the concentration risks in the collateral.

A limited number of the collateral agreements entered into by the Bank include terms and conditions concerning rating-based threshold amounts for Handelsbanken. These conditions mean that the Bank must provide further collateral for the counterparty in question, in the event of the Bank's external rating weakening. In the event of a downgrading by one level from AA- to A+, the total requirement for

increased collateral amounted at year-end to a value of approximately SEK 150m.

Agreements on netting and provision of collateral are also entered into with counterparties in repurchase transactions and equity loans.

### Counterparty risks in derivative contracts

SEK m	2007
Positive gross market value for derivative contracts	57,945
Netting gains	- 40,606
Current exposure set off	17,339
Collateral	- 5,570
<b>Net credit exposure for derivatives</b>	<b>11,769</b>

The Bank holds a portfolio of Credit Default Swaps. The values of these transactions are presented in the table below.

SEK bn	Total	of which for trading	of which protection of own portfolio
Purchased protection	5.4	5.4	0.0
Sold protection	1.8	1.8	-

## Payment risk

Payment risks arise in transactions where the Bank has fulfilled its commitments in the form of foreign exchange conversion, payments or delivery of securities but cannot check at that same moment whether the counterparty has fulfilled its commitments to the Bank. The risk amount equals the amount of the payment transaction. The payment risks are not included in the credit limit of each customer: instead they are covered by a separate limit. Normally, the limit for the payment risk is approved at the same time as the credit limit. At Handelsbanken, the risk of value changes in spot transactions is categorised as payment risk, while the risk of value changes in derivative transactions is categorised as credit risk.

Handelsbanken is a member of CLS (Continuous Linked Settlement), which is a global organisation that aims to perform secure foreign exchange conversion transactions. Through its membership, the Bank can perform secure currency transactions for the currencies and with the counterparties that are members of the organisation. Approximately 80% of the Bank's foreign exchange conversion transactions take place through CLS.

## Credit portfolio

This section gives details of the credit portfolio in a number of tables. The first section shows the credit portfolio as a whole, broken down by geographical area, sector and types of collateral. The second section shows the impairment losses that have been recognised in the credit portfolio.

The first two sections provide information for the whole Group's credit portfolio.<sup>1</sup>

The third section shows the credit portfolio for the part which is approved for internal risk classification in a capital adequacy perspective. This part contains description based on the various exposure classes the Bank applies. However these descriptions do not cover the entire credit portfolio since not all credits are covered by the approved risk classification system. Approximately 74% of the credit portfolio is covered in this section. The remaining credits are subject to capital cover under the older regulations. They are not split into exposure classes until they are approved. Thus they cannot be presented in the manner prescribed in Pillar 3.

## Composition of the credit portfolio

### Credit risk exposure

SEK m	2007	2006
Loans to the public*	1,292,988	1,100,538
<i>of which reverse repos</i>	31,158	21,947
Loans to credit institutions	185,149	177,175
<i>of which reverse repos</i>	119,451	120,491
Unutilised part of granted overdraft facilities	135,081	130,956
Credit commitments	221,784	166,576
Certificate programmes	23,461	22,392
Other commitments	71	61
Guarantees, credits	21,431	18,395
Guarantees, other	42,149	39,618
Documentary credits	51,604	49,150
Derivatives **	57,945	53,703
Treasury bills and other eligible bills	33,702	86,565
Bonds and other interest-bearing securities	142,270	180,178
Shares and participating interests	46,356	72,372
<b>Total</b>	<b>2,253,991</b>	<b>2,097,679</b>

\* SEK 4,210m of this amount is lending which upon initial recognition was classified at fair value through profit or loss.

\*\* Refers to the total of positive market values. Including legally viable netting agreements, the exposure is SEK 17,339m.

### Geographical distribution

SEK m	Lending				Off-balance-sheet commitments		Total
	Public	Credit institutions	Derivatives	Investments	Guarantees	Other	
Sweden	942,325	102,039	52,890	157,673	36,894	305,328	1,597,149
Norway	140,994	215	645	1,487	6,132	21,603	171,076
Finland	73,423	544	783	1,980	9,497	21,884	108,111
Denmark	39,770	7,561	149	2,121	2,754	2,275	54,630
Great Britain	51,243	771	258	2,609	1,687	9,029	65,597
Other countries	45,233	74,019	3,220	56,458	6,616	71,882	257,428
<b>Total</b>	<b>1,292,988</b>	<b>185,149</b>	<b>57,945</b>	<b>222,328</b>	<b>63,580</b>	<b>432,001</b>	<b>2,253,991</b>

<sup>1</sup> Only the banking group's credits are covered by the capital adequacy requirements and are classified according to the IRB approach. The Group's credit portfolio is somewhat broader since, for example, the insurance operations' credit exposures are included in the Group but not in the banking group.

## Loans to the public, by sector

SEK,m	2007		2006	
	Loans, before provisions	Provisions for, probable loan, losses	Loans, after provisions	Loans, after provisions
Private, individuals	548,983	-409	548,574	483,693
<i>Of which mortgage loans</i>	380,839	-15	380,824	338,065
Property management	397,172	-238	396,934	321,932
<i>Of which ownership housing co-operatives</i>	86,807	-40	86,767	79,117
Corporate services	56,790	-71	56,719	40,291
Retail	53,286	-223	53,063	37,135
Manufacturing	50,622	-381	50,241	40,435
Transport and communication	20,835	-22	20,813	17,311
Construction	19,278	-48	19,230	12,622
Municipalities	8,850	0	8,850	7,880
Agriculture, hunting and forestry	6,769	-7	6,762	6,365
Hotel and restaurant	6,766	-19	6,747	5,199
Insurance operations	13,692	0	13,692	10,671
Other sectors	111,813	-157	111,656	117,343
<b>Total loans to the public, before taking into consideration collective provisions</b>	<b>1,294,856</b>	<b>-1,575</b>	<b>1,293,281</b>	<b>1,100,877</b>
Collective provisions			-293	-339
<b>Total loans to the public</b>			<b>1,292,988</b>	<b>1,100,538</b>

## Impairments and past due loans

A receivable with an impairment loss is a bad debt, that is a receivable where the payments will probably not be met under the terms of the contract. A receivable is not a bad debt if there is collateral which covers the principal amount, interest and penalties for late payments by a satisfactory margin.

A past due receivable is a loan where interest, repayments or overdrafts have been due for payment for more than 5 days.

All units with customer and credit responsibility in the Handelsbanken Group regularly perform individual assessments of the need for recognising impairment losses for loan receivables and other receivables that are recognised at amortised cost. Impairment testing is performed where there is objective evidence that the recoverable amount of the receivable is less than its carrying amount. Objective evidence could, according to the circumstances, be late or non-payment, changed credit rating or a decline in the market value of the collateral.

