



# Risk and capital management 2016

Pillar 3 report

## 1. Table of Contents

2.	Introduction.....	4
3.	Santander Consumer Bank AS.....	4
3.1	Background.....	4
4.	Macroeconomic Developments .....	5
4.1	Denmark .....	5
4.2	Finland .....	5
4.3	Norway .....	6
4.4	Sweden .....	6
5.	Governance and control.....	6
5.1	Management of SCB.....	6
5.2	Organisational set-up .....	7
5.3	Control functions and “three-lines-of-defense” approach .....	7
6.	Capital adequacy .....	8
6.1	Capital management governance .....	8
6.2	Capital requirements.....	9
6.2.1	Pillar 1 requirement.....	9
6.2.2	Pillar 2 requirements .....	10
6.2.3	Pillar 3 requirements .....	10
6.2.4	Leverage ratio requirements.....	10
6.3	Capital position per December 2016.....	11
7.	Overview of Risk management.....	11
7.1	Risk Governance .....	12
7.2	Lines of Defense Framework.....	13
7.3	Overview of risk weighted assets.....	13
8.	Credit risk .....	14
8.1	General information about credit risk.....	14
8.2	Credit Risk Profile .....	14
8.2.1	Credit exposure .....	14
8.2.2	SCB Group Portfolio Mix.....	15
8.2.3	Materiality of Risks .....	18
8.2.4	Non-performing assets, losses and write-offs.....	19

8.3	Credit risk under IRB approach.....	20
8.3.1	IRB Roll-Out .....	20
8.3.2	Approved IRB Portfolios .....	23
8.3.3	Regulatory Limits .....	23
8.3.4	IRB Portfolio Parameters Estimation and Rating Assignment.....	24
8.3.5	Recognition of credit risk mitigation .....	25
8.3.6	Governance and Control of IRB Models.....	25
8.3.7	Back-testing of IRB parameters.....	27
8.4	Credit Risk Management Tools.....	29
8.4.1	Scorecards .....	29
8.4.2	Internal Rating Model.....	30
8.4.3	ICAAP Stress Test.....	31
9.	Counterparty credit risk .....	31
10.	Securitization.....	31
11.	Market risk.....	32
11.1	Currency risk.....	32
11.2	Interest rate risk .....	32
11.3	Credit Spread risk .....	34
12.	Operational risk.....	34
13.	Liquidity risk .....	35
13.1	Diversification of funding sources .....	36
13.2	Liquidity portfolio .....	37
13.3	Liquidity Stress Tests .....	37
13.4	Encumbered assets.....	38
14.	Business and strategic risk.....	38
15.	Compliance risk .....	38
16.	Pension Obligation risk.....	39
17.	Overview of Charts, Tables and Figures .....	41

## 2. Introduction

The purpose of this report (“**the Pillar 3 report**”) is to provide information to the market in order to assess the risk and capital management of Santander Consumer Bank AS (“SCB”) and its subsidiaries as required under the Pillar 3 of the capital adequacy regulations. When including the subsidiaries we refer to “SCB Group”. In the following chapters we will also refer to both “SCB” and “SCB Group” as “the bank”. The report meets the information requirements outlined in the capital adequacy regulation part IX (*NO: “Kapitalkravsforskriften del IX”*) and CRR regulation 575/2013 (part eight). In addition we publish an appendix to the report (see Pillar 3 Appendix, where we publish 1) capital position, 2) terms of capital instruments, 3) own funds disclosure template, as recommended in Circular 14/2014 “Publishing information regarding own funds”, 4) Leverage ratio calculations and 5) Countercyclical Buffer calculations). This Pillar 3 report is updated annually.

The capital adequacy regulations allows for different methods for calculating capital requirements. In December 2015, SCB received approval from the Norwegian Financial Supervisory Authority (hereinafter “**the Norwegian FSA**”) and Bank of Spain to use Advanced Internal Rating Based approach (hereinafter “**A-IRB**”) for calculating capital requirements for part of our credit portfolios. For the remaining credit portfolios and market risk we use the standardized approach, whilst for operational risk we use the Basic Indicator Approach. We expect to receive approval for using the A-IRB approach for additional credit portfolios in coming years.

## 3. Santander Consumer Bank AS

### 3.1 Background

SCB is a commercial Nordic bank, operating in Norway, Sweden, Denmark and Finland, with the Nordic head office located at Lysaker in Norway. The bank is governed by Norwegian law and supervised by the Norwegian FSA. The bank is a leading consumer finance provider across the Nordic countries (Norway, Sweden, Denmark and Finland) and offers car financing, consumer loans, credit cards and sales financing. The bank also offers customer deposits in Norway, Sweden and Denmark. The bank operates through branches in Sweden and Denmark and a wholly-owned subsidiary in Finland. In this document we will refer to car financing as “secured financing” due to collateral in the vehicle and consumer loans, credit card loans and sales finance as “unsecured financing” as these loans are without collateral.

The bank is a 100% owned subsidiary of Santander Consumer Finance S.A., a leading player within car and consumer financing in Europe. Santander Consumer Finance S.A. (SCF) is again fully owned by Banco Santander, one of the world’s largest banking groups, with head office in Madrid. SCB is subject to the Norwegian Capital Requirement Regulation (“*kapitalkravsforskriften*”) and related requirements under Norwegian law. As SCB is part of a Spanish banking group, SCB also aims to comply with the Capital Requirements Directive IV (“CRD IV”) & Capital Requirements Regulation (“CRR”) legislative package applicable in the EU. Being part of the Banco Santander Group, SCB benefits from expertise and guidance within various risk management areas, in particular related to models and processes required to become an A-IRB bank.

The bank has been operating under the Santander name since 2005, after Santander Consumer Finance’ acquisition of Elcon Finans AS in Norway in 2004. On July 1 2015, SCB merged with GE Capital’s business in Norway, Sweden and Denmark, GE Money Bank, with SCB as the surviving entity. GE Money Bank’s main areas of business were consumer loans, sales-finance and credit cards offered across Norway, Sweden, and Denmark. The merge increased the product and geographical diversifications across the Nordic countries.

The Group had 1287 employees (excluding temporary hired employees) at year-end 2016. Of these, 525 worked in Norway, 344 in Sweden, 246 in Denmark and 172 in Finland.

## 4. Macroeconomic Developments

Being a Pan-Nordic bank, SCB is directly exposed to the macroeconomic developments in the four major Nordic countries. This diversification provides a natural hedge, as the economic environment across the countries in the region differs over time.

Real GDP growth (y/y): Actuals and forecast

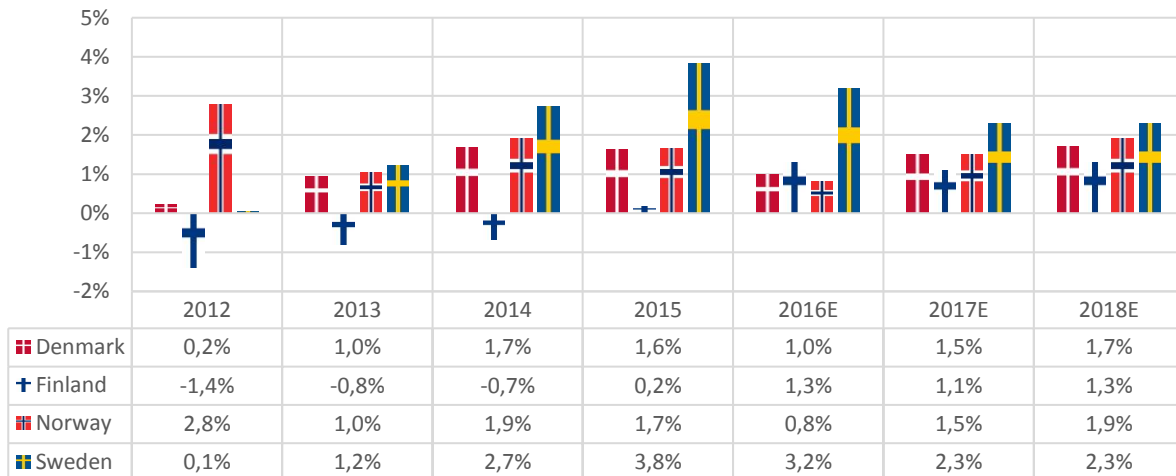


Figure 1 Real GDP forecast. Source Bloomberg

### 4.1 Denmark

Denmark has experienced a steady recovery over the past four years, with real GDP growth expected around 1.0% for 2016. The growth has been underpinned by decent consumer spending and somewhat expansive fiscal policies, offset by a decline in exports of oil and gas and sea transportation services in 2016.

Improved outlook for global GDP growth is expected to support exports going forward, and consensus forecast for real GDP growth is 1.5% in 2017 and 1.7% in 2018. The rising growth rate is also supported by expectations of continued growth in private spending, underpinned by low unemployment and solid wage growth.

### 4.2 Finland

After several years of negative or no growth, the growth rate for real GDP is expected at 1.3% in 2016. This growth is primarily driven by private consumption (new car registrations +9% y/y) and domestic investments. Weak exports in recent years (down ~20% since 2008) have weighed heavily on the Finnish economy, which has struggled to regain competitiveness amidst the lack of effective monetary tools. However, recent developments leave room for optimism, with the deal reached between labor organisations and employers in 2016, expected to lower unit labor costs by around 4% and thus improve competitiveness. Exports to Russia is also expected to recover in 2017, and the fiscal budget for 2017 is less austere than previously expected. Consensus forecast for real GDP growth is 1.1% in 2017 and 1.3% in 2018.

### 4.3 Norway

The oil driven downturn continued in Norway in 2016, with oil investments (down ~15% y/y) affecting the wider economy with real GDP growth expected at 0.8% in 2016. However, the historically weak NOK and fiscal stimuli helped alleviate the impact somewhat, and mainland investments rose by approximately 5% y/y during the year. Norges Bank reduced the deposit rate from 0.75% to 0.5% in March 2016 and kept it unchanged for the remainder of the year. Key considerations for Norges Bank have been to keep the NOK weak amidst a low interest rate environment abroad, a fragile economic recovery, but also a heated housing market (all regions +12% y/y, Oslo +23% y/y in January 2017).

Looking ahead, the decline in oil investments is expected to slow in 2017 (down ~10% y/y in a November survey) and the recent oil price recovery is expected to support the economy going forward. Consensus is that the lowpoint in the economic cycle is behind us, and that the real GDP growth will reach 1.5% in 2017 and 1.9% in 2018.

### 4.4 Sweden

The Swedish economic growth continued its strong pace in 2016 at around 3.2%, although slightly down from 3.8% in 2015. Private spending, domestic investments and increased government spending due to high immigration contributed positively, although the impact abated somewhat towards the end of the year. Riksbanken reduced the policy rate from -35bps to -50bps in February 2016, and has left the rate unchanged since then. The market is at the time of writing implying that the bottom is already behind us, and for the policy rate to move into positive territory in 2H18. Rising inflation and a strong housing market supports the view of the market.

The outlook for the Swedish economy is good, although at a lower growth rate than in the past two years. Consensus indicates a real GDP growth of 2.3% in both 2017 and 2018.

## 5. Governance and control

### 5.1 Management of SCB

The Board of Directors of SCB is comprised of eight members and has extensive powers to manage, administer and govern all matters related to SCB's business, subject only to any powers exercisable solely by the General Meeting of shareholders (NO: "Generalforsamling").

SCB has a separate Audit Committee, as a subcommittee of the Board of Directors, consisting of three members, assisting the Board of Directors in relation to its administrative and supervisory tasks, control, financial management and reporting duties and follow-up of the internal and external audit of the bank. SCB also has a separate Board Risk Committee, consisting of three members, with the objective of advising the Board of Directors on the overall current and future risk, appetite and strategy, and assist them in overseeing the implementation of the bank's risk strategy. The Board Risk Committee met 8 times during 2016. SCB has further established a Remuneration Committee, consisting of three members, advising the Board of Directors in the preparation of the bank's remuneration policy and monitoring the effects of the policy. SCB also has a Nomination Committee, consisting of three members, advising in the preparation of nominations and selections of candidates to the Board of Directors and the Nordic CEO.

In addition SCB has established the following management committees:

- Capital Committee. The purpose of the Capital Committee is to have an effective forum for supervising, authorising and evaluating all aspects related to the capital and solvency of SCB within the framework decided by the Board of Directors.

- Internal Control Committee: The main purpose of the Internal Control Committee is to oversee SCB’s risk profile, including oversight of all risks and the establishment of appropriate control systems and the compliance with laws, regulations and internal policies.
- Asset and Liability Committee (ALCO): The Asset and Liability Committee is a management committee which is delegated authority from the Board of Directors to oversee activities related to funding, liquidity, interest rate risk, FX risk, derivatives and any other products or activities related to Asset and Liability Management.
- Central Credit Committee: the CCC is responsible for approving large credit proposals. Credit proposals above a certain threshold, are processed and recommended for approval to the SCF Loan Committee in Madrid.
- Nordic Approval Committee (NAC): The NAC is a collegiate decision body responsible for the risk management in accordance with the authorities attributed by the Board of Directors and will monitor, in its area of action and decision, all the risks identified by SCB.

## 5.2 Organisational set-up

SCB is organised into eight staff divisions and four business units, representing operations in Norway, Sweden, Denmark and Finland, in addition to Internal Audit which is functionally reporting to the Audit Committee, per delegation of the Board of Directors, and administratively to the Nordic CEO. The management of Customer Deposits is located with Financial Management, Marketing and External communication is managed by the head of the Danish business unit, Insurance by the head of the Norwegian business unit and the Unsecured products are managed by the head of the Swedish business units.

