

# Länsförsäkringar Hypotek

YEAR-END REPORT 2006



## Summary

- Lending increased by 18%, from SEK 31 billion to SEK 37 billion.
- The market share for mortgage lending to private homes and tenant-owned apartments rose from 2.9% to 3.0%.
- The share of new sales on the mortgage loan market amounted to approximately 5%.
- Operating income amounted to SEK 45 M (23).
- Net interest income increased by 19% to SEK 198 M (166).
- An unconditional shareholders' contribution of SEK 200 M was received from the Parent Company.
- Capital adequacy was 11.2% (12.1) and the Tier 1 ratio 9.4% (10.0).
- The number of customers increased to 90,400 (83,000).
- For the second consecutive year, Länsförsäkringar's mortgage customers were more satisfied than other customers at other mortgage lenders according to the Swedish Quality Index (SKI).

Figures in parentheses pertain to 2005.

### Anders Borgcrantz, President of Länsförsäkringar Hypotek

2006 was a strong and favorable year for Länsförsäkringar's mortgage operations. We captured market shares and increased our net interest income despite increasingly intense competition. Our success was based on a strong total solutions offering combined with attractive prices and conditions. The Swedish Quality Index indicated that for the second consecutive year we have the most satisfied customers, which is the result of continuously challenging the market and contributing to increased competition. The mortgage market is undergoing a period of change with new conditions creating equal competition. We have been highly successful as a challenger. In 2007, we will intensify pressure on competitors now that we are able to compete under equal conditions.



## Key figures

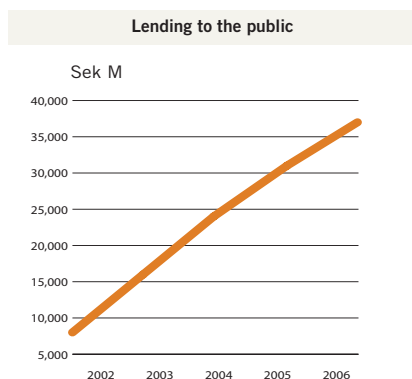
	2006	2005	2004
Return on equity, %	1.82	1.13	2.00
Return on total capital, %	0.13	0.08	0.13
Investment margin, %	0.57	0.60	0.78
Interest margin, %	0.37	0.45	0.57
Cost/income ratio before loan losses	0.62	0.68	0.65
Cost/income ratio after loan losses	0.52	0.60	0.61
Capital adequacy, %	11.15	12.07	11.28
Tier 1 ratio, %	9.41	10.00	9.12
Percentage of doubtful receivables, gross %	0.10	0.09	0.14
Percentage of doubtful receivables, net %	0.01	-0.04	-0.01
Provision ratio for doubtful receivables, %	91.51	139.48	107.05

## Quarterly development

SEK 000s	Q4 2006	Q3 2006	Q 2 2006	Q 1 2006	Q 4 2005
Net interest income	52,058	51,993	47,518	46,909	39,236
Net income from financial transactions	1,087	–	–	–	–
Net commission income	-27,935	-28,213	-25,772	-25,524	-31,126
Other revenue	12	37	49	53	932
<b>Total operating revenue</b>	<b>25,222</b>	<b>23,817</b>	<b>21,795</b>	<b>21,438</b>	<b>9,042</b>
Personnel costs	-1,289	-1,574	-1,986	-1,400	-1,538
Other expenses	-13,238	-12,716	-12,493	-12,503	-5,284
<b>Total expenses</b>	<b>-14,527</b>	<b>-14,290</b>	<b>-14,479</b>	<b>-13,903</b>	<b>-6,822</b>
<b>Income before loan losses</b>	<b>10,695</b>	<b>9,527</b>	<b>7,316</b>	<b>7,535</b>	<b>2,220</b>
Loan losses	3,121	2,832	2,583	922	1,600
<b>Operating income</b>	<b>13,816</b>	<b>12,359</b>	<b>9,899</b>	<b>8,457</b>	<b>3,820</b>

## Total assets

The company's total assets amounted to SEK 37 billion (31), an increase of 17%. Lending to the public rose by 18%, or SEK 6 billion, to SEK 37 billion (31). Borrowing rose by 17%, or SEK 5 billion, to SEK 34 billion (29).



## Capital adequacy

The capital adequacy ratio amounted to 11.15% (12.07) and the Tier 1 ratio was 9.41% (10.00). In 2006, the company received SEK 200 M from Länsförsäkringar Bank in an unconditional shareholders' contribution. The target level for capital adequacy is 10.5% and for the Tier 1 ratio 8.5%. A deviation of  $\pm 0.5$  percentage points is allowed for both targets.

