Telia Finance AB

Capital Adequacy & Risk Management (Pillar III) Report 2019

Telia | FINANCE

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1 Introduction

1.1 Regulatory framework

The current banking regulation is based on the three “Pillars” concept.

Pillar 1 establishes minimum capital requirements for credit risks, market risks and operational risks, based on explicit calculation rules. In addition, certain capital requirements must be fulfilled.

Pillar 2 determines the supervisory authorities’ functions and powers and describes national supervisory authorities’ evaluations of the companies’ risks and risk processes. It also sets frameworks for institutions’ internal processes for assessing risk and capital in order to supplement the capital requirements calculated within the scope of Pillar 1.

Pillar 3 promotes openness and transparency. Disclosures in this report are governed by Pillar 3 requirements. This report complements, and is to be read in conjunction with, the Annual Report. Information regarding TF’s Remuneration Policy can be found in Note 10 of the Annual Report. Further details on internal governance are disclosed in the Corporate Governance Report, which is an integral part of the Annual Report. The information in this report is not required to be subjected to external audit and, accordingly, is unaudited.

1.2 Telia Finance

Telia Finance AB (TF) is a 100% owned by Telia Company AB (TC). TF conducts business in Sweden, Denmark, Norway and Finland via local branches. Telia Finance's business started year 1982 in Sweden, year 2001 in Denmark and year 2007 in both Norway and Finland.

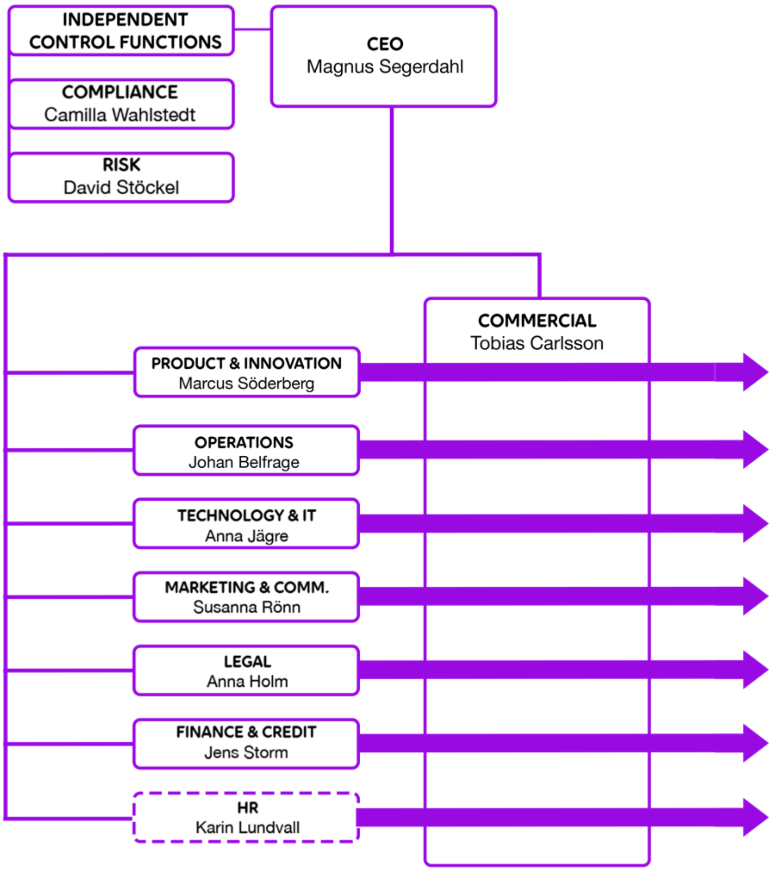

Figure 1: Telia Finance organization chart.

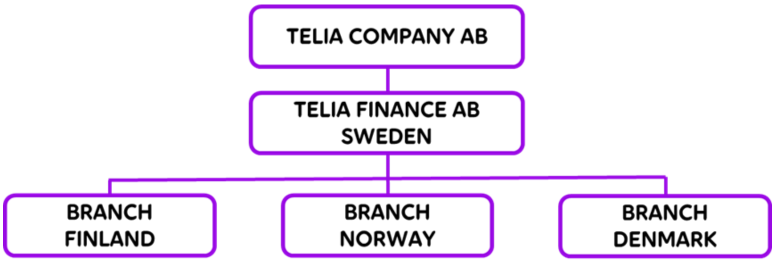

Figure 2: Telia Finance legal structure.

1.3 TF's operations

Sweden is by far the largest market, which is natural since Telia Company have a strong presence in Sweden.

The strong connection between the Telia Finance and Telia Company business ensure a good cooperation and a mutual beneficial business development. All funding for Telia Finance AB is managed in line with the Telia Group policies set by the groups treasury function i.e. the parent company Telia Company AB. Telia Finance's main task is to support the Group with its business by offering financing solutions. The main debtor is also the parent company Telia Company AB which is also the one that provide the company with additional capital if needed. If Telia Finance or Telia Company in some way would be insolvent, there is always an alternative to stop sale and the current portfolio would expire over time.

1.4 Highlights 2019

In 2019 the Enterprise business has stayed on a stable level including the total stock volume but the Net interest income has increased 11%.

The net result in the Consumer business is on the same levels as last year. The volume is growing which also shows in the net result, the increased portfolios, primarily in Denmark and Norway increased both commission and fees from consumers. The net interest income from the consumer business has slightly decreased due to a decreased portfolio of Fiber loans

TF continues to maintain a strong capitalization with a total capital ratio of 21,6%. Due to a growing business and write offs (see next section) additional capital was added from the group during the winter. Losses due to incidents were maintained at a low level and credit losses are stable.

During 2019 implementation of a new core banking system was paused due to complexity of the task. Moving forward the current banking system will continue to support the organization. Further analysis on how to continue the replacement of the current banking system will take place during 2020.