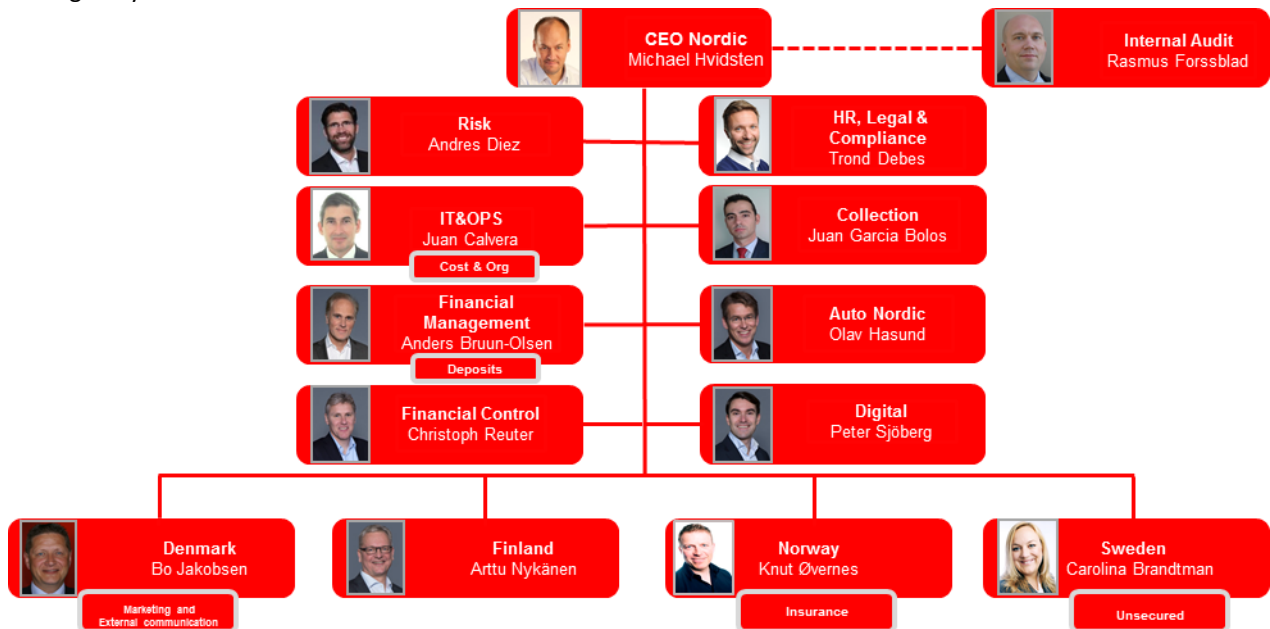


Figure 2 Organisation of Santander Consumer Bank

## 5.3 Control functions and “three-lines-of-defense” approach

To ensure a sound risk management approach and effective internal control, SCB is organized according to a ‘three-lines-of-defense’ model. The model creates a clear and transparent division of roles and responsibilities to ensure

sound internal control throughout the bank. The roles and responsibilities in SCB's three lines of defense model are organized as follows;

	1 <sup>st</sup> line of defence	2 <sup>nd</sup> line of defence	3 <sup>rd</sup> line of defence
<b>Function</b>	Business	Risk control and Compliance	Internal Audit
<b>Role</b>	Acting risk owner and ensure sound internal control through documented control activities.	Risk control: Ensure sound risk management and internal control in business, on behalf of the CEO. Compliance: Ensure regulatory compliance in business, on behalf of the CEO.	Ensure internal control and regulatory compliance in the entire bank, on behalf of the Board of Directors.
<b>Responsibilities</b>	<ul style="list-style-type: none"> <li>- Manage business so that all risks are identified, managed and controlled</li> <li>- Ensure that internal control is developed and maintained in areas of responsibility (e.g. Implement controls to detect non-compliance)</li> <li>- Take ownership and actions on deficiencies identified</li> </ul>	<p>Risk control:</p> <ul style="list-style-type: none"> <li>- Ensure risk level is in line with risk appetite</li> <li>- Monitor and control risk framework</li> </ul> <p>Compliance:</p> <ul style="list-style-type: none"> <li>- Ensure compliance with internal/external regulations</li> <li>- Monitor and control Compliance risk framework</li> </ul> <p>Both:</p> <ul style="list-style-type: none"> <li>- Risk assessments</li> <li>- Risk reporting with deficiencies and recommendations</li> <li>- Challenge the work and reporting in the first line of defence and the risk management work (setting risk appetite etc.) of the Senior Management team and Board of Directors</li> </ul>	<ul style="list-style-type: none"> <li>- Audit and evaluate organisational and process effectiveness</li> <li>- Ensure business is in accordance with applicable internal and external regulations</li> <li>- Report deviations to Board of Directors on regular basis</li> </ul>

## 6. Capital adequacy

### 6.1 Capital management governance

Governance and responsibilities related to capital management are outlined in the bank's Capital Policy. The objective with the policy is to ensure adequate solvency levels, regulatory compliance and efficient use of capital.

The Board of Directors have the ultimate responsibility for the solvency and capital adequacy of the bank.

Capital management decisions that need Board of Directors' approval should be approved and recommended by the Capital Committee before being recommended to the Board of Directors. Certain items will also need to be reviewed in the Board Risk Committee before being presented to the Board. Capital management decisions will include capital adequacy, capital targets and composition, capital plan, dividend policy and capital contingency plans. The Capital Committee consist of members of senior management (the Chief Financial Officer, Chief Risk Officer and the Chief Controlling Officer) who have voting power and representatives from Risk, Financial Management, Financial Control and Legal who have an advisory role.



The Board of Directors approves minimum and target capital ratios, at least on an annual basis. Capital positions and forecasts are presented to the Board of Directors on a regular basis. Capital reporting to the Norwegian FSA is approved by the Capital Committee before submission.

Dividend must be approved in the General Meeting of SCB, based on proposal by the Board of Directors.

Capital increases and capital reductions must be approved by the Board of Directors and in the General Meeting of SCB. Capital increases will also need approval by the owner both at SCF and at Banco Santander level. In case of repayment of hybrid capital and subordinated loan capital, approval from the Board of Directors will be sufficient.

Norwegian FSA has to approve both capital increases and capital decreases.

## 6.2 Capital requirements

SCB is supervised by the Norwegian FSA and has to comply with the capital requirements for banks in Norway.

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

- Pillar 1 - Calculation of minimum regulatory capital: banks shall at all times satisfy capital adequacy requirements reflecting credit risk, operational risk and market risk. Equity can be in the form of core and supplementary capital. Core capital will typically consist of equity capital, while supplementary capital can be subordinated loan capital. The capital requirements must be complied with at all times. Banks are obligated to document their compliance with these requirements by reporting to the Norwegian FSA on a quarterly basis;
- Pillar 2 - Assessment of overall capital needs and individual supervisory review: banks must have a process for assessing their overall capital adequacy in relation to their risk profile and strategy for maintaining their capital levels. The Bank assess the capital needs according to circular 12/2016 from the Norwegian FSA. The Norwegian FSA shall review and evaluate such internal capital adequacy assessments and strategies and may take supervisory action if it is not satisfied with the result of such an evaluation process. Norwegian FSA publishes their review of the ICAAP process and also publishes the Pillar 2 requirement for the bank.
- Pillar 3 - Disclosure of information: banks are required to disclose relevant information on their activities, risk profile and capital situation to the market.

The bank is required to comply with capital requirements at both SCB AS level and SCB Group level.

### 6.2.1 Pillar 1 requirement

On 1 July 2013, the Norwegian Parliament passed an act which implemented the CRD IV capital adequacy rules. The minimum capital adequacy requirement of 8% shall consist of at least 4.5% common equity tier 1 capital ("**CET1 capital**") and the remaining 3.5% may consist of other eligible capital instruments. In addition, Norwegian banks are required to hold a capital conservation buffer of 2.5% CET1 capital and a systemic risk buffer of 3% CET1 capital. Systemic important financial institutions should hold an additional 2% buffer of CET1 capital. SCB is currently not considered to be a systemic important financial institution. In addition banks are required to hold a counter cyclical buffer ranging between 0% and 2.5%. Per 31.12.16 the countercyclical buffer requirement was 1.5% for Norway (to be increased to 2% from December 2017). For Sweden the requirement was 1.5% as per end 2016, which will increase to 2% by the end of Q1 2017. In the other countries SCB has exposures to, the countercyclical buffer requirement is

0%. In accordance with article 140 of the CRD IV, the bank calculates its countercyclical buffer as a weighted average of the country specific countercyclical buffers in Norway, Denmark, Sweden and Finland. As of 31.12.2016 the weighted average countercyclical buffer requirement for SCB was 1.01% while at SCB Group level the requirement was 0.91%.

In total, the Pillar 1 CET1 capital requirement per 31.12.16 was 10.90% for SCB Group and 11% for SCB.

Norwegian banks are required to meet and report the capital requirements to the Norwegian FSA on a quarterly basis.

### 6.2.2 Pillar 2 requirements

SCB conduct at least annually an internal capital adequacy assessment process (ICAAP) assessing capital adequacy and thus it's input to the Pillar 2 capital requirement. The combined Pillar 1 and Pillar 2 requirements will be the basis for the bank's target capital ratios set by the Board of Directors. Several departments are involved in the ICAAP process including the Risk function, Financial Control, Financial Management and Legal and Compliance department. Stress scenarios, as well as outcomes of various analyses in the ICAAP report are reviewed and approved by the Capital Committee. In addition, all analyses and governance processes leading to the ICAAP report is reviewed by Internal Audit.

Subsequently ICAAP is reviewed by the Board Risk Committee which gives its recommendations to the Board of Directors. Finally the ICAAP is reviewed and approved by the Board of Directors before being submitted to the Norwegian FSA.

The Pillar 2 requirement from the Norwegian FSA was set to 2.2% following the ICAAP delivered in 2016. The result was published on 8 December 2016 and applies from 1 January 2017. The Pillar 2 requirement must be met by CET1 capital.

### 6.2.3 Pillar 3 requirements

This Pillar 3 report is updated at least annually. In addition we publish an appendix to the report (see Pillar 3 Appendix), where we disclose 1) capital position, 2) terms of capital instruments and 3) own funds disclosure template, as recommended by the Norwegian FSA in Circular 14/2014 "Publishing information regarding own funds", 4) Leverage ratio calculations and 5) Countercyclical Buffer calculations). The senior management members of the Capital Committee, consisting of the Chief Risk Officer, the Chief Controlling Officer and the Chief Financial Officer, approves the content of the Pillar 3 report.

The Board of Directors has approved the guidelines and procedures for the Pillar 3 report. Internal Audit assesses the quality of the disclosure of information about the bank's capitalization, risk profile and management and control of risk. The report is approved by the Capital Committee before publication.

### 6.2.4 Leverage ratio requirements

In addition to the Pillar 1 and Pillar 2 capital requirements, banks must report their leverage ratio even though there is no legal minimum requirement for leverage ratio as of the date of this report. By June 30 2017, Norwegian banks are required to have a minimum leverage ratio of 3%, in addition to a 2% buffer requirement for non-SIFI banks and 3% for SIFI<sup>1</sup> banks. Hence, From June 2017, SCB will have a leverage ratio requirement of 5%, as we are not a SIFI bank.

---

<sup>1</sup> SIFI bank is systemic important banks.

## 6.3 Capital position per December 2016

Per December 2016, SCB had a CET1 capital ratio of 15.67%, Tier1-ratio of 18.14% and a Tier2-ratio of 19.46%. On SCB Group level the CET1 capital ratio was 15.09%, Tier1-ratio was 17.41% and the Tier2 ratio was 18.66%.

SCB calculates the leverage ratio in accordance with CRR article 429. The Leverage ratio for SCB as of 31.12.2016 was 12.53%. For SCB Group the Leverage ratio was 11.53%. This shows that the bank is well above the future leverage ratio requirements.

Please see Pillar 3 Appendix for details of capital positions.

## 7. Overview of Risk management

SCB Nordics operating under Banco Santander, has set itself the target of achieving excellence in risk management. Throughout its history of operation, risk management has always been a priority for the bank. In 2016, major progress has been made to anticipate and to meet the big challenges faced against a constantly shifting economic, social and regulatory background.

SCB's policy is that the risk function is based on the following pillars, which are aligned with Banco Santander's strategy and business model that take on board the recommendations of supervisory bodies, regulators and best market practices:

1. **The business strategy is defined by the risk appetite.** The Board of Directors of SCB determines the quantity and type of risk it considers reasonable to assume in the execution of its business strategy and to create targets that are objective, comparable and consistent with the risk appetite for each key activity.
2. **A risk culture** which is integrated throughout the organization, composed of a series of values, skills and guidelines for action to cope with all risks. SCB Nordics believes that advanced risk management cannot be achieved without a strong and steadfast risk culture which is found in each and every one of its activities.
3. **All risks have to be managed** using advanced models and tools and integrated in the different businesses. SCB is promoting advanced risk management using models and metrics, and also a control, reporting and escalation framework in order to manage risks.
4. **The forward-looking approach** for all risk types must be part of the risk identification, assessment and management processes.
5. **The independence of the risk function** encompasses all risks and provides an appropriate separation between the risk generating units and units responsible for controlling these risks. It implies that the risk function should also have sufficient authority and direct access to management and governance bodies which are responsible for establishing and overseeing risk strategy and policies.
6. **Risk management has to have the best processes and infrastructures.** A continuous effort in developing risk management support infrastructure and processes.



