

# *Risk Management 2015*

Danske Bank Group





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The objective of Risk Management 2015 is to inform shareholders and other stakeholders of Danske Bank Group's risk management, including policies, methodologies and practices.

Additional Pillar III disclosures required under Regulation [EU] No. 575/2013 of the European Parliament and of the Council of 26 June 2013 (CRR) and the Danish Executive Order on Calculation of Risk Exposure, Own Funds and Solvency Need can be downloaded from [www.danskebank.com/ir](http://www.danskebank.com/ir).

*2015 in brief*

*1.*

In 2015, the economic conditions in Danske Bank's home markets were benign, but they necessitated frequent adjustments to address negative short-term interest rates, an uncertain European political and economic outlook, and a sharp decline in commodity prices against the backdrop of a highly dynamic, multi-speed global economy. Danske Bank's financial results for 2015 were the culmination of a two-year effort to transform and de-risk the balance sheet, among other things. We continued to strengthen our risk profile while maintaining a solid capital and liquidity position, and with our customer-centric focus, we emphasised banking services that are not interest-rate sensitive in order to lower earnings volatility.

The negative short-term interest rates affected our net interest income adversely. On the other hand, the low interest rate environment and improved economic conditions in the past few years have resulted in improved asset quality and reduced impairment charges.

Moreover, the improved economic environment has allowed us to meaningfully reduce our non-performing assets. We have actively reduced our Non-core portfolio (9% in 2015) and announced the sale of a large part of the Baltic Personal Banking portfolio. We expect the sale to be completed in the first half of 2016, pending the approval of local authorities.

The initiatives to focus on our core activities have contributed to stronger capital ratios, improved asset quality and sound earnings, all of which helped improve our external ratings, which rose to A/A/A2 (S&P/Fitch/Moody's) in July 2015 in accordance with our rating goal. We achieved this despite a change in methodology by the rating agencies to exclude any government support after the June 2015 implementation of the Banking Resolution and Recovery Directive (BRRD) in Denmark.

In 2015, we made several changes to our risk organisation. In April 2015, Gilbert Kohnke joined Danske Bank as chief risk officer (CRO) and member of the Executive Board. We reorganised and strengthened the risk and compliance organisations to ensure a better alignment between the business units and the geographic regions. We continued to refine the Risk Management Framework and corporate governance practices in order to ensure that our risk-taking activities remain fully aligned with our risk appetite statements, changing economic conditions and the rapidly evolving regulatory environment.

In 2015, we received approval from the Danish Financial Supervisory Authority (the FSA) to use the foundation internal ratings-based (F-IRB) approach for our Finnish corporate portfolio. The FSA also approved an extension of our internal market risk model (IMM) to include bond spread risk and company-specific equity risk (i.e., specific market risk). Our incremental risk model was approved by the FSA as well. The revised model framework resulted in reduced trading exposure and trading limits in our corporate and institutional client segments. The framework will also improve our risk management capabilities, giving us less volatile earnings and ensuring more efficient use of risk-adjusted capital.

With the main risk areas improving significantly, we also increased our attention on internal control processes and compliance. In January 2015, we centralised a number of functions in Group Compliance in order to ensure integrity and a better alignment in our compliance processes. We launched several initiatives across the Group in an ongoing effort to promote and ensure compliance with regulation and industry standards. Notably, we increased our resources in the anti-money laundering (AML) area. Our efforts in the compliance area will support a better customer experience, lead to greater efficiency, and reduce operational and reputational risks.

In order to diversify across our Nordic footprint, we are pursuing a selective growth strategy on the Norwegian and Swedish markets. We share the general concerns about housing price developments in Sweden and broadly across the Nordics that reflect increased risks from accelerated asset price growth because of low interest rates and ample financing capacity. In the Personal Banking segment, we are targeting low-risk, mass-affluent customers in these markets. The partnership agreements that we established with large professional unions in Norway and Sweden in 2015 support this strategy.

In the coming years, the changing banking landscape and our ambition to more closely align our strategy and our financial targets with our risk targets will keep us focused on strengthening and optimising our risk governance framework.

# *Risk organisation*

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## 2.1 Risk organisation

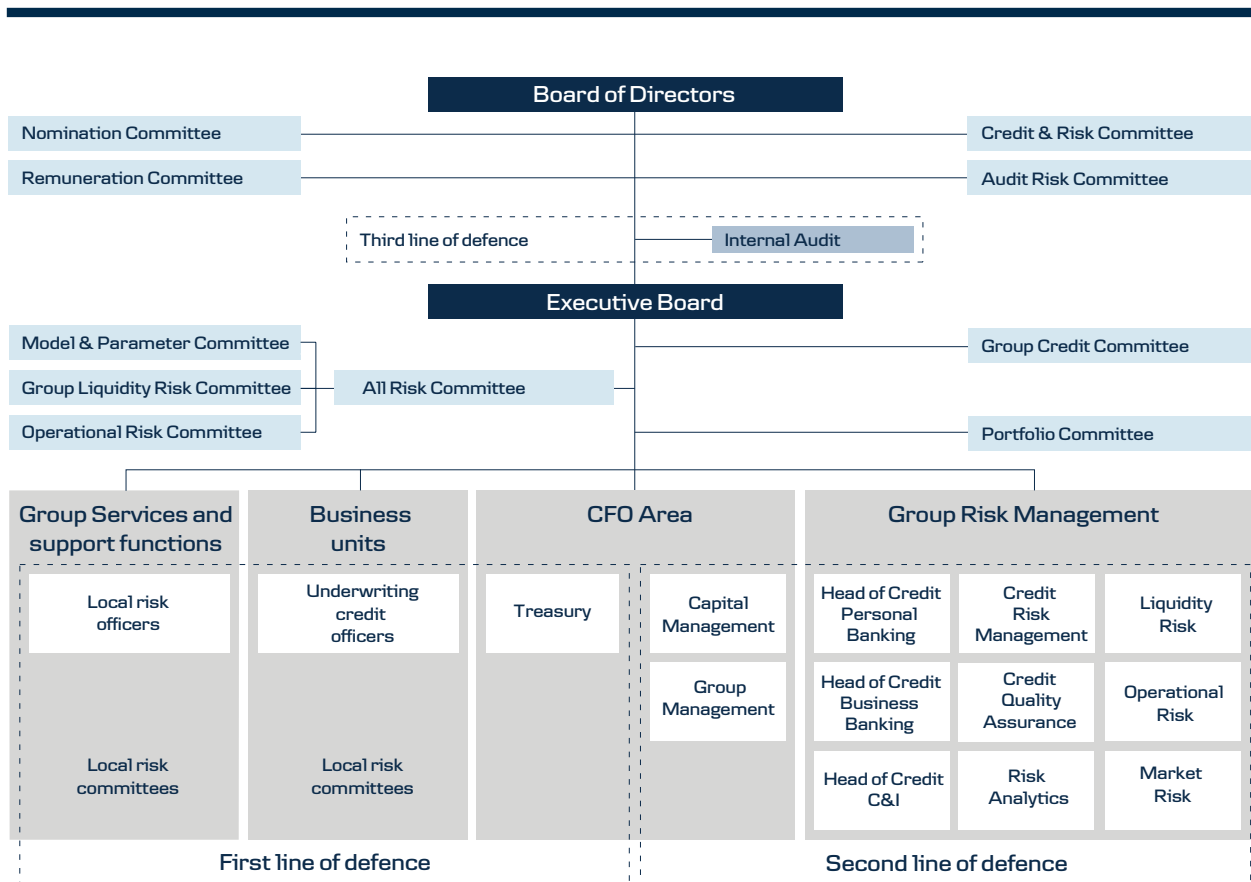
Danske Bank's rules of procedure for the Board of Directors and rules of procedure for the Executive Board specify the responsibilities of the two boards and the division of responsibilities between them. The two-tier management structure and the rules of procedure, which were developed in accordance with Danish law, regulations and relevant corporate governance recommendations, are central to the organisation of risk management and the delegation of authorities in the Group.

Danske Bank operates in accordance with statutory requirements governing listed Danish companies in general and financial institutions in particular, for example the requirements set forth in the Danish Executive Order on Management and Control of Banks etc. issued by the Danish Financial Supervisory Authority (the FSA). Danske Bank also follows relevant recommendations for effective corporate governance.

The Group's management structure reflects the statutory requirements governing listed Danish companies in general and financial institutions in particular, including the Executive Order on Management and Control of Banks issued by the Danish FSA. The executive order specifies the obligations of boards of directors as presented in the Danish Financial Business Act and sets forth requirements for effective corporate governance.

The heads of the business units, operations areas and service areas are responsible for all business-related risks. The segment-based organisation allows risk management processes to be tailored to the various customer segments and to be aligned across borders.

### Risk organisation: Two-tier management structure with three lines of defence





### 2.1.1 Board of Directors

The Board of Directors ensures that the Group is organised properly. As part of this duty, it appoints the members of the Executive Board, the Group chief audit executive (CAE) and the secretary to the Board of Directors.

In accordance with its rules of procedure, the Board of Directors approves the overall business model, risk profile and strategy. In addition, the Board receives regular reporting on and monitors the main risks and reviews the largest credit facilities. The Board reconsiders risk appetites, policies, instructions and delegated risk mandates at least once a year.

Regular reporting enables the Board of Directors to monitor whether the risk appetites, policies, instructions and mandates are being complied with and whether they are appropriate, given Group's business model, risk profile and strategy. In addition, the Board regularly reviews reports analysing the Group's portfolios, including information on concentrations.

The Board of Directors consists of six to ten members elected by the general meeting and a number of employee representatives as stipulated by Danish statutory rules. At the end of 2015, the Board consisted of 12 members, including four employee representatives.

The Board meets about 12 times a year, in accordance with a schedule that is set for each calendar year. Once a year, the Board holds an extended two-day strategy seminar to discuss the Group's strategy.

The CAE, who is the head of the Group Internal Audit department, reports directly to the Board of Directors. The primary role of Group Internal Audit is to help the Board of Directors and the Executive Board protect the assets, reputation and sustainability of Danske Bank Group. The scope of Group Internal Audit's work is unrestricted. The CAE prepares an audit plan for the year that is reviewed by the Audit Committee and the Board of Directors and is approved by the latter.

The Board of Directors of Danske Bank A/S has decided that the CAE will not issue an auditors' report on the Annual Report.

### 2.1.2 Executive Board

The Executive Board is responsible for the day-to-day management of the Group as stated in its rules of procedure. The Executive Board defines specific risk instructions, supervises the Group's risk management practices, approves credit applications up to a defined limit, and ensures that bookkeeping and asset management are sound and in accordance with business model, strategy plan, policies, instructions and guidelines established by the Board of Directors and applicable legislation.

Three Executive Board members are the heads of the three banking business units. The risk, financial and services/IT areas are also represented on the Executive Board.

## 2.2 Risk monitoring

On the basis of risk policies and appetites defined by the Board of Directors, specific risk instructions are prepared by the Executive Board for each business unit. These instructions are the foundation for the business and control procedures of the business units and for system development in the Group.

The Board of Directors sets forth risk appetites for credit risk, market risk and liquidity risk. Each risk appetite specifies the risk types and risk amounts that the Board of Directors is willing to accept in pursuit of the Group's strategic goals. Relevant KPIs are incorporated in regular risk reporting, and this enables the Group to monitor whether the risk profile stays in line with the risk appetite formulated. Please see the sections on the various risk types for further details.

The Board of Directors determines what risks Danske Bank may assume, the size of such risks, the limits on Danske Bank's significant activities, and the principles for calculating and measuring such risks. The risk profile covers the following:

- Credit risk, including counterparty credit risk
- Market risk
- Liquidity risk
- Operational risk
- Insurance risk

At the business unit level, new product approval procedures are based on instructions provided by the Executive Board to the heads of the business units. Materiality criteria determine whether the approval of new products is escalated to the Group's chief risk officer and possibly to the Executive Board and whether the new products need to be reviewed by the Board of Directors.

## 2.3 Risk committees

The Board of Directors has established four committees to supervise specific areas and to prepare topics for consideration by the complete Board. Under Danish law, board committees have no independent decision-making authority but solely a consulting role. The role of each committee is described in the table below.

### Committees established by the Board of Directors

<p><b>Credit &amp; Risk Committee</b></p> <p>Convenes at least four times a year</p>	<p>The Credit &amp; Risk Committee operates as a preparatory committee for the Board of Directors with respect to Danske Bank's risk management and related matters.</p> <p>The committee advises the Board of Directors on Danske Bank's risk profile, risk culture, risk appetite, risk strategy and risk management framework.</p> <p>The committee therefore reviews and submits recommendations to the Board of Directors regarding Danske Bank's risk appetites, risk policies, risk instructions, capital, leverage, liquidity, solvency need, recovery requirements, business continuity plans, impairment levels, products and services from a risk perspective, and loan portfolio credit quality. Furthermore, the Credit &amp; Risk Committee reviews the use of internal models, the adequacy of staff resources in the risk management control function, and incentive programmes from a risk perspective.</p>
<p><b>Remuneration Committee</b></p> <p>Convenes at least twice a year</p>	<p>The Remuneration Committee operates as a preparatory committee for the Board of Directors with respect to matters concerning remuneration, with a special focus on the remuneration of members of the Board of Directors, the Executive Board, material risk takers, key employees and executives in charge of control and internal audit functions, and incentive programmes.</p> <p>The committee reviews and submits recommendations to the Board of Directors regarding remuneration policies and practices and developments in remuneration levels, including variable remuneration. The committee monitors the incentive programmes to ensure that they promote ongoing, long-term shareholder value creation and that they comply with the Remuneration Policy.</p>
<p><b>Nomination Committee</b></p> <p>Convenes at least twice a year</p>	<p>The Nomination Committee operates as a preparatory committee for the Board of Directors with respect to the nomination and appointment of candidates to the Executive Board and to the Board of Directors and to the evaluation of the work and performance of the Executive Board, the Board of Directors and its individual members.</p> <p>The committee also submits proposals to the Board of Directors on policies on succession planning and diversity and inclusion.</p>
<p><b>Audit Committee</b></p> <p>Convenes at least four times a year</p>	<p>The Audit Committee operates as a preparatory committee for the Board of Directors with respect to accounting and auditing matters, including related risk matters. The committee reviews and submits recommendations to the Board of Directors regarding financial reports and the assessment of the related risks, key accounting principles and procedures, internal controls, reports from both internal and external audit, whistleblowing, compliance and anti-money laundering activities.</p>

The Executive Board has established a committee – the All Risk Committee – that has overall responsibility for risk management within the framework determined by the Board of Directors.


In addition to the All Risk Committee, the Executive Board has established two committees to perform duties related specifically to credit risk management:

1. The Group Credit Committee sets a venue and allocates time for the review of credit applications referred by business units to the Executive Board for approval. The committee consists of Executive Board members.
2. The Portfolio Committee oversees, discusses and acts on developments in the credit portfolio to ensure that the credit risk profile is in accordance with the credit policy and credit risk appetite statements.

The All Risk Committee has established three sub-committees to ensure that adequate time and attention are given to the specific risk management areas. These sub-committees consist of representatives from the All Risk Committee and senior staff from relevant risk management functions.

The roles of the committees are described in the table below.

**Committees established by the Executive Board**

<p><b>Portfolio Committee</b></p> <p>Consists of industry experts, risk management representatives and business unit representatives.</p> <p>Convenes once a month</p> <p>Responsibilities:</p> <ul style="list-style-type: none"> <li>Proposing industries for risk mitigation based on a scorecard, tailored analytics as well as expert knowledge</li> <li>Proposing limits to the Executive Board and giving input to the annual Credit Risk Appetite process</li> </ul>	<p><b>All Risk Committee</b></p> <p>Consists of the members of Executive Board and senior staff from selected business areas.</p> <p>Convenes once a month</p> <p>Responsibilities</p> <ul style="list-style-type: none"> <li>Managing the balance sheet structure and development</li> <li>Defining the overall funding structure</li> <li>Defining the general principles for measuring and managing risks</li> <li>Monitoring effects of regulation</li> <li>Ensuring a robust and well-functioning risk management structure</li> </ul>	<p><b>Group Credit Committee</b></p> <p>Consists of the members of Executive Board.</p> <p>Convenes once a week</p> <p>Discusses and approves credit applications from business units</p> 
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**Three sub-committees report to the All Risk Committee**

<p><b>Group Liquidity Risk Committee</b></p> <p>Convenes at least eight times a year</p>	<p><b>Operational Risk Committee</b></p> <p>Convenes at least four times a year</p>	<p><b>Model &amp; Parameter Committee</b></p> <p>Convenes at least four times a year</p>
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In general, the committees assist the Board of Directors and the Executive Board in ensuring strict risk management within the Group and in ensuring that risk management and risk reporting are always compliant with statutory regulations and the Group’s general principles for such practices.

**2.4 Risk management**

The Group’s risk management practices are organised according to the principles of three lines of defence. The three lines of defence segregate duties between (1) units that enter into business transactions with customers or otherwise expose the Group to risk, (2) units in charge of risk oversight and control and (3) the internal audit function.

The first line of defence is represented by the business units and the operations and service organisations. Each unit operates in accordance with the risk policies and delegated mandates. The units are responsible for having adequate skills, operating procedures, systems and controls in place to comply with policies and mandates and to exercise sound risk management.

The second line of defence is represented by group-wide functions that monitor whether the business units and the operations and service organisations adhere to the general policies and mandates. These functions are located in Group Risk Management.

The third line of defence is represented by Internal Audit, as described above in the section on the Board of Directors.

**2.4.1 Business units**

Each business unit is headed by a member of the Executive Board.

The business units' mandate to originate credit applications for the Group is regulated by risk policies, instructions and limits. The Group strives to cultivate a corporate culture that supports and enforces the organisation's objective to undertake selected risks according to guidelines that have been agreed upon.