## Earnings and profitability

Operating income amounted to SEK 35 M (18) before loan losses and SEK 45 M (23) after loan losses, corresponding to a return on equity of 1.82% (1.13).

## Revenues

Net interest income rose by 19% to SEK 198 M (166), attributable to increases in volumes and somewhat higher margins. The company has an agreement regarding refinancing with the Parent Company. This agreement features an interest calculation model that reflects the actual interest expense.

## Expenses

Operating expenses rose by SEK 19 M to SEK 57 M (39). The largest portion of this increase is attributable to services bought from the parent company regarding development projects. The cost/income ratio – costs in relation to income – was 0.62 (0.68) before loan losses and 0.52 (0.60) after loan losses.

## Loan losses

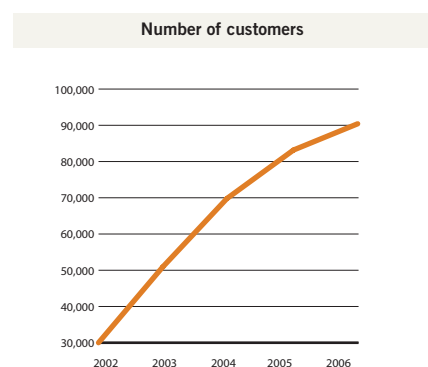
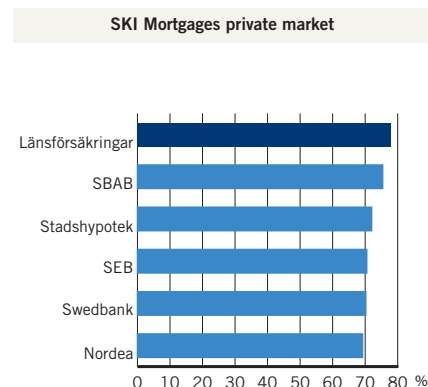
The company's loan losses (both probable and confirmed) amounted, net, to a gain of SEK 9 M (gain: 5). The loan portfolio mainly comprises private homes and tenant-owned apartments and only a minor portion of leisure homes. Group-wise provisions are made for new mortgage loans based on a percentage of the loan portfolio outstanding. The percentage is determined based on the industry's and own experiences of this product. The size of the provision is determined taking into account a longer time period with varying interest rates and economic conditions. Individual provisions are made for loans not issued by the regional insurance companies (old stock).

## Funding

The company is refinanced exclusively from the Parent Company in relation to the needs of the company with respect to volumes and maturities. The goal is to eliminate interest risk within the Financial Policy's risk mandate. To the extent that interest-rate risk arises, interest-rate swaps are employed.

## Most satisfied customers

For the second consecutive year, Länsförsäkringar's mortgage customers were more satisfied than other customers at other mortgage lenders according to the Swedish Quality Index (SKI). Länsförsäkringar received the highest rating in all categories surveyed.



## Basel II

As of February 1, 2007, Länsförsäkringar Hypotek calculates its capital adequacy in accordance with the Internal Ratings-based Approach (IRB approach) for household borrowings. The Swedish Financial Supervisory Authority (Finansinspektionen) approved Länsförsäkringar Bank's method on December 18, 2006.

Based on the new regulations, the possibility of attracting suitable customers under the business and loan strategy will improve and will allow prices to be set based on this knowledge. This also creates equal expense and margin conditions compared with competitors. At the same time, the company obtains an improved and more sophisticated understanding of its risks in relation to returns.

The risk models and measuring approaches are important components in each loan preparation process and in follow-ups of total credit risks. Accordingly, in 2006 credit processors utilized the risk classification system that categorizes customers and loans into different groups. Alignment of the capital requirement to the new regulatory system, in accordance with prevailing transition rules, will occur over a three-year period. After the transition period, the company's risk-weighted assets will decline significantly. The pace at which capital will be released depends on the company's total risk exposure, rating considerations and the Finansinspektionen's assessments.

The company's capital adequacy target will be tested continuously within the internal process for capital valuation. The company will strive to remain adequately capitalized relative to comparable mortgage institutions.

Combined with the IRB approach, the internal capital assessment process (ICA) will also develop the possibility of applying profitability calculations, pricing and control of risks and loans in 2007.