When performing impairment testing, the recoverable amount of the receivable is calculated by assessing the estimated future cash flows related to the receivable and any collateral, and discounting these by the effective interest rate of the receivable. If the collateral is a listed asset, the valuation of the collateral is based on the quoted price; otherwise the valuation is based on the yield value or the market value estimated in some other manner. Collateral in the form of property mortgages are valued in the same way as repossessed property. An impairment loss is recognised if the estimated recoverable amount is less than the carrying amount and is recognised as a loan loss in profit or loss. A recognised loan loss reduces the carrying amount of the receivable in the balance sheet.

In addition to this assessment of individual loan receivables, a collective assessment is made of individually measured loan receivables and of homogenous groups of

receivables with a similar risk profile with the purpose of identifying the need to recognise an impairment loss that cannot yet be allocated to individual loans. If necessary, a group impairment loss is recognised is made for the group of loan receivables. Impairment losses which have been recognised for a group of receivables are transferred to impairment losses for individual receivables as soon as there is available information about the impairment in value at an individual level.

Loan losses for the period comprise actual losses and probable losses on credit granted, minus recoveries. Actual loan losses may refer to all or part of receivables and are recognised when there is no realistic possibility of recovery. This is the case, for example, when a trustee in bankruptcy has estimated bankruptcy dividends, when a scheme of arrangement has been accepted, or the receivable has been reduced in some other way. An amount forgiven in connection with reconstruction of a receivable or group of receivables is always classified as an actual loss. If the customer is following a payment plan for a loan which was previously classified as an actual loan loss, the amount of the loss is subject to new testing. Information about probable and actual losses is provided in the Bank's annual report.

Recoveries comprise written-back amounts from actual losses in previous years and reversals of previous impairment losses for probable loan losses. An estimate of the recovery value for probable loan losses by discounting future cash flows means that the recovery value increases as the time for payment from the customer approaches. The difference thus arising in the carrying amount is recognised as interest income.

Impairment losses on available-for-sale financial assets are recognised when there is objective evidence that one or more events of default have occurred leading to a permanent decrease in the fair value of the instrument. Examples of events of default that may lead to an impairment loss are a probable future bankruptcy or evidence of considerable financial difficulties on the part of the issuer. When recognising an impairment loss, the part of the cumulative loss that was previously recognised in equity (corresponding to the difference between the acquisition cost and the current fair value less any previous impairment loss) is recognised in profit or loss.

Previously recognised impairment losses on debt instruments classified as available-for-sale financial assets are reversed in profit or loss if the fair value of the asset has increased since the impairment loss was recognised and the increase can be objectively related to an event occurring after the impairment loss was recognised. Previous impairment losses on equity instruments classified as available-for-sale financial instruments are not reversed.

## Bad debts and/or non-performing loans, by sector

SEK m	Bad debts				Non-performing loans which are not bad
	Gross	Reserves	Net*	Of which nonperforming	
2007					
Private individuals	724	-409	315	292	482
Property management/corporate services	638	-309	329	161	147
Manufacturing	490	-381	109	68	55
Retail	292	-223	69	47	62
Transport and communication	30	-22	8	4	5
Construction	92	-48	44	43	7
Hotel and restaurant	22	-19	3	3	1
Other	206	-166	40	40	31
<b>Total</b>	<b>2,494</b>	<b>-1,577</b>	<b>917</b>	<b>658</b>	<b>790</b>

## Bad debts and/or non-performing loans, geographic distribution

SEK m	Bad debts				Non-performing loans which are not bad
	Gross	Reserves	Net*	Of which nonperforming	
2007					
Sweden	1806	-1088	718	542	444
Norway	180	-94	86	86	214
Finland	105	-46	59	10	114
Denmark	282	-233	49	15	13
Great Britain	114	-110	4	4	5
Rest of Europe	7	-6	1	1	0
North America	0	0	0	0	0
Asia	0	0	0	0	0
<b>Total</b>	<b>2 494</b>	<b>-1 577</b>	<b>917</b>	<b>658</b>	<b>790</b>

\* Book value after taking into account specific provisions for individually valued loan receivables and provisions for collectively valued loan receivables but excluding collective provisions for loan receivables which are individually assessed.

## Provisions

SEK m	Group	
	2007	2006
<b>Opening balance</b>	<b>1,996</b>	<b>2,433</b>
Write-back of previous provisions for possible loan losses which are reported as actual loan losses in the year's accounts	-294	-499
The year's provision for probable loan losses	606	468
Write-back of provisions for probable loan losses which are no longer necessary	-422	-302
Allocation to/dissolution of provision by group	-46	-77
Allocation to/dissolution of provision for loan losses for collectively assessed homogenous groups of loan receivable	9	2
Exchange rate differences	21	-29
<b>Closing balance</b>	<b>1,870</b>	<b>1,996</b>



### Analysis of past due receivables which are not bad debts

SEK m	Loans to credit institutions	Loans to the public			Total
		Households	Corporate	Other	
Past due 5-30 days	2	4,141	1,246	3	5,392
Past due 31-60 days		571	343	1	915
Past due 61-90 days		135	61	1	197
Past due 91-360 days		348	92		440
Past due more than 360 days		96	57		153
<b>Total</b>	<b>2</b>	<b>5,291</b>	<b>1,799</b>	<b>5</b>	<b>7,097</b>

### Past due exposures, exposures with impairment losses and the impact on profit/loss

SEK m	Past due 5 days EAD	EAD with provision	Provision probable losses	Impact on profit/loss 2007	
				Gross provisions	Net incl. written back
<b>Corporate exposures</b>	1,978	725	485	313	140
<b>Household exposures</b>	4,087	432	378	178	147
- private individuals	3,595	148	133	52	37
- of which property loans	3,158	12	8	7	3
- of which other	437	136	125	45	34
- small companies	492	284	245	126	110
- of which property loans	73	11	6	4	0
- of which other	419	273	239	121	109

### Capital requirement for credit risks

The table on the next page shows exposures and the total exposure amount\* within the IRB approved credit portfolio and their risk-weighted amounts and the capital requirement the exposures will generate. In addition, the average exposure amount during the year is shown, the average risk weight for the exposures (the risk-weighted amount divided by the exposure amount) and the average LGD value applied for the exposure types where the Bank uses its own models to calculate LGD.

\* Exposures are total exposures on and off the balance sheet. Exposure at default (EAD) is the exposure on which the capital requirement is calculated under the capital adequacy regulations which is smaller compared to the exposure, mainly since the full value of off-balance sheet commitments is not subject to capital requirement.