2 Risk and Capital Management

2.1 TF's Risk Framework

TF risk framework is ultimately governed by TF's mission from its owner, the Telia Company, and TF's business model. The Board of Directors sets additional constraints for TF's operations in the form of policies, risk appetite, capital target and limits. TF's Chief Executive Officer (CEO) is responsible for the preparation of TF's business plan, which sets the strategic objectives for the company. The Board of Directors approves the business plan and determines the overall risk strategy that the company shall follow while executing the business plan. The independent Risk control function controls that TF operates within the established risk framework, i.e that the company follows its defined risk strategy, risk policies. risk appetite and that the risks are identified, measured, monitored, reported and controlled on a regular basis. The risk management process is performed on a daily basis for the main risks, for example, credit risk, market risk, liquidity and operational risk, and regularly for the other risks. Regular follow-ups are carried out to ensure that the risk management process is performed at a satisfactory level of internal control. The company emphasizes the importance of broad risk awareness and a strong risk culture among staff and understanding the importance of preventive risk management in order to keep risk exposure within the determined level. TF's risk framework encompasses all TF's operations, all its risks and all relevant personnel.

2.1.1 Telia Finance Risk Metric

Main Risk	Risk Definition	Risk Management
Operational risk	Operational risk in TF is defined as "The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk." The risk of loss includes direct or indirect financial loss, and impacts from regulatory sanctions, legal exposure, reputational damage and critical business process disruption. Operational risk also covers compliance risk with respect to capital requirements. Operational risk is inherent in all activities within the organization, in outsourced activities, and in all interactions with external parties.	Operational risks are managed based on guiding principles and overall rules as set out in the "Instruction on Risk Assessment and Internal Control". This covers the key processes within the Operational Risk Management Framework which are in place to identify, asses, create actions plan, mitigate and review operational risks.
Credit risk	Credit risk is defined as the potential for loss due to failure of a borrower to meet its obligations to clear a debt in accordance with agreed terms and conditions.	Credit risks shall be managed based on guiding principles and overall rules as set out in the "Credit Policy". The Policy is supplemented by Guidelines issued by the Credit function and relevant first line of defense units The daily risk responsibility is delegated to the Credit Manager while the large exposure risk is delegated to the CEO. Telia Finance has a Credit Committee that decides in credit related regulatory questions, larger exposures and decision criteria's for the credit granting.
Market risk	Market Risk is defined as the risk of loss in TF's holdings and transactions in the banking book positions as a result of changes in market rates and parameters that affect the market value, for example changes to interest rates, credit spreads and FX rates. Market Risk covers the potential impact of asset and liability price movements upon the risk bearing capacity of the balance sheet (including off balance sheet items)	Market risk is managed based on guiding principles and overall rules as set out in the "Finance Policy". This policy is supplemented by Guidelines issued by Finance and relevant first line of defense units.

	through changes to Profit and Loss and other comprehensive income. Interest Rate Risk in the Banking Book is the current or prospective risk to both the earnings and capital of TF, arising from (adverse) movements in interest rates.	TF minimize market risks by hedging currencies and matching debts and assets, with no speculation in neither currencies or interest rates.
Liquidity Risk	Liquidity and refinancing risk is the risk of TF not being able to refinance its existing assets or being unable to meet increased demands for liquid funds. Liquidity risk also includes the risk of TF having to borrow at an unfavorable interest rate or needing to sell assets at unfavorable prices in order to meet its payment commitments.	The company's primary funding source are the parent company, Telia Company AB, equity and float management within the Telia Company group. The company measures the liquidity risk continuously to get indicators early on if there is an increased risk. The liquidity risk is measured in the short and long term, whereby the company measures its structural liquidity risk by following the appropriate key ratios in the balance sheet to highlight the financial structure and specific features of the company's liquidity risk.
Business Risk	Business risk is the risk of an unexpected decline in revenue as a result of a decrease in volumes and/or falling margins and an unexpected increase of cost.	Telia Finance's management team and the Board continuously assess the company's efficiency. Business risk is identified through risk analysis of the drivers and is monitored and prevented as deemed necessary. Costs to reduce risk exposures must be in proportion to the effect of such measures.

2.2 Risk Governance

The Board of Directors has the ultimate responsibility for the company's organizational structure and administration of the company's affairs, including overseeing and monitoring risk exposure, risk management and compliance, and for ensuring satisfactory internal control of the company's compliance with legislation and other regulations governing the company's operations. The Board determines overall risk management, for example, by establishing risk appetite and risk strategy. These are determined annually in connection with the business plan to ensure that risk management, the use of capital and business strategies are consistent. The Board also determines the company's risk policy and decides on issues relating to credits of great significance to TF. The Board has established the Risk & Compliance Committee, which assists the Board with overall issues regarding the governance and monitoring of risk-taking, risk management and the use of capital. For a detailed description of the work of the Board, please refer to the Corporate Governance Report in TF's Annual Report. TF's Chief Executive Officer is responsible for the day-to-day management of business operations. The CEO has established executive management committees to follow up on matters, prepare matters for decision by the CEO or to prepare matters for decision by the Board. The Credit Committee (CC), which is responsible for matters regarding lending and credit risk management within TF. Under its mandate, and on the basis of the delegation of authority established by the Board, the Credit Committee is authorized to make credit decisions. TF has organized risk management and control according to the three lines of defense principle with a clear division of responsibilities between the business and support functions that own the risks, the control functions that independently controls the risks, and the internal audit function that reports directly to the Board (more details are found in 2.9).

2.3 Capital Target

The company's capital target is one of the most central steering parameters. TF's capital target serves the purpose to ensure that the company's capital strength is sufficient to support the strategy set out in the company's business plan and to ensure that capital adequacy is always higher than the regulatory requirement, even during severe economic downturns, and;

The margin above the capital requirement is to cover volatility that can be expected under normal circumstances. TF aims to hold at least a total capital ratio of 16%. TF's total capital ratio per December 31, 2019 amounted to 21,6 %.

2.4 The Board's risk declaration and statement

Risk declaration

The Board hereby declares that the TF has overall satisfactory risk management in relation to the company's profile and strategy.