## Covered bonds

Provided the company is granted permission by Finansinspektionen, Länsförsäkringar Hypotek will issue covered bonds during the second quarter or third quarter of 2007. Work to develop this offering to the market took place throughout 2006 and is progressing according to plan.

Investors who have already invested in bonds issued under Länsförsäkringar Bank's MTN program and EMTN program, or in bonds issued under the program for benchmark loans, will be offered the opportunity to exchange their bonds for corresponding covered bonds when these covered bonds are issued. However, one difference is that Länsförsäkringar Hypotek will be the issuer of these new bonds. The exchange offer that is to be presented will take place without any premium being paid.

The goal is to achieve a triple-A rating for the covered borrowing to the bank.

## Transition to IFRS

As of 2007, Länsförsäkringar Hypotek AB applies the International Financial Reporting Standards (IFRS) in its reporting, with the exceptions and additions stipulated in the Swedish Financial Accounting Standards Council's recommendation RR 32:06 Accounting for Legal Entities, unless otherwise stipulated in law or other statute. Due to the introduction of IFRS, comparative periods for 2006 will be restated in accordance with the new standards.

The transition to the new accounting standards primarily affects the reporting of financial instruments in accordance with IAS 39. Financial instruments covered by IAS 39 are valued at either fair value or accrued acquisition value, depending on the classification of the instrument. All derivatives instruments are reported at fair value. Lending and financial liabilities are reported at accrued acquisition value, with the exception of those to which hedge account-

ing is applied. One method of counteracting the increased volatility of income as a result of derivatives being reported at fair value is to apply hedge accounting. This means that both the hedged item and the hedge instrument are valued at fair value. The change in fair value is reported in the income statement.

Another significant difference between currently applied accounting principles and IFRS accounting principles is that compensation for interest-rate differences will be reported in its entirety when the deposit is made and not allocated over the original term of the loan as takes place now.

Operating income for Länsförsäkringar Hypotek AB amounted to SEK 45 M in accordance with the principles applied in 2006, compared with estimated income of SEK 36 M in accordance with IFRS. This decline in income is primarily explained by the negative effect of compensation for interest-rate differences (SEK 8 M).

As a result of the transition to IFRS, shareholders' equity will increase by SEK 13 M, which is also attributable to compensation for interest-rate differences.

Based on the above, the Tier 1 ratio and capital adequacy are not expected to be materially affected by the transition to IFRS.

## Income statement

SEK 000s		2006	2005
Interest income	Note 2	1,501,135	1,160,928
Interest expense	Note 3	-1,302,657	-994,738
<b>Net interest income</b>		<b>198,478</b>	<b>166,190</b>
Commission revenue		1,568	1,388
Commission expense		-109,012	-116,554
Net income from financial transactions		1,087	5,505
Other operating revenue		151	3
<b>Total operating revenue</b>		<b>92,272</b>	<b>56,532</b>
General administration expenses		-57,184	-38,629
Other operating expenses		-15	-3
<b>Total expenses before loan losses</b>		<b>-57,199</b>	<b>-38,632</b>
<b>Income before loan losses</b>		<b>35,073</b>	<b>17,900</b>
Loan losses, net	Note 4	9,458	4,778
<b>Operating income</b>		<b>44,531</b>	<b>22,678</b>
Tax on income for the period		-12,472	-6,356
<b>NET PROFIT FOR THE PERIOD</b>		<b>32,059</b>	<b>16,322</b>

## Balance sheet

SEK 000s		Dec. 31, 2006	Dec. 31, 2005
<b>Assets</b>			
Lending to credit institutions		174,456	409,230
Lending to the public	Note 5	36,549,595	30,964,061
Other assets		51	625
Prepaid expenses and accrued income		131,763	45,434
<b>TOTAL ASSETS</b>		<b>36,855,865</b>	<b>31,419,350</b>
<b>Liabilities and shareholders' equity</b>			
Liabilities to credit institutions		33,542,343	28,142,917
Borrowing from the public		437,281	795,802
Other liabilities		19,246	4,581
Accrued expenses and prepaid income		542,321	361,367
Subordinated debt		362,614	362,614
<b>TOTAL LIABILITIES</b>		<b>34,903,805</b>	<b>29,667,281</b>
<b>Shareholders' equity</b>			
Share capital, 70,335 shares	Note 6	70,335	70,335
Statutory reserve		14,067	14,067
Profit brought forward		1,835,599	1,651,345
Net profit for the period		32,059	16,322
<b>Total shareholders' equity</b>		<b>1,952,060</b>	<b>1,752,069</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>36,855,865</b>	<b>31,419,350</b>
<b>Memorandum items</b>			
Assets pledged for own liabilities		none	none
Contingent liabilities		none	none
Commitments			
loans approved but not disbursed		105,827	93,886
interest-rate swap agreements		18,340,000	10,420,000
		<b>18,445,827</b>	<b>10,513,886</b>