**Credits approved for internal risk classification Exposures according to various definitions, details of capital requirements, for various exposure classes**

SEK m	Exposure	Of which off-balance sheet	Exposure amount (EAD)	Of which off-balance sheet	Average exposure amount	Risk-weighted amount	Average risk weight	Exposure weighted (LGD)	Capital requirement
<b>Corporate exposures</b>	760,277	233,817	616,973	109,064	589,261	254,599	41%	–	20,368
<b>Retail exposures</b>	442,807	17,725	444,626	19,352	427,931	37,643	8%	27%	3,011
- private individuals	418,380	10,435	419,509	11,451	402,075	27,592	7%	18%	2,207
- of which property loans	385,178	0	385,178	0	–	19,419	5%	–	1,554
- of which other	33,202	10,435	34,331	11,451	–	8,173,	24%	–	654
- small companies	24,427	7,290	25,117	7,901	25,856	10,051	40%	49%	804
- of which property loans	5,643	0	5,643	0	–	1,276	23%	–	102
- of which other	18,784	7,290	19,474	7,901	–	8,775	45%	–	702
<b>Equity exposures*)</b>	5,366	–	5,366	–	6,388	5,366	100%	–	429
<b>Exposures without a counterparty</b>	2,055	–	2,055	–	1,884	2,055,	–	100%	164

In the corporate exposure class, SEK 35,869 m are covered by guarantees which reduces the exposure amount. For other exposure classes, the Bank does not include guarantees as credit risk protection.

For the non IRB-approved parts of the credit portfolio, the capital requirement for credit risks in 2007 is calculated using the old capital cover regulations. The table below sets out the breakdown of this part of the portfolio into the various risk weight categories.

**Exposures for the parts of the credit portfolio where capital requirements are calculated according to Basel I**

According to Basel I	On balance sheet	Off balance sheet
Group A	202,378	17,398
Group B	56,570	14,496
Group C	110,728	1,099
Group D	179,299	12,701
	<b>548,975</b>	<b>45,694</b>

**IRB-approved exposures by sector and type of counterparty,  
broken down by exposure class**

SEK m	Exposure
<b>Household exposures</b>	<b>442,807</b>
<i>Private individuals</i>	418,380
Mortgage loans	385,178
Others	33,202
<i>Small companies</i>	24,427
Real estate operations	4,892
Retail	5,185
Hotels and restaurants	1,073
Construction	2,066
Manufacturing	2,316
Transport	869
Other service operations	1,962
Other corporate lending	6,063
<b>Corporate exposures</b>	<b>760,277</b>
Real estate operations	380,819
Retail	29,683
Hotels and restaurants	2,295
Construction	14,108
Manufacturing	48,650
Transport	19,373
Other service operations	68,949
Other corporate lending	196,400
<b>Total IRB exposures</b>	<b>1,203,084</b>

All the IRB-approved exposures relate to the Swedish market, except for part of the corporate portfolio, which comes under the Norwegian operations. Of the total corporate exposure, SEK 658bn relates to Sweden, and SEK 103bn to Norway.

**IRB-approved exposures broken down by maturity for the different classes of exposure**

SEK m	Exposure	Within 3 months	3 mon to 1 yr	1 yr to 5 yrs	>5 yrs
<b>Corporate exposures</b>	760,277	173,965	100,765	241,592	243,956
<b>Household exposures</b>	442,807	94,783	48,326	154,943	144,756

## IRB-approved exposures broken down into groups of risk classes

SEK m	Exposure amount	Risk class PD 1-3	Risk class PD 4-5	Risk class PD 6-7	Risk class PD 8-9	Risk class PD Default
<b>Corporate exposures</b>	616,973	367,418	215,610	29,158	3,055	1,731
<b>Retail exposures</b>	444,626	362,641	62,097	12,496	6,067	1,325
Retail exposures	419,509	352,776	52,198	9,131	4,578	826
- of which property loans	385,178	331,253	42,451	7,745	3,729	N/A
- of which other	33,505	21,523	9,747	1,386	849	N/A
- small companies	25,117	9,865	9,900	3,365	1,489	499
- of which property loans	5,643	2,178	3,037	355	73	N/A
- of which other	18,976	7,687	6,904	2,969	1,415	N/A

## Market risk

Market risks arise from price changes in the financial markets. Market risks are divided into interest rate risks, equity price risks, exchange rate risks and commodity price risks.

The market risks in the Bank's business operations mainly arise in Handelsbanken Capital Markets, at the Treasury unit, in insurance operations and in Stadshypotek. Market risks also emerge in the regional bank operations, but to a limited extent. The insurance operations are described in a separate section.

The Bank has low tolerance for losses related to market risks in its business operations. Risk taking is therefore limited and positions are generally only taken as a stage in customer-related transactions. The central board establishes measurement methods and limits for the market risks as a way of restricting risk taking. The limits are allocated in the Group by the CEO.

### Decision levels and follow-up of market risk



Handelsbanken Capital Markets takes market risks by being a market maker for fixed-income products, currencies, equity instruments and commodities. Market risks also emerge in customer-related transactions, or through the Bank's own positions in the financial markets as a result of customer transactions. The market risks at the Treasury unit mainly comprise interest rate risks and they arise in conjunction with borrowing to finance the Bank's lending operations in, for example, Stadshypotek and the regional banks. In addition, the Bank manages a liquidity reserve,

with government bonds and bonds that have a sound rating. These securities are eligible as collateral with the Riksbank and other central banks. The portfolio secures the Group's payments in daily clearing operations and ensures that the Bank has a liquidity reserve that can be immediately converted into liquid assets in the event of liquidity disturbances in the market.

## Risk measurement

Market risk is measured in several ways in the Group. To a great extent different scenario-based measurements are used, which show the effect of pre-defined changes in prices and volatilities. Examples of these are the effect of a parallel shift in the yield curve for interest rates or the effect of assumed changes in prices and volatilities of shares. Value-at-Risk (VaR) is also used. VaR expresses in kronor the losses that may arise in risk positions due to movements in the underlying markets over a specified holding period and for an assumed confidence level. The VaR method implies that various risk categories such as equity risk, interest rate risk and exchange rate risk can be handled in a uniform way and that they can be compared and aggregated into a total market risk.

For the trading portfolios, VaR is calculated for individual classes of risk and at portfolio level with a 99% confidence level and a one-day holding period. The calculations are based on historical simulation and measure the impact on the portfolio in question, revalued using the past year's daily changes in interest rates and prices. The model used implies that every hundredth trading day, a loss will occur which exceeds VaR.

Since VaR is based on model assumptions, it is important to continually verify the effectiveness of the model. For that reason VaR is regularly evaluated using back testing. These tests verify the number of days when the actual loss exceeded VaR. Back testing is performed on both the actual result and on the hypothetical result. The latter measures the result excluding the impact of commission income and intra-day trading, that is, the outcome if the holding had been kept for the entire trading day.

### Analysis of market risk

VaR for the Capital Markets trading portfolio was on average SEK 39m during the year. VaR fluctuated between at most SEK 72m and at least SEK 18m.