Risk statement

TF's mission is to ensure access to financial solutions for Telia Company products and services. The company is consequently exposed mainly to credit risk. At the close of 2019, the total internally assessed economic capital excluding any buffer, amounted to 83,8 MSEK, or 2,76% of risk weighted asset.

2.5 Risk strategy

TF shall have a documented risk strategy setting the steering principals of risk taking, risk steering and risk management within TF. The risk strategy shall include principals of risk taking, limitations of risk taking and risk steering.

The risk strategy shall be designed integrated with the business strategy and will be reviewed annually when the business strategy is updated but also when external or internal conditions significantly affect or may affect the risk picture.

Below is a summary of TF risk strategy based on the three constituents, risk philosophy, risk profile and risk steering.

2.5.1 Risk philosophy

- TF is a wholly owned subsidiary of TC that should act in the interest of the same. It is done by delivering world class customer experience through effortless and flexible financial solutions.
- TF operations build on an active risk taking where TF chooses how much and what kind of risks to take in order to create opportunities for TC and be the financial engine.
- TF tries to avoid insecurity, namely, unpredictable events of which the probability and consequence cannot be judged
- TF aims at having a sound risk culture.

2.5.2 Risk profile

- **Capital adequacy** - TF should secure that both the regulatory and internal capital is fulfilled.
- **Long term** – TF's capital adequacy and risks should be judged in a prospective perspective, taking in to account capital adequacy in the long run and the future business of TC
- **Robustness** – TF's risk taking should be that both the company, as well as the business model can be preserved in as many relevant future scenarios as possible.

- **Fast pace –** have exceptional governance to be able to fast turn decisions in to reality
- TF should adopt its risk taking to be able to clearly communicate it to the Group and its Risk function.

2.5.3 Risk steering

- **Risk framework –** TF should have a clear risk framework with policies and instructions which determines how TF should work with risk taking and that states the boundaries for risk taking
- TF should always adapt its ecosystem of risk management to be appropriate
- **Valuation of risks and opportunity when making decisions** – Business decisions should be weight against the potential risks of value-creating opportunities.
- When taking strategic decisions profitability should be weight against factors such as capital adequacy, liquidity coverage and the costs that are associated with these factors
- **Challenge of risk taking** - TF should always improve its ways of taking risk by challenge the decisions that entails risk taking.

2.6 Risk appetite

The Board of Directors decides the company's risk appetite that describes the outer constraints for all of the company's significant risk types. The risk appetite sets the level and direction of TF's risks that the Board accepts in order to achieve TF's strategic goals. The risk appetite should further specify the risk measurements that the Board believes provides sufficient information for the Board members to be well informed of the nature and extent of the company's risks. Risk appetite is strongly linked to the company's capacity to withstand losses and thereby to the company's equity. The Board comprehensively monitors the risk exposures related to the risk appetite at least on a quarterly basis.

2.7 Risk management process

As part of the overall Internal Control Framework, TF Risk Management Framework is developed and maintained to ensure consistent processes for managing and controlling risks at TF and to enable informed decisions on risk-taking to be made. The Risk Management Framework should encompass all risk types that TF is or could be exposed to.

Risk identification: The identification of risks are on a holistic basis and include the identification of emerging or latent risks. Risks are evaluated from a top-down and bottom-up perspective.

Risk measurement: Measurement of risk exposure witin TF shall be in line with regulatory requirements, using appropriate methodologies and supporting the identification of risk concentrations. This includes the use of both forward-looking and backward-looking quantitative tools and supplemented by qualitative approaches such as expert judgements and critical analysis and to adopt appropriate model controls and a sound governance culture. Stress tests are carried out to assess the potential risk profile against risk appetite under stressed circumstances.

Risk mitigation: Potential risk mitigation actions are assessed at the time the risk exposure is established, as well as on an ongoing basis or when needed.

Risk limits and monitoring: risk limits are set to ensure that risk-taking activities remain with risk appetite and appropriate monitoring of risk exposures are carried out and documented accordingly.

Risk reporting: Stakeholders with interest in risk within TF shall receive accurate, timely and relevant information on the holistic risk picture, including emerging risks, risk concentrations, and forward-looking assessments to ensure appropriate actions.

Risk Profile: Each risk category follows a certain profile in line with the risk strategy.

Risk Appetite Metrics: the different main risk categories can be found in the company risk appetite statement.

2.8 Internal Capital and Liquidity Adequacy Assessment Process (ICLAAP)

The purpose with the internal capital and liquidity adequacy assessment process (ICAAP/ILAAP) is to ensure that TF is adequately capitalized and has sufficient liquidity to cover its current risks as well as risks from the company's expansion in the future.

Summary of 2019

Telia Finance (TF) should secure that both the regulatory and internal capital is fulfilled. The forecast shows a decrease in the capital ratio during 2020 due to the growing consumer business, but the level will be stable in 2021 with a slight increase in 2022. This since the portfolios are expected to stabilize. The net effect is the combination of an increase in the consumer lease (Svitsj) portfolio which is compensated by the planned credit risk and funding agreements for the Danish and Norwegian Credit account portfolios.

All risks are stressed and a sharp decline scenario where the credit losses are tripled within the Consumer segment and bankruptcy in one of the largest exposures within the Enterprise segment are simulated. Own fund will be affected in this scenario since there will be a negative net result in 2020. The pause of the current Credit risk and funding agreements together with the assumption that the planned implementation of the Danish and Norwegian Credit account product increases the exposure against retail. This will reduce the capital ratio to 15,1% during 2020 and thereafter the capital ratio will decrease to 13,8% the coming years.

The result shows that in a severely stressed scenario the company will have a negative net result but since capital adequacy is not simulated to go below the external requirements, no additional capital is needed. Therefore, the company is not in need of more capital the coming years and the own funds will be enough even in a stressed scenario.