Responsibility for all business-related risks is placed with the heads of the business units and the heads of the operations and services areas. Their responsibilities extend across national borders. Lending authorities for specific customer segments and products are granted to each of the heads of credit, who delegate lending authorities further within their units. While the business units are responsible for risk assessment, credit oversight functions headed by the heads of credit monitor whether the credit decisions are within the defined credit policy and credit risk appetite. Credit decisions exceeding the delegated authorities are submitted to the Group Credit Committee and to the Board of Directors.

The business units carry out the fundamental tasks required for sound risk management and controls. These tasks include updating the information about customers that is used in risk management tools and models as well as maintaining and following up on customer relationships.

Each business unit is responsible for preparing documentation before undertaking business transactions and for recording the transactions properly. Each unit is also required to update information on customer relationships and other topics as necessary.

The business units must also ensure that all risk exposures stay within the specific risk limits and comply with the Group's other guidelines.

Certain risk areas, such as market risk and liquidity risk, are managed centrally at the group level.

Country managers and local risk officers are responsible for ensuring compliance with local rules and regulations. Local risk committees as well as asset and liability management committees are established where they are relevant. The Group has established a dual reporting matrix organisation in which local risk officers now also report to the heads of risk areas in Group Risk Management regarding specific risk events.

#### **2.4.2 Group Risk Management**

Group Risk Management serves as the Group's second line of defence. It has overall responsibility for setting and monitoring the Group's risk appetite and policies and for following up and reporting on risk issues across risk types and organisational units. Group Risk Management also serves as a resource for referrals from local risk committees.

The department is headed by the Group's chief risk officer (CRO), who is a member of the Executive Board. On 1 April 2015, Gilbert Kohnke was appointed CRO.

The Group CRO reports to the Board of Directors in cooperation with the Group CEO. The CRO has the authority to veto any credit proposal. The following terms also apply to the CRO position:

1. The CRO cannot be removed from office without the express approval of the Board of Directors.
2. The CRO is the only Executive Board member who is a permanent member of the Credit & Risk Committee.
3. The CRO is also responsible for the credit risk reports that are submitted to the Board of Directors, the Board Credit & Risk Committee, the Executive Board, and the All Risk Committee. These reports do not require prior approval from the CEO.

Group Risk Management oversees the risk management framework and practices across the organisation. It serves as secretariat for the All Risk Committee, the Group Credit Committee and the Portfolio Committee. Senior staff from the department also chair the Group Liquidity Risk Committee, which oversees liquidity management and funding activities; the Model & Parameter Committee, which monitors the Group's use of risk models and the results of parameter validation; and the Operational Risk Committee, which evaluates the management of the Group's key operational risks.

Heads of credit who report directly to the CRO have a seat on the management teams of the three business units. They are responsible for delegating credit risk mandates and oversee the day-to-day risk management in the first line of defence. Within Group Risk Management, sub-departments are dedicated to oversee management of the Group's main risk types.

Credit risk management is organised in multiple departments that are responsible for setting the group-wide credit risk appetite and policies, reviewing the approval and follow-up processes in the business units' lending books, facili-

tating the quarterly process of calculating and consolidating the impairment of credit exposures, and monitoring and reporting on the Group's consolidated credit portfolio, including the determination of portfolio limits for specific industries and countries. Other departments develop credit rating and valuation models and ensure that they are available for day-to-day credit processing at the business units and that they meet statutory requirements. A separate unit is responsible for validating credit risk parameters in collaboration with the business units.

Risk appetite, policy setting, monitoring, controlling and reporting for market risk, liquidity risk and operational risk are also performed by dedicated departments within Group Risk Management. Group Risk Management conducts internal liquidity adequacy assessments (ILAA) annually.

### 2.4.3 CFO Area

The CFO Area is headed by the Group's chief financial officer (CFO), who is a member of the Executive Board. The department oversees the Group's financial reporting, budgeting and strategic business analysis, including the tools used by the business units for performance follow-up.

The department is also in charge of the Group's investor relations; relations with international rating agencies; legal, regulatory and corporate matters; and compliance and anti-money laundering activities.

It is responsible for the Group's capital management, including the compilation of the total risk exposure amount (REA), the Group's internal capital adequacy assessment process (ICAAP) and the internal capital allocation to business units.

Within the CFO Area, Group Treasury is responsible for executing the funding plan, managing the Group's liquidity plan and monitoring liquidity needs. Group Treasury also ensures that the Group's structural liquidity profile enables the Group to comply with the limits and meet the targets set by the Board of Directors and the All Risk Committee as well as regulatory and prudential requirements. Furthermore, Group Treasury is responsible for asset liability management, private equity activities and long-term funding activities.

## 2.5 Reporting

The Group allocates considerable resources to risk monitoring and to ensuring ongoing compliance with the approved risk limits. It has procedures for reporting to relevant management bodies and committees, including the Board of Directors and the Executive Board, on developments in risks, liquidity, the credit portfolio and non-performing loans, among other things.

The Board of Directors receives risk reports, including ICAAP and ILAA reports, at regular intervals (see the tables below). The Group's ICAAP report is submitted to the Board of Directors quarterly and in an expanded annual version that is supplemented with a detailed review of the Group's risk profile (Annual Risk Review).

### Annual and quarterly risk reporting

Risk management framework	
Risk policies	Review of risk policies, risk instructions and risk appetite. Submitted at least once a year.
Annual Risk Review	Review of the Group's risk profile and risk management framework. Submitted annually.
Risk Framework Overview	Comprehensive description of the risk management framework for all risk types. Submitted annually as part of the Annual Risk Review.
Risk profile	
Risk profile reports	Analyses of selected credit portfolios (industries and customer segments). Submitted annually.
Credit portfolio reports	Quarterly analysis of the current credit risk profile and the trends in the credit risk profiles at the business units and of selected sub-portfolios, industries and products. Overview of exposures equal to or exceeding 10% of the Group's total capital.
Impairment Overview	Quarterly report on the trends in collective and individual impairments.
Market risk reports	Quarterly analyses of the Group's losses caused by changes in the market value of the Group's assets, liabilities and derivatives resulting from changes in market prices or rates as well as follow-up on delegated risk mandates.
Liquidity risk reports	Quarterly analyses of liquidity risk, including liquidity coverage ratio, 12-month liquidity risk, structural liquidity risk and stress testing.

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**Risk mitigation**


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ICAAP report	Review of the adequacy of the Group's capital resources. Presents conclusions drawn from stress testing, including the effects of various scenarios on expected losses and capital needs. Submitted annually.
Quarterly ICAAP report	Quarterly review of the adequacy of the Group's capital resources in a more abbreviated form than the preceding report.
ILAA report	Evaluation of the liquidity situation and liquidity management, including the Group's funding profile and plan. The report also assesses liquidity risk by liquidity stress testing and similar analyses and presents a conclusion on the minimum amount of liquidity reserves required. Submitted annually.

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**Risk resilience**


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Contingency planning	Contingency plans describing options available to the Group to improve its capital and liquidity under stressed conditions. Updated annually.
Recovery planning	Identifies possible options under a given recovery plan for various stressed scenarios. Updated annually.
Recovery Dashboard	Key risk indicators for severe stress. Updated quarterly.

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The All Risk Committee (or in some cases, the Executive Board) evaluates risk reports to be submitted to the Board of Directors or one of the Board's committees. It also receives periodic reports on the Group's liquidity and solvency and monitors risk trends at the group level and at the business units.

## *2.6 Management declaration*

The Group adjusts the risk management framework regularly to take into account new regulatory requirements, to expand risk capabilities and to improve efficiency. The adjustments are reported in the Annual Risk Review, which along with other reporting serves as a basis for Board of Directors to assess the adequacy of the risk management framework. The Management Declaration of its assessment of current framework is included in the appendix, section 12.1.

# *Capital management*

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# 3.

The main purposes of Danske Bank Group's capital management policies and practices are to support its business strategy and to ensure that it is sufficiently capitalised to withstand even severe macroeconomic downturns.

With substantial capital in excess of the regulatory requirements, the Group considers itself well capitalised. In accordance with its business strategy, the Group has set capital targets: a total capital ratio of at least 17% and a common equity tier 1 (CET1) capital ratio of at least 13%. The Group has met these targets since the end of 2012. It is the Group's objective to maintain a level of capital sufficient to support its business strategy and to meet the regulatory capital requirements at all times. It is also the Group's ambition to have a capital level that rating agencies and investors consider robust. In the current low-growth environment, the Group considers a CET1 capital ratio of around 14% and a total capital ratio well above 17% as appropriate levels. The capital structure will be adjusted if excess capital is available after dividends have been paid out and the capital targets have been met.

In 2015, the Group optimised its capital structure through retained earnings, capital issuance and a share buy-back programme. The Group issued DKK 5.6 billion of additional tier 1 capital and redeemed tier 2 instruments in the amount of DKK 5.1 billion. Danica Pension issued Solvency II-compliant tier 2 capital in the amount of DKK 3.7 billion.

In 2015, the Group also expanded the use of internal models for the calculation of its total risk exposure amount (REA). In June, the Group received approval from the Danish FSA to implement an internal model method (IMM) for the calculation of counterparty risk and approval to use an expanded Value-at-Risk model (VaR model) for market risk. The Group's subsidiary Danske Bank Plc (Finland) as well as the Group also obtained approval to use the F-IRB approach for its corporate segment in Finland.

The results of both internal and regulatory stress tests confirmed the Group's substantial capitalisation. Stress tests are performed to verify that the Group is sufficiently capitalised to withstand adverse events caused by material risks arising from its business strategy at present and in future.

Under a share buy-back programme of DKK 5.0 billion in 2015, the Group purchased 24.9 million shares.

Regarding new regulation, we expect a minimum requirement for own funds and eligible liabilities (MREL) to be set for Danske Bank in 2016. The Group, which at the end of 2015 held own funds and eligible liabilities of DKK 250 billion, is well prepared for the new capital requirement.

Furthermore, 2016 is expected to bring more clarity on Basel IV, which will contain an extensive review of the risk-weighted capital framework by the Basel Committee on Banking Supervision (BCBS). The review includes a revision of the various methods for calculating the REA and introduces a permanent capital floor, among other things. Danske Bank is monitoring the BCBS process closely, but the timeline for the EU is unknown at the moment.

### *3.1 Total capital*

On 31 December 2015, Danske Bank's CET1 capital amounted to DKK 134 billion, or 16.1% of the total REA, and tier 1 capital amounted to DKK 155 billion, or 18.5% of the total REA. Total capital amounted to DKK 175 billion and the total capital ratio was 21.0%.

The high-level components of total capital are shown in the table below (a more detailed breakdown can be found in Danske Bank's Annual Report 2015). The figures reflect the capital subject to the transitional rules according to the CRR on 31 December 2015.

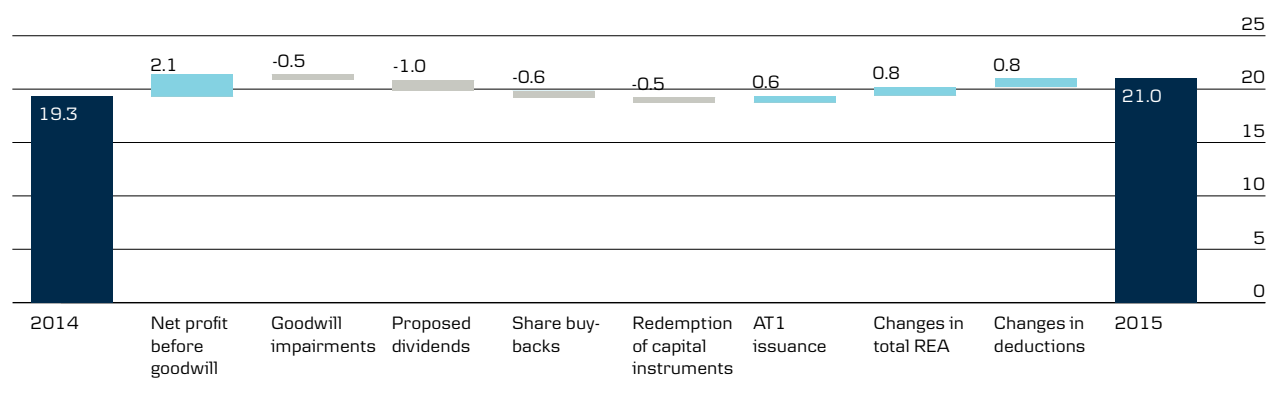


### Danske Bank Group's total capital and ratios

(DKK millions)	31 Dec. 2015	31 Dec. 2014
Total equity	160,830	152,384
Adjustment to total equity	3,714	3,806
Total equity calculated according to the rules of the Danish FSA	164,544	156,190
Additional tier 1 (AT1) instruments included in total equity	-11,177	-5,597
Adjustments for accrued interest and tax effect on AT 1 capital	-119	-60
<b>Common equity tier 1 (CET1) instruments</b>	<b>153,248</b>	<b>150,533</b>
Deductions from CET1 capital	-18,890	-20,130
Portion from goodwill	-6,426	-11,169
Portion from statutory deductions for insurance subsidiaries	-2,885	-1,850
CET1 capital	134,358	130,403
AT1 capital	22,338	17,434
Deductions from AT1	-2,171	-3,711
Portion from statutory deductions for insurance subsidiaries	-2,164	-3,701
<b>Tier 1 capital</b>	<b>154,525</b>	<b>144,126</b>
Tier 2 instruments	22,782	26,310
Deductions from tier 2	-2,171	-3,711
Portion from statutory deductions for insurance subsidiaries	-2,164	-3,701
<b>Total capital</b>	<b>175,136</b>	<b>166,725</b>
<b>Total risk exposure amount</b>	<b>833,594</b>	<b>865,086</b>
Common equity tier 1 capital ratio	16.1%	15.1%
Tier 1 capital ratio	18.5%	16.7%
Total capital ratio	21.0%	19.3%

### Change in total capital ratio, 2014 to 2015

(%)



The Group makes a full internal allocation of its total equity across business units on the basis of each unit's contribution to the Group's total risk as estimated by means of regulatory and internal risk models. The Group is constantly improving its capital allocation framework in order to reflect the effects of new regulation and the risk entailed in its business activities as closely as possible. In the first quarter of 2016, we will change the principles for allocating capital across the business units so that they are fully aligned with the regulatory requirements and our CET1 capital ratio target of around 14%.

### 3.1.1 Consolidation methods

The consolidation of the Group's financial statements is based on IFRSs, whereas the prudential consolidation in the statement of capital is based on the rules of the Danish FSA and the CRR. The main difference is that under IFRSs, Danica Pension is consolidated line by line, whereas under the rules of the Danish FSA, it is treated as a (net) investment in a subsidiary in accordance with the equity method.

In addition, the Group consolidates Danmarks Skibskredit A/S and LR Realkredit A/S on a pro rata basis in the statement of capital, whereas, in the IFRS financial statements, the two companies are accounted for under the equity method and thus treated as (net) investments in associates. The Group has ownership shares of 24% and 31%, respectively, in the two companies. Danmarks Skibskredit A/S offers loans to ship-owners and other shipping companies secured by mortgages on vessels. At the end of June 2015, the company had total assets of DKK 73.4 billion and a total capital ratio of 16.5%. LR Realkredit A/S provides mortgage loans primarily for subsidised housing and other subsidised properties. On the same date, the company had total assets of DKK 20.1 billion and a total capital ratio of 21.4%.

In December 2013, the Danish FSA designated the Group as a financial conglomerate because of its ownership of Danica Pension. The Group is therefore subject to supplementary supervision as a financial conglomerate (at the group level). For this reason, the Group's solvency calculations are treated according to the deduction method described in section 3.1.3.

In rare circumstances, companies taken over by the Group because they have failed to meet their obligations are consolidated in the financial statements and are sold as soon as they are marketable. They are not included in the calculation of the total capital, but the holdings are included in the calculation of the total REA. The table below shows the differences between the ordinary consolidation principles used in the financial statements and those used in solvency calculations for subsidiaries and associated credit institutions.

#### Consolidation principles for subsidiaries and other holdings of Danske Bank A/S

	Consolidation of solvency calculations			Consolidation in IFRS accounts	
	Full	Pro rata	Capital deduction	Full	One line
Subsidiaries and other holdings of Danske Bank A/S					
Credit institutions	•			•	
Associated credit institutions		•			•
Insurance operations (consolidated according to capital deduction method)			•	•	
Investment and real property operations	•			•	
Foreclosed companies (risk-weighted)				•	

### 3.1.2 Common equity tier 1 capital

Starting with the Group's total equity under IFRSs, the Group makes a number of adjustments in order to determine its CET1 capital.

In accordance with IFRSs and the Danish FSA's accounting rules, total equity is subject to the following adjustments:

- Revaluation of domicile property is recognised at estimated fair value. Revaluation to a value above the cost of acquisition is recognised as CET1 capital.
- Special reserve funds totalling DKK 3.0 billion stemming from LR Realkredit A/S and Danmarks Skibskredit A/S are consolidated on a pro rata basis. These reserve funds cannot be distributed but can be used to cover any losses at the companies after their other reserves.
- The new CRR-compliant additional tier 1 instruments issued in March 2014 and February 2015 count as equity according to accounting rules, but do not qualify as equity according to capital and solvency rules. The additional instruments are therefore excluded from CET1 capital instruments and instead categorised as additional tier 1 capital.

In addition to the adjustment listed above, total equity is also subject to certain deductions to determine CET1 capital in accordance with the CRR and the Danish Executive Order on Calculation of Risk Exposure, Own Funds and Solvency need.