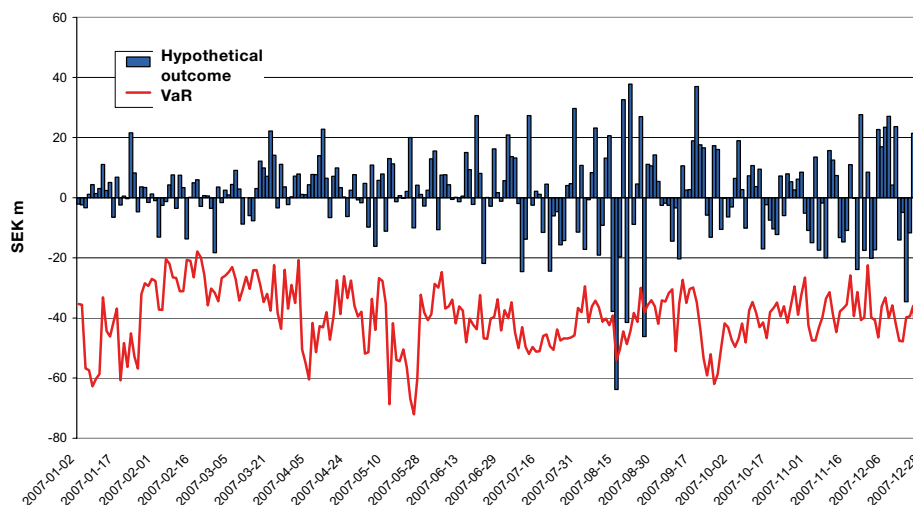
#### VaR for the Capital Markets trading portfolio

SEK m	Total		Equities		Interest		Currency	
	2007	2006	2007	2006	2007	2006	2007	2006
Average	39	32	21	15	32	27	6	6
Maximum	72	61	49	49	56	53	14	19
Minimum	18	10	1	2	13	10	2	2
Year-end	47	44	29	29	31	24	12	3

The next diagram shows how VaR for the trading portfolio developed in relation to a hypothetical outcome. On two occasions in 2007 the hypothetical outcome was

worse than the VaR. This is in line with the two to three occasions implied by a VaR model with a 99 % confidence level.

### Value-at-Risk in relation to hypothetical outcome 2007, trading portfolio, Capital Markets



The VaR model does not identify risks associated with extreme market fluctuations. The calculations are therefore regularly supplemented by stress tests of the trading portfolios. The portfolios are tested against scenarios based on events in the financial markets during the period 1994–2007. Where necessary the portfolios are also tested against hypothetical extreme events. The tests in 2007 show that at the time of testing, the portfolios could at most lose SEK 200m with the given position and the historic market events. In a comparison with VaR for the days in question for the worst outcomes in the stress test it is shown that the outcome in the stress tests was about four to six times as large as VaR.

### Worst outcome in stress test of trading portfolio, Capital Markets

SEK m	Worst outcome scenario test
Average	112
Maximum	200
Minimum	71
Year-end	99

## Interest rate risk

Interest rate risk is the largest market risk for the Bank. It mainly arises at Handelsbanken Capital Markets, the Treasury unit and in the lending operations. In the latter the interest rate risk arises as a result of the lending partly having longer maturities than the funding. The Bank eliminates most of this risk by entering into interest rate swap agreements. In general, interest rate risk is taken in markets which are characterised by good liquidity.

Interest rate risk is measured in the Group in several ways. VaR and various other risk measurements, supplemented by different stress scenarios are used for Handelsbanken Capital Markets trading portfolio. For other units and for the aggregate interest rate risk in the Group, the interest rate risk is measured as the effect on fair value of a major instantaneous parallel shift of all interest rates. The risk measurement covers all currencies where there is an exposure. For deposits without a contractual maturity, the average interest fixing period is assumed to be 30 days.

As at 31 December 2007, the interest rate risk in the case of a parallel shift in the yield curve of one percentage point was SEK -861m (-642) for the whole Group. For other operations, that is excluding trading, the interest rate risk was SEK -724m.

**Change in value in SEK millions in the case of a parallel shift in the yield curve of 100 basis points per currency for other operations**

Currency	Position
SEK	-528
GBP	-72
EUR	-63
DKK	-29
NOK	-12
USD	-11
Others	-9
<b>Total</b>	<b>-724</b>

The non-linear interest rate risk is measured and a limit set with pre-defined stress scenarios expressed in matrixes. This means that the risk is measured as the effect of changes in underlying market interest rates and volatilities.

A supplementary measurement of sensitivity to changes in the market interest rate is the net interest income risk, measured in the Bank as the impact on net interest income for the next year of an immediate parallel shift in the yield curve – for all currencies – of one percentage point. The net interest income risk in the banking operations as at 31 December 2007 was SEK 1,205m (1,010). Net interest income risk is calculated by assuming that all interest-bearing assets, liabilities and off-balance sheet items falling due during the next twelve-month period are renewed in an interest rate environment where the rate is one percentage point higher.

## Interest rate adjustment periods for the Group's assets and liabilities

SEK m	-3 mths	3-6 mths	6-12 mths	1-5 yrs	5 yrs–	Total
<b>Assets</b>						
Lending	924,291	53,165	50,196	228,232	47,370	1,303,254
Banks and other financial institutions	171,260	2,864	1,878	603	31	176,636
Bonds, etc.	83,911	5,275	7,495	56,191	19,749	172,621
<b>Total assets</b>	<b>1,179,462</b>	<b>61,304</b>	<b>59,569</b>	<b>285,026</b>	<b>67,150</b>	<b>1,652,511</b>
<b>Liabilities</b>						
Deposits	-477,072	-6,451	-3,667	-5,860	-19,784	-512,834
Banks and other financial institutions	-283,747	-13,998	-3,126	-3,102	-349	-304,322
Issued securities	-271,347	-79,685	-19,764	-304,659	-54,867	-730,322
Other liabilities	-2,242	-3,974	-2,238	-34,236	-13,921	-56,611
<b>Total debts</b>	<b>-1,034,408</b>	<b>-104,108</b>	<b>-28,795</b>	<b>-347,857</b>	<b>-88,921</b>	<b>-1,604,089</b>
Off-balance sheet items	111,363	-142,598	37,109	36,182	1,834	43,890
Difference between assets and liabilities including off-balance-sheet items	256,417	-185,402	67,883	-26,649	-19,937	92,312

The table shows the interest rate adjustment periods for the Group's interest-rate related assets and liabilities as at 31 December 2007, reported by the trade date. Non interest-bearing assets and liabilities have been excluded.

## Equity price risk

Bankens aktiekursrisk uppstår framför allt i bankens strategiska aktiebok och i Handelsbanken Capital Markets.

### Equity price risk in the trading book

Handelsbanken Capital Markets is a market maker for structured products, which gives rise to equity price risk, both linear and non-linear. In connection with these transactions, generated by the Bank's customers, the Bank takes its own positions to some extent. This is minor in scope and restricted by the limits set by the central board of the Bank.

The Bank limits and measures the equity price risk in Handelsbanken Capital Markets with matrixes. The advantage of the method is that it identifies both equity price risk and non-linear risk effectively. VaR and other risk measures and stress scenarios are used as a complement in the trading operations.