The total capital requirements for Telia Finance is 445,5MSEK. Of the total amount 54% is within Pillar 1, 19% in Pillar 2 and 27% in capital buffers. The risk weighted exposures per December 2019 is 3 039 MSEK and a total capital adequacy ratio of 21,6%.

The cash flows for the company vary significantly due to the quarterly invoicing cycle with higher inflows on a quarterly basis. The reserve is on a constant high level since the company do not decrease the reserve on a month to month basis. This together with the binding liquidity reserve, unutilized borrowing limit, cash resources in the company's cash pool and other cash resources in the form of deposits at the company's funder Telia Company AB makes the liquidity situation good. The company are not in need for any additional capital for the liquidity risk.

2.9 The three lines of defense

The three lines of defense model describes roles and responsibilities for risk management and control (see figure below).

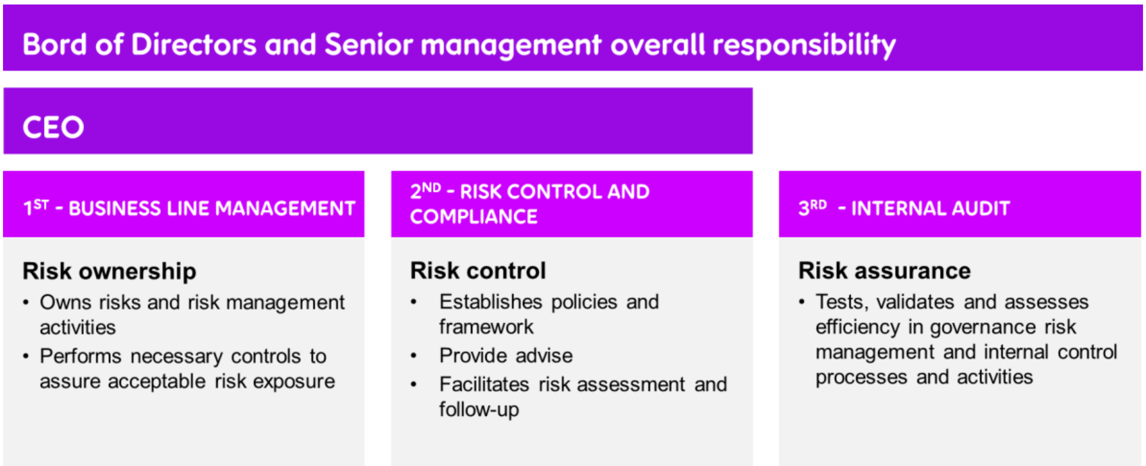

Figure 3: Telia Finance risk governance with its three lines of defense.

3 Capital and Liquidity position

3.1 Summary of capital and liquidity positions

Own funds fully exceed both regulatory and internally assessed capital levels. At the end of December 2019 TF's own funds amounted 658 MSEK while the legally binding minimum capital requirement including buffers amounted 243,1 MESK and internally assessed capital amounted to 83,8 MSEK.

Table 1 shows the capital adequacy for 2018 and 2019

Capital adequacy (KSEK)	2019	2018
Capital instruments eligible as CET1 Capital	45 000	45 000
Retained earnings	636 421	545 449
Reserves	37 336	118 994
(-) Intangible assets	- 28 335	- 110 029
(-) Deferred tax assets	- 31 913	- 17 647
(-) Cash flow hedge reserve	- 662	- 415
Common Equity Tier 1 Capital (CET1)	**657 847**	**581 352**
Additional Tier 1 Capital		
Tier 1 Capital (T1)	**657 847**	**581 352**
Tier 2 Capital	-	-
Total Tier 2 Capital (T2)	**-**	**-**
Own Funds	**657 847**	**581 352**
Capital requirements for credit risk, standardised approach	178 515	198 667
of which exposures in central governments and central banks	-	-
of which exposures in regional governments	-	-
of which exposures in public sector entities	-	-
of which exposures in institutions	281	321
of which exposures in corporates	44 814	44 098
of which exposures in retail	125 365	145 637
of which exposures in exposures in default	1 076	1 410
of which exposures in other items	6 979	7 201
Capital requirements for position, foreign exchange and commodities risks	3 177	762
Capital requirements for operational risk	61 419	50 884
Total Capital Requirements	**243 111**	**250 313**
Risk weighted exposure amounts for credit risk	2 231 447	2 483 340
Total Risk Exposure Amount for position, foreign exchange and commodities risks	39 717	9 525
Total Risk Exposure Amount for operational risk	767 739	636 059
Total Risk Exposure Amount (REA)	**3 038 903**	**3 128 924**
CET1 Capital ratio, %	**21,6**	**18,6**
T1 Capital ratio, %	**21,6**	**18,6**
Total capital ratio, %	**21,6**	**18,6**

3.2 Capital requirements

Table 2 shows the capital assessment for Telia Finance

	Aggregated capital assessment by risk type (KSEK)	2019	2018
Pillar 1	Credit risk	178 516	198 667
	Operational risk	61 419	50 884
	Currency risk	3 177	901
	Total pillar 1	**243 112**	**250 452**
Pillar 2	Interest risk	32 411	11 225
	Pension risk	32 646	30 340
	Concentration risk	18 788	20 094
	Total pillar 2	**83 845**	**61 659**
Capital buffers	Capital conservation buffer	75 516	78 223
	Contracyclical buffer	43 043	50 585
	Capital planning buffer		
	Total Capital buffers	**118 559**	**128 808**
	Total capital assessment	**445 516**	**440 919**
	Risk weighted exposures	3 038 903	3 128 924
	Capital base	657 847	581 352
	Total capital coverage ratio	21,65%	18,58%

3.3 Regulatory changes

Telia Finance monitor the development of upcoming regulations as well changes to current regulations in order to ensure proper preparation and assessment prior to implementation. The upcoming CRD 5 and CRR 2 are under assessment and on plan to be implemented before given end dates. EBA guidelines on ICT and security risk management are under implementation and shall be implemented prior to 2020-06-30.