These are the main deductions:

- Proposed dividend
- Carrying amounts of intangible assets, including goodwill
- Deferred tax assets
- Defined benefit pension fund assets
- Statutory deduction for insurance subsidiaries (see also section 3.1.3)
- Prudential filters
- Adjustment to eligible capital instruments

The phase-in of the CRR increases the level of deductions from CET1 capital until 2018. The increase comes mainly from the transfer of current deduction elements from tier 1 and tier 2 capital to CET1 capital.

The Group estimates that the CET1 capital ratio will decline by around 0.7 of a percentage point from the level on 31 December 2015 (16.1%) when it is calculated on the basis of the CRR with fully loaded capital deductions (fully phased-in rules by 2018).

The Group estimates that 0.5 of a percentage point of the decline in the CET1 capital ratio after the rules are fully phased in will derive from deductions for Danica Pension.

### 3.1.3 Statutory deductions for insurance companies and significant investments

The statutory deductions for insurance companies were previously divided equally between tier 1 and tier 2 capital. According to the transitional rules of the CRR, these deductions will gradually be phased out and moved to CET1 capital by 2018.

As a financial conglomerate, Danske Bank has obtained approval to use the Danish FSA's deduction method for insurance subsidiaries. Since 2014, the deduction has been based on Danica Pension's solvency need; previously, it had been based on the minimum capital requirement. The modification is being phased in linearly until 2016.

Danske Bank's statutory deductions for insurance subsidiaries and other statutory deductions from the total capital in 2015 were as follows:

- Danica Pension's solvency need less the difference between Danica Pension's total capital and the carrying amount of Danske Bank's capital holdings in Danica Pension. This method ensures that the Group's total capital is reduced fully by deductions made from Danica Pension's total capital, among other things.
- Capital holdings in other credit and financial institutions that represent more than 10% of the share capital of such institutions, excluding capital holdings in subsidiaries. The deduction will be phased out since the position is lower than the threshold defined in the CRR. Instead, the position will be risk-weighted at 250%.

#### Total capital deductions for insurance subsidiaries and other deductions

(DKK millions)	31 Dec. 2015	31 Dec. 2014
Capital requirement at Danica	7,865	8,432
Add-on for positive difference between solvency need and capital requirement (transitional)	1,593	649
Less the difference between		
Danica's capital base	17,686	17,469
Danske Bank's capital holdings	15,752	18,087
Danica's holding of Danske Bank shares etc.	311	447
Deduction for insurance subsidiaries	7,213	9,252
Deduction for holdings in other credit institutions	14	25
<b>Total deductions, divided equally between tier 1 and tier 2 capital</b>	<b>7,227</b>	<b>9,277</b>
<b>Total deductions from common equity tier 1 capital</b>	<b>2,885</b>	<b>1,850</b>

Note: The carrying amount of Danske Bank's capital holdings in Danica less the total deduction for Danica from the Group's total capital is included in the total REA calculations at a 100% weight. Danske Bank's capital holding in Danica at the end of 2015 reflects the deduction of a proposed dividend from Danica.

### 3.1.4 Additional tier 1 capital and tier 2 capital

At the end of 2015, the Group's additional tier 1 capital (including old hybrid capital issues) amounted to DKK 22.3 billion, or 2.7 percentage points of the total capital ratio. On the same date, the Group's tier 2 capital amounted to DKK 22.8 billion, or 2.7 percentage points of the total capital ratio.

In February 2015, Danske Bank issued its second set of CRR-compliant additional tier 1 instruments in the amount of EUR 750 million (DKK 5.6 billion), giving the Group total CRR-compliant additional tier 1 capital of DKK 11.2 billion. In order to qualify as tier 1 capital under the CRR, the instruments must fulfil a number of requirements. These requirements include the Group's capacity, at its discretion, to cancel coupon payments and to write down (permanently or temporarily) the principal or convert it to equity if a certain CET1 level is breached. In the Group's issue of CRR-compliant additional tier 1 instruments, the level at which a temporary write-down would take place is set at 7%. The issue is perpetual, with the first call option in April 2020. Early redemption requires the prior approval of the Danish FSA.

Danica Pension issued Solvency II-compliant tier 2 capital in the amount of DKK 3.7 billion, which reduced Danske Bank's statutory deductions for its holdings in Danica.

The phase-in of the CRR will affect the way outstanding additional tier 1 instruments and tier 2 instruments will be incorporated in total capital. Outstanding old hybrid tier 1 instruments and tier 2 instruments not eligible under the CRR requirements will be phased out over a period that started in 2014. All of the Group's issues of additional tier 1 instruments and tier 2 instruments since September 2013 are fully CRR-compliant.

For a description of the conditions of the Group's outstanding issues of individual additional tier 1 instruments and tier 2 instruments, see note 21 in Annual Report 2015.

## 3.2 Capital requirements and solvency need

The Group's management of its total capital is based on the Internal Capital Adequacy Assessment Process (ICAAP). The Group's ICAAP, including the ICAAPs of its subsidiaries, gives a clear picture of the Group's capital and risks.

As part of the ICAAP, management identifies the risks to which the Group is exposed in order to assess its risk profile. The Group also determines its solvency need (Pillar II) on the basis of the minimum capital requirement (Pillar I) and conducts stress tests to ensure that it always has sufficient excess capital to support its business strategy, among other things.

The Group assumes risks as a normal part of its business activities and expects to incur some financial losses as a consequence of these risks. Under normal circumstances, it expects such losses to be well covered by its earnings. If earnings are not sufficient to cover the losses, they are covered by the Group's capital.

The Group is involved in a broad range of business activities. These activities can be divided into five segments for the purpose of risk identification: banking, market, asset management, insurance and group-wide activities. The latter category covers management activities that are not specific to any of the first four business segments but broadly support them all. Each of these activities entails various risks, which fall into the seven main categories of the Group's risk management framework.

## Risk identification across activities

Activities	Danske Bank Group's risk categories						
	Counterparty credit risk	Market risk	Operational risk	Pension risk	Insurance risk	Business risk	Liquidity risk
Banking activities	√	√	√			√	√
Market activities	√	√	√			√	√
Asset management			√			√	
Insurance (Danica)					√		
Group-wide activities			√	√		√	√

After identifying the risks, the Group determines how and to what extent it will mitigate them. Mitigation usually takes place by means of business procedures and controls, contingency plans and other measures. Finally, the Group determines what risks will be covered by capital. The Group thus ensures that it has sufficient excess capital to cover the risks associated with its business activities. It uses models and expert assessments to monitor all significant risks.

The Group's ICAAP also forms the basis for the Supervisory Review and Evaluation Process (SREP), which is a dialogue between an institution and the financial supervisory authorities on the institution's risks and capital needs. The outcome of the latest SREP was that the supervisory colleges, led by the Danish FSA, considered the Group adequately capitalised.

### 3.2.1 Minimum capital requirement

The regulatory minimum capital requirement under Pillar I of the CRR is defined as 8% of the risk exposure amounts for credit risk (including counterparty credit risk), market risk and operational risk.

Credit risk amounted to 77.6% of the total REA, making it Danske Bank's largest risk type. In collaboration with other national financial supervisory authorities, the Danish FSA has approved Danske Bank's use of the A-IRB approach for the calculation of credit risk.

The Danish FSA has granted the Group an exemption from the A-IRB approach for exposures to government bonds and equities, among other things. The exemption also applies to exposures at the legal entities Danske Bank Limited (Northern Ireland) and Danske Bank International (Luxembourg) as well as to retail exposures at Danske Bank Plc (Finland) and Danske Bank Ireland. For these exposures, the Group currently uses the standardised approach. In 2015, the Group obtained approval to use the F-IRB approach for credit risk exposure to corporate customers at Danske Bank Plc.

Counterparty credit risk, including central clearing counterparty (CCP) and CVA risk charges, amounted to 5.0% of the total REA. In 2015, the Group obtained approval to use an IMM to calculate REA for counterparty credit risk.

Market risk amounted to 8.7% of the total REA. The Group uses an internal VaR model for market risk on items in the trading book and for foreign exchange risk on items outside the trading book. In 2015, the Danish FSA approved an extension of the internal VaR model and also approved the Group's incremental risk model for calculating the REA for market risk.

Operational risk amounted to 8.7% of the total REA. The Group uses the standardised approach for the calculation of operational risk.

## Risk exposure amount and risk weights

At 31 December (DKK millions)	2015		2014	
	REA	Avg. risk weights	REA	Avg. risk weights
Credit risk				
IRB approach:				
Institutions	7,618	24%	8,409	24%
Corporates	314,065	39%	308,250	39%
Exposures secured by real property	89,547	14%	93,765	15%
Other retail	29,005	22%	30,674	23%
Other assets	16,013	69%	20,468	74%
IRB approach, total	456,249	28%	461,566	29%
FIRB Corporate	33,512	56%		
Standardised approach, total	156,972	24%	196,498	34%
Credit risk, total	646,733		658,064	
Counterparty credit risk	31,271		45,874	
CCP default risk	1,404		7,358	
CVA risk charge	9,282		21,436	
Counterparty credit risk (incl. CCP and CVA)	41,957		74,668	
Market risk, total	72,172		59,089	
Operational risk, total	72,732		74,001	
<b>Total risk exposure amount</b>	<b>833,594</b>		<b>865,822</b>	

From 2014 to 2015, the total REA declined DKK 32 billion to DKK 834 billion. In 2015, we continued to lower our risks in selected areas when market conditions were unfavourable.

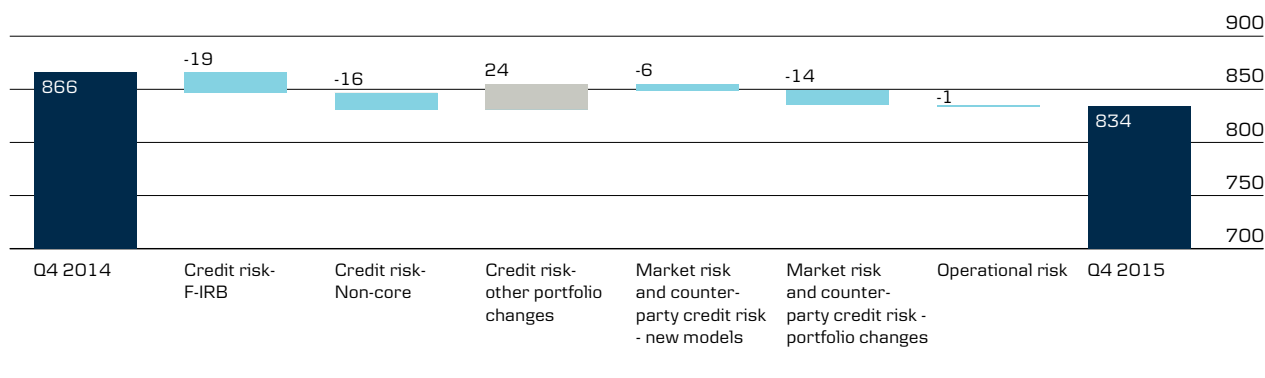
The REA for credit risk fell DKK 11 billion. The winding-up of Non-core activities accounted for a DKK 16 billion reduction of the REA, and lending growth in our core markets and other portfolio changes contributed an increase in the REA of DKK 24 billion. Finally, we implemented the F-IRB approach for corporates in Finland, and this led to a reduction of the REA of DKK 19 billion.

The REA for market risk and counterparty risk fell DKK 20 billion. The implementation of an IMM for counterparty risk and the expansion of the VaR model for market risk led to a reduction of the REA of DKK 6 billion. Portfolio changes, including the diversification strategy at Corporates & Institutions, led to lower positions and a reduction of the REA of DKK 14 billion.

The REA for operational risk decreased slightly by DKK 1 billion.

### Change in the total risk exposure amount, 2014 to 2015

(DKK billions)



### 3.2.2 Internal assessment of the solvency need

The Group must meet the regulatory minimum capital requirement. As part of the ICAAP under Pillar II, the solvency need is determined on the basis of an internal assessment of the Group's risk profile in relation to the minimum capital requirement. The solvency need is the amount of capital that is adequate in terms of size and composition to cover the risks to which a financial institution is exposed. According to Danish law, the solvency need ratio is the solvency need divided by the total REA determined under Pillar I.

An important part of the process of determining the solvency need is evaluating whether the calculation takes into account all material risks to which the Group is exposed. The Group uses its internal models, combined with expert judgement and [Danish FSA] benchmark models, to quantify whether the regulatory framework indicates that additional capital is needed. The table below shows the approaches used under Pillar I and Pillar II for each risk type.

	Risk type	Regulatory framework	Internal framework
Pillar I risks	Credit risk	Internal model Assumes granular portfolio One-factor model	Internal model Takes into account concentrations and country-specific factors
	Market risk	Internal model for general risk; standardised approach for specific risk and commodity risk	Internal model for general risk; standardised approach for specific risk and commodity risk
	Operational risk	Standardised approach	
Other risks	Pension risk	Internal model	
	Insurance risk	Included in credit risk	Internal model
	Business risk	Internal model	
	Interest rate risk outside the trading book	Internal model	Part of market risk

Capital add-ons are quantified on the basis of input from internal experts. When determining the solvency need on the basis of the minimum capital requirement, if the results of the model calculations do not appear sufficiently conservative, the Group evaluates whether there is a need for capital add-ons. This may be the case, for example, if the Group believes that the result of the regulatory approach is not conservative enough or if macroeconomic uncertainty raises similar doubts. The capital add-ons are additive, although they may overlap, and the process thus represents a conservative and careful assessment of the Group's solvency need.

In addition to determining the solvency need, the Group uses the Basel I transitional rules as a "backstop" measure to determine the adequacy of its total capital. That is, the transitional rules determine the minimum level of total capital

needed if they indicate an amount that is larger than the solvency need plus the phased-in regulatory buffer requirements. The regulatory buffer requirements are described in further detail in section 3.2.3.

The Group does not set aside capital to cover liquidity risk but rather mitigates such risk by means of its funding strategy, contingency plans, stress test analyses and other measures. The Group recognises, however, that a strong capital position and good ratings are necessary for maintaining a strong liquidity and funding position.

At the end of 2015, the Group's solvency need was DKK 88.9 billion, or 10.7% of the total REA, and its total capital was DKK 175.1 billion, or 21.0% of the total REA. The Group's capital in excess of the solvency need and combined buffer requirement as described in section 3.2.3 was DKK 78.9 billion.

The solvency need declined DKK 3.2 billion, or 0.1 of a percentage point, from the level at the end of 2014.

For information about the general methods of calculating the solvency need and solvency need ratio, see the ICAAP report, which is updated quarterly and published along with the Group's quarterly and annual reports at [danskebank.com/ir](http://danskebank.com/ir).

### 3.2.3 Combined buffer requirement

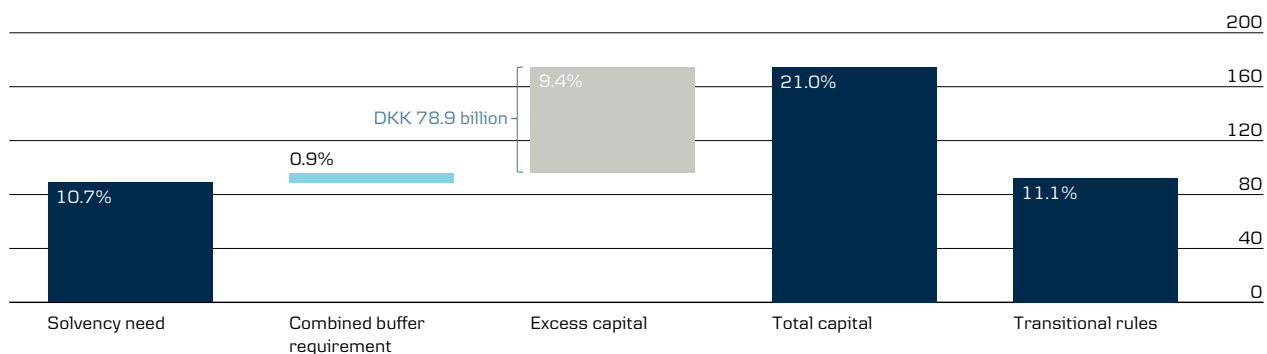
CRD IV introduced a combined buffer requirement that will be phased in for Danske Bank from 2015 to 2019. This requirement applies in addition to the solvency need. The combined buffer requirement consists of regulatory requirements for three separate buffers: the capital conservation buffer, the countercyclical capital buffer and a systemic risk buffer. When a financial institution fails to maintain the combined buffer requirement, it will be restricted from making discretionary distributions. At the end of 2015, the combined buffer requirement was 0.9%, consisting of a 0.3% countercyclical buffer and a 0.6% SIFI buffer requirement. In 2015, the capital conservation buffer was 0%.

In accordance with Danish law, the capital conservation buffer (2.5% of CET1 capital) and the countercyclical capital buffer (up to 2.5% of CET1 capital) will be phased in in the period through 2019. The Group will be subject to countercyclical buffer requirements set in every country where it has exposure. The countercyclical buffers in Norway and Sweden are currently 1% but will increase to 1.5% in Q2 2016. On the basis of the country-specific countercyclical buffer requirements at the end of 2015, the Group's total countercyclical buffer requirement is 0.3%.

In Denmark, the systemic risk buffer is used primarily for the implementation of the capital buffers for systemically important financial institutions (SIFIs). Danske Bank was designated as a SIFI in Denmark in 2014. This means that the Group is subject to stricter requirements than non-SIFI banks. Danske Bank's SIFI buffer requirement is set at an additional 3% above the CRR requirement for CET1 capital. The SIFI buffer requirement phase-in began on 1 January 2015 and will be completed by 2019. As stated above, at the end of 2015, the Group's SIFI buffer requirement was 0.6%.