The table below shows the risk in the Bank's equity positions as at 31 December 2007, for hypothetical changes in underlying prices and volatilities.

#### Equity price risk, 31 December 2007

SEK m	Change in volatility					
	- 25 %		0 %		25 %	
Change in equity price	2007	2006	2007	2006	2007	2006
10 %	664	605	592	596	528	590
-10 %	-538	-550	-577	-567	-613	-590

#### Equity exposures in other operations

The majority of the Group's holdings in other operations are shares listed on an active market. These are valued at market price. Unlisted shares are measured at fair value using valuation models. The choice of model is governed by what is considered appropriate for the individual share. For listed shares where the company agreement stipulates the price at which the shares can be divested, the holdings are valued at the pre-determined divestment price. For example, there are cases where the shareholders' meeting resolves the value at which transfers will be made.

#### Equity risk outside the trading book

SEK m	2007
Classified as available for sale	5,366
- of which listed	4,892
- of which unlisted	474
Classified as available for sale	5,366
- of which business-related	403
- of which other holdings	4,963
Fair value reserve at beginning of year	1,128
Unrealised market value change value during the year for remaining and new holdings	130
Sold during the year	-204
Fair value reserve at end of year	1,054
Included in tier 2 capital	1,054

#### Exchange rate risk

The Bank's foreign exchange exposure mainly arises as a consequence of intra-day trading in the international foreign exchange markets. Trading is conducted in Handelsbanken Capital Markets. The central board of the Bank has set VaR limits for exchange rate risk. Some foreign exchange exposure also arises in the normal banking operations as part of managing customer payment flows. The central board

has decided to allocate minor position limits for these. The exchange rate risk was SEK -12m (-21), measured as the impact on the Bank's earnings of a 5% change in exchange rates.

## Liquidity risk

Liquidity risk is the risk that the Bank will not be able to meet its payment obligations when they fall due, without being affected by unacceptable costs or losses.

The Bank's liquidity requirements arise when expected outgoing payments exceed expected incoming payments. The size of this gap is restricted by limits. Liquidity risk is measured and limited by carrying out a gap analysis of cash flows for various maturities and all currencies, and also gap analysis of groups of currencies. As a general rule, a larger exposure is permitted in currencies with high liquidity than in currencies where the liquidity is low.

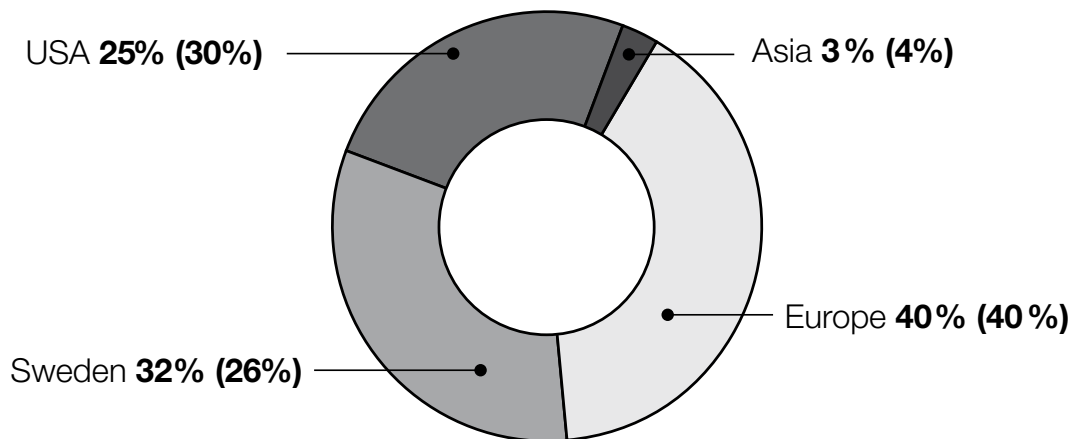
The Treasury unit has overall responsibility for the Bank's liquidity and funding. The Department ensures that the Bank has continual control of its balance sheet and that the actual funding costs are allocated out in the organisation.

The Bank's fundamental approach to liquidity management is based on a prudence concept which includes supplementing daily liquidity management with contingency reserves to meet any disruptions in the market. The Bank therefore holds assets that can be turned into liquidity at short notice through borrowing in central banks or on the capital market. The Bank's objective is to meet liquidity requirements for 90 days without any new borrowing. If there are additional requirements the Bank can – within a three-month period – liquidate assets to cover liquidity requirements for a 12-month period.

Liquidity is planned so that the Bank can manage for a 12-month period without borrowing any new money on the market. The Bank aims to achieve this objective through well-diversified funding in terms of currency, market and product.

Short-term funding is obtained by means of active commercial paper programmes in Sweden, the US and Europe. These programmes are supplemented by borrowing in the international interbank market. Long-term funding is mainly obtained through covered bond issues in Swedish kronor and utilisation of other funding programmes at the Bank. If the concentration in the funding portfolio or maturity structure entails too high a risk, it is the responsibility of the Treasury Department to make sure that the concentration is reduced or that the maturity structure of the balance sheet is changed.

### Short-term volatile financing by market



<sup>1</sup> Refers to the average market distribution during 2007 for issued securities with a residual maturity of less than one year and financing from credit institutions.

### Maturity analysis for contracted payment commitments – remaining contractual time to maturity

2007					
SEK m	Up to 3 mths	3-12 mths	1-5 yrs	Over 5 yrs	Total
Sight deposits from the public	365,771	–	–	–	365,771
Other borrowing from the public and credit institutions	374,650	25,777	13,207	26,894	440,528
Issued securities and subordinated loans	188,342	179,139	337,313	56,604	761,398
Short-term positions	2,175	4,146	34,019	13,354	53,694
Unutilised credit commitments – unutilised part of overdraft facilities	356,865	–	–	–	356,865
<b>Total</b>	<b>1,287,803</b>	<b>209,062</b>	<b>384,539</b>	<b>96,852</b>	<b>1,978,256</b>

The table above shows all sight deposits as maturing debt within one month. Historically, these deposits have been very stable over time and the Bank expects the majority of the sight deposits to be available to the Bank for a considerably longer period. The table shows credit promises and unutilised overdraft facilities for the contracted tenors. The total outstanding amount of these commitments does not necessarily represent future funding requirements.

The Central Risk Control function checks limits and follows up liquidity targets. The Bank also carries out regular scenario tests in which the effect on liquidity is simulated, given such factors as substantially reduced deposit volumes and high utilisation of committed credit lines.

## Operational risk

Operational risk refers to the risk of loss due to inadequate or failed internal processes, human error, erroneous systems or external events. The definition includes legal risk.

Operational risk exists in all types of operations within Handelsbanken and the responsibility for the day-to-day identification, management and control of risk is a clear and integrated part of managerial responsibility at all levels. The Bank's decen-

tralised method of work promotes cost-consciousness that results in vigilance against potential loss risk in daily procedures and events.