4 Credit risk

4.1 Risk management

Governing Documents and responsibility TF's credit risk is governed by the Risk Policy, the Credit Risk Policy, the Credit Instruction, and other governing documents issued by the Board, the CEO, the Head of Risk Control (CRO) and the Chief Credit Officer (CCO). These governing documents set out the framework for the level of credit risk assumed by TF, and describe decision-making bodies and their mandates, the credit process, fundamental principles for limits and problem loan management. In addition, the Board decides on the risk strategy, including credit strategy, risk appetite as well as the overall limits the company will operate within. Overall responsibility for the relationship with TF's enterprise clients lies with business account managers. They are responsible for assessing customers' product needs, credit risk assessment (with the support of credit analysts) and sustainability assessment, limit and exposure management, and assume ultimate responsibility for credit risk and its impact on TF's income statement and balance sheet.

To support the growth in the consumer segment Telia Finance have external credit risk and funding agreements in place with two banks. Credit Agricole in Finland as of December 2016 and BNP Paribas in Sweden as of February 2018. In these solutions Telia Finance on-board the customers, but after the customer have started to amortise on their loan the credit risk is sold or through agreement transferred to the external banks and they also take over the funding of the receivables. All payments from the customers are from this point on transferred to the banks and they also take all credit losses that occur. In Sweden, Telia Finance have provided an indemnification (guarantee) to the bank that will apply if the actual credit losses exceed a statistically high threshold, however with a max loss limit.

The guarantee component in the Swedish credit risk and funding agreement was included to reduce the cost of the solution and have a very limited impact on the actual risk transferred to the BNP Parabias. Simulations were made on a transfer of credit risk for a 1000 MSEK portfolio using historical statistical data. The analysis shows that there is less than a 3% probability that Telia need to make an additional payout because of the guarantee. If the guarantee is trigged, the average payout would be approx. 350 KSEK and the calculated max pay-out 1500 KSEK.

The probability for this to be utilized is so small that the expected amount would be less than 10 KSEK, an assessment of the size will be made continuously.

4.2 Credit risk mitigation methods

Credit risks are managed based on guiding principles and overall rules as set out in the "Credit Policy". The Policy is supplemented by Guidelines issued by the Credit function and relevant first line of defense units

Credit Risk exists in the following business areas in the company:

- Unsecured revolving credit
- Unsecured loans
- Leasing
- Residual value
- Third party risk – Residual Values, capitalized service & support, hosting, licenses, etc.

The overall responsibility for Telia Finance's credit risks is the Board while the CEO has the ongoing management responsibility. The daily risk responsibility is delegated to the Credit Manager while the large exposure risk is delegated to the CEO.

Telia Finance has a Credit Committee that decides in credit related regulatory questions, larger exposures and decision criteria's for the credit granting. The Credit Committee consists of CEO, CFO, Sales manager, Credit manager and Head of product and innovation. The Credit Committee also manage other credit related questions, for instance, deferment, debt purchase agreement and collection agency agreements.

For the majority of the portfolio volume, Telia Finance sells the defaulted receivables to an external collection agency for a set price. The price is defined as a percentage of the defaulted capital debt. For a part of the portfolio volume, Telia Finance has outsourced the collection process to an external collection agency to collect the defaulted receivables on behalf of Telia Finance.

4.3 Measurement

TF adopt the standardized method for calculation of capital requirements for credit risk.

Capital requirements

Table 3 shows the capital requirements for credit risk

Capital adequacy (KSEK)	2019	2018
Capital requirements for credit risk, standardised approach	178,515	198,667
of which exposures in central governments and central banks	-	-
of which exposures in regional governments	-	-
of which exposures in public sector entities	-	-
of which exposures in institutions	281	321
of which exposures in corporates	44,814	44,098
of which exposures in retail	125,365	145,637
of which exposures in exposures in default	1,076	1,410
of which exposures in other items	6,979	7,201
Risk weighted exposure amounts for credit risk	2,231,447	2,483,340

4.4 Monitoring

There are two segments within credit, Enterprise e.g. companies, and Consumer e.g. private customers.

For Consumer, the credit risk is measured as net credit losses in relation to the portfolio rolling 12 months and for Enterprise, net credit losses is measured on an average for the current calendar year (counting up). The credit losses are measured separately for respective segment. Net credit loss is the defaulted receivables amount after, if applicable, debt purchase from external collection agency.

4.4.1 Stress tests

For monitoring and control of large exposures, TF has defined internal limits, which place further restrictions on the size of such exposures beyond those referred to in the Capital Requirements Regulation (EU) No. 575/2013. In addition, stress testing is an important credit risk management tool for TF. Stress tests and stress scenarios are not only performed under the ICAAP framework but are also carried out on a regular basis in accordance with TF's framework for stress testing. Stress tests include macroeconomic scenarios, rating migration analysis and reverse scenarios. The effects of these factors and scenarios are analyzed on TF's large exposures, expected loss and capital requirements. Stress tests form an integral part of the risk reporting to the Board and the Risk and Compliance Committee.

4.4.2 Internal reporting

The Credit Department is responsible for presenting the credit risk levels to internal and external stakeholders, including the Credit committee and the Board of Telia Finance. If the credit risk level exceeds risk tolerance set by the board, this is reported according to the risk appetite statement.

Credit risk is analyzed and reported to management and board on a monthly basis, divided in consumer and enterprise business.

4.5 Credit related concentration risk

Concentration risk is the risk of increased vulnerability arising from Telia Finance's commitment that is concentrated on a limited number of customers, geographical area or a particular industry.

To estimate Pillar 2 requirement for potential losses caused by a high concentration risk Telia Finance uses FSA's methodology Herfindahl index to estimate industry/sector concentration, geographical concentration and name concentration among the 30 largest exposures. Telia Finance evaluates the concentration risk on a quarterly basis.