Figure 3 Risk Strategy

### 7.1 Risk Governance

In terms of governance, SCB is organized as a Nordic cluster with central support functions and four business units: Norway, Sweden, Finland and Denmark. Additionally, each business unit has a local risk management function with a risk director reporting directly to the Nordic Chief Risk Officer.

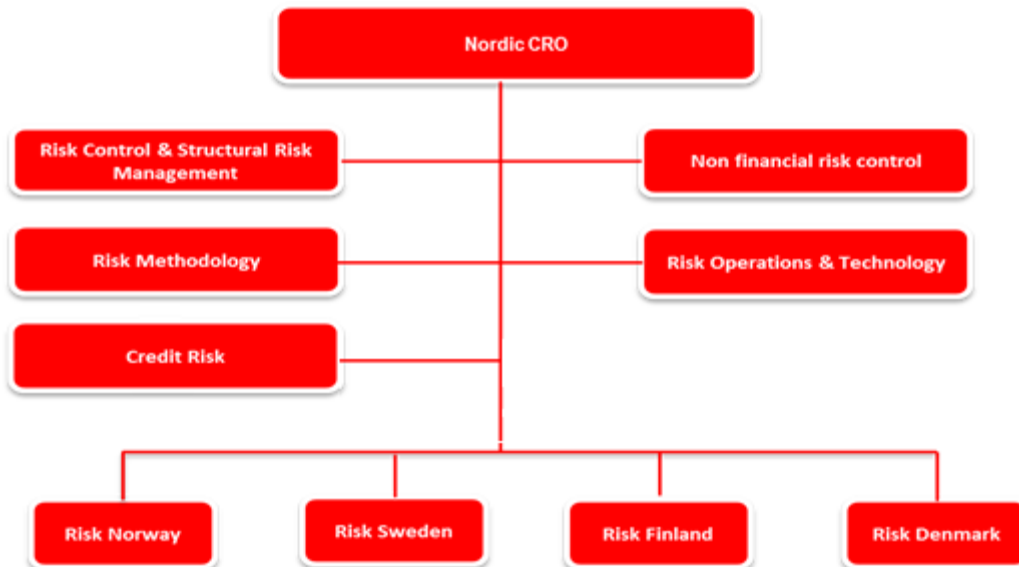


Figure 4 Risk Organisation

The Board of Directors receives, in accordance with article 435 2e of the CRR, relevant credit reports and instigates relevant actions in order to reduce undesired rise in risk levels. The Board of Directors shall approve parameter and management limits, as well as any proposed remedial action when facing breach of limits.

## 7.2 Lines of Defense Framework

The risk function is divided into three lines of defence. The roles and responsibilities of these lines take the following forms in the field of credit risk management and control.

**The business functions or activities that create exposure to a risk are the first line of defence.** The acceptance or generation of risk in the first line of defence should be within the risk appetite and the risk limits defined by the Board of Directors. In order to operate this function, the first line of defence must have the resources available to identify, measure, manage and report the risks assumed.

**The second line of defence consists of the risk control and oversight function and by the compliance function.** This line vouches for effective control of the risks and ensures they are managed in accordance with the level of risk appetite defined.

**Internal audit is the third line of defence** and as the last layer of control in the bank's regularly assesses the policies, methods and procedures to ensure they are adequate and are being implemented effectively.

## 7.3 Overview of risk weighted assets

Figure 5 provides an overview of the risk weighted assets (RWA) of the main risk categories that SCB Group is required to hold capital for and that are described in this report. The breakdown distinguishes between assets where we use the Standardized Approach and the IRB Approach.

	RWA ('000 NOK)		Capital Req.
	Dec.16	Dec.15	Dec.16
Credit Risk (Excluding Counterparty Credit Risk)	86 064 559	82 277 661	6 885 165
of Which Standardized Approach	60 365 366	58 752 752	4 829 229
of Which IRB Approach	25 699 193	23 524 909	2 055 935
Market Risk	1 123 306	313 078	89 864
Of which Credit Valuation Adjustment	269 068	313 078	21 525
Of which FX risk	854 238	-	68 339
Operational Risk	9 835 184	7 100 262	786 815
Of which Basic Indicator Approach	9 835 184	7 100 262	786 815
<b>Total RWA (Risk-based)</b>	<b>97 023 049</b>	<b>89 691 001</b>	<b>7 761 844</b>

Figure 5 Overview of risk weighted assets and capital requirements for the main risk categories for SCB Group

The share of IRB has remained constant during 2016, a year in which the portfolios of SCB Group have shown a successful growth with stable risk metrics.

In Figure 5 the Market Risk RWA for FX risk is not shown for Dec. 15 since the bank was not required to hold capital for Market Risk because the foreign-exchange position did not exceed the 2% of total own funds (ref. *Article 351 of the CRR*).

## 8. Credit risk

### 8.1 General information about credit risk

Credit risk is the most significant risk for the bank. Credit risk is kept at a level that (over time) corresponds to the average of companies within the Santander Consumer Finance S.A. Group, taking into account differences in product mix and collection processes.

The SCB organizational structure is designed to support the credit risk management of the bank. The bank leverages pan-Nordic initiatives and strategies resulting in highly homogeneous credit risk practices across the business units while also considering the local market's needs and operating climate.

Credit risk management is divided into "Standardized" and "Non-Standardized" risk areas, where Standardized includes Retail and Small-Medium enterprises (SMEs) and Non-standardized includes corporates.

Standardized (Retail) exposures are managed via a highly automated credit approval process using internally developed scorecards.

The Non-Standardized risk segment is defined as all stock finance related clients and also customers with a credit exposure of over 5 MM local currency in case of Norway, Sweden and Denmark and EUR 0.5 MM in case of Finland.

### 8.2 Credit Risk Profile

#### 8.2.1 Credit exposure

SCB Group consists of the following main business areas:

##### **Auto Finance**

- Auto loans and leasing offered to private persons and business customers. Mainly distributed through dealers, but also distributed direct online.
- Stock Finance provided to dealers. This includes demo financing and new and used car stock financing. Agreements with both importers and dealers.
- Business lines: Norway, Sweden, Finland and Denmark.

##### **Consumer Loans**

- Consists of unsecured loans to private persons between EUR 2,000 and EUR 50,000. The product is distributed through direct online distribution, brokers and cross-selling the SCB portfolio. Automated and stable business model with primarily risk based pricing.
- In Norway and Sweden there is a high level of distribution through brokers, while this share is increasing in Finland.
- Business lines: Norway, Sweden, Finland and Denmark.

##### **Credit Cards**

- Revolving credit lines up to EUR 10,000 offered to private persons.

- The credit card holder can use their credit card up to a credit limit assigned based on the credit profile of the customer.
- Business lines: Norway, Sweden and Denmark.

### Sales Finance

- Loans offered to private persons for buying commodities at merchants.
- Predominant point of sales in physical stores but e-commerce is growing.
- Business lines: Norway, Sweden, Finland and Denmark.

### 8.2.2 SCB Group Portfolio Mix

SCB Group’s gross outstanding increased from NOK 119 billion to NOK 128 billion from 2015 to 2016 and was largely driven by growth in Norway, but also from growth in Denmark and Finland. As can be seen in 7, the growth is largely attributed to continuous growth in the Auto portfolio.

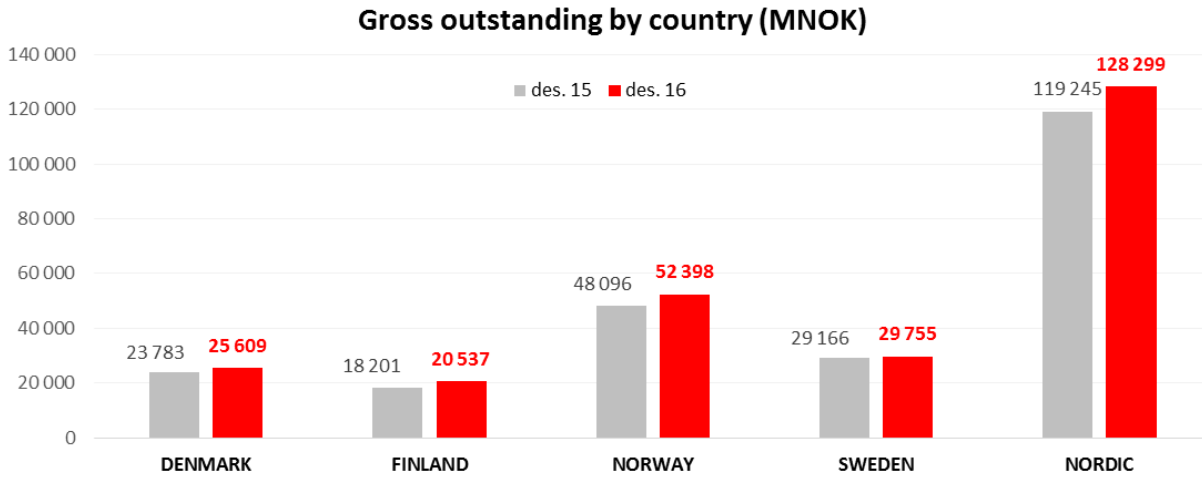


Figure 6 Gross Outstanding by Country

The country break-down for gross outstanding as of December 2016 and compared to December 2015 can be found in the graph below. Geographical distribution of assets are similar for 2015 and 2016, signifying the balanced growth in all operating markets in line with business strategy.

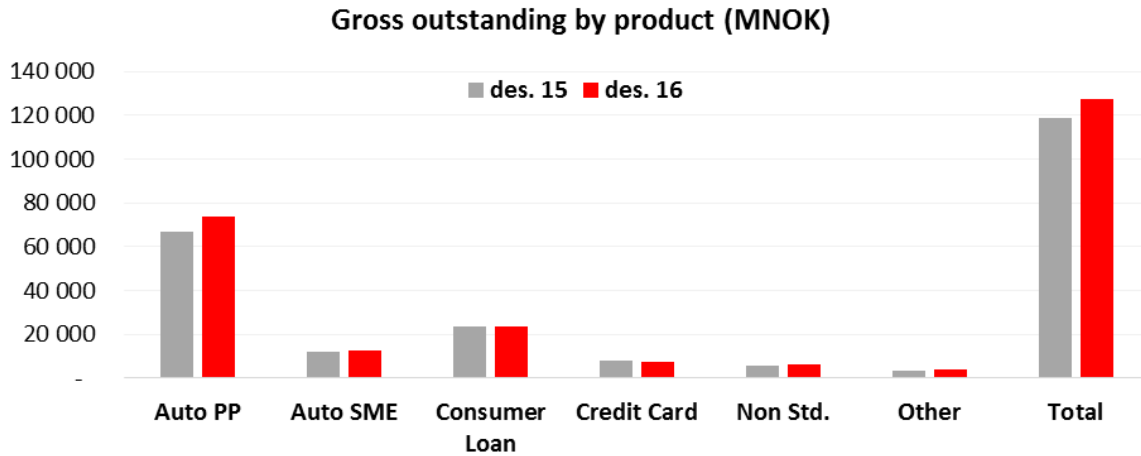


Figure 7 Gross Outstanding by Product

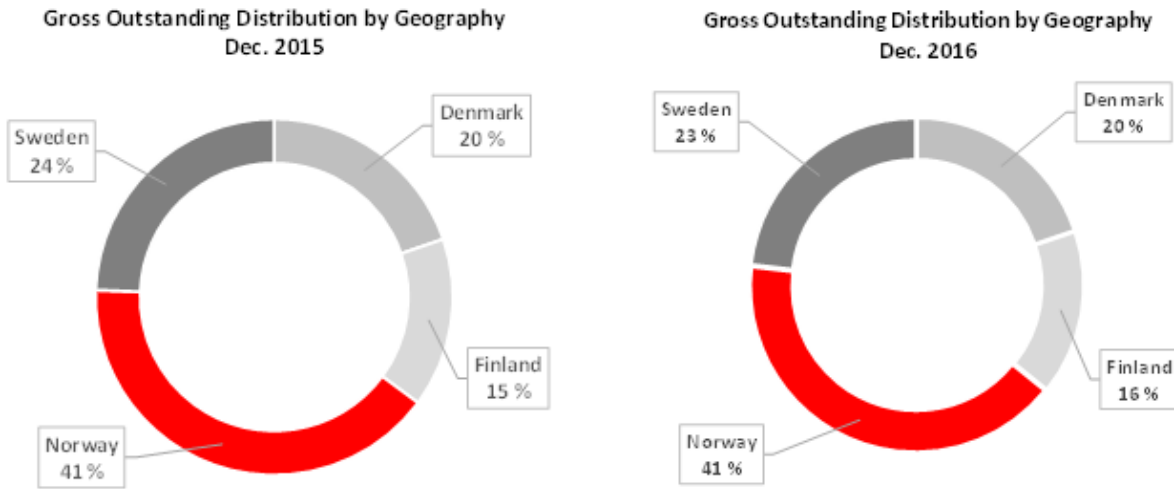


Figure 8 Share of Gross Outstanding by Country

The share of gross outstanding for SCB Group by product is shown below. As of December 2016, the biggest product exposure is to Auto Private Persons (PP), with Auto PP Norway being the largest single portfolio of the bank. Consumer Loans has the second biggest share of the bank. Auto has increased its share slightly due to continued growth in the Auto segment.