Apart from the responsibility for operational risk borne by the managers respectively, there are managers with special responsibility for information security and physical security who report directly to the CEO.

The Central Risk Control function has the overall responsibility for the methods used for identifying and quantifying operational risk and for monitoring and reporting these risks to the management and the central board.

As an aid to identification, handling and assessment of operational risk, the Bank has a separate reporting system for operational incidents and losses. The reports are examined and a lot of effort is put into ensuring that the occurrence is not repeated. In 2007, the Bank's operational losses were SEK 85m. This refers to the total of individual losses in excess of SEK 25,000. Of these, SEK 34m were losses referring to processing errors.

In addition to the day-to-day control of operational risk, all main departments, regional banks and subsidiaries carry out an annual self-evaluation of operational risk. This review is for the purposes of identifying operational risk and quantifying the losses that may arise. Following the review, measures are proposed which must be taken to reduce the risks. A general review of the Group's operational risks is performed twice a year by the heads of the regional banks, main departments and subsidiaries. The outcome of these reviews is reported to the central board.

New and major changes in products, services and IT systems undergo risk analysis including operational risk.

There are emergency and continuity plans in place in all parts of the Group for dealing with serious disruptions.

At present the Bank uses the standardised approach to calculate the capital requirement for operational risks. According to the standardised approach, the capital requirement is calculated by multiplying a factor specified in the regulations by the average operating income. Different factors are applied in different business segments. The factors vary between 0.12 and 0.18 for different business segments.

The total capital requirement for operational risks for the Handelsbanken Group was SEK 3,168m, without taking into account the transitional rules. However, during 2007 the previous capital adequacy regulations (Basel I) had to be applied to parts of the credit portfolio that are not approved for internal risk classification. Since operational risk was considered to be included in the capital requirement for credit risks according to the old rules, operational risk is taken into account when capital cover is calculated according to the old rules. The capital requirement for operational risk can therefore be adjusted downwards so that it only corresponds to that part of the Bank that the internal risk classification is applied to. Following this adjustment, the capital requirement is SEK 1,933m.

# Risks in the insurance operations

Risks in the insurance operations mainly comprise market risks and insurance risks.

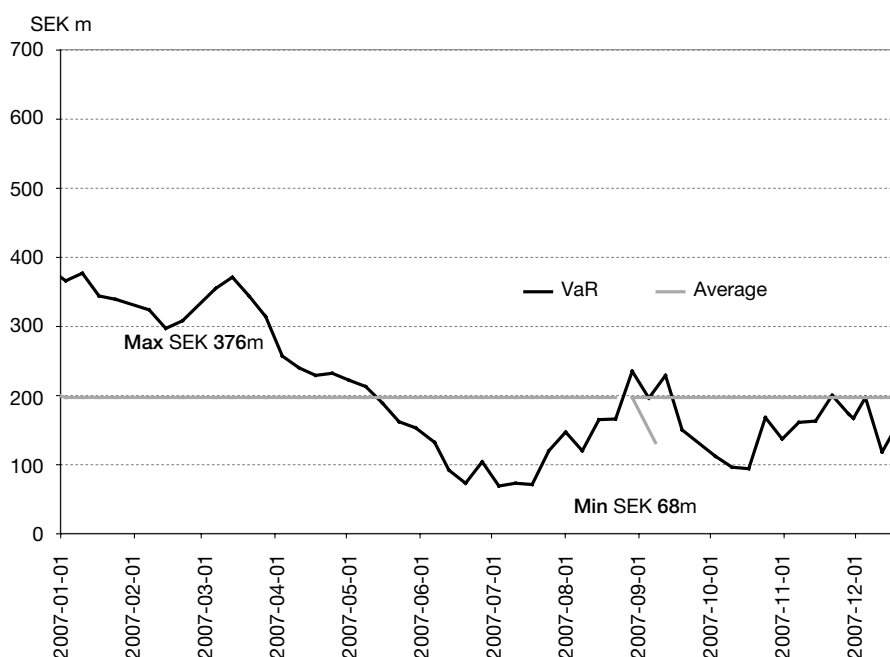
The insurance operations in 2007 comprised SPP and Handelsbanken Liv. After the sale of SPP the risks remain in Handelsbanken Liv. The main risk in the insurance operations is market risk. Market risk in the insurance operations refers to the insurance company's obligations to the policyholders and to the management of assets on behalf of policyholders and the company. The asset management is mainly exposed to interest rate and equity price risks. The insurance operations are also subject to insurance risk, i.e. the uncertainty of outcome of a policy dependent on the life or health of the person insured.

The risk in Handelsbanken Liv is not limited by the central board. However, the risk is subject to continuous follow-up and analysis. In addition risk exposure in relation to a certain amount specified by the central board – called norm risk – is reported on a current basis to the central board and the CEO. The insurance operations report their insurance risks and market risks to the insurance company's chief executive and Handelsbanken's Central Risk Control.

The board of Handelsbanken Liv determines the investment policy that sets the framework for asset management and controls exposure in the various asset classes allowed. The strength of the balance sheet is calculated continually through sensitivity analysis to guarantee the company's undertakings to the policyholders. Liquidity risk in the insurance operations is the risk that the company will not be able to meet its payment obligations when they fall due, or that the company will not be able to sell securities at acceptable prices. This risk is limited by most of the investment assets being invested in listed securities with good liquidity.

At Handelsbanken Liv, VaR is calculated using a 99% confidence interval and a one-month holding period. The calculations are based on historical simulation and measure the impact of the 250 most recent monthly changes in market prices.

## Value at Risk in the insurance operations



In the insurance operations, the main groups of insurance risks are:

- death – payment in the event of the death of the insured person
- life – payment as long as the insured person lives
- disability/accident – payment in the event of illness/inability to work

A policy often includes combinations of the three insurance risks.

The increased life expectancy in Sweden will affect the insurance company's future pension insurance commitments. If actual mortality proves to be 10% lower than the assumptions that are normally used in the sector, which represents an additional 1.0 to 1.5 years' life expectancy, this will result in a profit reduction in Handelsbanken Liv of about SEK 10m per annum over a fifty-year period.

Most of Handelsbanken Liv's risk products, which provide financial compensation in the event of death, illness or accident, are priced annually and the company can unilaterally change the premium from year to year. Thus, an incorrect mortality assumption can be corrected with rapid effect.

## Capital base and capital requirement

### Capital base

The Bank's annual report provides a description of the composition of the capital base for the banking group, the terms applying to the different parts of the capital base and the deductions from the various items.

For the Bank's risk management it is important that in risk terms both the Group and the banking group can be viewed as one unit. To enable efficient risk management in the Group, capital may need to be re-allocated among the various companies in the Group. In general, Handelsbanken has the opportunity to re-allocate capital among the Group companies, to the extent that is permitted by legislation, for example capital adequacy requirements and restrictions in corporate law.