### Solvency need, combined buffer requirement and total capital ratio, end-2015

(DKK billions)





### 3.3 Capital planning

The Group ensures that its total capital is sufficient to meet the regulatory capital requirements at all times and that it maintains access to the funding markets under all market conditions. The Group's capital planning takes into account both short-term and long-term horizons in order to give the Board of Directors a comprehensive view of current and future capital levels. The capital plan includes a forecast of the expected capital performance and a scenario analysis of the effect of adverse conditions on its capital level. The short-term scenarios are based on the effects that changes in business and possible capital challenges have on earnings. The long-term scenarios evaluate the ability of the Group to comply with regulatory capital requirements and maintain appropriate excess capital. The Group identifies possible negative effects and then takes appropriate action to maintain efficient capital consumption at an early stage.

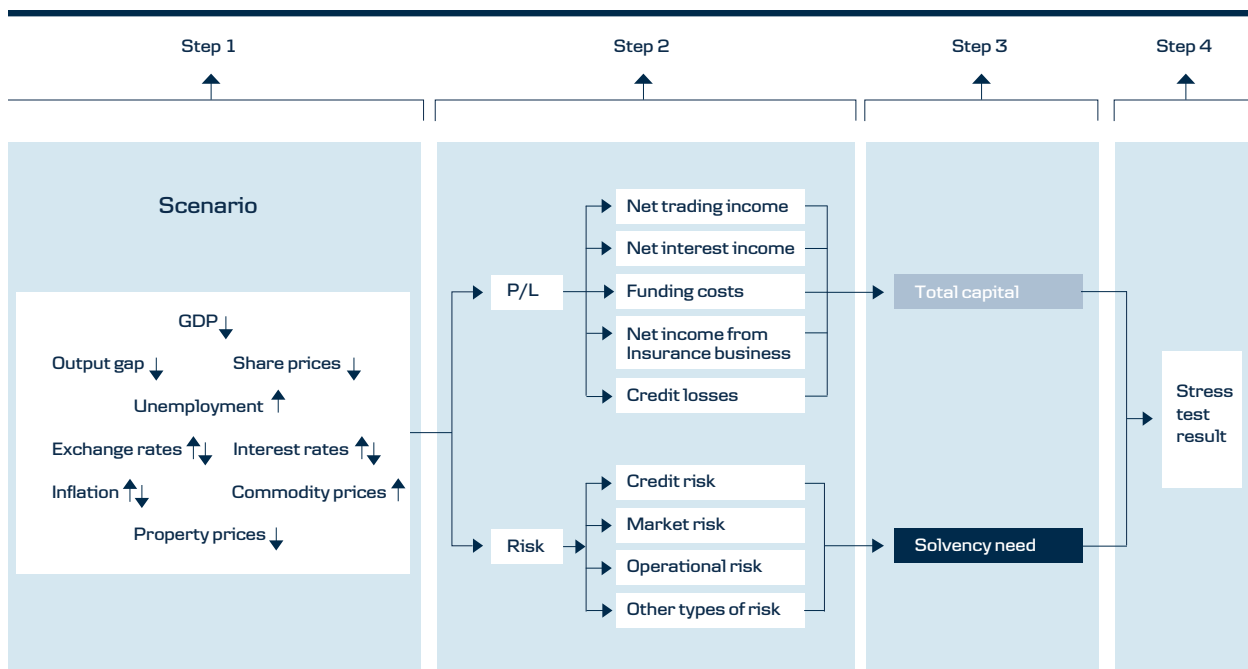
To ensure that the Group maintains an appropriate level of capital above the regulatory capital requirements, the Board of Directors has set specific capital targets for the Group: a total capital ratio of at least 17% and a CET1 capital ratio of at least 13%. The Group's capital considerations are based on the rules on the transition from current regulations, the phase-in of CRR/CRD IV rules, and the SIFI requirements. It is the Group's objective to maintain a level of capital sufficient to support its business strategy and to meet the regulatory capital requirements at all times. It is also the Group's ambition to have a capital level that rating agencies and investors consider robust. In the current low-growth environment, the Group considers a CET1 capital ratio of around 14% and a total capital ratio well above 17% as appropriate levels. The Group revises its capital policy at least once a year.

#### 3.3.1 Stress tests

Danske Bank uses macroeconomic stress tests in the ICAAP for the purpose of projecting its solvency need and actual capital level in various unfavourable scenarios. Stress tests are an important means of analysing the risk profile since they give management a better understanding of how the Group's portfolios are affected by macroeconomic changes, including the effects of negative events on the Group's total capital. The stress tests support the Group's internal capital planning and its compliance with the regulatory capital requirements.

When the Group uses stress tests in capital planning, stress is applied to risks, income and the cost structure. Stressing income and costs affects the Group's total capital, while stressing risk exposures affects the solvency need. The stress test methodology consists of four steps.

#### Effects of stress test scenarios on earnings and risk



The first step is to define and prepare the internal stress test scenarios. Each scenario consists of a set of macroeconomic variables. The scenarios are generally used both at the group level and for subsidiaries. Specific scenarios are also developed for subsidiaries. The scenarios are submitted to the Board of Directors for approval.

### Danske Bank's most important stress test scenarios

Scenario	Duration	Description
Mild recession	3 years	A mild slowdown in the global economy reduces exports, private consumption and GDP while increasing unemployment. Interest rates are kept low, and property prices decline. This scenario assumes a slight economic contraction in the first year, followed by a slow recovery.
Severe recession	3 years	A sharp slowdown in the global economy reduces exports, private consumption and GDP while increasing unemployment. This scenario assumes a significant setback in property prices because of weak consumer confidence, high unemployment and tight credit policies. There is no recovery within the 3-year duration of this scenario.
Extreme recession	3 years	A very sharp slowdown in the global economy reduces exports, private consumption and GDP while increasing unemployment. This scenario assumes deflation in most economies and a very sharp drop in property prices.
Regulatory scenarios	2 years	Danish FSA: Base case and stress scenarios.

The second step is to determine the effects of the scenarios on the various risk types. For credit risk, the Group uses statistical models that transform the macroeconomic scenarios into loss levels and thus the effects on risk, income and the cost structure.

In the third step, the Group calculates its solvency need, combined buffer requirement and total capital under each scenario. Finally, the results and the methodology are evaluated and discussed by management as well as the Group's specialists in various risk types in order to ensure consistency and reliability.

Danske Bank uses a "mild recession" scenario to determine whether the solvency need should be supplemented by an add-on for business cycle fluctuations. If a negative macroeconomic trend indicates that the Group will incur a loss for the year, an add-on is included in the calculation of the solvency need.

In its capital planning, the Group uses a "severe recession" scenario to determine whether the capital level is satisfactory. If it concludes that its excess capital is too small in the scenario's worst year, it will consider changing the risk profile or raising capital.

In its crisis management (recovery planning), the Group uses an "extreme recession" scenario to ensure the credibility and effectiveness of its capital and liquidity contingency plans. If the current combination of elements in the contingency plans does not improve the Group's capital and liquidity situation sufficiently, the Group will consider actions to increase the effectiveness of the contingency plans.

Besides these three main scenarios, Danske Bank also uses various specialised scenarios that give management an understanding of how the Group will be affected by specific events.

The stress test framework shows that the Group is robust in the event of unfavourable economic developments in the selected stress test scenarios.

### Reverse stress test

A reverse stress test is a risk management tool that complements the standard risk framework. The idea behind a reverse stress test is to identify an extreme event (or combination of events) that could bring the Group into a recovery state and then to determine the likelihood of the events. The Group can then judge whether it is comfortable with the probability that the events will occur in relation to the implications of their occurrence.

Along with the results from the various stress tests in the ICAAP, the reverse sensitivity analysis shows that the Group has a comfortable level of capital in excess of its solvency need – even when heavily stressed income is combined with unprecedented impairments, trading losses, operational losses and funding costs.

### 3.4 Leverage ratio

Since January 2014, the CRR/CRD IV rules have required credit institutions to calculate, report and monitor their leverage ratios, defined as tier 1 capital as a percentage of total exposure. The leverage ratio will be assessed under Pillar II pending a political decision in the EU on whether it should be included as a Pillar 1 requirement beginning in 2018. The leverage ratio represents a non-risk-adjusted capital requirement, and it will be introduced as a “back-stop” measure for risk-based capital.

The Group's overall monitoring of leverage risk is done in the ICAAP. The ICAAP also includes an assessment of changes in the leverage ratio under stressed scenarios. The leverage ratio is determined and monitored monthly. To ensure sound monitoring, the Group has set forth policies for the management and control of each component that contributes to leverage risk.

The determination of tier 1 capital and the estimated fully phased-in tier 1 capital is explained in subsection 3.1 above. For the purpose of calculating the leverage ratio, the total exposure is DKK 3,293 billion.

<b>Leverage ratio</b>		
At 31 December (DKK billions)	2015	2014
Total assets according to IFRSs	3,292.9	3,453.0
Adjustments in scope of consolidation (IFRSs to DK GAAP)		
Insurance assets (Danica)	-297.5	-295.0
Other	21.3	20.7
<b>Total assets according to DK GAAP*</b>	<b>3,016.7</b>	<b>3,178.7</b>
Derivatives (accounting asset value)	-335.6	-412.9
Derivatives (exposure to counterparty credit risk ex collateral)	170.2	235.1
Securities-financing transactions (exposure to counterparty credit risk)	6.0	25.5
Undrawn committed and uncommitted facilities, guarantees and loan offers	431.4	554.6
Other	6.6	
Tier 1 capital deductions (intangibles, deferred tax assets, etc.)	-21.6	-24.4
<b>Total exposure for leverage ratio calculation</b>	<b>3,273.7</b>	<b>3,562.5</b>
Reported tier 1 capital (transitional rules)	154.5	144.9
Tier 1 capital (fully phased-in rules)	139.0	126.7
Leverage ratio (transitional rules)	4.7%	4.1%
Leverage ratio (fully phased-in rules)	4.2%	3.6%

\*Total assets include SFTs on the balance sheet.

At the end of 2015, the leverage ratio was 4.7% under the transitional rules. This represents an increase of 0.6 of a percentage point from the end of 2014. The change was caused mainly by a decline in the balance sheet and an increase in tier 1 capital. The definition of the leverage ratio was also revised in 2015, and this had a minor effect on the calculated exposure to securities-financing transactions and derivatives. The fully phased-in leverage ratio increased from 3.6% to 4.2%. The difference between transitional and fully phased-in measures is the treatment of grandfathered capital, which is not included in the fully phased-in leverage ratio.

In November 2015, a group of experts on the leverage ratio appointed by the Danish government published a report with recommendations that may serve as a basis for the government's position in future EU negotiations on leverage ratio requirements. The group emphasised that risk-based capital requirements should continue to be the backbone of capital regulation and therefore be the binding capital requirements for credit institutions. The group recommended that the government endorse an EU-harmonised leverage ratio requirement of 3% under Pillar I beginning in 2018 and that the implementation of a leverage ratio requirement in Denmark await the outcome of the EU negotiations.

### *3.5 Minimum requirement for own funds and eligible liabilities*

Since the implementation of the Bank Recovery and Resolution Directive (BRRD) in Denmark, the Danish FSA is required to set a minimum requirement for own funds and eligible liabilities (MREL) for Danish banks after consulting with Finansiel Stabilitet A/S. The general objective of introducing the MREL is to ensure that banks hold a sufficient amount of bail-in-able liabilities to absorb losses equal to the capital requirements and restore their critical functions without support from public funds. The MREL is expected to be set in 2016 and to take effect on 1 January 2017.

At the end of 2015, Danske Bank Group's MREL resources amounted to DKK 250 billion.

In November 2015, the Financial Stability Board (FSB) issued the final total loss-absorbing capacity (TLAC) standard for the 30 banks identified as global systemically important banks (G-SIBs). The TLAC requirement contains two conditions that need to be fulfilled in a two step-approach. By 1 January 2019, the minimum TLAC must be equivalent to at least 16% of the total REA and 6% of the Basel III leverage ratio exposure measure. By 1 January 2022, the minimum TLAC must be equivalent to at least 18% of the total REA and 6.75% of the Basel III leverage ratio exposure measure.

Going forward, the European Commission is expected to consider how to relate the MREL to the TLAC and whether it will seek to apply the TLAC requirement to all EU banks, as in the BRRD, or only to EU-domiciled G-SIBs. Danske Bank will monitor the developments in the discussions about TLAC implementation in the EU.

### *3.6 Basel IV*

After the implementation of the Basel III standards, the Basel Committee on Banking Supervision (BCBS) began conducting a review of the risk-weighted capital framework. This comprehensive review, which has been named Basel IV by market participants, includes a revision of the various methods of calculating the total REA (i.e., standardised approaches and internal models) as well as the introduction of a permanent risk-weighted capital floor and a review of interest rate risk in the banking book. The BCBS intends to issue the final standards covering the outstanding revisions to the regulatory framework by the end of 2016, and the EU implementation process will begin subsequently. Danske Bank will follow the BCBS review and EU implementation process closely, but the timeline is still unknown.

# *Credit risk*

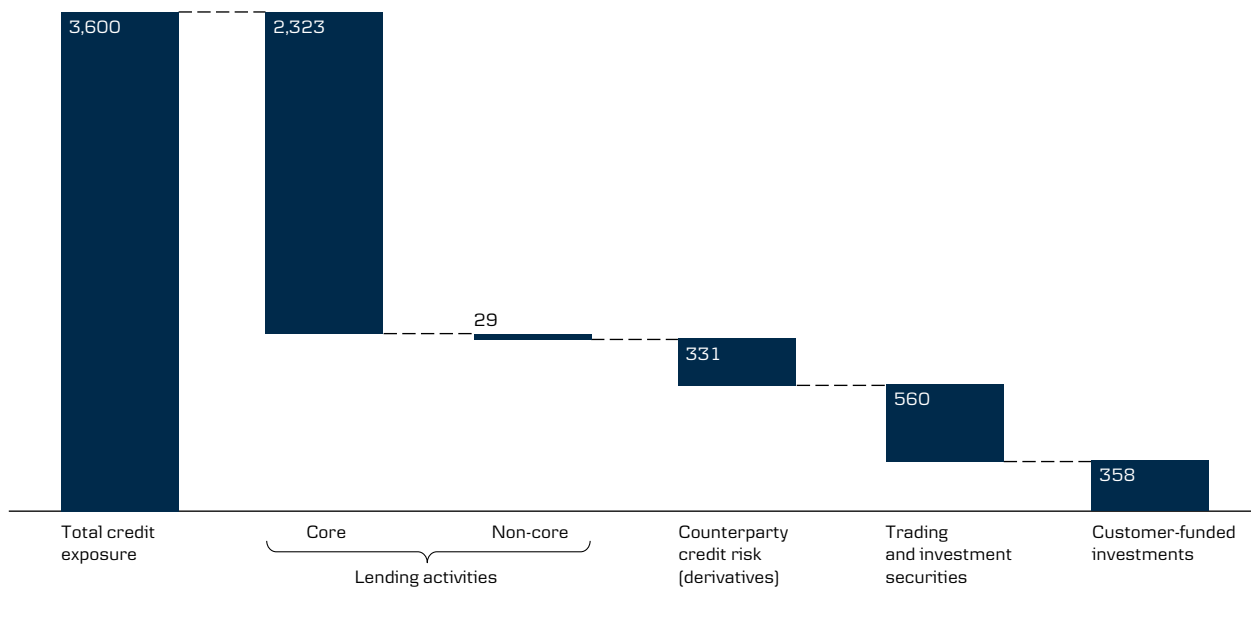
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# 4.

Danske Bank Group's total credit exposure is defined as balance sheet items and off-balance-sheet items that carry credit risk. At the end of 2015, the Group's total credit exposure for accounting purposes was DKK 3,600 billion (2014: DKK 3,722 billion).

### Breakdown of exposure (carrying amounts)

(DKK billions)



Credit exposure from lending activities accounts for most of the Group's credit exposure and is the focus of this section.

At the end of 2015, credit exposure from core lending activities amounted to DKK 2,323 billion (2014: DKK 2,269 billion). Credit exposure from Non-core lending activities amounted to DKK 28.6 billion (2014: DKK 31.3 billion). Credit exposure from lending activities includes amounts due from credit institutions and central banks, loans, guarantees and irrevocable loan commitments. The exposure is measured net of accumulated impairment charges and includes repo loans.

From section 4.1 onwards, credit exposure from lending activities (referred to as "credit exposure") excludes Non-core exposure (unless otherwise stated). Non-core exposure is described separately in section 4.10.

At the end of 2015, counterparty credit risk amounted to DKK 331 billion (before close-out netting and collateral reduction). This type of risk is explained in section 5.

Credit exposure from trading and investment securities arises from securities positions taken by the Group's trading and investment units, and it also entails credit risk. This type of risk is explained in the credit risk notes to Danske Bank's annual accounts.