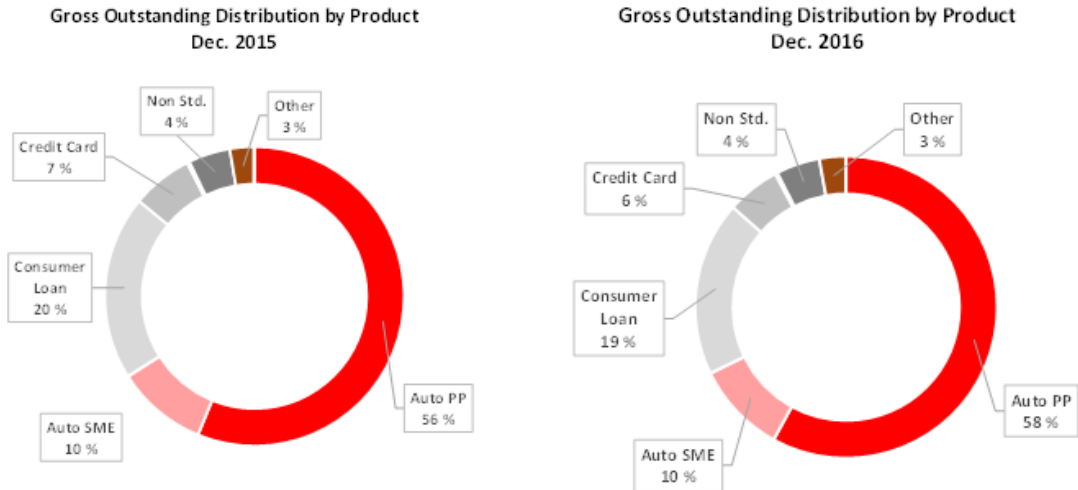


Figure 9 Share of Gross Outstanding by Product

Figure 10 show the share of gross outstanding for secured and unsecured portfolio at country and consolidated level. The exposure to secured products constitutes a significant part of the exposure representing more than 70% of gross outstanding at consolidated level.

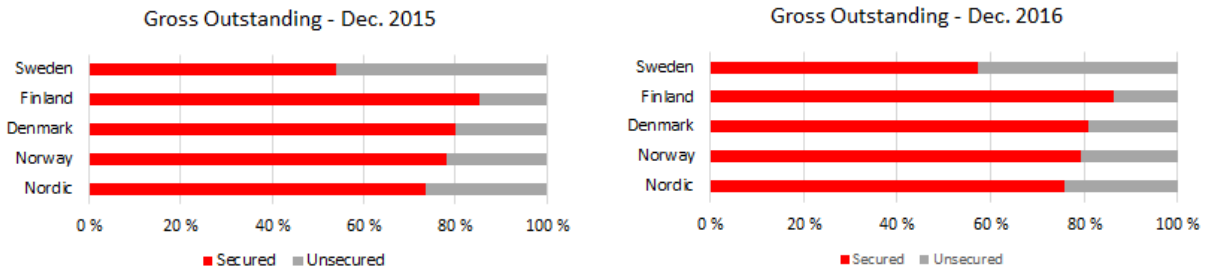


Figure 10 Share of Gross Outstanding by Secured/Unsecured

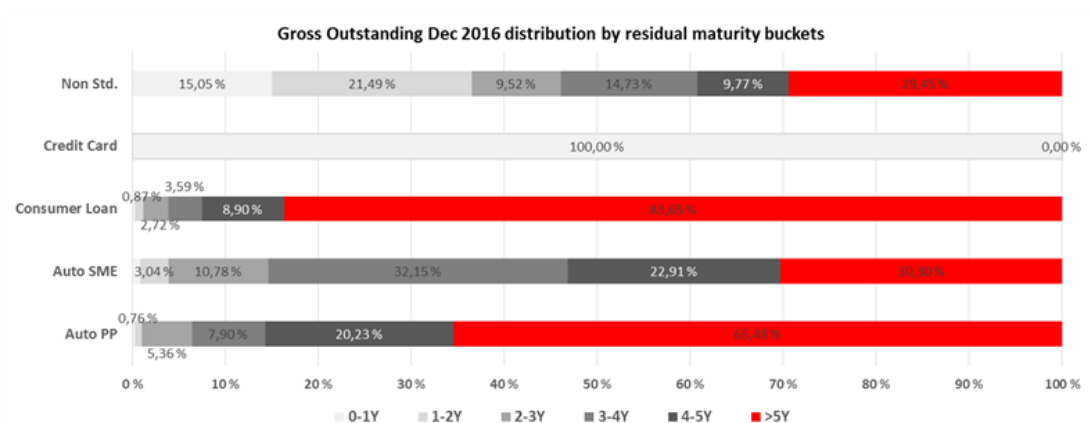


Figure 11 Share of Gross Outstanding by Maturity

Figure above provides distribution of gross outstanding by different residual maturity bucket. Credit card, being an open end loan, are reported without any maturity split.

### 8.2.3 Materiality of Risks

The figure below provides an overview of the risk weighted assets for Credit risk for the SCB Group.

	RWA ('000 NOK)		RWA Share	
	Dec.16	Dec.15	Dec.16	Dec.15
Regional Governments or local authorities	62 940	65 025	0,1%	0,1%
Institutions	1 522 496	1 643 007	1,8%	2,0%
Corporates	6 177 816	5 735 249	7,2%	7,0%
Retail STD	45 017 196	45 865 473	52,3%	55,7%
Retail IRB	25 699 193	23 524 909	29,9%	28,6%
Exposures in default STD	901 448	706 547	1,0%	0,9%
Covered bonds	863 747	642 011	1,0%	0,8%
Other Exposures	5 819 723	4 095 439	6,8%	5,0%
<b>Total Credit Risk</b>	<b>86 064 559</b>	<b>82 277 661</b>	<b>100,0%</b>	<b>100,0%</b>

Figure 12 Overview of risk weighted assets for Credit exposure in SCB

Risk weighted assets in SCB Group is managed under the IRB Approach for the three Auto Private portfolios in Norway, Sweden and Finland and under the Standardized Approach (STD) for the rest of the portfolios. With subsequent roll-out of IRB portfolios<sup>2</sup>, most of the Retail STD and Corporates portfolios will move into IRB.

<sup>2</sup> see chapter 8.3.1 for more details on IRB Roll-Out

## 8.2.4 Non-performing assets, losses and write-offs

This section outlines the bank's default, write-offs and loan loss reserve definitions and describe the developments in these parameters. SCB uses the following definitions;

- **Default:** A default is considered to have occurred when the entity considers that the obligor is unlikely to pay its credit obligations or if the obligor is past due more than 90 days on any credit obligation (in line with CRR Art.178 (1)). Defaults are also referred to as non-performing loans ("NPLs").
- **NPL-ratio:** Defaulted outstanding loans over total outstanding loans
- **Write-off:** The entity considers that any credit obligation is written-off and removed from the on-balance exposure according to IAS 39.17 (a), which states that "an entity shall derecognize a financial asset when, and only when the contractual right to the cash flows from the financial asset expire". SCB interprets the contractual right also to mean low probability of receiving further payments.
- **Loan Loss Reserves ("LLR"):** represents management's best estimates of losses incurred in the bank's loan portfolio at the balance sheet date. The LLR can be classified as Specific write-downs or Generic write-downs, where the former is related to the individual loan, while the latter is related more generally to the portfolio as a whole. Changes to LLR from one reporting period to the next, will impact the profit & loss account under item "Loan Losses". If LLR increases, this will increase Loan Losses, while if LLR decrease this will decrease Loan Losses.

Figure 13 below shows the development in the NPL-ratios divided into the secured (auto) and the unsecured portfolio, for the period 2014-2016, where for 2014 and 2015 year end NPL ratios and for 2016 quarterly NPL ratios have been provided. As can be seen from the table, the NPL-ratio for the combined portfolio has increased from 1.5% in 2014 to 2.1% in 2015. The increase was mainly driven by the legal merge with GE Money Bank and the corresponding increase in the share of unsecured loans. In 2016, both for secured and unsecured product, the NPL ratio have remained stable over the quarter ending the year with a NPL-ratio of 2%.

NPL ratio	Dec-14	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
<i>Secured</i>	1.1%	1.0%	1.0%	1.0%	0.9%	1.1%
<i>Unsecured</i>	4.8%	5.0%	4.7%	4.7%	4.5%	4.8%
<b>Nordic</b>	<b>1.5%</b>	<b>2.1%</b>	<b>2.0%</b>	<b>1.9%</b>	<b>1.8%</b>	<b>2.0%</b>

Figure 13 NPL-ratio developments 2014-2016 per secured (auto) and unsecured portfolio,

Figure 14 shows the development in NPL-ratio broken down per country. As can be seen from the table, Norway has the highest NPL-ratio. This is largely due to a higher share of credit cards than in the other countries and partly due to early write-off policies in practice in the other Nordic countries compared to Norway following local legal requirements.

NPL ratio	Dec-14	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Denmark	0.6%	1.0%	0.9%	0.9%	0.9%	1.2%
Finland	0.9%	0.7%	0.7%	0.7%	0.6%	0.7%
Norway	2.4%	3.4%	3.3%	3.3%	3.1%	3.4%
Sweden	0.6%	1.5%	1.3%	1.2%	1.2%	1.2%
<b>Nordic</b>	<b>1.5%</b>	<b>2.1%</b>	<b>2.0%</b>	<b>1.9%</b>	<b>1.8%</b>	<b>2.0%</b>

Figure 14 NPL-ratio developments 2014-2016 per country

NPL coverage ratio is shown in the graph below. NPL coverage is defined as Loan Loss Reserve set by the bank divided by Non-Performing Loans. The drop in NPL coverage from 2014 to 2015 is due to increase in NPL balance after the legal merge with GE Money Bank as mentioned above. The NPL coverage ratio for SCB Group has been above 100% during the entire 2016. The NPL coverage has increased in last 2 quarters signifying higher loss absorbing ability of the bank.

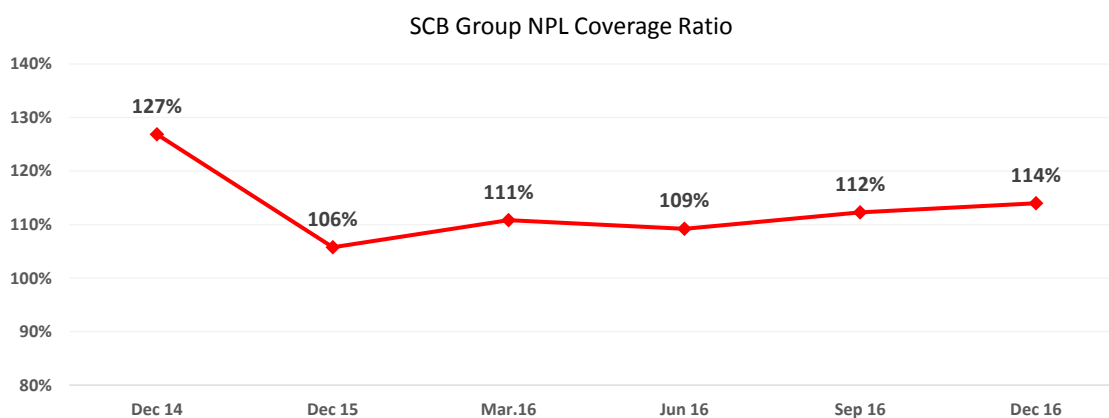


Figure 15 Coverage ratio developments 2014-2016

## 8.3 Credit risk under IRB approach

### 8.3.1 IRB Roll-Out

SCB considers the implementation of A-IRB to be strategically important and a key business driver for sustainable growth and future competitiveness. The operational benefits of A-IRB are related to improved client information, increased accuracy of models, and improved scoring, processes and routines and in general risk management practice of the bank.

The SCB credit portfolio can be divided to the following exposure classes under the Basel II accord:

- Corporate
- Retail
- Sovereigns
- Municipalities

- Financial Institutions/Banks

Of these segments, Corporates and Retail will be rolled out under the A-IRB Approach and the exposures under Sovereigns, Municipalities and financial institutions will remain under standardized approach.

Figure 16 below provides an overview of the Basel II approach by segments. As can be seen from the figure, some portfolios will remain under the standard approach based on the underlying obligor and the materiality of the portfolio.

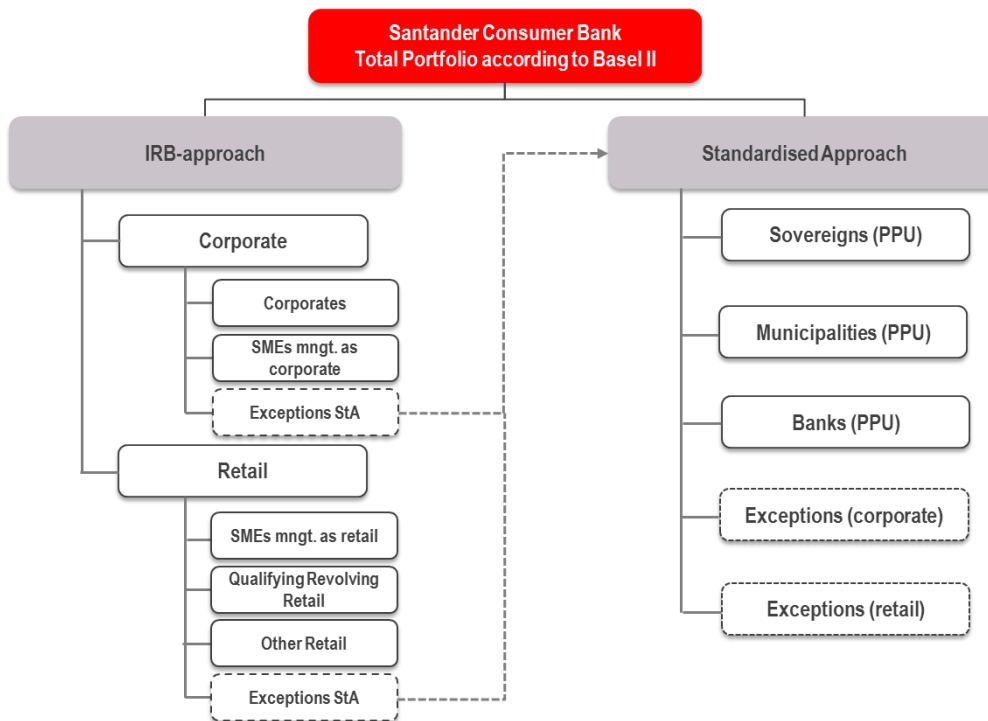


Figure 16 SCB Portfolio according to Basel

SCB has a three wave approach for the IRB Roll Out, with each wave incorporating different credit portfolios. The details for the Roll Out are provided in the table below. Wave I was submitted in December 2013 and was approved for IRB in December 2015, and included Auto PP for Norway, Finland and Sweden. Wave II was submitted in December 2016 as planned, while the wave III portfolios is planned for submission in March 2019.