Sweden is the company's largest market, with approximately 56 % of the total exposure as of 31 December 2019. One of the large Counties in Sweden is the largest exposure followed by Finnish entertainment device manufacturer. As of 31 December 2019 the pillar 2 requirement for concentration in sector is estimated to 10 040 KSEK. The requirement related to geographical concentrations is estimated to 4 383 KSEK and requirement related to the name concentration within the 30 largest exposures is estimated to 4 365 KSEK, resulting in a total Pillar 2 own funds requirement for concentration risks of 18 788 KSEK.

5 Market risk

5.1 Risk management

TF's Board of Directors decides on the market risk appetite, risk strategy and risk policy. TF's Chief Financial Officer decides on the methodology for measurement of market risks and suggests changes to the limit structure and limits levels in conjunction with limit and risk appetite reviews. All instructions are re-established annually. Market risk exposures are reported by the financial control function to the CEO on a monthly basis and to the Risk and Compliance Committee and the Board at their scheduled meetings. If a limit breach occurs, it is timely escalated by the CRO to the CEO and the Board. TF conducts no active trading and the TF's business model entails that all transactions are normally held to maturity.

5.2 Risk mitigation methods

Market risk is managed based on guiding principles and overall rules as set out in the “Finance Policy”. This policy is supplemented by Guidelines issued by Finance and relevant first line of defense units. TF minimize market risks by hedging currencies and matching debts and assets, with no speculation in neither currencies or interest rates.

The aim of managing currency risks is to minimize the variability in profits at reasonable costs. Currency risk must therefore not be eliminated but instead minimized while taking into consideration the cost of the management. Foreign currency exposure is minimized by matching the assets and liabilities in currency and duration.

5.3 Measurement

Telia Finance measures the currency risk monthly to get indicators early on if there is an increased risk. The currency risk is measured in the short and long term, whereby the company measures its structural currency risk by following the appropriate key ratios in the balance sheet to highlight the financial structure and specific features of the company’s currency risk. For this purpose, the company uses cash flow and cash flow analyses as key figures and measurement methods.

The Interest rate risk is measured according with SFSA’s method of calculating capital requirement in pillar II for Interest Rate Risk in the Banking Book (IRRBB). SFSA’s method calculates the capital requirement as a function of the mismatch of repricing dates and maturities between liabilities and assets. This is achieved by the method taking account of the sensitivity in the firm's economic value to changes in the yield curve and differences between the firms' financing cost and market rate of interest. The repricing date for the firms' equity and NMDs is set at zero. The economic value is calculated as the present value of the future net interest income for interest-bearing positions in a firm's banking book and the calculation of the yield curve stress scenario is based on three different kinds yield curve stress scenario (parallel shifts, slope changes and shift of the firms credit spread)

Each quarter, an interest rate risk calculation is reported to Swedish Financial Supervisory Authority on the impact of a sudden change in the general interest rate situation. The calculation is based on an assumption that an interest rate change occurs in parallel with two percentage points. If such an interest rate shock results in the company’s economic value falling by more than twenty percent in relation to the capital base, Telia Finance has to report to Swedish Financial Supervisory Authority on measures to reduce risk. In October 2017 the EBA presented a consultation paper on its guidelines of the interest rate risk in the banking book (IRRBB),

5.4 Stress testing

Currency risk stress testing is performed on a monthly basis where the last 10 years are analyzed by looking at the currency changes for EUR, NOK, USD and DKK. The highest month-month change is evaluated and stressed. For the same period of time month-month changes are simulated using day-day changes using a Monte Carlo simulation and a VaR of 99,9 %.

The interest rate risk has a new approach since previous years where the new model presented by the Swedish FSA for IRRBB pillar II requirements are used. Doing the six different scenario analysis gives the capital requirement for interest rate risk.

5.5 Capital requirements

The capital requirement for currency risk in pillar 1 is calculated using the Standardized approach, as 8% of risk-weighted exposures of the total net position in foreign currency. The currency risk in pillar 1 is per 2019-12-31 3 177 KSEK.

5.6 Monitoring

Market risks are measured, analyzed and reported to management on a monthly basis. Limit breaches are reported, escalated and managed according to documented internal procedures. A more thorough analysis of markets, market risk trends and stress tests of the portfolio is performed and reported to management on a quarterly basis and to the Board quarterly.

The interest rate risk per 2019-12-31 was 32 411 KSEK KSEK i.e. 1,07% of the RWA. Compared to last year the 3 times increase is both due to the updated model and the shift in interest positions.

6 Operational Risk

6.1 Risk management

Operational risk exists in potentially all TF's activities. The risk management responsibilities follows the three lines of defense where managers are responsible for the identification and management of operational risks within their own function. The responsibility for monitoring and reporting operational risk, lies with the independent Risk function. The Risk function is also responsible for monitoring the suitability and effectiveness of the management of operational risk. In the same way, the Compliance function has the responsibility for monitoring and reporting compliance risk. Exposure to operational risk is reported by the Risk function to the Risk and Compliance Committee and the Board of Directors.

6.2 Risk identification

The main activities used to manage the operational risk are described below.

6.3 Risk workshops

TF conducts yearly risk workshops with all functions. The workshops are based on self-assessment with the Risk function making an independent reasonability control. Risks are identified both through top-down executive management involvement, Risk workshop with the Executive management team, and bottom-up through the Risk workshops with the individual functions. Based on identified operational risks, action plans are developed for the management or reduction of identified risks. Any identified risk that are not within the risk appetite of the company are to be closed. The independent Risk function carries out an aggregated analysis and monitoring of all identified risks and action plans. The material risks are then analyzed and monitored individually. The annual risk analyses are conducted in coordination with business planning and the internally assessed economic capital as part of the strategic planning.

6.4 Incident management

TF views incident reports as an important part of its continuous improvement measures and these reports comprise a key source of information. The company separate IT-incidents from business incidents. When operational risk events, incidents, occur, the immediate focus lies on resolving the direct event in order to minimize damage, independently of type of incident. After having resolved the incident, an analysis of the root cause is performed to understand why it occurred, and remedial actions are determined and followed up in order to prevent repetition of the event. All IT-incidents that can be connected to operational risks are also reported as a business incident to enable calculation of economic capital. Business incidents are reported to the independent risk function and other interested parties. The company encourages staff to report incidents and applies no materiality criteria for reporting incidents.