The companies in the Handelsbanken Group are also covered by other capital requirements than those applying to individual credit institutions and the banking group according to the law on capital adequacy. Handelsbanken is a financial conglomerate pursuant to the Act (2006:531) on special supervision of financial conglomerates. The material difference compared to the banking group is that Handelsbanken Liv is included in the conglomerate. The capital requirement for the conglomerate was SEK 82,475m at the end of 2007, while the capital base was SEK 107,415m.

Handelsbanken Liv, Handelsbanken Skadeförsäkring and Svenska Re are subject to special capital requirements pursuant to insurance legislation. These capital requirements are specified in these companies' annual reports.

## Capital base

SEK m	2007	2006
<b>TIER 1 CAPITAL</b>		
Equity <sup>1</sup>	66,284	61,467
Tier 1 capital contribution	6,831	5,358
Minority interests	0	0
Deducted items		
Goodwill and other intangible assets	-6,215	-5,917
Revaluation reserve	-145	-152
Deferred tax asset	-197	-264
Special deduction for IRB institutions	-264	
Capital contribution in insurance companies	-8	
Adjustments in accordance with stability filter		
Cash flow hedges	-139	-97
Unrealised accumulated gains/losses, equities	-1,054	-1,123
Unrealised accumulated gains/losses, fixed income instruments	507	
<b>Total tier 1 capital</b>	<b>65,600</b>	<b>59,272</b>
<b>TIER 2 CAPITAL</b>	<b>23,171</b>	<b>20,838</b>
Perpetual subordinated loans	23,084	25,072
Dated subordinated loans		
Additional items	1,054	1,128
Unrealised accumulated gains/losses, equities	145	152
Revaluation reserve		
Deducted items	-264	
Special deduction for IRB institutions	-8	
Capital contribution in insurance companies	47,182	47,190
<b>Total tier 2 capital</b>	<b>112,782</b>	<b>106,462</b>
<b>Total tier 1 and tier 2 capital</b>		
Items deducted from total capital base		
Capital contribution in insurance companies	-6,317	-22,148
Surplus value pension assets	-1,961	-1,066
<b>Total capital base for capital adequacy purposes</b>	<b>104,504</b>	<b>83,248</b>

<sup>1</sup> Tier 1 capital has been affected by the central board's proposed appropriations.

## Capital requirement

The capital requirement for credit risks is calculated by a risk-weighted exposure amount being calculated for all the banking group's exposures. The risk-weighted exposure amount is calculated with through internal risk classification or according to the old capital adequacy rules (Basel I).

The table below shows the total capital requirements and its various components and the total capital base.

### Capital requirement

SEK m	2007	2006
Credit risk according to standardised approach	20,980	
Credit risk according to IRB approach	23,973	
Interest rate risk	2,395	
Equity price risk	81	
Foreign exchange risk	–	
Commodities risk	26	
Settlement risk	14	
Operational risk, reduced in accordance with transitional rules 2007	1,933	
<b>Total capital requirement according to Basel II</b>	<b>49,402</b>	
Adjustment according to transitional rules 2007	31,335	
<b>Adjustment according to transitional rules 2007</b>	<b>80,737</b>	
Risk-weighted assets according to Basel I	1,069,290	876,178
Capital requirement according to Basel I (8% of risk-weighted assets)	85,543	70,094
Lowest permitted capital requirement according to transitional rules	80,737	
Operational risk according to Basel II	3,168	
<b>Capital adequacy analysis, %</b>	<b>2007</b>	<b>2006</b>
Capital requirement in Basel II compared with Basel I	58	
Capital requirement in Basel II compared with transitional rules 2007	61	
Capital ratio according to Basel II	16.9	
Capital ratio according to Basel I	9.8	9.5
Capital ratio according to transitional rules 2007	10.4	
Tier 1 ratio according to Basel II	10.6	
Tier 1 ratio according to Basel I	6.2	6.8
Tier 1 ratio according to transitional rules 2007	6.5	
Capital base in relation to capital requirement Basel II	212	
Capital base in relation to capital requirement Basel I	122	
Capital base in relation to capital requirement according to transitional rules 2007	129	



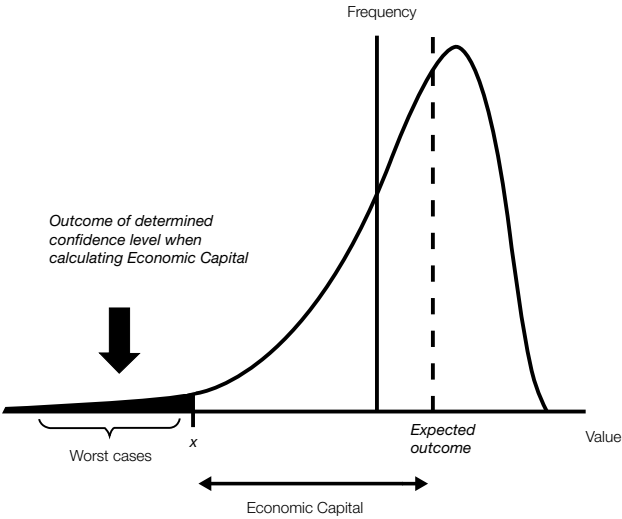
# Comprehensive risk management by means of the economic capital model

Handelsbanken’s model for calculating economic capital identifies the Group’s overall risks and corresponds to the capital which, with very high probability, will cover unexpected losses or decreases in value.

The Central Risk Control is responsible for comprehensive monitoring of the Group’s various risks. The model for economic capital (EC) is an important tool in this monitoring work; the Bank adopted the model in 2007.

Handelsbanken calculates EC with a time horizon of one year and a confidence level that reflects an acceptable level of risk. The central board therefore decided that as of 1 February 2007, the calculation of economic capital must be made with a 99.97% confidence level. The confidence interval implies a “worst outcome” in just 3 of 10,000 cases. EC constitutes the difference between the outcome during an average year – with positive results and good growth in the value of the Bank’s assets – and the extreme shock at a 99.97% confidence level.

### Definition of economic capital



Diversification effects between the different types of risks are taken into account when calculating the economic capital. The capital requirement for all risks is therefore lower than the sum of the capital requirements for each individual risk, because the risks are partly independent of each other. The diversification effect is distributed according to the risk’s marginal contribution to the total EC.

The capital and other financial resources which form a buffer that can absorb negative outcomes are called Available Financial Resources (AFR). AFR act as an estimate of the size of Handelsbanken’s equity and other available financial values on and off the balance sheet, with a one-year time horizon.

The central board continuously sets the targets for the Bank’s capital and tier 1 capi-

tal ratio. For 2007, the tier 1 ratio was to exceed 6.0%.