The Basel Roll out Calendar is shown below:

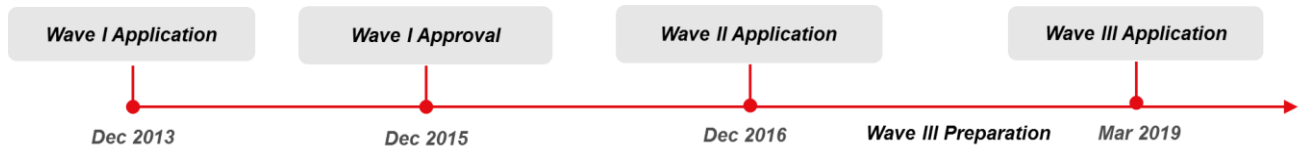


Figure 17 Basel Roll-Out Calendar

Existing coverage with Wave I approval and the estimated IRB coverage both in terms of Exposure at Default (EAD) and RWA with the subsequent approvals of the IRB portfolios (Wave II and Wave III) is shown in the graphs below.

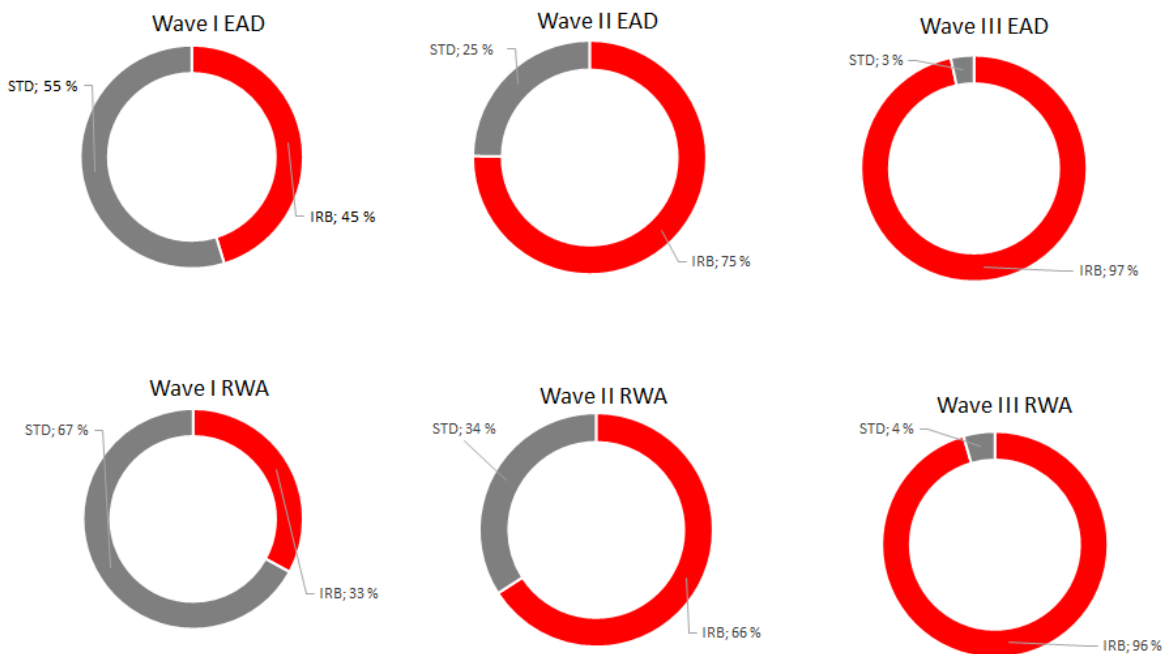


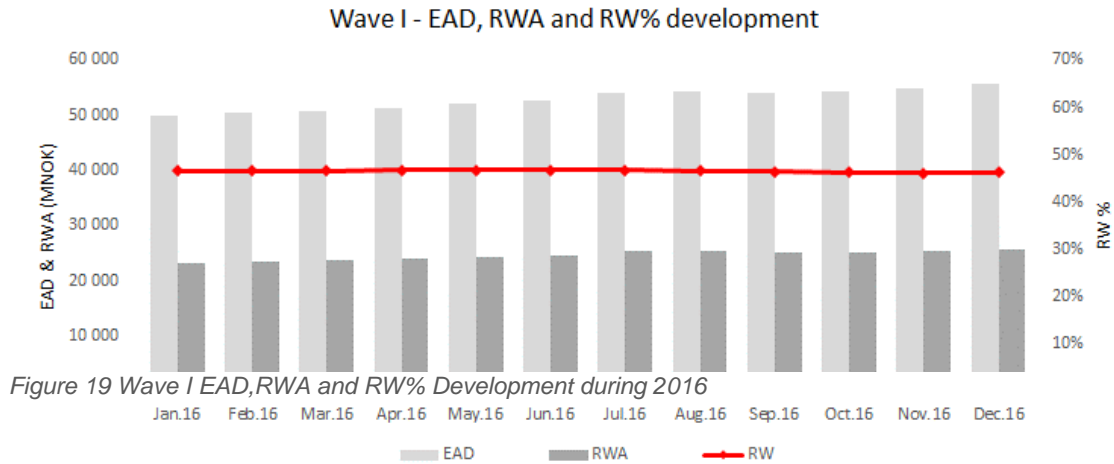
Figure 18 IRB Coverage of EAD and RWA for Wave I-III

Following the planned roll-out of the Wave III, close to 97% of eligible assets and 96% of the eligible RWA in the loan portfolio will be under IRB and the bank has ensured to maximize the roll-out without any selective approach on portfolios. Portfolios which are in run-off or where the materiality of the portfolio does not fulfill requirements of data availability and parameter estimations are excluded from IRB coverage.

### 8.3.2 Approved IRB Portfolios

In December 2015, SCB received the approval from the Bank of Spain and the Norwegian FSA, to report under IRB the Auto Private Persons portfolios for Norway, Sweden and Finland. The stability of the parameters and the underlying data for the portfolios performance has been monitored closely even before the IRB approval.

The EAD, RWA and Average Risk Weight (RW) development can be found in the graph above. The exposure to the



three IRB portfolios shows a stable growth during 2016. The average risk weight of these three portfolios has remained stable during for 2016.

Figure 20 provides an overview of the IRB portfolio exposures and risk parameters. The figure meets the recommendation outlined by the Basel Committee on Banking Supervision (BCBS) table CR6 of the document entitled ‘Revised Pillar 3 disclosure requirements’, of January 2015. Since SCB group IRB portfolio consists of installment loans without any assigned credit limit, Credit Conversion Factor (CCF) columns have not been reported.

PD_Bucket	On Balance Sheet gross exposure	EAD post CRM and post CCF	Average PD	# Obligors	Average LGD	Average Maturity	RWA	RWA Density	EL	Provisions
A [0.00-0.50)	8 627 653	8 627 762	0,26 %	53 000	34,5 %	4,07	1 523 572	17,7%	7 748	26 409
B [0.50-1.00)	16 575 707	16 575 885	0,72 %	136 587	45,1 %	3,85	6 968 237	42,0%	54 998	42 609
C [1.00-1.38)	12 786 210	12 786 264	1,09 %	93 046	40,9 %	3,96	5 848 798	45,7%	57 083	53 699
D [1.38-3.35)	8 452 519	8 452 710	2,02 %	70 140	41,7 %	3,93	4 828 722	57,1%	73 835	28 016
E [3.35-4.07)	901 678	901 861	3,39 %	6 146	41,9 %	4,19	568 029	63,0%	12 789	2 478
F [4.07-8.21)	4 653 417	4 653 632	5,53 %	35 743	40,6 %	4,06	2 990 120	64,3%	103 685	16 966
H [10.64-100)	3 187 615	3 188 190	24,09 %	25 287	37,8 %	3,87	2 901 823	91,0%	293 720	12 141
PD 100	503 707	505 915	100,00 %	5 022	39,1 %	2,10	69 892	13,8%	197 742	383 315
<b>Total</b>	<b>55 688 506</b>	<b>55 692 219</b>	<b>3,61 %</b>	<b>424 971</b>	<b>41,1 %</b>	<b>3,93</b>	<b>25 699 193</b>	<b>46,1%</b>	<b>801 600</b>	<b>565 633</b>

Figure 20 Overview of IRB portfolio exposure and parameters according to BCBS CR6

### 8.3.3 Regulatory Limits

In order to measure any significant variation within the portfolio and ensure stability, regulatory limits are established on key performance indicators for the IRB portfolios. These limits are also part of the “Management and Regulatory Limits” document which are reviewed on a yearly basis and approved by the Board of Directors.

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

- Risk Weight for total portfolio

- Expected Loss for total portfolio
- Probability of Default (PD) for total portfolio
- Loss Given Default (LGD) for total portfolio
- Risk Weight (RW) for New business volume for the month
- Expected Loss (EL) for New business volume for the month

Actual performance of the IRB portfolios are then reviewed against the set limits on a monthly basis and are delivered to relevant stakeholders, with any point of attention clarified and managed in case necessary.

The regulatory limits have not been breached during 2016, and will be reassessed for 2017. The new limits for 2017 will also include Wave II portfolios for which application has been submitted to regulators. This is to ensure management integration of parameters.

### 8.3.4 IRB Portfolio Parameters Estimation and Rating Assignment

Measuring the credit risk of a transaction involves calculating both the expected and the unexpected loss of the transaction. The unexpected loss is the basis for the calculation of both regulatory and economic capital and refers to a very high, albeit improbable, level of loss that is not considered a recurring cost but must be absorbed by capital. Measuring risk involves two separate steps: estimating the risk, and then assigning the credit risk parameters: PD, LGD and EAD.

PD or probability of default estimates the likelihood that a client or a contract will default within 12 months. The PD used for regulatory capital is long-term, or 'through-the-cycle' PD, which is not conditioned to a specific point in the cycle. Modelling default events are based on the definition contained in Article 178 of the CRR which considers that default is defined for a client/contract when at least one of the following circumstances arises:

- The institution considers there is a reasonable doubt that the obligor will pay its credit obligations in full.
- The client/contract is past due more than 90 days on any material credit obligation.

The event to be modelled in retail portfolios is contract default and calculations of PD are based on the entity's own internal experience, i.e. on past observations of defaults in ratings or scorings.

LGD or Loss Given Default is defined as the mathematical expectation of the percentage of economic loss in the event of a default event. Calculations of LGD are based on internal data concerning income and expense incurred by the institution during the recovery process once the default event has arisen, discounted at the date of commencement of default.

The LGD calculated to determine regulatory capital is 'downturn' LGD, i.e. considered for a worst-case scenario in the economic cycle.

Lastly, EAD, or exposure at default, the value of the debt at the time of default, is also calculated. For lending products or any product with no off-balance sheet amount, EAD equals the balance of the operation plus any interest accrued and not paid.

Historical information on portfolios is essential for estimating regulatory parameters. The EU Regulation (UE NO 575/2013)<sup>1</sup> stipulates that the minimum period of data to be used in estimates for retail portfolios is five years. For



this reason SCB Group has an internal data model containing past information on portfolios, which is subject to review by the internal supervisory divisions (Validation and Audit), and by the supervisory authorities.

As already mentioned, for regulatory purposes observations of frequency of default and the associated losses must be averaged out over an entire economic cycle, in the case of PD, or represent a downturn situation in the case of LGD or EAD.

It is for this reason that recent observations are not directly comparable to regulatory parameters, and back testing exercises should be treated with due caution. In general, the default frequencies recently observed are below regulatory PD during high growth period meaning growth rates above the average for the cycle. Conversely, when economic growth falls short of the average, default observations may exceed regulatory PD.

The major application of the PD, LGD and EAD credit risk parameters is to determine minimum capital requirements of the IRB portfolios within the legal framework. The legal framework states that these parameters and their associated metrics, including expected and unexpected loss, are to be used not only for regulatory purposes but also for internal credit risk management.

In SCB, the internal credit risk parameter estimates are used in a variety of management tools, including pre-classifications, RORWA (Return on Risk Weighted Asset) calculation, stress testing, and scenario analyses, the results of which are reported to senior management through various internal committees.

### 8.3.5 Recognition of credit risk mitigation

In the regulatory capital calculation, credit risk mitigation techniques affect the risk parameters. The IRB portfolios in SCB consists of Auto Loans to Private Persons where new and used vehicles serves as collateral. Following CRR article 199.1(c) these collaterals can be classified as “other physical collaterals” and is the only form of collateral that is used in the risk parameter estimations by bank. In the event of a customer default the bank will be able to repossess and sell the underlying collateral. Due to this the bank are able to use the underlying collateral as a credit risk mitigator in the LGD calculations. When calculating the LGD, the bank is using updated values of the underlying collaterals.