6.5 New Product Approval Process (NPAP)

In order to maintain the risk level within the company and to not expose the company to unwanted risk exposure when making significant changes to or developing new products, processes and systems, the company has established a new product approval process and a New Product Approval Committee (NPAC). When significant changes are made, the affected functions analyze what consequences might arise to their processes, system support and the regulations that apply to them. When identifying consequences that need to be addressed, the adjustments must be made before the new product, process or system can be approved.

6.6 Business Continuity Management and information security

At TF, security involves protecting customers, individuals, information and physical assets. Information must be kept confidential, be reliable and accurate, and it must be made available to the appropriate people as and when needed. TF's security efforts include technical, organizational and administrative measures, which are based on the international information security standard ISO/IEC 27000. TF works in a pre-emptive manner to prevent security incidents that may affect the company's ability to operate. TF has an established contingency organization that is responsible for crisis and catastrophe management, and communication in case of serious incidents, crises or disasters.

The identification of Risks related to Information security is integrated in the Risk workshops conducted with all functions. In addition, the Chief Security Officer conducts an independent overall risk assessment. TF manages information security risks by identifying risks in the logical, technical and physical domains and by monitoring that control processes for information security are effective and in line with the defined risk appetite and relevant Operational. TF has adopted a standardized threat profile that is extended on demand by more detailed information security threat assessments. Combined, these provide a baseline for the annual information security risk assessment that is supplemented with risk treatment plans. To ensure continuous availability of business-critical processes, TF annually conducts a review of its use of technology, premises and staff in the operational processes. The requirements for this are part of the information security framework. TF runs two geographically separated IT centers between which critical servers are duplicated and data is mirrored. In addition, TF has access to separate backup office facilities outside the city center with enough capacity for staff to run all critical business processes, including IT operations and maintenance. The effectiveness of data centers and recovery procedures is assured through disaster recovery exercises at least once a year.

6.7 Compliance risk and Anti Money Laundering

The Compliance function is responsible for identifying the risk that business is not conducted in compliance with laws and regulations The Compliance function further assists the organization in identifying and assessing the risk of legal or regulatory sanctions, material financial loss, or loss to reputation that TF may suffer as a result of its failure to comply with the applicable regulations. This assessment also covers new legislation, internal regulations and the risk of conflicts of interest. Money laundering risks are identified in accordance with the Swedish Act on Measures against Money Laundering and Terrorist Financing. Procedures for monitoring money laundering risks include the collection and review of customer information and the monitoring of transactions in accordance with a risk-based approach. All employees receive regular training and information regarding changes in regulations and new trends and patterns, as well as regarding methods that may be used for money laundering and terrorist financing. TF has process for providing information regarding suspicion of money laundering to the Swedish National Police Board.

6.8 Measurement

TF measures the level of operational risk on an ongoing basis. The company's conclusion regarding the risk level is based on an assessment of primarily five components:

- Risks identified in risk workshops and in the ongoing business

- Monitoring incidents and follows up on provisions
- The amount of losses from reported incidents
- Key risk indicators
- Whether efficient internal controls relating to financial reporting, in accordance with the Group's standards exist

6.9 Monitoring

The Risk function monitors the compliance with the Risk appetite on a continuous basis. Compliance with the Risk appetite is followed up both with a forward-looking evaluation, i.e. one year expected loss from identified risks, as well as a backward-looking approach, i.e. actual realized losses.

Key risk indicators - TF follows a selection of indicators that give an early warning of increased levels of operational risk including IT-risks. If an increased level is indicated the independent risk function analyses the reason behind the increase and follows up on the mitigating actions, if needed.

6.10 Capital requirements

Over the years, the overall level of operational risk has decreased as a result of long term work focusing on continuous improvement, well documented procedures and higher awareness of the importance of managing operational risk.

6.10.1 Operational incidents

Operational incidents are valued by their impact level pending on a four graded criticality scale level (ranging from minor < 10 tsek to significant > 1 msek). No significant incidents were reported as of last year.

Table 4 shows of minimum capital requirement and internally assessed capital

Operational risk (KSEK)	2019 Pillar I	2019 internal assessed	2018 Pillar I	2018 Internal assessed
	61 419	43 782	50 884	49 121

6.11 Internal control

The Risk function monitors and reports both the overall appropriateness of implemented Internal Controls as well as the results from the testing activities to the Risk and Compliance Committee and to the Board.

7 Pension risk

Pension risk arises from the obligation under TF's defined-benefit pension plans to provide agreed compensation to existing and former employees of the company. Even though TF makes ongoing payments to secure this obligation, a risk exists in the form of a negative outcome in terms of the return on the capital provision. The present value of the pension obligation could also increase depending on actuarial assumptions in terms of mortality and as a result of a lower discount rate. TF quantifies pension risks in accordance with the

Swedish FSA's methods for assessing individual types of risk within Pillar 2. Pension risk in pillar 2 per 2019-12-31 is 32 646 KSEK. The company assesses that this is sufficient.

8 Business risk

8.1 Risk Management

Telia Finance's management team and the Board continuously assess the company's efficiency. Business risk is identified through risk analysis of the drivers and is monitored and prevented as deemed necessary. Costs to reduce risk exposures must be in proportion to the effect of such measures.

Residual value

By residual value Telia Finance mean agreements where the customer have not paid the whole credit amount at end-of-lease and the residual value at end-of-lease is guaranteed by Telia Finance. The articulation and management of Residual Value risk is specified in the "Instruction on Residual Value" and categorized as a business risk.

Due to the risk in residual values the ambition is to have at least 45% margin on the residual value stock at end-of-lease.

