
7. OTHER RISKS

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7.1 Business risk

7.1.1 Definition

Business risk is the risk of losses caused by changes in external circumstances or events that harm the Group's reputation or earnings. It includes the risk of a decline in earnings due to strategic decisions (strategic risk).

Business risk manifests itself in the form of an unexpected fall in earnings. The fall may be due to narrowing lending margins as a result of increasing competition, falling lending volumes because competitors introduce new products, strikes, new legislation or negative press coverage. The business needs to adjust its expenses to such factors in order to avoid their full effect on earnings.

This risk is measured on the basis of fluctuations in earnings which cannot be ascribed directly to other risk categories.

7.1.2 Control and management

Business risk constitutes a separate risk factor in the Group's calculation of economic capital.

Part of business risk is the result of external factors, whereas reputational risk and strategic risk are deemed to be primarily of an internal nature.

Consequently, a broad range of tools is used to identify and report on business risk exposure. Several management processes ensure that new external risks are channelled to the relevant department or the right organisational level.

Reputational risk is managed via policies and business procedures, including compliance activities.

The management of strategic risk is considered to be largely a top-down process in which decisions are made by executive management.

7.1.3 Use of models

The Group has developed a model for calculating economic capital in connection with business risk based on the measurement of earnings volatility in the individual business areas. The Group continues to develop methods to estimate business risk in order to improve its integration in financial reporting.

Economic capital is currently calculated on the basis of a model that includes calculations of historical volatility over the past 12 quarters for each business area. Fluctuations and the correlation of income and expenses, for each business unit and at Group level, are calculated and scaled to a 99.97% confidence level based on a normal distribution function.

The model was first used in the first quarter of 2006. The calculated results are validated against actual results on an ongoing basis.

7.1.4 Capital requirements

The capital requirements related to business risk are covered by the ICAAP (see section 8.2).