## Cash-flow statement

SEK 000s	2006	2005
<b>Liquid funds, January 1</b>	<b>409,230</b>	<b>52,126</b>
<b>Operating activities</b>		
Operating income	44,531	22,678
<b>Adjustment for items not included in cash flow</b>		
Booked non-chargeable tax	-12,471	-6,356
	<b>32,060</b>	<b>16,322</b>
Increase/decrease in lending to the public	-5,585,534	-7,217,754
Change in other assets	-85,755	-1,115
Change in other liabilities	208,090	42,767
<b>Cash flow from operating activities</b>	<b>-5,431,139</b>	<b>-7,159,780</b>
<b>Investing activities</b>		
Change in fixed assets	-	-
<b>Cash flow from investing activities</b>	<b>-</b>	<b>-</b>
<b>Financing activities</b>		
Change in borrowing from the public	-358,521	-142,550
Change in other borrowing	5,399,426	7,080,134
Group contribution	-44,540	-22,700
Increase in subordinated loan	-	74,000
Shareholders' contribution received	200,000	528,000
<b>Cash flow from financing activities</b>	<b>5,196,365</b>	<b>7,516,884</b>
<b>CASH FLOW FOR THE PERIOD</b>	<b>-234,774</b>	<b>357,104</b>
<b>Liquid funds, Dec. 31</b>	<b>174,456</b>	<b>409,230</b>
<b>Liquid funds include:</b>		
Other lending to credit institutions	174,456	409,230
Interest received amounted to	1,415,657	1,158,052
Interest paid amounted to	1,111,845	980,565

## Notes

### NOTE 1 ACCOUNTING PRINCIPLES

This year-end report is prepared in accordance with the Swedish Annual Accounts (Credit Institutes and Securities Companies) Act, and the application of the Financial Accounting Standards Council's regulations and general guidelines (FFFS 2002:22) and with additions in accordance with the transitional provisions to the Financial Accounting Standards Council's regulations and general guidelines (FFFS 2005:33).

Remuneration to the regional insurance companies is now reported as commission expense instead of as general administration expenses as previously reported. The principle for the calculation of doubtful receivables has also changed.

The changed accounting principles are also applied to comparative figures.

In all other respects, the accounting principles remain unchanged compared with the 2005 Annual Report.

### NOTE 2 INTEREST INCOME

SEK 000s	2006	2005
Interest income, lending to the public	1,191,728	942,907
Interest income, Swedish credit institutions	309,404	218,016
Interest income, other	3	5
<b>Total interest income</b>	<b>1,501,135</b>	<b>1,160,928</b>
Average interest rate, lending to the public	3.5%	3.5%

### NOTE 3 INTEREST EXPENSE

SEK 000s	2006	2005
Interest expense, borrowing from credit institutions	1,257,599	937,524
Interest expense, borrowing from the public	32,506	47,426
Interest expense, subordinated debt	12,551	9,788
Interest expense, other	1	–
<b>Total interest expense</b>	<b>1,302,657</b>	<b>994,738</b>

### NOTE 4 LOAN LOSSES, NET

SEK 000s	2006	2005
<b>Specific provision for individually appraised loan receivables</b>		
Write-off of confirmed loan losses during the period	4 724	1 722
Reversed provisions for probable loan losses reported in the interim accounts as confirmed losses	–4 229	–1 376
Provision for probable loan losses during the period	215	286
Payment received for prior confirmed loan losses	–10 627	–8 285
Reversed provisions no longer required for probable loan losses	–3 015	–1 511
<b>Net expense during the period for individually appraised receivables</b>	<b>–12 932</b>	<b>–9 164</b>
<b>Group-wise provisions for individually appraised receivables</b>		
Allocation/dissolution of provisions for group-wise provisions	–	–
<b>Group-wise appraised groups of loan receivables of limited value and similar credit risk</b>		
Allocation/dissolution of provisions for loan losses	3 474	4 386
<b>Net expense for the period for Group-wise appraised loan receivables</b>	<b>3 474</b>	<b>4 386</b>
<b>Net expense for the period for loan losses</b>	<b>–9 458</b>	<b>–4 778</b>

All data pertains to receivables from the general public.