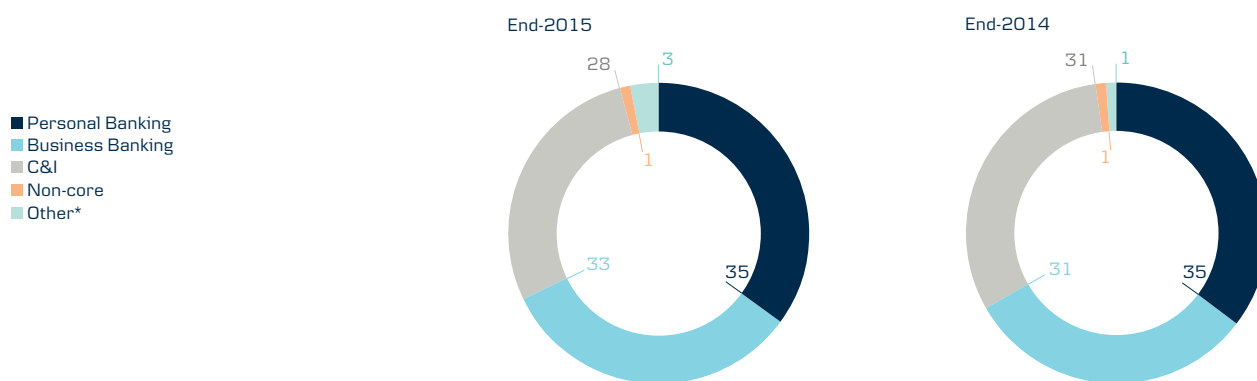
The Group's exposure to the credit risk on some balance sheet items is limited. This is the case for assets in customer-funded investment pools, unit-linked investment contracts and insurance contracts (customer-funded investments). The risk on assets under pooled schemes and unit-linked investment contracts is assumed solely by the customers, while the risk on assets under insurance contracts is assumed primarily by the customers. The credit risk on customer-funded investments and insurance contracts is explained in the notes on credit risk and insurance contracts in Danske Bank's annual accounts.

At the end of 2015, some 77.6% of the total REA related to credit risk, excluding counterparty credit risk.

### Credit exposure from lending activities

Lending at Personal Banking, which accounted for the largest share of the exposure (35%), consisted mainly of mortgage products in the Nordic countries. The commercial portfolios at Business Banking and C&I are diversified across various industries.

### Breakdown of net credit exposure by business unit, lending activities



\* Other includes Danske Capital and other entities.

Business unit	Credit exposure (DKK billions)	NPL exposure (%)	Developments in 2015
Personal Banking	828	1.9%	Credit quality improved in most markets and there was a significant decline in individual impairments. NPL (%) declined.
Business Banking	766	3.6%	Credit quality improved across markets. There was a significant drop in individual impairments, primarily in Denmark and the commercial property sector. NPL (%) declined.
Corporates & Institutions	667	0.6%	Credit quality remained strong and individual impairments declined significantly. NPL (%) declined.

## 4.1 Credit risk profile and credit risk appetite

Improving macroeconomic conditions and managerial efforts to contain credit risk and enhance underwriting had positive effects on the credit risk profile in 2015. Overall credit quality improved, and impairment charges decreased. The credit risk profile also reflects the Group's position as a leading Danish mortgage finance provider, with 32% of total exposure related to Realkredit Danmark A/S.

The credit risk profile is monitored and strengthened in accordance with the Credit Risk Appetite, which encompasses credit quality (expected loss) and credit risk concentration (limits on single names, industries and geographical regions).

Regular risk reporting enables the ongoing monitoring of the Group's credit risk position relative to its risk appetite.

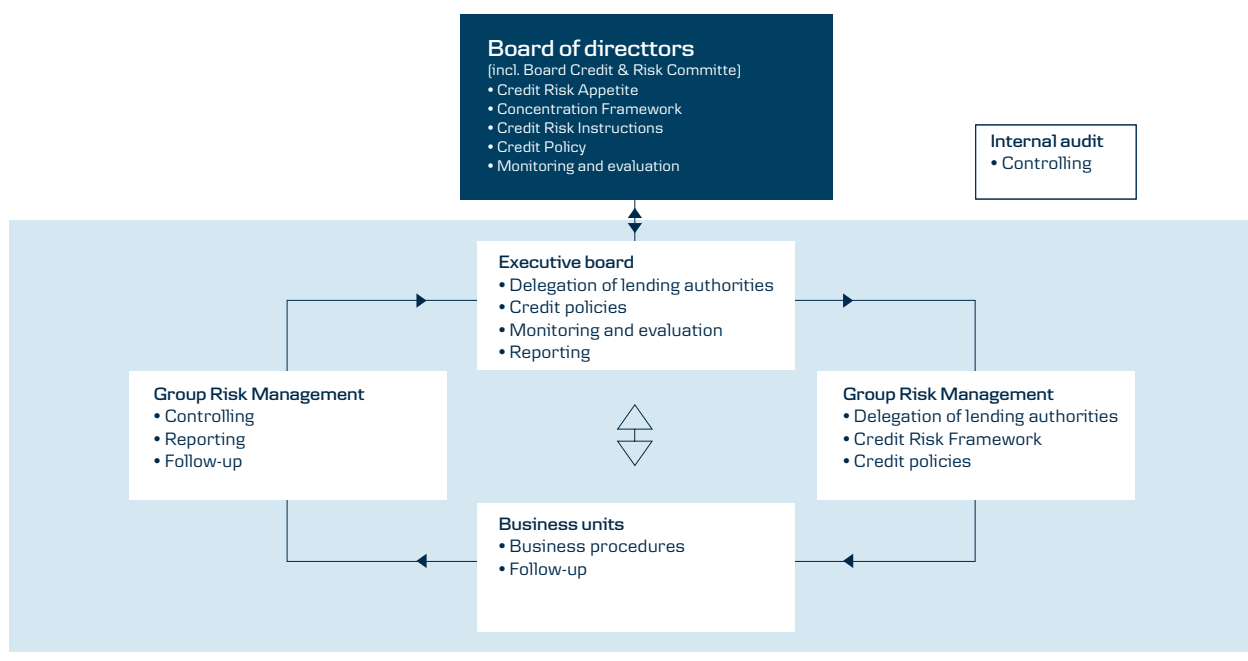
The Group Credit Risk Appetite statements are converted by the business units to their specific key performance indicators (KPIs) in collaboration with Group Risk Management. Monitoring functions determine whether credit facilities are granted in accordance with the risk appetite. Group Risk Management monitors and challenges the performance and reports the progress to the Executive Board and the Board of Directors.

## 4.2 Governance and responsibilities

The Executive Board approves the Credit Risk Framework, which provides the overall structure that supports effective governance of the Group's credit risk. The objectives of the Credit Risk Framework are as follows:

- To ensure the execution of credit risk responsibilities that are delegated by the Board of Directors to the Executive Board and to management
- To ensure efficient credit processes, robust decision making and a strong culture of credit risk management
- To support the Group's performance in accordance with strategic objectives
- To ensure compliance with legal and regulatory requirements related to credit risk

### Danske Bank Group's credit risk framework



The Executive Board ensures that the risk organisation is structured in such a way that the execution of tasks is separated from the control of the same tasks. The Group meets this requirement by organising its credit controls along three lines of defence.

Since 1 January 2015, the heads of credit have reported directly to the Group CRO. Over the past year, the risk organisation and the governance structure were strengthened by consolidating the second line credit approval functions and enhancing Group Risk Management's oversight of international operations in alignment with best international practices.

## 4.3 IRB framework and model development

In 2008, the Danish FSA approved the Group's application to use the advanced internal ratings-based (A-IRB) approach for calculating the total risk exposure amount (REA). At the end of 2015, the Group reported DKK 2,350 billion of exposure at default (EAD), with 69% calculated according to the A-IRB approach, 3% according to the foundation approach (F-IRB), and 28% according to the standardised approach.

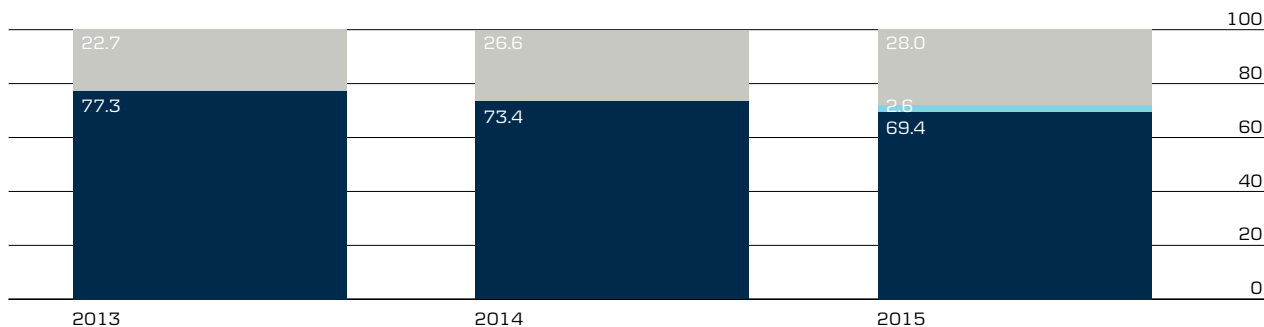
In 2015, the Group received approval to use the F-IRB approach for corporate asset class exposure at Danske Bank Plc (Finland). As the table below shows, the percentage of EAD covered by the standardised approach rose because of a rebalancing of our liquidity buffer portfolio and an increase in sovereign bonds.



## EAD broken down by credit risk measurement approach

[%]

■ Advanced IRB   ■ Foundation IRB   ■ Standardised



The Group is awaiting approval to calculate the REA at Danske Bank Plc (Finland) according to the F-IRB approach for the institutions asset class and according to the A-IRB approach for the retail asset class. Approval to use the A-IRB approach for the retail asset class is expected in 2016.

### Monitoring of the IRB framework

Group Risk Management reviews and follows up on compliance with the minimum IRB requirements in CRR/CRD IV. This annual process includes reporting to the Executive Board and Internal Audit. The IRB governance structure and the modelling framework are evaluated regularly.

In June 2013, the Group received a number of orders from the Danish FSA related to the IRB framework. In September 2013, the Group implemented a temporary increase in risk weights of 10 percentage points through a loss given default (LGD) add-on because of the orders. From 2013 to 2015, Group Risk Management redeveloped a number of models to improve their performance and adapt them better to both business needs and regulatory requirements. The applications for these model changes were sent to the Danish FSA in 2014 in order to permanently resolve the issues in the orders. The FSA gave its approval on 4 January 2016, with implementation in the first half of 2016.

### IRB exemptions

The Danish FSA has granted the Group exemptions for the following exposures:

- Exposure to the sovereigns asset class
- Exposure to regional and local authorities (when the Group has treated them as part of the institutions asset class)
- Exposure to equities
- Exposure to purchased receivables
- Intragroup exposures
- Exposure through branches in Estonia, Latvia and Lithuania
- Exposure to the retail asset class through branches in the Republic of Ireland
- Exposure to the retail and institutions asset classes in Danske Bank Plc (Finland) (application for IRB pending)
- Exposures at the legal entities Danske Bank Limited (Northern Ireland) and Danske Bank International (Luxembourg)
- Exposure to covered bonds
- Selected other minor portfolios

For these exposures, the Group currently uses the standardised approach.

## 4.4 Reporting and monitoring

The Group has a number of systems for measuring and controlling credit risk. Among the most important are the Credit System (including the Delegated Lending Authorities System), the Collateral System, the Rating/Scoring System and a number of follow-up systems. Several controls are incorporated in these systems to ensure the following:

- Accurate classification of customers
- Timely registration and accurate valuation of collateral
- Granting of credit facilities according to delegated lending authorities
- Formalised monitoring and follow-up procedures

The Credit System is the foundation of an efficient and effective credit process that gives access to all relevant details about credit facilities, financial circumstances and customer relations. The system is used for all customer segments and products across all sales channels. It ensures that the basis for decision making, including file comments and credit exposure, is created and stored.

The Group closely monitors changes in customers' financial conditions in order to determine whether the basis for granting credit facilities has changed. The facilities should adhere to the Group's Credit Policy, including the Principles of Responsible Lending. The Principles of Responsible Lending focus on the customer's understanding of the consequences of borrowing; the assessment of the customer's needs and ability to repay; and possible conflicts with the Group's environmental, social and governance guidelines. The Delegated Lending Authorities System ensures the efficient administration and control of lending authorities. If a delegated lending authority is exceeded, a report or a request for verification will be sent to the relevant manager or local credit office.

Group Risk Management oversees the Group's credit activities and reports on developments in the credit portfolios. Portfolio reports are produced for the Executive Board and the All Risk Committee on a monthly basis and for the Credit & Risk Committee and the Board of Directors on a quarterly basis.

## 4.5 Credit risk concentrations

As part of the Risk Appetite Framework, the Group has implemented a set of frameworks to manage credit risk concentrations. The frameworks cover the following concentrations:

- Single-name concentrations
- Industry concentrations
- Geographical concentrations

The following sections explain the breakdown of the Group's credit exposure across single names and industries.

### Single-name concentrations

Single-name concentrations are managed according to two frameworks:

1. Large exposures framework: This framework is based on the regulatory definition of large exposures specified in article 395 of the CRR (Regulation (EU) No. 575/2013). At the end of 2015, The Group was well within the regulatory limits for large exposures. The Group has also defined stricter internal limits for managing single-name concentrations, including the following:
  - absolute limit on single-name exposures
  - the sum of single-name exposures larger than 10% of the total adjusted capital may not exceed a portfolio limit of 95% of the total adjusted capital (at the end of 2015, no exposures exceeded 10%)
  - the sum of single-name exposures equal to 5% to 10% of the total adjusted capital may not exceed 150% of the total adjusted capital (at the end of 2015, this segment represented 29% of the total adjusted capital)
2. Single-name concentration framework: The Group has also implemented a risk-sensitive internal framework that sets limits on exposure, expected loss (EL) and LGD in order to limit losses on single-name exposures.

The largest single-name exposures are monitored daily under the large exposures framework and are reported on a monthly basis to the All Risk Committee and the Credit & Risk Committee. Large exposures are reported on a monthly basis to the All Risk Committee and the Credit & Risk Committee and on a quarterly basis to the Board of Directors.

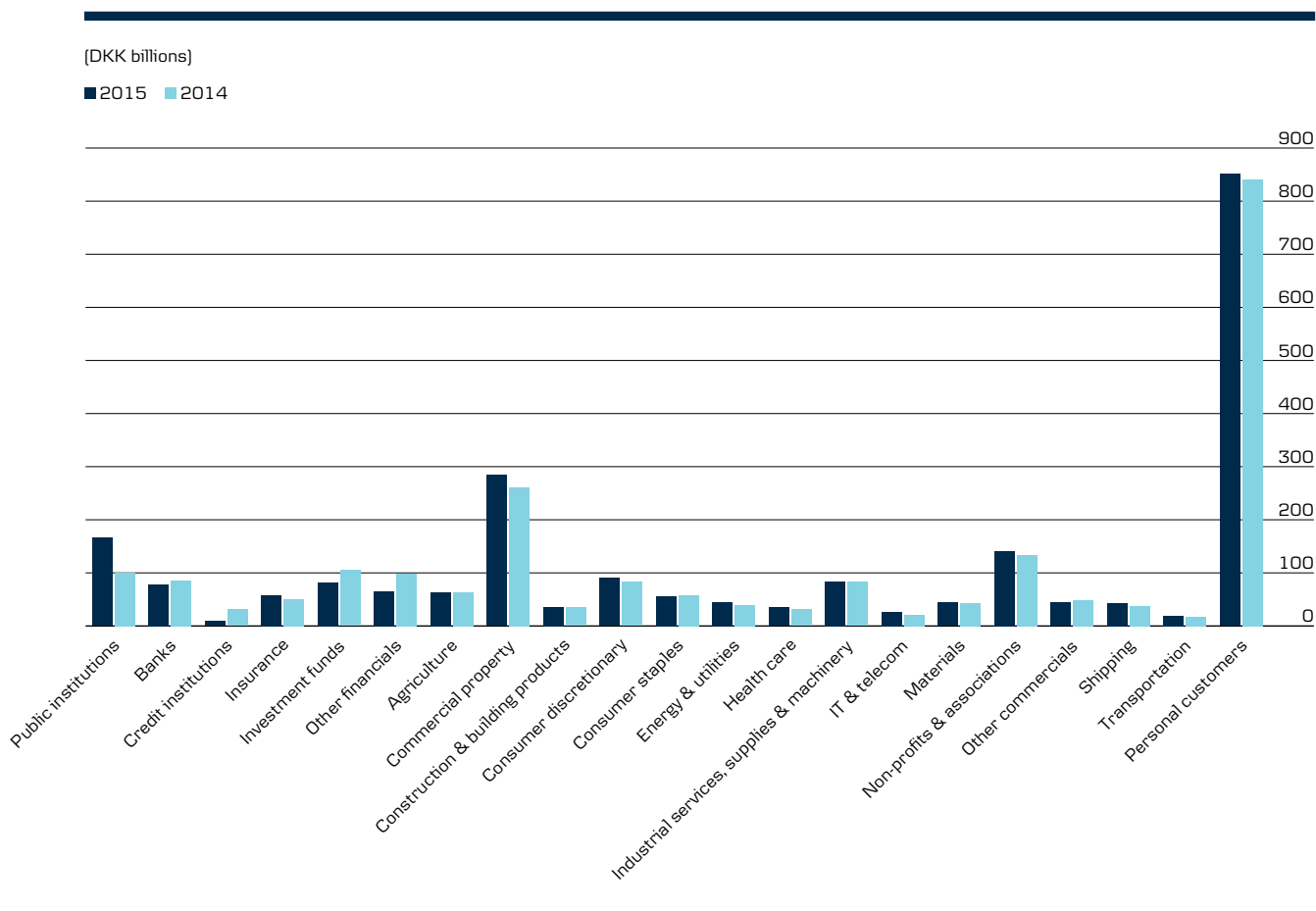
The Group has reduced single-name exposures substantially in recent years.

#### Industry concentrations

The Industry Concentration Framework outlines the principles of managing industry exposures. A portfolio committee consisting of industry experts, risk representatives and business unit representatives proposes industry limits based on a scorecard, tailored analytics and expert knowledge. The committee then submits the proposed limits to the Executive Board as well as input to the annual Credit Risk Appetite process.

At the end of 2015, exposure to personal customers, which consisted mostly of home financing secured on real property, represented the largest share of total exposure (37%). The remainder of the exposure, which related mainly to commercial customers, was diversified across various industries. Of these industries, commercial property represented the largest exposure, at 12% of total exposure.