In view of the stress tests and the Bank's conservative attitude to risk, at the beginning of 2008, the central board decided that the tier 1 ratio must be at least 6.0% taking into consideration the transitional regulations in Basel II and that it must be between 9% and 11% according to Basel II.

The Group applies a shareholder perspective of the risk and capital situation. The economic capital model which is a component in this, is designed to ensure that the Group has sufficient capital in relation to all its risks at any point in time. An overall picture makes it possible to optimise the risk and capital situation from the perspective of shareholders. The outcome of the calculations plays an increasingly important role when new transactions or structural changes are considered.

Credit risk is calculated using simulated outcomes of default for all the Bank's counterparties and exposures.

In addition to trading risks, interest rate risk in the banking operations and market risks in the insurance operations, market risks also consist of the risk for value losses in strategic shareholdings.

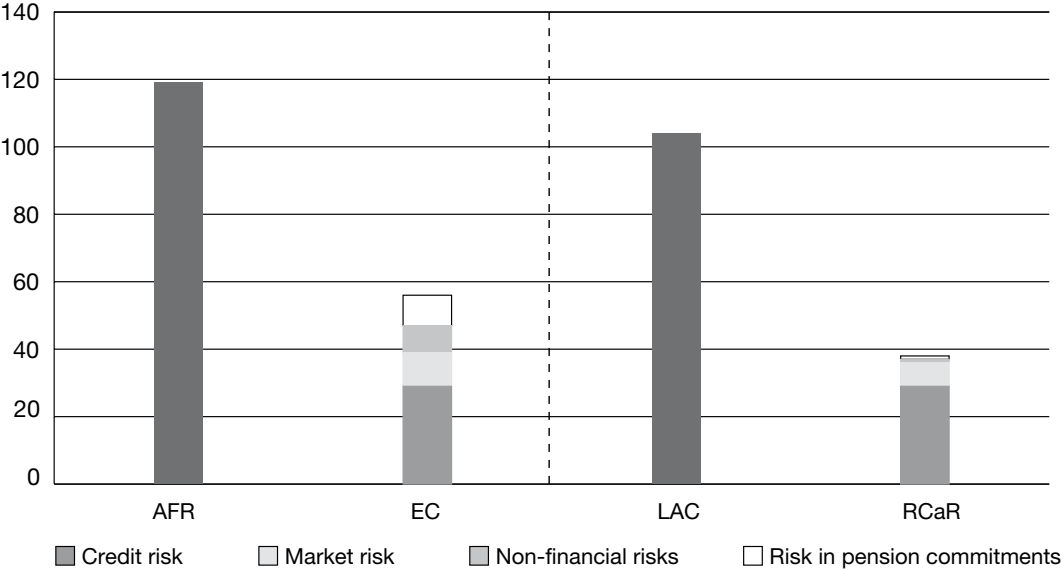
The non-financial risks are operational risk, business risk, property risk and insurance risk. Business risk is related to unexpected variations in income and expenses that may arise if, for example, demand or competition changes unexpectedly, resulting in lower volumes and narrower margins. Property risks capture the risk of the Bank's property holdings – mainly comprising the Bank's own office premises in the centre of Stockholm – falling in value.

The risk in the pension commitments mainly consists of the risk of a decrease in the values that exist for securing the Bank's pension commitments. The pension commitments are secured in a pension foundation and in an occupational pension fund with large surplus values.

EC was SEK 55bn at year-end. The AFR/EC ratio was 215% at year-end, which illustrates that the Bank is well-capitalised in relation to its overall risks.

Another perspective in the Group's risk and capital situation is to use the regulations and the capital currently on the balance sheet as a starting point. Regulatory Capital at Risk (RCaR), which is calculated using the same method and confidence level as EC, is to be compared to the Group's Loss Absorbing Capital (LAC), which mainly comprises equity adjusted for this purpose and subordinated debt which is deemed as equivalent to equity for the purposes of covering losses.

**Summary of EC and RCaR diversified**



In calculating the RCaR, business risk and property risk are zero, which explains the lower non-financial risks. With very high probability, the Bank is expected to have a positive result in the parts of the income statement that are taken into account when calculating business risk. The difference between the fair value and the book value of the Group’s property portfolio is also larger than the estimated property risk. The lower risk in the pension commitments in the RCaR compared with EC is due to the surplus values in the pension system comprising an off-balance sheet buffer for the pension commitments. In this perspective too, the Bank is well-capitalised.

The risk and capital situation reported above is a snapshot picture. Nevertheless, the risk calculations include buffers for business cycle fluctuations. To perform a final assessment of the Group’s capital requirement, consideration must also be taken of the stress and scenario analysis carried out within the Bank’s capital planning.

## Capital planning

Handelsbanken’s capital planning aims to ensure that the Bank’s capital is of adequate size and composition.

The capital requirement is a function of an assessment of the Bank’s performance, the operating regulations, Handelsbanken’s model for economic capital and the outcome of stress tests.

A long-term capital plan is drawn up annually, which is designed to give a comprehensive picture of the Group’s current capital situation, a forecast of expected capital performance and outcome in various scenarios. The capital plan also contains proposals for how to maintain the capital situation at a satisfactory level in a strongly negative business environment. from both a regulatory and shareholder perspective.

The capital planning is divided into short-term and mid to long-term forecasting.

## Short-term forecasting

The part of capital planning that comprises short-term forecasts of up to one year ahead principally focuses on assessing existing performance and the development of the capital requirement. This forecasting is necessary to enable continual adaptation of the size and composition of the capital base. The capital planning work is performed through ongoing analysis of changes in volume, risk and performance and by monitoring events that may affect the capital requirement and capital volume. This work also encompasses conducting various sensitivity analyses, with a short-term perspective, of the expected change in capital requirements and capital base. The Bank can thereby be prepared to alter the size and composition of the capital base if required – through market operations, for example.

The result of the short-term analysis forms the basis of any capital operations performed and is continually reported to the CFO and, if necessary, to the CEO. The analysis stems from a cautious basic scenario, with decision points in the near future for how existing earning capacity can cope with various changes in volume, as well as what effects arise from potential capital operations.

## Mid to long-term forecasting

The part of capital planning that comprises mid to long-term forecasts aims to ensure that the Group has AFR at any time that exceed statutory requirements and that by a margin cover all risks calculated using the EC model. The objective is to forecast expected performance and judge whether the Bank's resistance is satisfactory in various scenarios. The planning period is at least five years and takes account of the whole of the Group's business operations.

Scenario and stress tests are also constantly performed in this forecasting work. A basic scenario forms the foundation of the capital forecast. This scenario is obtained from expected performance in the coming five years regarding profit; volume growth; financial assumptions, such as loan losses; and performance of the equity, property and fixed income markets. The basic scenario is then compared to the outcomes in a number of business cycle scenarios and crisis scenarios. The stress scenarios have been established following analysis of the historical links between the impact of different macroeconomic variables on the financial markets and have been selected by using the scenarios expected to have greatest adverse impact on Handelsbanken.