**NOTE 5 LENDING TO THE PUBLIC**

SEK 000s	Dec. 31, 2006	Dec. 31, 2005
<b>Loan receivables, gross</b>		
Commercial sector	174,028	168,361
Household sector	36,407,491	30,829,479
Other	3,024	4,724
<b>Total</b>	<b>36,584,543</b>	<b>31,002,564</b>
<b>Less:</b>		
<b>Specific provisions for individually appraised loan receivables</b>		
Commercial sector	–	–6,729
Household sector	–1,877	–2,177
<b>Total individual provisions</b>	<b>–1,877</b>	<b>–8,906</b>
<b>Provisions for group-wise appraised groups of loan receivables</b>		
Commercial sector	–8	–15
Household sector	–33,063	–29,582
<b>Total group-wise provisions</b>	<b>–33,071</b>	<b>–29,597</b>
<b>Total provisions</b>	<b>–34,948</b>	<b>–38,503</b>
<b>Loan receivables, net</b>		
Commercial sector	174,020	161,617
Household sector	36,372,551	30,797,720
Other	3,024	4,724
<b>Total loan receivables, net</b>	<b>36,549,595</b>	<b>30,964,061</b>
<b>Doubtful receivables</b>		
Commercial sector	900	7,882
Household sector	37,290	34,730
<b>Total doubtful receivables</b>	<b>38,190</b>	<b>42,612</b>
<b>Non-performing receivables included among doubtful receivables</b>		
Commercial sector	1,007	2,922
Household sector	12,283	13,597
<b>Total non-performing receivables included among doubtful receivables</b>	<b>13,290</b>	<b>16,519</b>

**Definitions:**

**Non-performing receivables** are loans for which interest payments, amortization or overdrafts are more than 60 days past due.

**A doubtful receivable** is a non-performing receivable or a receivable for which payments are unlikely to be made in accordance with the terms of the claim, and for which the value of the collateral is not adequate with a secure margin to cover both the principal and accrued interest, including penalties for possible late payments.

The change in accounting principles for the calculation of doubtful receivables also applies to the comparative figures.


**NOTE 6 SHAREHOLDERS' EQUITY**

SEK 000s	Dec. 31, 2006	Dec. 31, 2005
<b>Restricted equity</b>		
Share capita	70,335	70,335
Statutory reserve	14,067	14,067
<b>Total restricted equity</b>	<b>84,402</b>	<b>84,402</b>
<b>Non-restricted equity</b>		
Profit brought forward	1,835,599	1,651,345
Net profit for the year	32,059	16,322
<b>Total non-restricted equity</b>	<b>1,867,658</b>	<b>1,667,667</b>
<b>Total shareholders' equity</b>	<b>1,952,060</b>	<b>1,752,069</b>
<b>Change in shareholders' equity</b>		
Opening balance	1,752,069	1,224,091
Unconditional shareholders' contribution from Parent Company	200,000	528,000
Group contribution paid	-44,540	-22,700
Tax effect of Group contribution paid	12,472	6,356
Net profit for the period	32,059	16,322
<b>Closing balance</b>	<b>1,952,060</b>	<b>1,752,069</b>

**NOTE 7 DERIVATIVE INSTRUMENTS**

SEK 000s	Nominal value	Fair value
<b>Derivative instruments with positive value</b>		
Interest-rate derivatives	10,120,000	140,997
<b>Derivative instruments with negative value</b>		
Interest-rate derivatives	8,220,000	73,106

This year-end report is unaudited.  
Stockholm, February 20, 2007.



**Anders Borgcrantz**  
President

**Reporting dates in 2007:**

Interim report, January – March

April 24

Interim report, January – June

August 21

Interim report, January – September

October 23



The Länsförsäkringar Alliance organization is based on 24 local, independent and customer-owned regional insurance companies. The regional insurance companies jointly own Länsförsäkringar AB. In turn, Länsförsäkringar AB owns Länsförsäkringar Bank AB (Bank Group), with the Parent Company and the subsidiaries Länsförsäkringar Hypotek AB, Wasa Kredit AB and Länsförsäkringar Fondförvaltning AB. Customer contact always occurs at the regional insurance companies. There are 90 offices. From the customer's viewpoint, the regional insurance companies operate as local banks, in the same manner as with non-life insurance and life assurance.

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