#### Breakdown of industry net credit exposure



#### Geographical concentrations

Credit reporting includes a breakdown by region. Limits are set on exposures outside the Group's home markets (sovereigns, financial institutions and counterparties in derivatives trading). A country portfolio committee proposes country limits based on expected business volume and an assessment of the specific country risk.

## 4.6 Credit risk assessment

The Group uses credit risk models to assess the risk associated with its customers. The calculations, which are made in accordance with the IRB framework, take into account the likelihood of default and the estimated loss if a customer defaults.

The Group classifies customers by means of probability of default (PD) models on a regular basis. The main objectives of risk classification are to quantify risk at the customer level and to estimate the probability of default of each customer.

The Group uses loss given default (LGD) models to estimate the loss on facilities in case of default. The LGD models are based on historical data, and the primary factors are collateral and cure probability. The conversion factor (CF) models express a conservative estimate of the exposure at default (EAD).

In the credit risk management process, the Group uses point-in-time (PIT) PD estimates for risk classification, PIT LGDs and PIT CFs. The PIT PD estimates are based on inputs that are sensitive to the current macroeconomic conditions, and the PIT PD estimates thus change over a business cycle. Since the PD bands of the overall scale are fixed, the percentage of customers within each PD band will vary over a business cycle. During a downturn, a customer's PIT PD may increase, and the customer may migrate to a lower rating category.

For regulatory (REA) purposes, PIT PDs from most models are converted to through-the-cycle (TTC) PD levels by means of a scaling mechanism that ensures fixed-target levels while preserving the customer rankings. A small number of models use a hybrid PD approach in which PDs are not scaled to fixed-target levels. For regulatory purposes, downturn LGDs and CFs are used – with regulatory floors and additional prudential margins.

### Rating and scoring

The Group uses a number of PD models to assess the probability of default of customers in various segments. Large business and financial customers (generally customers with an exposure exceeding DKK 2 million and customer groups with an exposure exceeding DKK 7 million) are classified by rating models, while small business customers and personal customers are classified by scoring models. Group Risk Management is responsible for the rating and scoring models and processes.

Corporate and financial customers are rated by models in which the primary factor is the customer's financial statements. The customer's prospects and qualitative information, such as the earnings outlook for the industry, are also assessed. Relationship managers and customer advisers can provide factual information in the process but have no influence on the outcome. On the basis of this input, the model proposes a rating. The final rating takes into account input from expert assessments by rating officers.

The Bank rates sovereign counterparties and central banks by consulting external ratings from international rating agencies in combination with internal assessment. Local authorities and regions in the Nordic countries are assigned the same rating as the country. External ratings of local authorities in other countries are limited, so the customer ratings are based on expert assessment.

The rating of customers is performed by Group Risk Management. The process includes a manual control insofar as two employees are involved in most of the rating decisions: a rating officer who recommends the rating and a senior rating officer with authority to approve the rating.

Ratings are assessed regularly, at a frequency based on materiality (at least annually), or when new information becomes available. The reassessments are based on new information, including financial statements, budgets and other information, that affects a customer's creditworthiness.

The Bank assigns credit scores to customers that are not rated. These customers include personal customers and small business customers. Scoring models are statistically based PD models. Since the accessibility of data on personal and small business customers varies from country to country depending on the local legislative and business environment, the Group has developed models for each market in which it operates. A score is based on either application data or behavioural data. After the statistical calculation, a score may be downgraded if a risk event is registered for the customer. Risk events are registered either automatically or by advisers.

Credit scores are updated monthly in an automated process. The updated scores are subject to a number of automated controls at the model level, and the automated controls are reviewed periodically.

### Risk classification distribution

The Group's classification scale consists of 11 main categories, with category 11 containing customers in default. Most of the categories are divided into two or three subcategories, making a total of 26 classification categories.

Scoring and rating are integral parts of the credit approval process and the overall credit risk management process. In the following sections, the term “rating categories” refers to the 11 main categories of the scale, which covers both ratings and credit scores.

At the end of 2015, the overall credit quality of the Group’s portfolio remained stable since 97% of total credit exposure had a rating classification from 1 to 8 (2014: 97%). At Personal Banking, credit exposure in rating categories 1-8 accounted for 97% of total exposure. At Business Banking and C&I, exposure in rating categories 1-8 accounted for 95% and 99% of credit exposure, respectively.

### Rating category breakdown

At 31 December Rating category	PD scale (%)		Net credit exposure (DKK billions)	
	Upper	Lower	End-2015	End-2014
1	0.00	0.01	99	69
2	0.01	0.03	248	185
3	0.03	0.06	382	394
4	0.06	0.14	459	447
5	0.14	0.31	494	510
6	0.31	0.63	302	289
7	0.63	1.90	196	213
8	1.90	7.98	70	82
9	7.98	25.70	16	22
10	25.70	99.99	37	38
11	100	100	19	18
<b>Total</b>			<b>2,323</b>	<b>2,268</b>

The internal PD rating scale can be compared with the rating scales used by the international rating agencies. Ratings 1 to 5 are comparable to investment grades; ratings 9 and 10 designate highly vulnerable customers; and rating 11 represents customers in default. The Group’s internal ratings are based on PIT parameters, which means that the ratings reflect the probability of default within a year. Since Standard & Poor’s and Moody’s use TTC parameters, the rating scales are not 100% comparable.

#### Validation of credit risk models

In accordance with the CRR requirements, the Group has an internal validation process aimed at ensuring and improving the performance of models, processes and systems. The models are validated annually, independently of the business units and the team that develops the models. The validation process plays an important role in the adjustment and further development of the models.

##### PD validation

The accuracy of the rating, the rating age, distribution, overrides and rating events are monitored by the credit departments and centrally by Group Risk Management. The PD models are validated centrally by Group Risk Management.

##### LGD and CF validation

The accuracy of the LGD models is validated centrally by Group Risk Management, which compares the estimated losses with the observed losses on customers in default. For the validation of the CFs, the estimated EAD is compared with the observed EAD.

Validation includes both a quantitative and a qualitative aspect. The quantitative aspect covers the models’ ability to rank customers and their ability to predict observed parameters. The qualitative validation is a broad assessment of the model framework that includes the implementation of the model, model usage and data quality. The annual validations of the credit risk models are reviewed by the Model & Parameter Committee.

#### Underwriting for profitability

In 2015, Group Risk Management initiated two strategic programmes with the overall objective of improving customer experience and credit risk management. The programmes are cross-functional, involving a broad collaborative effort across Group Risk Management, the COO area and the business units.

Personal Banking Credit and Business Banking Credit manage the programmes, and their functional scopes include improvements in the analytics, processes and models that the Group uses in its retail underwriting activities. The targeted business outcomes include more consistent, better informed and faster credit decisions that result in a better customer experience as well as reduced losses and processing costs because decisions are based on analytical intelligence and automated to a greater degree.

## 4.7 Credit risk mitigation and collateral management

The Group uses a number of measures to mitigate credit risk, including collateral, guarantees and covenants. The main method is obtaining collateral.

The market value of collateral is monitored and re-evaluated by advisers, internal or external assessors, or automatic valuation models. Automatic valuation models are validated annually and are monitored quarterly. The Group regularly evaluates the validity of the external inputs on which the valuation models are based. The Collateral System supports the process of reassessing the market value to ensure that the Group complies with regulatory requirements.

The market value of collateral is subject to a haircut. A haircut reflects the risk that the Group will not be able to obtain the estimated market value upon the sale of an asset in a distressed situation. The haircut applied depends on collateral type. For regulatory purposes, the Group also applies a downturn haircut.

The most important collateral types, measured by volume, are real property as well as custody accounts and securities (financial assets in the form of shares and bonds). Personal customers' real property accounts for 48% of the total collateral base (after haircuts).

### Collateral value by type (after haircuts)

	Personal Banking		Business Banking		C&I		Other		Total	
	End-2015	End-2014	End-2015	End-2014	End-2015	End-2014	End-2015	End-2014	End-2015	End-2014
(DKK billions)										
Real property	705	667	443	417	24	29	0	0	1,173	1,113
- Personal	704	665	16	24	0	0	0	0	721	690
- Commercial	1	2	381	347	22	26	0	0	404	375
- Agricultural	0	0	46	45	2	2	-	-	48	47
Bank accounts	1	1	1	1	0	0	0	0	1	2
Custody accounts & securities	7	6	6	6	190	282	4	3	207	297
Vehicles	2	2	15	12	0	0	0	0	17	15
Equipment	0	0	22	21	1	1	0	0	24	21
Vessels and aircraft	0	0	3	2	25	21	-	-	28	23
Guarantees	4	4	3	3	6	3	-	-	13	9
Amounts due	0	0	5	5	0	1	0	0	5	6
Other assets	0	0	30	25	6	4	0	-	36	29
<b>Total collateral</b>	<b>720</b>	<b>681</b>	<b>526</b>	<b>490</b>	<b>254</b>	<b>339</b>	<b>4</b>	<b>3</b>	<b>1,504</b>	<b>1,515</b>

## 4.8 Impairment charges and non-performing loans

The Group conducts impairment tests, assessing all credit facilities for objective evidence of impairment (OEI) in accordance with IFRSs and guidelines set out in the Executive Order on Financial Reports for Credit Institutions from the Danish FSA.

Impairment charges are based on discounted cash flows. The Bank's systems calculate impairment charges for small loans automatically, taking into account the discounted market value of the collateral after the deduction of the costs of realising the assets (a haircut, according to IAS 39). Impairment charges for all medium and large exposures with OEI are assessed by senior credit officers. The accumulated impairment charges constitute the allowance account.

### Individual impairment charges

When OEI exists for a facility, the Group applies it to all the customer's facilities and calculates the impairment charge on the basis of the total customer exposure. Under certain conditions, OEI for one customer may be applied to other customers when the customers have a "financial relationship"; for example, if they are part of the same customer group.

All customers with OEI are downgraded to rating category 10 or 11.

### Customers in default and not in default

Customers are designated as being in default when they have a material credit facility that is 90 days past due or when the Group assesses that they are unlikely to comply with their payment obligations to the Bank.

Customers in default (with the probability of default set at 100%) are downgraded to rating category 11 even if collateral values or other means of recovery exceed the exposure and, consequently, no impairment charges are booked against it.

Impairment charges against facilities granted to customers in rating category 11 are based on the exposure less the present value of the expected proceeds from realising collateral and other assets. The collateral values are calculated as the estimated realisation value within a six-month time horizon less a haircut to cover the estimated realisation costs.

Customers with OEI that are not in default are automatically downgraded to rating category 10. These customers are deemed to be in significant financial difficulties even though they are not yet in default; for example, their cash flows may be insufficient to service their future obligations over a realistic period, their capital situation is unsatisfactory, or a return to sustainable earnings and capital levels cannot be expected.

The calculation of impairment charges against facilities granted to customers that are in significant financial difficulties (in rating category 10) is based on an expectation of either financial restructuring or bankruptcy. In the restructuring scenario, the Group assumes that the customer is a going concern, although the debt is too high in relation to the cash flow. The credit officer's best estimate of the amount of debt that the borrower will be able to service in a future financial restructuring serves as a basis for the impairment charge. If restructuring is judged to be impossible, the credit officer assumes that bankruptcy will occur with an estimated probability, and the impairment charge is based on the exposure less the present value of the expected proceeds from realising the collateral and other assets.

During the collection process, the Group may determine that a loss is unavoidable, and the loan in question will be written off, either partly or fully. If the Group later arranges a payment agreement for a loan that has been written off, the loan is recognised on the balance sheet as a new loan at a value equal to the present value of the payment agreement.

### Collective impairment charges

Loans without OEI are included in a pool for collective assessment of the need for impairment charges. Collective impairment charges are calculated for loans with similar credit characteristics, for example when the expected cash flow from a customer group deteriorates but no corresponding adjustment has been made to the earnings margin. The charges are based on changes in customers' rating classifications over time.

When external market information indicates that an impairment event has occurred, even though it has not yet caused a change in ratings, the Group registers an "early event" impairment charge. Early events represent an expected rating change because of deteriorating market conditions in an industry. If a rating downgrade does not occur as expected, the charge is reversed.

### Non-performing loans

The Group defines non-performing loans (NPL) as facilities with objective evidence of impairment and for which individual impairment charges have been booked.<sup>1</sup> For non-retail exposures to customers with any NPLs, the entire amount of the customer's exposure is considered to be non-performing. For retail exposures, only impaired facilities are included in NPLs.

### Impairment charges, allowance account and non-performing loans

In 2015, impairment charges declined to DKK 0.1 billion (2014: 2.8 billion), or 0 bps (2014: 15 bps) of loans and guarantees. Individual impairment charges fell across all business units, reflecting improving macroeconomic conditions.

<sup>1</sup> The Group's definition of non-performing loans differs from the EBA's definition by excluding fully covered exposures to customers in default and previously forborne exposures that are now performing and are under probation.

Net NPL exposure decreased to DKK 24.7 billion at the end of 2015 (2014: DKK 29.4 billion). The decrease came mainly from a few single-name customers.

### NPL and impairment charges broken down by industry

At 31 December (DKK millions)	2015				2014			
	Gross NPL	Acc. individual impairment charges	Net NPL exposure	Net NPL exposure, ex collateral	Gross NPL	Acc. individual impairment charges	Net NPL exposure	Net NPL exposure, ex collateral
Public institutions	1	1	1	1	1	1	1	1
Banks	142	142	0	0	246	91	155	155
Credit institutions	-	-	-	-	-	-	-	-
Insurance	30	9	21	0	30	12	18	0
Investment funds	604	434	170	74	1,574	462	1,112	0
Other financials	25	9	16	0	142	142	0	0
Agriculture	3,845	2,733	1,111	591	3,434	2,529	906	377
Commercial property	10,756	4,763	5,993	421	16,714	7,386	9,328	850
Construction & building products	1,990	1,378	612	119	2,744	2,135	608	186
Consumer discretionary	3,005	1,891	1,114	187	3,799	2,463	1,337	169
Consumer staples	384	220	164	39	712	386	325	119
Energy & utilities	288	145	144	8	596	171	425	374
Health care	128	75	53	10	129	91	38	1
Industrial services, supplies & machinery	2,515	1,332	1,184	304	2,559	1,491	1,068	383
IT & telecom	216	151	66	15	247	206	41	0
Materials	1,744	1,144	600	209	1,849	1,304	545	68
Non-profits & associations	2,441	945	1,497	190	3,808	1,237	2,571	0
Other commercials	303	253	50	3	336	336	0	0
Shipping	2,816	1,134	1,682	0	4,486	1,797	2,689	794
Transportation	312	186	126	12	362	241	121	0
Personal customers	16,273	6,207	10,066	2,639	14,671	6,569	8,102	1,191
<b>Total</b>	<b>47,820</b>	<b>23,151</b>	<b>24,670</b>	<b>4,822</b>	<b>58,439</b>	<b>29,049</b>	<b>29,390</b>	<b>4,668</b>

The stock of impairments is reduced by write-offs and reversals of charges.

The Group engages in work-out processes with customers in order to minimise losses and help viable customers through their financial difficulties. Because of the length of the work-out processes, the Group is likely to maintain impairments for these customers for years.

Some impairments are held against assets with a non-linear repayment profile such as interest-only home loans. Customers with such loans are able to make their current payments but have an increased risk of default when the interest-only period expires. Impairments held against such assets are likely to be maintained until a default occurs and a loss is deemed to be inevitable or until the customer's financial situation changes.



## 4.9 Customers subject to forbearance and repossessed assets

The Group adopts forbearance plans to assist customers in financial difficulty. Concessions granted to customers include interest-reduction schedules, interest-only schedules, temporary payment holidays, term extensions, cancellation of outstanding fees, waiver of covenant enforcement and settlements.

Forbearance plans must comply with the Group's Credit Policy. They are used as an instrument to maintain long-term customer relationships during economic downturns if there is a realistic possibility that the customer will be able to meet obligations again and are used for minimising loss in the event of default.

If it proves impossible to improve the customer's financial situation by forbearance measures, the Group will consider whether to subject the customer's assets to a forced sale or whether the assets could be realised later at higher net proceeds. At the end of 2015, the Group recognised properties taken over in Denmark at a carrying amount of DKK 76 million (2014: DKK 106 million) and properties taken over in other countries at DKK 388 million (2014: DKK 520 million).

Forbearance leads to OEI, and impairments relating to forborne exposures are handled according to the principles described in the Group's basis of preparation for the measurement of loans (more details can be found in Danske Bank's Annual Report 2015).

The Group implemented the European Banking Authority's (the EBA's) definition of loans subject to forbearance measures at the end of 2014. The table below is based on the EBA's definition, which states that a minimum two-year probation period must pass from the date forborne exposures are considered to be performing again. Such exposures are included in the Under Probation category. Exposures with forbearance measures are divided into performing and non-performing loans.

Exposures subject to forbearance measures				
(DKK millions)	2015		2014	
	Performing	Non-performing	Performing	Non-performing
Modification	36	1,347	163	1,394
Refinancing	1,848	9,150	789	3,884
Under probation	5,312	-	2,657	-
<b>Total</b>	<b>7,196</b>	<b>10,497</b>	<b>3,609</b>	<b>5,278</b>

The increase in forborne exposures in 2015 was attributable primarily to two factors:

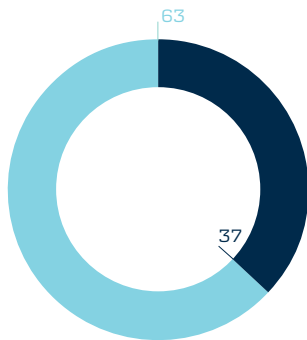
1. In 2015, the Group continued to focus on forbearance after the system-wide implementation of the EBA definition. This led to additional forbearance registrations.
2. The benign economic environment allowed the Group to offer forbearance measures to customers in financial difficulties, and this lowered future expected losses for the customers and the Group.