### 8.3.6 Governance and Control of IRB Models

A fundamental part of the process implementing IRB models is to establish robust control and review mechanisms by Internal Validation and Internal Audit. This will ensure effective monitoring, validation and documentation of the capital models and their integration into risk management.

The governance model involves different levels of control structured around three lines of defense with an organizational structure and independent, clearly defined functions: 1st line (Model Owner and Methodology), 2nd line (Model Risk, Internal Validation, Risk Control and Supervision Units) and 3rd line (Internal Audit).

This governance meets the following regulatory requirements for IRB models:

- a) Existence of a strong governance model.
- b) Existence, separation and independence of the Risk Control and Supervision, Internal Validation and Internal Audit areas.
- c) Independent annual reviews by Internal Validation and Internal Audit, both at Banco Santander level.
- d) Communication processes with Management which ensure all associated risks are reported

SCB has defined a set of standards to develop, monitor and validate its models. Any models used must meet these standards. The standards provide a guarantee of quality for the models used by the Group for decision-making purposes.

One key feature of proper management of Model Risk is a complete exhaustive inventory of the models used. SCB has a model inventory containing all relevant information on each of the models, enabling to properly monitor according to their relevance.

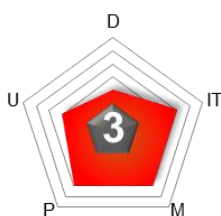
This phase involves all those affected by the life cycle of models - users, developers, validators, data providers, IT etc. - and draws up and establishes priorities. Models are planned on an annual basis, approved by local governance bodies, and validated at Banco Santander level.

SCB as part of Banco Santander has wide experience in the use of models for risk management decisions. Internal Validation at Banco Santander level assess and review all IRB models prior to implementation. The assessment will cover methodological and technological aspects, data quality, their functionality and their application. Robustness, usefulness and effectiveness are validated prior to implementing any model.

The quality of the model is summed up in a final rating, which indicates the model's risk on the following scale:

- 1) Low: The model's performance and use are appropriate. The quality of the data used in developing the model is good. The methodology used complies with the set standards and best practices.
- 2) Moderate-low: The model's performance and use are appropriate. The assumptions used in developing the model are reasonable.
- 3) Moderate: The model's performance and use are appropriate. The assumptions used in developing the model are reasonable. There are aspects of the model that need to be improved.
- 4) Moderate-high: There are deficiencies in the model's performance or use. The model's assumptions, the quality of the data in the development sample or the model's predictions are questionable.
- 5) High: The model's performance is inadequate, the model is not being used for the purpose for which it was developed, or the model's assumptions are incorrect.

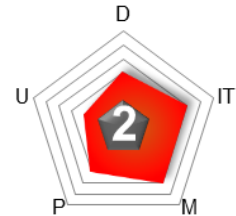
Norway PD



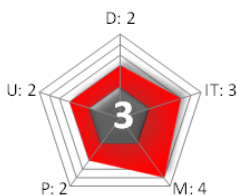
Sweden PD



Finland PD

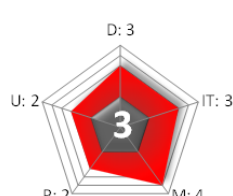


Norway LGD



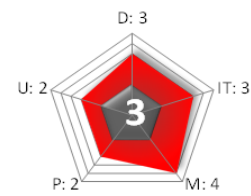
**3: Moderate model risk**

Sweden LGD



**3: Moderate model risk**

Finland LGD



**3: Moderate model risk**

Figure 21 Internal Validation Scorecard Review Auto Private Persons

Figure 21 summarizes the scores assigned to the credit risk models as a result of Internal Validation's review of credit risk parameters and rating models during 2016

Internal Audit is the third line of defense: The analysis carried out by this independent team covers five main areas of activity:

1. Review of compliance with both the Group and regulator's internal governance model
2. Integration in management and models rating. Detailed analysis on the importance of the model, valuation tools and implementation process as well as verifying the existence of procedures and compliance with rating policies.
3. Coherence and integrity of the databases and models construction. Review of the information control environment and the correct quality and integrity of the data
4. Review of the capital calculation process.
5. Analysis of the technical aspects and IT environment applications. Examination of the different processes' quality and environment supporting the models, as well as their involvement in management. Verification of the contingency plans to ensure strict compliance with the improvements laid down.

Once the review is finished, Internal Audit issues a report containing recommendations and observations arising from its review process, which in turn have a stipulated deadline to submit their action and resolution plans. Internal Audit also reports independently to Banco Santander's Audit Committee, an independent body.

Following the approval from internal Validation, the model must be submitted for approval by the proper management bodies before being put into production. Nordic model committee at SCB level assesses and approves the model before the Consumer Model Committee at SCF level and Global Model Committee at Banco Santander level approves the model before implementation

Senior management at SCB periodically monitors Model Risk in a set of reports that provide a consolidated view of the SCB's Model Risk and enable decisions to be taken in this regard.

### 8.3.7 Back-testing of IRB parameters

The aim of the PD Back test is to compare the regulatory PD used for calculating capital requirements with actual observed defaults (Observed Default Frequency (ODF)). The purpose of this exercise is to assess the predictive power of the IRB models.

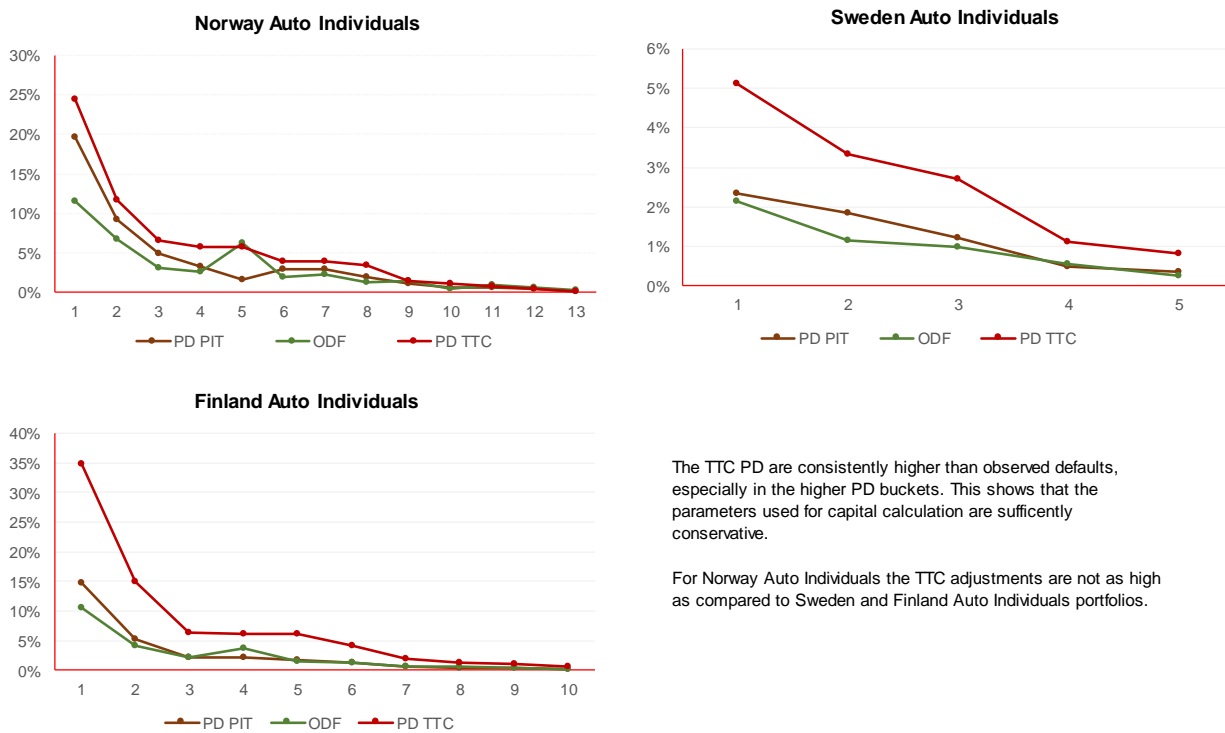
For each portfolio, regulatory PD buckets, representing different PD levels, are established. For each of these the average PD assigned for regulatory capital purposes is compared with the ODF. To observe defaults, operations that were not in default at a reference date is selected, and the rate of new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

The regulatory PD is a through-the-cycle (TTC) PD, i.e. a long-term average that is not tied to any particular point in the cycle. However, the default frequency is observed at a given point in time (2016). Given their different characteristics, the comparison between the two figures does not constitute a precise check on the regulatory PD, but it does serve to assess the size of the cyclical adjustment used in the calculation of the regulatory (TTC) PD.

To complete the analysis, the observed default frequency is also compared with the point-in-time (PIT) PD, which is influenced by the cyclical situation of the observation period. This allows the slope of the PD curve to be compared with the delinquency observed in each rating category.

Most of the following charts do not show the first PD bucket. This bucket includes very high values due to the inclusion of transactions in special situations: recovery process, irregular, etc. Including these would distort the scale of the graphs, hindering a proper assessment of the better-populated PD buckets.

The charts below summarize the information for the portfolios under IRB-Approach:



The TTC PD are consistently higher than observed defaults, especially in the higher PD buckets. This shows that the parameters used for capital calculation are sufficiently conservative.

For Norway Auto Individuals the TTC adjustments are not as high as compared to Sweden and Finland Auto Individuals portfolios.

Figure 22 Observed Default Frequency by PD bucket and PD %

The above analysis is further complemented by the quantitative study suggested by the Basel Committee on Banking Supervision (BCBS) in table CR9 in Figure 23 of the document entitled 'Revised Pillar 3 disclosure requirements', of January 2015.

SCB Nordics	PD Range	External Rating Equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Average historical annual
					End of previous	End of the year		
Nordics - Norway Auto Individuals	0 < 0,15%	AAA to A-	-	-	-	-	-	-
	0,15 < 0,25%	A- to BBB+	-	-	-	-	-	-
	0,25 < 0,50%	BBB+ to BBB-	0,26 %	0,26 %	46 263	52 364	84	0,21 %
	0,50 < 0,75%	BBB- to BB+	0,63 %	0,63 %	37 658	42 433	199	0,52 %
	0,75 < 2,50%	BB+ to BB-	1,38 %	1,41 %	56 994	59 474	517	1,04 %
	2,50 < 10,0%	BB- to B-	5,45 %	5,59 %	18 752	19 202	463	2,85 %
	10,0 < 100%	B- to C	22,67 %	23,24 %	14 061	15 035	1 478	15,61 %
	100% (Default)	D	100,00 %	100,00 %	3 708	3 856		
Nordics - Sweden Auto Individuals	0 < 0,15%	AAA to A-	-	-	-	-	-	-
	0,15 < 0,25%	A- to BBB+	-	-	-	-	-	-
	0,25 < 0,50%	BBB+ to BBB-	-	-	-	-	-	-
	0,50 < 0,75%	BBB- to BB+	-	-	-	-	-	-
	0,75 < 2,50%	BB+ to BB-	0,86 %	0,86 %	78 997	92 405	218	0,36 %
	2,50 < 10,0%	BB- to B-	3,34 %	3,36 %	27 539	28 363	295	1,46 %
	10,0 < 100%	B- to C	66,60 %	66,50 %	355	339	121	55,85 %
	100% (Default)	D	100,00 %	100,00 %	336	308		
Nordics - Finland Auto Individuals	0 < 0,15%	AAA to A-	-	-	-	-	-	-
	0,15 < 0,25%	A- to BBB+	-	-	-	-	-	-
	0,25 < 0,50%	BBB+ to BBB-	-	-	-	-	-	-
	0,50 < 0,75%	BBB- to BB+	0,62 %	0,62 %	12 871	14 019	21	0,18 %
	0,75 < 2,50%	BB+ to BB-	1,35 %	1,39 %	58 220	71 760	200	0,44 %
	2,50 < 10,0%	BB- to B-	4,94 %	4,95 %	14 166	12 924	205	1,83 %
	10,0 < 100%	B- to C	26,82 %	27,18 %	9 035	9 719	601	10,51 %
	100% (Default)	D	100,00 %	100,00 %	468	490		

Figure 23 BCBS CR9 Table

It can be seen that there is no major difference between the average exposure-weighted PD and the simple average in each bucket, indicating that the different transactions are fairly uniform with regard to exposure.

The following columns is divided into two, which contain the number of obligors (or transactions in the case of retail) at two different dates: December 2015 and December 2016. The intention is to detect customers/transactions migrating between PD buckets, though sometimes the migration is due more to a recalibration of regulatory models than to the dynamics of the rating system. In case of all models it can be observed that the distribution of obligors is fairly similar in these 2 years meaning no significant rating migration and stable portfolio quality.

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

In general it is observed that the PD assigned to IRB portfolios for capital requirement are conservative when compared with average defaults over last 5 years. This observation is in line with economic cycle development in the respective countries.

## 8.4 Credit Risk Management Tools

### 8.4.1 Scorecards

Credit risk management under the A-IRB approach is based on the use of scorecards. Admission and behavioral scorecards have been developed and implemented for the retail portfolios. The purpose of the admission scorecards is to separate the “good” customers from the “not so good customers”, whilst the purpose of the behavioral scorecards is to track how the customer is performing.

All the scorecards are continuously monitored. The goal is to ensure that portfolio delinquency is within acceptable limits by adjusting the score limits in line with the risk appetite of the bank. All implemented scorecards are monitored for their stability, accuracy and predictability to ensure they work as intended.

#### 8.4.2 Internal Rating Model

The Wholesale (Corporates) segment is composed of large and/or complex exposures evaluated individually by a risk analyst. Depending on the size of the loan the application will need to be escalated and submitted to the relevant Credit Committee for approval; this in compliance with delegated credit authorities' structure established in the Credit Policy.