Products limitations:

- Mobile phones and tablets, residual values standard on 24 months, maximum 36 months
- PC's residual values standard on 36 months, maximum 48 months

The level of residual vale must be followed up quarterly and every six month an analysis is made of all residual values in the portfolio. The analysis provide an overview of the residual values in the portfolio per country and product. A forecast on expected future value on second hand market at the End-of-Lease (EoL) date compared to the set residual values. EoL mean when agreed leasing time has ended, i.e. at the end of the agreement.

9 Buffer requirements

Capital conservation buffer constitutes 2,5% of the company's total risk weighted exposures and aiming to cover the company's possible losses during difficult times.

The contracyclical capital buffer calculates with a contracyclical buffer value of 0-2,5%. Reciprocity vis-à-vis other states buffer value is applied to the extent that the states have reported their buffer values to European Systemic Risk Board (ESRB), while others apply a buffer value of 0%. For Telia Finance this gives a total contracyclical buffer value of 1,41% per 2019-12-31.

The company is exempted from the requirement to hold a systemic risk buffer.

Common equity tier 1 capital is available to be used as a buffer after deduction of capital used to meet the capital requirement, which present 21,6 % of risk weighted exposure amount per 2019-12-31.

10 Liquidity risk

10.1 Risk strategy and management

TF's Board of Directors has the overall responsibility for liquidity risk management and establishes policies for liquidity risk management. Instructions established by the CEO regulate TF's management of liquidity risks. Operational responsibility for liquidity risk management lies within TF's Finance function. Short-term liquidity is monitored and managed on a monthly basis by business controller, while long-term liquidity planning is monitored on a quarterly basis and reported to Risk Control, CEO, and the Board of Directors. Responsibility for ensuring compliance with short-term and long-term liquidity risk limits lies within Finance. The risk control function is responsible for following up exposures versus limits and for escalating to executive management, the Board's Risk and Compliance Committee and the Board as appropriate.

10.2 Risk mitigation methods

Match funding of the company's balance sheet is a fundamental and integral part of TF's business operation.

10.3 Financial strategy and Liquidity strategy

The company measures the liquidity risk continuously to minimize the liquidity risk. As far as possible, the company borrows funds in accordance with agreed in the customer agreements about different maturities, currencies and interest levels. The company measures its liquidity risk in the short and long terms. The factors, which influence the company's liquidity, are the level of its equity, the possibility of borrowing funds from the Group and the "float". The "float" is the billing services that the company carries out for various Group entities, which affects the company's cash flow. Often Telia Finance invoices the end customer on a quarterly basis but the cash transfer to the other group entities are monthly. This arrangement reduces Telia Finance's need for borrowing by a corresponding amount. If this agreement between Telia Finance and Telia ceases, Telia Finance's borrowing need and interest expenses will increase. This increase at present falls within the borrowing limit agreed between Telia Finance and Telia's treasury function.

Current liquidity reserve in Telia Finance consists of liquid assets in form of "Kommuninvest" bonds. The holdings presented to current market value with a risk weight of 0%. As per 2019-12-31, the liquidity reserve amounted to 600 MSEK.

The company also has a binding liquidity reserve, unutilized borrowing limit, cash resources in the company's cash pool and other cash resources in form of deposits at the company's funder, Telia Company AB. The company deems this enough to fulfil the requirements for reserves according to the Swedish Financial Supervisory Authority, taking account of the principle of proportionality.

10.4 Liquidity reserve

The CFO has overall responsibility for managing, monitoring and reporting the liquidity risk. Management of this comes under the Controlling unit. In operating activities, the Financial Controller makes liquidity forecasts to safeguard the short-term liquidity flows. A long-term forecast is also made monthly in which the total assets and liabilities of the company are reviewed. If the company's borrowing limits are utilized to 80%, the CFO is informed.

The Business Controller makes a liquidity forecast every month to report the LCR to the Swedish Financial Supervisory Authority. This is a 30-day stressed forecast of future inflows and outflows. The requirements from the Swedish Financial Supervisory Authority is that 100% of the net outflow should be covered by a liquidity reserve. The internal risk limit is decided to 110% for this indicator. Long-term forecasts are also made quarterly to ensure that the company has enough liquidity reserve. This is also reported quarterly to the Board.

The company continuously analyses its inflows and outflows to synchronize and optimize cash flow. Current liquidity reserve consists of liquid assets in form “Kommuninvest” bonds and the holdings are taken up to current market value with a risk weight of 0%. The LCR per 2019-12-31 was 223%.

10.5 Monitoring

Liquidity risk is monitored through regular analysis and reporting to the Board, CEO and Risk Control function. Board reports are produced on a quarterly basis and include follow-up of Liquidity coverage ratio (LCR), Net stable fund Ratio (NSFR), internal measurements, portfolio composition and liquidity stress tests.

10.6 Contingency plan

If a situation would occur where Telia Company would not be able to provide more funding, there is also a possibility to go to other financiers. This would increase the cost but since the funding cost is approximately 5-7% of Telia Finance yearly result, an increased cost would be manageable without any major impact on the financial result.

11 Capital assessment

Telia Finance aggregated capital assessment is shown in the table below. The total assessed capital for 2019 is approximately the same levels as of 2018.

Table 5 shows the capital assessment for Telia Finance

Aggregated capital assessment by risk type (KSEK)		2019	2018
Pillar 1	Credit risk	178 516	198 667
	Operational risk	61 419	50 884
	Currency risk	3 177	901
	Total pillar 1	**243 112**	**250 452**
Pillar 2	Interest risk	32 411	11 225
	Pension risk	32 646	30 340
	Concentration risk	18 788	20 094
	Total pillar 2	**83 845**	**61 659**
Capital buffers	Capital conservation buffer	75 516	78 223
	Contracyclical buffer	43 043	50 585
	Capital planning buffer		
	Total Capital buffers	**118 559**	**128 808**
	Total capital assessment	**445 516**	**440 919**
	Risk weighted exposures	3 038 903	3 128 924
	Capital base	657 847	581 352
	Total capital coverage ratio	21,65%	18,58%