## 4.10 Trends in selected portfolios

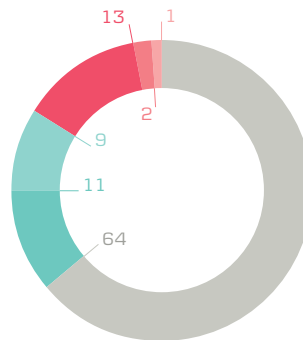
This section describes the trends in the credit quality of selected lending portfolios. These portfolios either have an increased credit risk or represent a significant portion of the Group's total lending portfolio.

## Personal customers

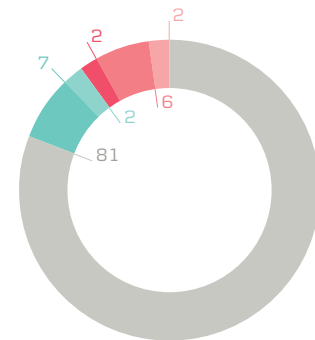
Gross credit exposure to personal customers as % of total portfolio



Gross credit exposure by country (%)



Individual allowance account by country (%)



■ Personal customers ■ The rest

■ Denmark ■ Sweden ■ Finland ■ Northern Ireland ■ Norway ■ Other

Measured by gross credit exposure, the personal customer portfolio is the Group's largest portfolio. At the end of 2015, gross credit exposure amounted to DKK 857 billion, with DKK 426 billion at Realkredit Danmark. The exposure to personal customers covers loans secured on customers' assets, consumer loans and fully or partly secured credit facilities. Mortgage loans represent by far most of the exposure to personal customers (87%).

## Developments in the personal customer portfolio

(DKK millions)	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure**	Share of total segment exposure [%]	Coverage ratio [%]
End-2014	847,584	6,569	1,862	23	707,416	14,671	1.7%	85%
End-2015	857,410	6,207	1,571	6	740,383	16,273	1.9%	70%

\* Gross credit exposure excludes accumulated collective impairment charges.

\*\* The way facility level data from a subsidiary are aggregated in the Group's non-performing loan data was improved in 2015. This affected primarily Personal Banking Denmark. Comparative figures have not been restated.

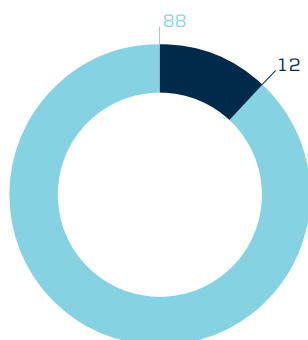
The total exposure increased somewhat in 2015, mainly because of new mortgage lending in Norway and Sweden. The credit quality of the personal customer portfolio benefited from the low interest rate environment and more favourable macroeconomic conditions.

The main risks in the personal customer portfolio relate to the following:

- Interest-only loans, Denmark: The exposure to interest-only loans with high LTV ratios that will be reset before the end of 2020 is limited to DKK 14.9 billion, and the vast majority of these customers have strong credit quality. The Group considers the current level of impairments to be sufficient. The Credit Risk Appetite includes a KPI for interest-only loans as a percentage of approvals of new lending, and the Group gives incentives for fixed rate loans and amortisation.
- Potential asset price bubbles: Rapid growth in house prices on some markets poses a potential risk. A focused underwriting strategy and a strict regulatory framework entailing low LTV ratios, among other things, mitigate the risk. In addition, Danske Bank encourages borrowing with fixed rate loans and amortisation.

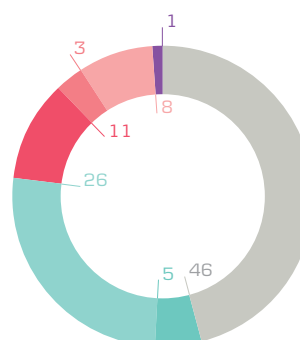
## Commercial property

Gross credit exposure to commercial property as % of total portfolio



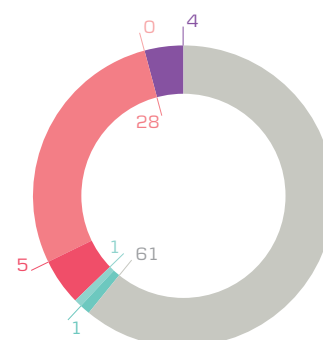
■ Commercial property ■ The rest

Gross credit exposure by country of residence (%)



■ Denmark ■ Finland ■ Sweden ■ Norway ■ Northern Ireland ■ C&I ■ Other

Individual allowance account by country of residence (%)



The commercial property portfolio consists primarily of secured property financing exposure to owners of property that is let to a third party. It also includes exposures in which the property owner and the property user are separate legal entities within the same group.

At the end of 2015, gross credit exposure amounted to DKK 289 billion. The individual allowance account for the portfolio, which amounted to DKK 4.8 billion, represented 2% of gross credit exposure.

Most of the Group's commercial property customers are managed by specialist teams for customer relationships and credit management.

## Developments in the commercial property portfolio

(DKK millions)	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges [bp]	Collateral (after haircut)	Gross exposure**	Share of total segment exposure (%)	Coverage ratio (%)
End-2014	268,626	7,386	903	-0	211,808	16,714	6.2%	90%
End-2015	289,055	4,763	1,823	-47	232,631	10,756	3.7%	92%

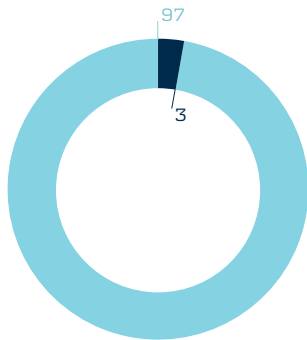
\* Gross credit exposure excludes accumulated collective impairment charges.

\*\* The way facility level data from a subsidiary are aggregated in the Group's non-performing loan data was improved in 2015. This affected primarily Personal Banking Denmark. Comparative figures have not been restated.

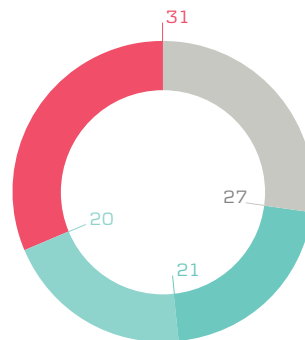
The credit quality of the commercial property portfolio improved slightly in 2015, mainly because of increased exposure to highly rated customers and the low interest rate environment.

## Agriculture

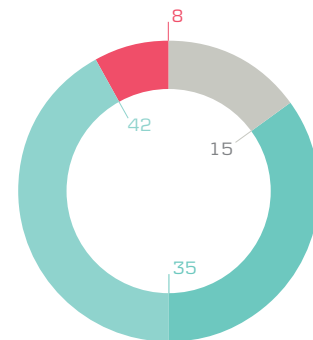
Gross credit exposure to agriculture as % of total portfolio



Gross credit exposure by segment (%)



Individual allowance account by segment (%)



■ Agriculture ■ The rest

■ Growing of crops, cereals ■ Dairy ■ Pig breeding ■ Mixed operations

The agriculture portfolio includes customers within traditional agricultural segments such as dairy, pigs, cereals and other crops and also customers within related activities such as the manufacture and wholesale distribution of feed and seed products. Exposure to agricultural customers includes loans and credit facilities.

At the end of 2015, gross credit exposure amounted to DKK 66.4 billion, compared with DKK 65.8 billion at the end of 2014. Denmark accounted for 78% of the portfolio's gross exposure and 90% of accumulated individual impairment charges. Of the Danish agricultural portfolio, Realkredit Danmark accounted for 83% of the gross exposure and 5% of accumulated individual impairment charges. Credit quality remained weakest among pig producers and dairy farmers.

Market conditions for dairy farmers and pig farmers were dominated by the continuing Russian embargo and lower demand from China. As a consequence, individual impairment charges increased, especially in the second half of the year.

Overall, high indebtedness and a very high proportion of variable interest rate loans remained major risks in 2015.

The Group's agricultural exposure is managed by specialist teams for customer relationships and credit management.

### Developments in the agriculture portfolio

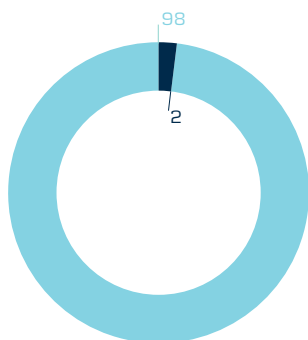
(DKK millions)	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure**	Share of total segment exposure (%)	Coverage ratio (%)
End-2014	65,805	2,529	219	53	50,217	3,434	5.2%	87%
End-2015	66,387	2,733	125	75	51,106	3,845	5.8%	82%

\* Gross credit exposure excludes accumulated collective impairment charges.

\*\* The way facility level data from a subsidiary are aggregated in the Group's non-performing loan data was improved in 2015. This affected primarily Personal Banking Denmark. Comparative figures have not been restated.

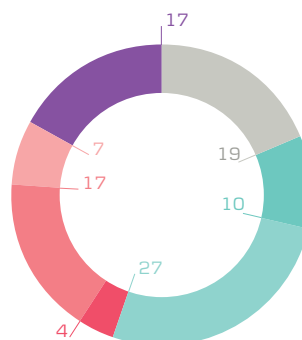
## Shipping

Gross credit exposure to shipping as % of total portfolio



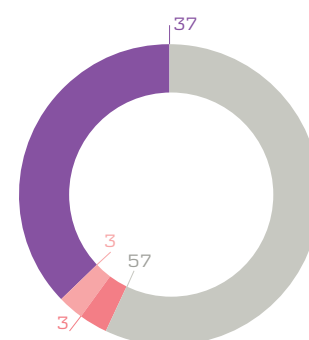
■ Shipping ■ The rest

Gross credit exposure by segment (%)



■ Tank ■ LNG/LPG ■ Offshore ■ Car carriers ■ Container ■ Dry bulk ■ Other

Individual allowance account by segment (%)



The shipping portfolio includes customers in standard segments such as container, tank, bulk and gas freight and also offshore-related activities. Exposure to shipping customers relates primarily to vessel financing secured by vessel or fleet mortgages.

At the end of 2015, gross credit exposure amounted to DKK 44.5 billion, compared with DKK 39.3 billion at the end of 2014. Market conditions are still difficult and continue to affect the portfolio's credit quality.

### Developments in the shipping portfolio

[DKK millions]	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges [bp]	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2014	39,338	1,797	356	25	19,598	4,486	11.4%	69%
End-2015	44,541	1,134	763	-8	24,237	2,816	6.3%	100%

\* Gross credit exposure excludes accumulated collective impairment charges.

In addition to exposure to the offshore shipping segment, direct exposure to oil-related industries (mainly oil service and oil majors, which are part of the energy and utilities portfolio) amounted to DKK 11.9 billion at the end of 2015.<sup>2</sup> So far, there have been few individual impairments because of low oil prices.

The Group's shipping exposure and most of the direct oil-related exposure are managed by specialist teams for customer relationships and credit management.

### Non-core

In 2015, the Group continued to focus on the controlled winding-up of the loan portfolio that is no longer considered part of Danske Bank's core activities. The reduction of loan volume progressed as expected over the year.

The Non-core portfolio is managed separately by a work-out team. The portfolio is divided into two parts: Non-core Banking (which includes Non-core Ireland and Non-core Baltics) and Non-core conduits etc.

<sup>2</sup> The increase in exposure in 2015 followed an in-depth review of the Group's customer base that highlighted customers that are sensitive to persistently low oil prices.

## Non-core Banking

### Developments in the Non-core Banking portfolio

(DKK millions)	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2014	27,062	6,840	4,098	244	17,162	12,154	45%	99%
End-2015**	23,378	2,808	3,678	-42	19,465	7,469	32%	90%

\* Gross credit exposure excludes accumulated collective impairment charges.

\*\* Non-core Banking encompasses Non-core Baltics (personal customers in the Baltics) and Non-core Ireland. Non-core Baltics is included in Non-core banking from 1 January 2015. Comparative figures for 2014 have not been restated.

### Non-core Ireland

At the end of 2015, gross credit exposure to Non-core Ireland fell to DKK 19.2 billion, or 0.8% of the Group's total gross credit exposure, compared with DKK 27.1 billion at the end of 2014. The individual allowance account amounted to DKK 2.8 billion, or 11% of the Group's total individual allowance account. The winding-up of the Non-core Ireland portfolio is proceeding according to plan.

The Non-core Ireland portfolio includes two sub-portfolios:

- Personal mortgages: Net exposure of DKK 15.9 billion to personal customers' home mortgage loans will amortise according to the terms of the loans. The management of these loans was outsourced to a third party.
- Commercial portfolio: Most of the commercial property portfolio has now been sold.

### Non-core Baltics

Non-core Baltics has been part of the Non-core banking unit since 1 January 2015. It consists of the personal customer segment in the Baltics that the Group is in the process of exiting.

In the third quarter of 2015, the Group entered into an agreement to sell a residential mortgage loan portfolio relating to the Group's Non-core mass personal customer business in Lithuania and Latvia. Pending approval by the Lithuanian competition authorities, the transaction is expected to be completed in the first half of 2016. For accounting purposes, the portfolio has been recognised under Assets held for sale and therefore not under credit exposure since the third quarter of 2015.

At the end of 2015, gross credit exposure to Non-core Baltics was DKK 4.2 billion.

### Non-core conduits etc.

### Developments in the Non-core conduits etc. portfolio

(DKK millions)	Key figures					NPL		
	Gross credit exposure*	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2014	11,362	259	157	157	8,246	1,410	12.4%	28%
End-2015	8,235	243	59	-	4,884	893	10.8%	27%

\* Gross credit exposure excludes accumulated collective impairment charges.

The portfolio represents 0.5% of the Group's total gross credit exposure and consists mainly of liquidity facilities for conduits. The Group originated its entire portfolio in the period 2001-07, and the gross credit exposure at the end of 2008 amounted to DKK 56.5 billion. The Group's strategy was to acquire bonds or enter into facilities for securitisation assets that were either structurally senior or were expected to obtain a triple-A rating from one or more of the major rating agencies. At the end of 2015, the Group had reduced the portfolio to DKK 8.2 billion.

The key risk on the portfolio relates primarily to the liquidity position on the underlying securitisation transactions. These transactions consist mainly of commercial mortgage loans that originated in the UK and Germany and residential mortgage loans that originated in the UK.

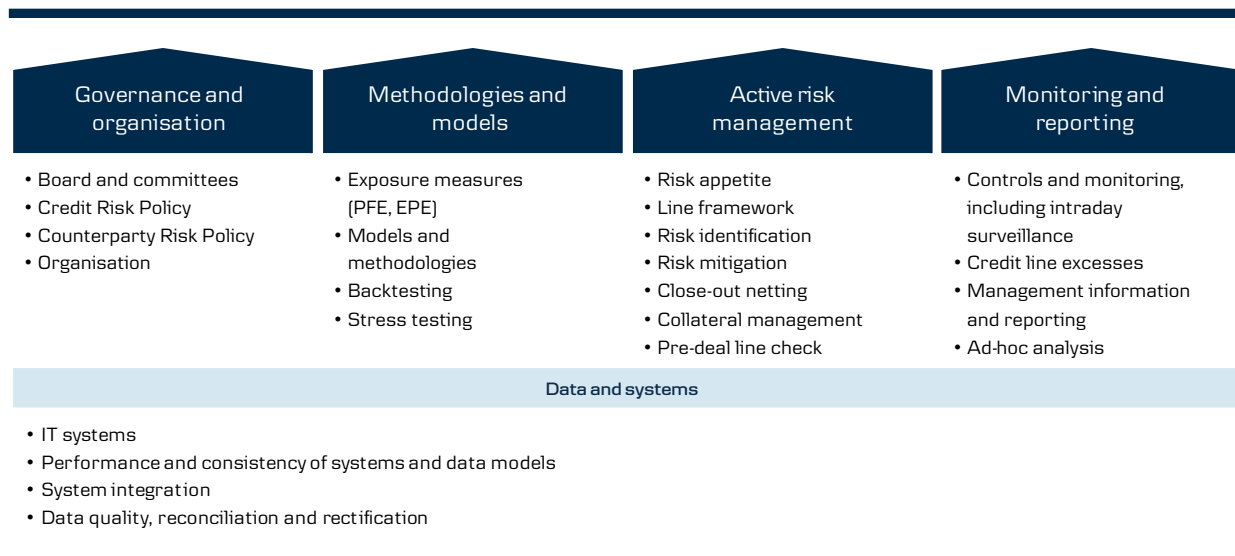
# *Counterparty credit risk*

46	5.1	Governance and organisation
46	5.2	Methodologies and models
47	5.3	Active risk management
47	5.4	Monitoring and reporting
47	5.5	Data and systems
47	5.6	Counterparty credit risk exposure

# 5.

Danske Bank Group enters into transactions involving derivatives and securities-financing instruments (SFTs), for example repurchase (repo) and reverse repo agreements, and thus takes on counterparty credit risk. SFTs are treated as loans against collateral. Most counterparty credit risk is related to interest rate and foreign exchange contracts. Some 5% of the Group's total risk exposure amount (REA) stems from counterparty credit risk, including central clearing counterparty (CCP) and CVA risk charges.

## Counterparty credit risk framework



### 5.1 Governance and organisation

The Counterparty Credit Risk Policy is approved by the All Risk Committee and forms part of the overall credit governance described in the Credit Risk section.

Group Risk Management is responsible for the consolidated counterparty credit risk management, risk modelling and reporting. Counterparty credit risk models are validated by an independent risk model validation team. The credit department is responsible for the day-to-day management of counterparty credit risk.