During 2010, an internal rating model developed centrally in Banco Santander (SCB's ultimate parent) was implemented in all units. This involved risk analysts reviewing all Wholesale clients and setting a rating score, following the Santander Rating scale (see below). Ratings from the Santander Internal Rating model method will result in an individual probability of default (PD) by Wholesale exposure.

Santander rating	PD %	Moody's	Standard & Poors
1.0	37,60 %	C	C
2.0	14,58 %	Ca	CC
2.5	9,08 %	Caa	CCC
3.0	5,56 %	B3	B-
3.5	3,52 %	B2	B-
4.0	2,19 %		
4.5	1,37 %	B1	B+
5.0	0,85 %	Ba3	BB-
5.5	0,53 %	Ba2	BB-
6.0	0,33 %	Ba1	BB+
6.5	0,21 %	Baa3	BBB-
7.0	0,13 %	Baa2	BBB-
7.5	0,08 %	Baa3	BBB+
8.0	0,05 %	A3	A-
8.5	0,03 %	A2-A1	A-A+
9.0	0,02 %	Aa3-Aa2	AA-AA
9.2	0,00 %	Aa1	AA+
9.3	0,00 %	Aaa	AAA

Figure 24 Santander Internal Rating model for Wholesale exposures

The Santander Internal Rating Model is a hybrid model, which takes into account expert judgement as well as objective criteria from the clients' Financial Statements and an assessment of the obligor's shareholders and management. The six main rating categories are rated and weighted as illustrated below:

Area	Weighting
Product/Demand/Market	20 %
Shareholders/Management	15 %
Access to Credit	10 %
Profitability/Return	15 %
Generation of Funds	25 %
Solvency	15 %

Figure 25 Santander Internal Rating Model weighting areas

### 8.4.3 ICAAP Stress Test

Stress testing is one of the risk management tools, which allow for better understanding of the bank's risk profile and its resilience to internal and external shocks. Given the natural limitations of the methodologies, parameters and data used, as well as overall uncertainty about forward looking assessment and the actual occurrence of assumed scenarios, stress testing cannot provide for absolute safety. Therefore, stress testing is used by the bank in combination with other risk management and control tools to make informed business decisions.

The result of the stress test for Internal Capital Adequacy Assessment Process (ICAAP) forms part of our Pillar 2 assessment and Pillar 2 capital requirement.

## 9. Counterparty credit risk

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

Transactions within the scope of Counterparty credit risk are cross currency swaps and interest rate swaps. These type of derivatives are used in order to hedge currency and interest rate risk related to funding transactions. In all derivatives the bank has entered into we have signed collateral agreement (CSAs) with the counterparty with bilateral daily collateral posting.

Since these derivatives are used for hedging purposes only and required capital for these transactions represent a very small share of total capital requirements, Counterparty credit risk is not considered a material risk for SCB.

## 10. Securitization

Securitization serves as an integral part of the bank's funding strategy. Since 2011, SCB has completed 15 asset backed securities transactions: seven securitizations from its Norwegian auto portfolio, two securitizations with Swedish assets, including a warehouse transaction, four securitizations from the Finnish business, and one out of Denmark. Per end December 2016, securitizations accounted for about 13% of funding, a decline since 2015. This following a change in the legislation in Norway making it more challenging to securitize auto loans in Norway in the same manner as we have done in the past. This does however not impact the securitization programs in the other Nordic countries.

SCB securitizes auto loans by selling portfolios of auto loans to a special purpose company, which funds the purchase by issuing bonds with security in the assets. The securitization program has been initiated for the purpose of funding operations. Mitigation of credit risk and/or achieving capital relief is currently not within the scope of the securitizations. The securitization program has not, and will not, affect the bank's front or back systems in any significant way.

SCB issues Asset Backed Securities (ABS) but do not invest in any ABS'es issued by others. All currency and interest rate risk created by a mismatch between issued notes and underlying assets are hedged through currency and interest rate swaps.

## 11. Market risk

Market risk is considered as the potential loss of value in assets and liabilities due to changes in market variables. Market risk arises as a result of the bank holding open positions in various financial instruments. It can be subdivided into the following main categories:

- Currency risk is the risk of loss as a result of changes in foreign exchange rates (key metric is open exposure in the relevant currencies)
- Interest rate risk is the risk of loss as a result of changes in the interest rate (key metrics are NIM and MVE sensitivity to the worst of +/-25, 50, 75, 100 bps parallel movement in the interest rate curves)
- Credit spread risk is the risk of loss as a result of changes in credit spreads

Market risk is managed by the Treasury department organized under the Financial Management Division and controlled by the Risk Division.

SCB has a strategy of not taking on market risk beyond what follows directly from our operations in the four countries where we are present. The bank is exposed to currency risk because it operates in four different countries and currencies, and through its use of international funding markets. The bank has interest rate risk to the extent there is a mismatch between interest rate exposure on the asset side and liability side. SCB does not have an active trading portfolio or positions in securities and commodities, but has a liquidity portfolio consisting of High Quality Liquid Assets where the intention is to hold the bonds to maturity.

The currency risk, interest rate risk and credit spread risk related to our liquidity portfolio will be described in more detail below with the relevant metrics and figures.

### 11.1 Currency risk

As the bank operates in countries with various currencies, as well as using international funding markets, it will inevitably be exposed to currency risks. The bank does not actively take on currency risk beyond what follows from the bank's operations in four different countries.

The bank aims for a composition of the balance sheet that minimizes currency risk by ensuring that the assets and liabilities are denominated in the same currency. When raising funding through the international debt market any open currency exposure will be closed through the use of derivatives.

The currency exposure is continuously monitored and controlled through monthly reports. The limits for currency risk are reviewed by the Board of Directors on an annual basis. For 2017 the limits are set to NOK 200 million equivalent towards SEK and DKK, and NOK 1000 million equivalent towards EUR on a consolidated basis. The reason for the higher EUR limit is to accommodate retained earnings in the Finnish subsidiary, SCF Oy. The combined FX exposure for the SCB Group is capped at 1200 million NOK equivalent.

The actual open positions of FX risks as per end 2016 are the following: NOK 498 million equivalent of EUR position, NOK 231 million equivalent of SEK position and NOK 125 million equivalent of DKK position. The breach in Sweden is due to a Bad Debt Sale performed in December and was resolved within few days after year end.

### 11.2 Interest rate risk

Interest rate risk is the risk of reduced earnings or reduction in the economic value of the equity due to changes in market rates.



SCB aims to achieve a balance sheet composition that minimizes the interest rate risk by balancing the total weighted interest term for both assets and liabilities. The bank is only exposed to interest rate risk that follows directly from the bank's operations, as does not actively take on interest rate risk.

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

The Financial Management Division proposes interest rate risk limits to the Risk Division which assesses the proposal and submits it to the Board of Directors for final approval. The limits reflect the risk appetite of both the parent Santander Consumer Finance SA and SCB. Limits must be reviewed annually for each of the following metrics:

**Net Interest Margin sensitivity (NIM):** The sensitivity of the Net Interest Margin is a measure of the difference between the return on assets and the financial cost of the liabilities on a 12 month horizon. The impact of the changes (-/+ 100 bps) in interest rates on NIM leads to changes in the Profit and Loss account and in the quality of the balance sheet.

**Economic Value or Market Value of Equity sensitivity (MVE):** The sensitivity of Market Value of Equity is a measure which complements the sensitivity of Net Interest Margin. It measures the implicit interest rate risk in the Market Value of Equity from a variation in interest rates (-/+ 100 bps) on the financial assets and liabilities in the bank.

The interest rate is calculated in the internally developed Asset and Liability Model by distributing all interest rate sensitive assets and liabilities into tenor buckets and then calculating the MVE and NIM sensitivities by applying certain mathematical formulas. The assets and liabilities are assigned their re-pricing maturities follow certain assumptions that are regularly reviewed. The assumptions include the behavioral aspects of non-maturity deposits that do not have contractual maturity and the re-pricing criteria of the loan portfolio that are contractually neither fixed or floating rate products.

The 2017 management limits for NIM and MVE sensitivity are the following:

	Limit	Actual (worst case of +/-100 bps)
<b>NIM</b>	Norway: NOK 70 Million Denmark: DKK 35 Million Sweden: SEK 35 Million Finland: EUR 6 Million	Norway: NOK 10,97 Million Denmark: DKK 0 Million Sweden: SEK 0 Million Finland: EUR 0,38 Million
<b>MVE</b>	Norway: NOK 200 Million Denmark: DKK 50 Million Sweden: SEK 65 Million Finland: EUR 12 Million	Norway: NOK 33,66 Million Denmark: DKK 5,98 Million Sweden: SEK 0 Million Finland: EUR 4,55 Million

Figure 26 Interest Rate risk limits and ratios per December 2016

### 11.3 Credit Spread risk

Credit spread risk is defined as the risk of changes in market value of securities or any credit derivatives as a result of an overall change in credit spreads. As mentioned, SCB's strategy is not to take on market risk in excess of what follows directly from the operations of the bank. Consequently, the bank's liquidity portfolio consists of high quality liquid assets. SCB did not have any credit derivatives per December 2016.

The market risk exposure of the liquidity portfolio is considered as low, since the investment mandate is limited to short term level 1 high quality liquid assets where the intention is to hold the bonds to maturity.

## 12. Operational risk

Operational risk is defined as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events". It includes events that may arise due to legal or regulatory risk, but does not include events arising due to strategic or reputational risk.

SCB is applying the Basic Indicator Approach for calculating the bank's capital requirement for operational risk. With the Basic Indicator Approach the capital charge for operational risk is calculated as a percentage (alpha) of the three last year's gross income. This alpha is given by article 315 (1) of the CRR and is currently 15%.

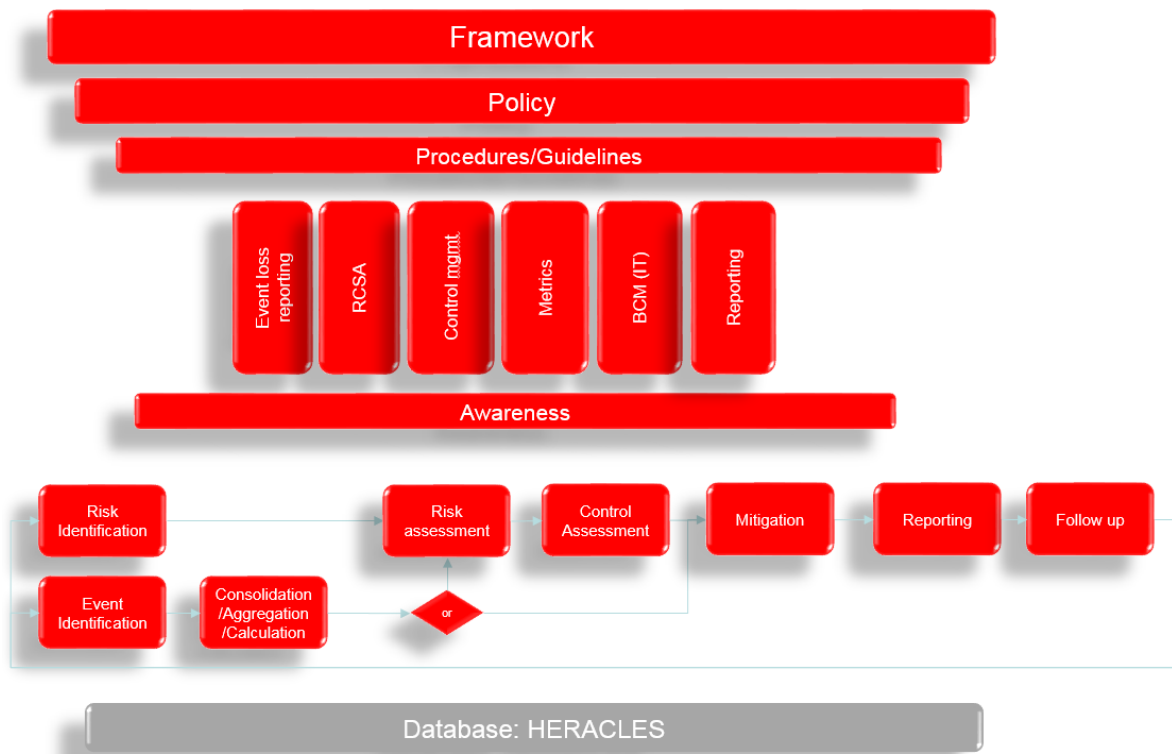


Figure 27 SCB's Operational Risk Management Framework

SCBs framework, as illustrated above, is based on Banco Santander governance and framework for Operational Risk. The model consist of six main processes, which all are interlinked to each other. All event data are reported into the global database called Heracles.

- **Event loss reporting process** – Identification, consolidation, aggregation, calculation, mitigations and reporting of events that has occurred, and in most case generates non-accountable or accountable losses. The Bank uses the 7 Basel categories for the classification of losses.
- **Risk Control Self-Assessment process (RCSA)** – An annual risk assessment identifying and evaluating potential risks and controls to proactively prevent unwanted events materializing. Potential risks are also managed continuously during the year within the event loss reporting process.
- **Control management** – Controls will constantly be a part of ‘business as usual’ within all processes and managed by both Operational Risk and Internal Control. Controls will be reviewed and assessed at least once a year.
- **Metrics** – Using different metrics, increasing risks can be prevented from being materialized.
- **Business Continuity Management (BCM)** – In the BCM program, plans are defined to quickly recover a system or a process exposed for a major event or a disaster. After the BCM plans have been activated the event will be a part of the event loss reporting process.

In November 2015, the new extended operational risk program was implemented in SCB. During 2016 focus has been to implement new processes and a new system to support the operational risk framework. The bank’s management emphasizes that operational risk is a continuous process and that it will be developed in accordance to the readiness and maturity of the organization.

From a governance perspective, the overall management of SCB operational risk is delegated to the Nordic Non-Financial Risk and Governance Director and the Nordic operational risk manager with local Operational risk controllers in each country.

Operational risk is measured as the losses incurred by operational related errors. The bank has for 2017 set a limit of 1% operational losses measured as  $\text{Losses Incurred} + (\text{provisions for operational losses} - \text{recoveries from operational losses}) / \text{Gross Margin}$ . The observed ratio in 2016 was 0,28%.

IT-Risk is managed through the Risk Control Self-Assessment process mentioned above.

### 13. Liquidity risk

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

Liquidity risk management in the bank aims to ensure sufficient funds to support the daily operations of the bank, a balance between weighted average life of the assets and liabilities, diversified funding sources and sufficient amount of liquidity reserves across all 4 currencies in order to survive a stress scenario.

The key ratios for the liquidity risk are LCR and NSFR.

- The LCR (Liquidity Coverage Ratio) is established as a metric to measure short-term liquidity risk. This ratio indicates the short-term resilience of the entity's liquidity risk profile, ensuring that there are sufficient high-quality liquid assets to withstand an event of combined systemic and global stress over a period of 30 calendar days. The LCR requirement for 2016 was 70%, increasing to 80% in 2017 and 100% in 2018. LCR for SCB Group was by end 2016, 118%.
- The NSFR (Net stable funding ratio) is the long-term funding ratio which compares the structural funding needs to the entity's stable funding sources. This ratio requires the banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. The requirement for NSFR is expected to be 100% from 2018. The ratio for SCB group was by end 2016, 99%.

### 13.1 Diversification of funding sources

SCB aims to reduce reliance on funding from parent company (ie. become self-funded) and to maintain a well-diversified funding source composition. Per end of 2016, the bank had a self-funding ratio of 70%<sup>3</sup>. Over the years, the bank has established the following funding sources:

- Customer deposits in Norway, Sweden and Denmark. The customer deposit products are demand deposits, fixed rate deposits and notification products
- Secured funding in the Nordic countries (asset backed securities)
- Senior Unsecured funding in the local Nordic markets and in international markets
- Intragroup funding from the parent company
- Liquidity facilities with 3rd party banks
- Available credit line with the Norwegian Central Bank
- Repo capabilities with Nordic counterparties

Figure 28 below shows the funding composition on a consolidated Nordic level for end of year 2016:

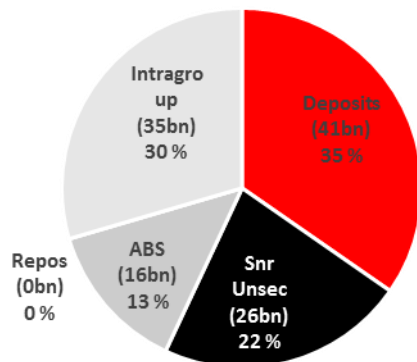


Figure 28 SCB Funding composition (figures in NOK)

Over the last few years retail deposits have been introduced in Norway, Sweden and Denmark. As of year-end 2016, deposits constituted about 35% of the bank's funding base, up from 33% in 2015.

<sup>3</sup> Calculated as a proportion of senior debt, excluding equity and subordinated debt

The bank's securitization program has been implemented across the four Nordic units over the past five years, and serves as an integral part of the bank's funding program. Per year-end 2016, securitization constituted about 13% of the bank's funding, down from 20% in 2015. This is mainly due to a change in legislation governing ABS issuances in Norway applicable from 2016, making new issuances in Norway challenging.

The bank is well-established in the Norwegian senior unsecured bond market and has increased issuances under its Euro Medium Term Note program (EMTN), which up until 1H 2016 was guaranteed by the parent Santander Consumer Finance S.A. During H1 2016, SCB obtained a rating of A3 with stable outlook by Moody's and A- with stable outlook from Fitch. The issuances under the EMTN program in H2 2016 was therefore made on a standalone basis without the guarantee from parent. Per year-end 2016 external senior unsecured funding constituted about 22% of the bank's funding, up from 17% in 2015.

SCB has available draw-down facilities with its direct parent and with other entities within the Banco Santander Group. Per year-end 2016, senior funding from parent constituted about 30% of the bank's funding, same as for 2015. In addition to senior funding, the SCB also has subordinated debt provided by the parent company.

In addition to drawdown facilities from the parent and Banco Santander Group, the bank has committed credit facilities provided by 3<sup>rd</sup> party banks. This is intended to cover short-term liquidity requirements of an operational nature and to serve as a liquidity buffer.

## 13.2 Liquidity portfolio

The bank holds a liquid bond portfolio to mitigate liquidity risk. The size of this liquidity portfolio is determined through the bank's liquidity stress tests as well as regulatory requirements, such as the Liquidity Coverage Ratio (LCR).

The bank has since October 2015, been required to comply with LCR requirements. The LCR requirement for 2016 was 70%, increasing to 80% in 2017 and 100% in 2018. Per year-end 2016, SCB had a LCR-ratio of 119%, up from 83% in 2015 and the liquidity bond portfolio was about NOK 11 Billion equivalent. The bank has a conservative mandate for liquidity portfolio investments and only invests in LCR level 1a securities. The portfolio is invested in Nordic government bonds, supranational bonds and AAA/Aaa rated Nordic covered bonds, issued in NOK, SEK, DKK and EUR. Further, the bank only invests in floating rate coupon bonds with a maturity up to 3 years and fixed rate bonds with a maturity up to 1 year. The intention is to hold the bonds in the liquidity portfolio to maturity. The bank can deposit bonds from the liquidity portfolio in the Norwegian Central Bank and provide intraday liquidity.

## 13.3 Liquidity Stress Tests

SCB is required by the regulator to have and maintain a Liquidity Stress Test model, which should be run on a monthly basis. The liquidity stress test of the bank is complying with requirements from the Norwegian FSA and is used both as a tool for measuring liquidity risk and for managing funding and liquid assets.

The Liquidity Stress Test is to be presented to Senior Management on a quarterly basis and on a semi-annual basis to the Board of Directors. The object of the Liquidity Stress Test is to ensure that the bank has sufficient liquidity to survive a given period of time under the stressed scenarios. The stress test is used as part of the liquidity risk management of the bank.

### 13.4 Encumbered assets

An asset is encumbered if the asset is pledged or collateralized and cannot be freely withdrawn. The source of encumbrance in SCB is securitization. Asset encumbrance (AE) are managed with a limit of 40%. By end 2016 the actual ratio observed was 15%.

Asset encumbrance is monitored and maintained within a limit for dual purposes. One is to prevent concern among unsecured creditors that they are unable to benefit from the liquidation of assets in case of insolvency, if too many assets of the bank are already encumbered. The other is to limit the amount of encumbered assets that are not available to obtain emergency liquidity in case of an unforeseen stress event.

The ratio of asset encumbrance is calculated as the ratio of the assets/collateral pledged for financing operations (encumbered assets) plus total collateral received and reused divided by the sum of total assets and total collateral received, expressed as:

$$\% \text{ AE} = \frac{\text{Total encumbered assets} + \text{Total collateral received reused}}{\text{Total assets} + \text{Total collateral received}}$$

### 14. Business and strategic risk

Business and strategic risk is the risk of lower earnings than expected. This may be due to lower than expected revenues, higher than expected operating cost, or a combination of the two. This risk is inherent in the operation of the bank and the macroeconomic environment where it operates.

The stress test conducted in the ICAAP uses different macro economical scenarios and shows how this impact the profitability and impact on the capital position of the bank. Due to the relative short duration of the bank's assets, a downturn stress-scenario will typically have some but limited impact on capital ratios since risk weighted assets will decrease in conjunction with reduced profit.

By operating in Norway, Sweden, Denmark and Finland the bank is less vulnerable to any challenging macroeconomic development in the individual countries. With the merger with GE Money Bank, in 2015, the diversification of customer and product portfolio has improved. Focus going forward will be more on increasing the number of products per customer, and consequently build customer loyalty and lasting customer relationships.

### 15. Compliance risk

The Nordic Chief Compliance Officer reports directly to the Nordic HR, Legal and Compliance Director who is subordinated the CEO. In addition, local Legal and Compliance Directors reports directly to – and is subordinated the Managing Directors (except for SCF OY – where L&C Director reports to Risk Director). In November 2016 the Board of Directors approved to separate the Legal & Compliance organization in the Nordics, and to appoint a Chief Compliance Officer (CCO), mandated to setup an independent second line of defense Compliance function across the Nordics, and implement the Group Compliance Program, aligned with local legal and regulatory requirements. To manage the organizational changes, recruitments and committee reviews, there will be a transition period until 30 June, 2017.

The primary role of the Compliance function is to ensure compliance with applicable laws and regulations as well as assess and monitor compliance risk, such as Anti-Money Laundering and terrorist financing, regulatory compliance, product governance and customer protection, as well as reputational and conduct risks. The Bank is compliant with both internal and external rules and regulations and establishes appropriate policies and procedures to minimise compliance risks. When designing internal rules and procedures, the bank takes into account the nature, scale and complexity, and the nature and scope of its services and business. The compliance function is also responsible for:

- evaluating the measures taken to remedy any deficiencies in its compliance and control, monitor and evaluate the first line of defense management and internal control structure;
- providing advice and support to the bank's employees and directors so that the business is run according to the statutes governing its licensed business;
- ensuring that the employees concerned are informed of new or revised regulations. Training of new regulations is primarily carried out by the legal function;
- verifying that new products, services, processes and systems are in compliance with the statutes governing its licensed business. Consideration is also given to the influence of known future changes in laws and regulations (dual ownership with legal function);
- making recommendations on the basis of the work carried out and the findings that the function does;

The compliance function report its findings and recommendations to the Managing Directors and the CEO on a regular basis, monthly or quarterly to the Local Internal Control Committee, quarterly to the Nordic Internal Control Committee and regularly to the Board Risk Committee and the Board of Directors.

The bank is yearly assessing its Compliance Risks applying the compliance risk assessment methodology of Banco Santander. The objective is to assess risks within core activity lines, in banking activities where customer relations need to be managed, and excludes therefore risks within Tax, Financial Accounting, HR, and similar non-core compliance areas.

The mandatory compliance risk assessment facilitates a homogenous approach to assess, report and escalate compliance risks to local and corporate management, as well as providing an effective supervision of risk management throughout the bank. The assessment ensures that inherent risk is assessed based on its probability and impact within main regulatory areas applicable to the business operations of each entity and measures the risk mitigating effect of the preventative and detective controls in place.

## 16. Pension Obligation risk

Pension obligation risk is the risk to a firm caused by its contractual or other liabilities with respect to a pension scheme. According to the EU accounting standards, there are two categories of pension scheme: contribution-defined plan and benefit-defined plan.

A contribution-defined plan is a retirement savings program under which an employer promises certain contributions to a participant's account during employment, but with no guaranteed retirement benefit. While a benefit-defined scheme is a retirement plan, which offers a guaranteed future benefit for employees at retirement. This diverges from the contribution-defined scheme in the way that employer's obligation is not limited to the contributions made, and it is the employer that bears the actuary risk and investment risk, which gives rise to the pension obligation risk.

Santander Consumer Bank AS has both types of pension schemes. The bank receives reports from the pension companies semi-annually where a detailed reconciliation of pension obligation are specified. By the end of 2016

the net pension liability for SCB was NOK 217 million which is below 0.2% of the total liabilities for the bank and hence does not represent any material risk for the bank.



## 17. Overview of Charts, Tables and Figures

Figure 1 Real GDP forecast. Source Bloomberg.....	5
Figure 2 Organisation of Santander Consumer Bank .....	7
Figure 3 Risk Strategy.....	12
Figure 4 Risk Organisation.....	12
Figure 5 Overview of risk weighted assets and capital requirements for the main risk categories for SCB Group.....	13
Figure 6 Gross Outstanding by Country.....	15
Figure 7 Gross Outstanding by Product.....	16
Figure 8 Share of Gross Outstanding by Country .....	16
Figure 9 Share of Gross Outstanding by Product.....	17
Figure 10 Share of Gross Outstanding by Secured/Unsecured.....	17
Figure 11 Share of Gross Outstanding by Maturity.....	18
Figure 12 Overview of risk weighted assets for Credit exposure in SCB.....	18
Figure 13 NPL-ratio developments 2014-2016 per secured (auto) and unsecured portfolio, .....	19
Figure 14 NPL-ratio developments 2014-2016 per country .....	20
Figure 15 Coverage ratio developments 2014-2016 .....	20
Figure 16 SCB Portfolio according to Basel .....	21
Figure 17 Basel Roll-Out Calendar.....	22
Figure 18 IRB Coverage of EAD and RWA for Wave I-III.....	22
Figure 19 Wave I EAD,RWA and RW% Development during 2016.....	23
Figure 20 Overview of IRB portfolio exposure and parameters according to BCBS CR6 .....	23
Figure 21 Internal Validation Scorecard Review Auto Private Persons .....	26
Figure 22 Observed Default Frequency by PD bucket and PD % .....	28
Figure 23 BCBS CR9 Table.....	29
Figure 24 Santander Internal Rating model for Wholesale exposures.....	30
Figure 25 Santander Internal Rating Model weighting areas .....	30
Figure 26 Interest Rate risk limits and ratios per December 2016 .....	33
Figure 27 SCB's Operational Risk Management Framework.....	34
Figure 28 SCB Funding composition (figures in NOK).....	36