### 5.2 Methodologies and models

For risk management purposes, counterparty credit risk is measured as potential future exposure (PFE) at the 97.5% percentile at a set of future time horizons. All transactions are assumed to be held to maturity.

The Group uses a simulation model to calculate counterparty credit risk exposure. The model simulates potential future market values of each counterparty portfolio of transactions. Close-out netting agreements and collateral management agreements are reflected in the simulation model. About 90% of all transactions are included in the simulation model.

For transactions not included in the simulation model, the potential change in market value is determined as a percentage (add-on) of the nominal principal amount. The add-on represents a conservative margin in comparison with the risk that the simulation model would have calculated if the trades had been covered by the model.

#### Internal models and regulatory capital

In June 2015, the Danish FSA approved the internal simulation model for calculating the regulatory capital requirement for counterparty credit risk (IMM approval). Since the Group received approval for specific market risk at the same time, it now uses the advanced method to calculate the CVA risk charge.



### *5.3 Active risk management*

In accordance with the Counterparty Credit Risk Policy, the credit department sets a credit line for counterparty credit risk on each counterparty. Counterparty credit risk is managed by PFE lines on a set of maturity buckets. Pre-deal line checks are performed prior to trading.

The Group has set limitations on trades entailing specific wrong way risk (SWWR). The limitations cover product range, counterparty rating and the rating of the underlying securities.

To mitigate counterparty risk, the Group generally requires close-out netting agreements. Collateral management agreements are often attached to the master agreements in order to reduce the counterparty credit risk on the netted market values. The Group's policy is to promote the use of close-out netting agreements and collateral management agreements with an increasing number of products and counterparties in order to reduce counterparty risk.

### *5.4 Monitoring and reporting*

The Group carries out counterparty credit risk measurement and monitoring as well as intraday line utilisation monitoring on a daily basis.

Consolidated counterparty credit risk exposure is reported to senior management. Trades entailing SWWR are monitored daily and reported to senior management on a regular basis.

The internal model is subject to quarterly backtests of underlying risk factors and resulting exposures. It is also subject to an annual validation performed by an independent validation team.

### *5.5 Data and systems*

The Group has an integrated system covering all aspects of counterparty credit risk management. The system is integrated in all the trading systems, the master agreement management system, the collateral management system and market data systems.

Internal management and monitoring of counterparty credit risk are performed in the Group's line system. The system covers all aspects of the internal counterparty credit risk management process, including the assignment of lines, monitoring and control of line utilisations, registration of master agreements, measurement and management reporting.

### *5.6 Counterparty credit risk exposure*

This section gives an overview of the Group's counterparty credit risk that arises from derivatives and SFTs, including the risk arising from exposure to CCPs.

At the end of 2015, the current exposure (after close-out netting and collateral reduction) of the Group's bilateral over-the-counter (OTC) transactions totalled DKK 44 billion. Of this amount, DKK 34 billion was exposure to counterparties with no collateral agreement.

In 2015, trading volume for both SFT products and derivatives declined. This was caused by lower activity and trade compression with CCPs.

At the end of 2015, some 55% of the trading volume of derivatives was cleared through CCPs. Of the total notional amount of OTC derivatives transactions that were not cleared through a CCP, 94% was supported by collateral management agreements. At the end of 2015, some 83% of the Group's collateral management agreement holdings consisted of cash. The remainder consisted of Danish and Swedish mortgage bonds and government bonds issued by Denmark, France, Germany, the Netherlands, Norway, Sweden and the United States.

Current exposure declined in 2015. This was owing to lower trading volume and changes in market values.

Exposure at default (EAD) declined in 2015. This occurred because of lower trading volume and also because the calculation principle for reported EAD has changed since 2014. EAD in 2015 is based on the internal simulation model for calculating the regulatory capital requirement for counterparty credit risk. In 2014, EAD was based on the standardised approach.

Most of the exposure is to real estate companies, financial institutions and production companies.

The OTC derivatives in the portfolio had a mixture of maturities – both short-dated transactions and very long-dated (up to 60-year) transactions. About 50% of the exposure was shorter than one year.

The table below shows the effect of netting and collateral on current exposure:

#### Current exposure after netting and collateral

At December 31 (DKK millions)	2015			2014		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
Current gross exposure	1,127,129	512,717	855,475	2,024,910	791,000	1,233,909
Current exposure after netting	708,412	94,001	855,475	1,343,146	109,236	1,233,909
Current exposure after netting and collateral	49,884	43,699	6,184	67,976	58,159	9,817

The next tables show a breakdown of current exposure and EAD by exposure class, after both netting and collateral:

#### Current exposure after netting and collateral by exposure class

At December 31 (DKK millions)	2015			2014		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
Central governments and central banks	6,273	4,308	1,965	8,894	5,774	3,119
Institutions	10,471	7,316	3,155	16,580	12,207	4,373
Corporates	33,060	31,996	1,064	42,401	40,076	2,325
Retail	80	80	-	101	101	-
<b>Total</b>	<b>49,884</b>	<b>43,699</b>	<b>6,184</b>	<b>67,976</b>	<b>58,159</b>	<b>9,817</b>

#### Exposure at default after netting and collateral by exposure class

At December 31 (DKK millions)	2015			2014		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
Central governments and central banks	56,964	10,625	46,339	62,865	12,542	50,324
Institutions	48,908	41,212	7,696	115,915	102,704	13,211
Corporates	59,356	57,027	2,328	74,218	67,686	6,531
Retail	154	154	-	159	159	-
<b>Total</b>	<b>165,382</b>	<b>109,019</b>	<b>56,363</b>	<b>253,157</b>	<b>183,091</b>	<b>70,066</b>

Most of the Group's counterparties in derivatives trading have high ratings, as shown in the table below.

#### Exposure at default after netting and collateral by rating category

At December 31 (DKK millions)	2015			2014		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
1	60,882	15,207	45,675	68,893	16,817	52,076
2	18,971	15,713	3,258	29,829	23,555	6,274
3	36,517	30,046	6,471	93,920	85,146	8,774
4	21,619	20,956	663	31,468	29,632	1,836
5	18,164	18,039	124	19,798	18,722	1,076
6	5,336	5,169	167	4,630	4,630	0
7	2,058	2,053	4	2,804	2,774	30
8	879	879	0	788	788	0
9	233	233	0	178	178	0
10	467	467	0	469	469	0
11	256	256	0	381	381	0
<b>Total EAD after netting and collateral</b>	<b>165,382</b>	<b>109,019</b>	<b>56,363</b>	<b>253,157</b>	<b>183,091</b>	<b>70,066</b>

# *Market risk*

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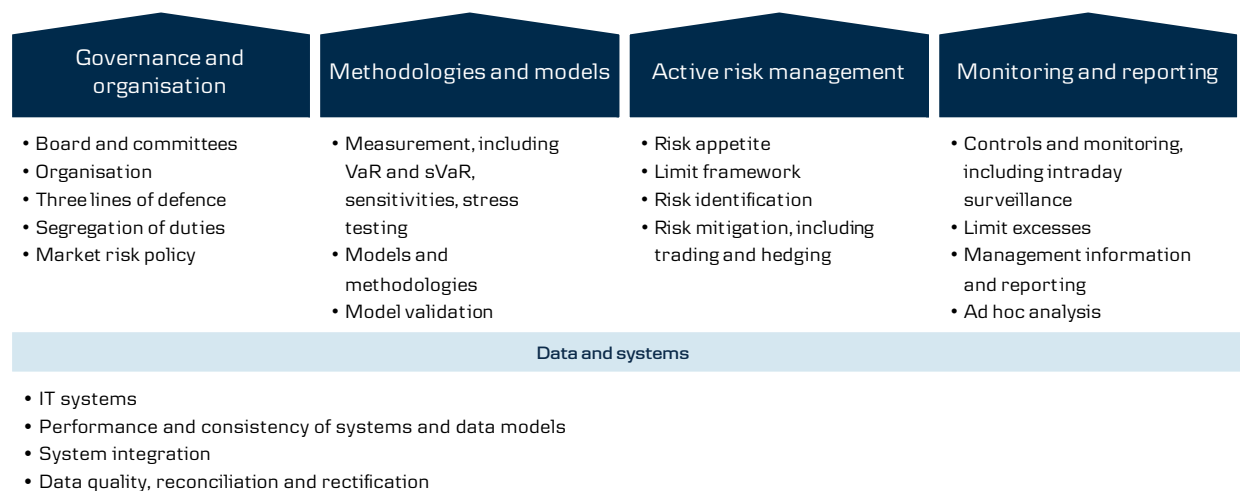
Market risk is the risk of losses or gains caused by changes in the market values of the Group's financial assets, liabilities and off-balance-sheet items resulting from changes in market prices or rates. Market risk affects the Group's financial statements through the valuation of the balance sheet items; some of the Group's financial instruments are valued by means of market prices, while others are valued on the basis of pricing models developed by the Group. In addition, net interest income at Personal Banking and Business Banking is influenced by the level of interest rates.

The Group's market risk originates from trading-related positions at C&I or as part of treasury management at Group Treasury. Market risk associated with activities at Personal Banking and Business Banking is either hedged by C&I or managed as part of Group Treasury's market risk positions.

Market risk at Danica Pension and in the Group's defined benefit pension plans is managed separately. For further information, please see section 9, Insurance risk, and section 10, Pension risk.

The Group's market risk management is designed to ensure proper oversight of all market risks, both trading-related market risk and non-trading-related market risk. It is anchored in a framework designed to systematically identify, assess, execute, monitor and report market risk.

#### Danske bank's framework for market risk management



## 6.1 Governance and organisation

The governance framework for market risk in relation to the risk organisation, including the roles and responsibilities of the Board of Directors and committees and general risk management principles such as three lines of defence and the segregation of duties, follows the Group's overall governance framework, which is described in section 2.

The Market Risk Policy set by the Board of Directors lays out the overall framework for market risk management and identifies the boundaries within which the Group's market risk profile and business strategy are defined. The Market Risk Policy is supported by the Market Risk Instructions, which defines the overall limits for various market risk factors and additional boundaries within which the trading activities operate. The Market Risk Policy and the Market Risk Instructions form the basis of written business procedures and daily control procedures for the Group's market risk management.

## 6.2 Methodologies and models

The Group uses a range of measures to create a framework that captures the material market risks to which the Group is exposed. Both conventional risk measures, such as sensitivities and market value, and mathematical and statistical measures, such as Value-at-Risk (VaR), are used in the daily market risk management.

The Group also develops and maintains internal models that are used for the pricing and risk management of financial products that cannot be valued directly or risk-managed on the basis of quoted market prices.

### 6.2.1 Value-at-Risk

The Group uses VaR to calculate and manage market risk at the portfolio level in day-to-day risk management. VaR is a quantitative measure that shows, with a certain probability, the maximum potential loss that the Group will suffer at the calculation date within a specified horizon.

The following risk types are included in the Group's internal VaR model: interest rate, bond spread, interest rate options, inflation rate, foreign exchange, equity market and company-specific equity risks. In the day-to-day risk management of trading-related positions, the internal VaR model estimates the maximum potential loss from changes in market risk factors at a confidence level of 95%, assuming unchanged positions for one day.

The Group uses a historical simulation model to estimate VaR on the basis of two years' historical market data. The main advantage of this method is that it makes no assumptions regarding loss distribution. The simulation uses one thousand scenarios to generate the loss distribution. To construct the scenarios, independent drawings are made from a data set of two years' historical daily returns. The drawings are generated at random, and 70% of the scenarios are based on the latest year of historical market data. Each outcome contains all the risk factors so that the correlation is maintained. The constructed scenarios are used to calculate the market value of the trading portfolio through a full revaluation of each position. Consequently, the model incorporates both linear and non-linear effects.

In general, a VaR model enables an estimation of a portfolio's aggregate market risk by incorporating a range of risk factors and assets. As a result, the VaR measure takes portfolio diversification or hedging activities into account. VaR has well-known limitations, including the following:

- Past changes in market risk factors may not be good predictors of the distributions and correlations of future market movements.
- The VaR calculation may not capture the market risk of positions that cannot be liquidated or hedged within the chosen horizon.
- VaR does not capture the level of potential losses beyond the chosen confidence level (e.g., 95%).

The Group has a comprehensive stress testing framework in place to mitigate these limitations of VaR.

### 6.2.2 Incremental risk

For regulatory purposes, the Group has a separate internal model designed to measure incremental risk. The incremental risk model captures the potential loss resulting from downgrading (or upgrading for short positions) and defaults of bond issuers and underlying securities in CDSs.

The incremental risk model is a Monte Carlo simulation model featuring correlations between the underlying issuers. The correlations are introduced into the model by means of a Gaussian copula with one systemic factor and one idiosyncratic factor. Key inputs to the model are default and migration probabilities, recovery rates, asset correla-

tions and scenario spread changes. The liquidity horizon is fixed at one year for all asset classes, implying a one-year constant position approach.

In the Group's day-to-day risk management, rating migration risk is captured in VaR and supplemented by limits on rating categories, whereas default risk is limited by individual credit assessments and credit lines for bond holdings and CDS positions.

### 6.2.3 Stress testing

As a supplement to the daily calculation of VaR and more conventional risk measures, the Group performs stress tests and sensitivity analyses on a regular basis. Some of these tests are part of the daily limit control, while others are performed weekly or quarterly.

Stress test scenarios feature changes in interest rates, exchange rates, equity prices, volatilities and bond spreads. Such changes affect the Group's earnings directly through value adjustments. The scenarios are often based on large changes in a single risk factor or on conditions that reflect historical periods of economic or financial crisis, combined with large changes in risk factors relevant to the current positions and market conditions.

The Group's stress testing framework also includes scenarios with extreme market developments, such as hypothetical scenarios involving extreme financial or macroeconomic events. This includes scenarios periodically defined by the European Banking Authority (EBA) or the Danish FSA as well.

### 6.2.4 Regulatory capital for market risk

The internal VaR model is used to measure the regulatory capital for market risk in the Group's trading book. For regulatory capital purposes, VaR is calculated at a confidence level of 99% with a 10-day horizon. The 10-day scenarios used for generating the loss distribution are generated by means of a so-called bootstrap method. To construct a 10-day scenario, 10 independent drawings are made from a data set of two years' historical daily returns similar to the scenario construction process used in the day-to-day risk management.

The internal VaR model is also used to calculate the stressed VaR capital charge. The stressed VaR is calculated for current positions and historical market data from September 2008 to August 2009, which represents a period of significant financial stress for the current positions in the Group's trading book.

Incremental risks, such as default and rating migration risks on bond issuers and CDS names, are estimated in the incremental risk model.

Regulatory capital for the Group's minor exposures to commodity risk and collective investment undertakings are calculated according to the standardised approach.

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## Approval of internal models for regulatory capital

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In 2007, the Danish FSA approved the Group's internal VaR model for the calculation of regulatory capital for general market risk.

In June 2015, the Danish FSA approved an extension of the internal VaR model to include bond spread risk and company-specific equity risk (i.e., specific market risk) and also approved the Group's incremental risk model.

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### 6.2.5 Model validation

The Group conducts a variety of activities to maintain a healthy model apparatus in the market risk area. The activities can be divided into validation of pricing models used in daily risk management and validation of internal models used to calculate regulatory capital.

Group Risk Management is responsible for validating pricing models independently of the development process. A model must be validated before the trading unit can trade in any new type of product that is priced or risk-managed according to a model. The purpose of the validation process is to evaluate, independently of the business unit, whether the stability and quality of the model are sufficient to enable the Group to price and risk-manage the financial products in question in a satisfactory manner.

To supplement the initial validation of pricing models, Group Risk Management has established an ongoing monitoring process in which the crossing of specific thresholds (such as indications of a deterioration in model quality or an increase in the magnitude of risk involved) calls for additional validation activities.

An independent validation unit carries out the validation of internal models used for the regulatory capital calculations, including the validation of material changes to existing internal models and recurring validations of the major model assumptions. The standards for these validations are set forth in a validation policy for internal risk models. As with pricing models, these guidelines are in line with best practices presented in the US Office of the Comptroller of the Currency (OCC) guidelines.

In addition, the Group conducts a number of activities to continually monitor the internal VaR model, including an annual review of the model in accordance with regulatory requirements, quarterly risk factor reviews, and daily back-testing of the model. The quarterly risk factor reviews include an assessment of the materiality of risk factors that are not included in the model. Currently, the internal VaR model contains all significant risk factors.

## 6.3 Active risk management

### 6.3.1 Market risk appetite

The Group operates with a market risk appetite for its trading-related activities. The market risk appetite is expressed as a risk mandate assessment that is based on the business strategy and the market environment expected in the near future. The purpose of the risk mandate assessment is to measure the effect of proposed limits by quantifying the expected upside of using the limits (that is, expected earnings) and the potential downside (that is, the potential loss if the expectations do not materialise). The market risk appetite for trading-related activities is approved by the Board of Directors and reassessed at least once a year.

The Group's exposure to non-trading-related market risks is managed under selected limits and operational targets that govern and control the market risk on these activities in relation to specific capital, liquidity, operational and earnings objectives.

### 6.3.2 Limit framework

Market risk limits are established on various metrics so that activities subject to market risk are covered from several perspectives. The Group operates with three levels in the limit hierarchy for market risk (encompassing trading-related and non-trading-related market risks):

1. Board limits
2. All Risk Committee limits
3. Detailed operational limits

Board limits are set by the Board of Directors in the Market Risk Instructions, in which overall limits are defined for specific major risk factors and are supplemented by an overall VaR limit. The All Risk Committee delegates the Board limits to the business areas (C&I and Group Treasury) and assigns additional limits for less significant risk factors. Detailed operational limits are set at the desk level for relevant risk categories and metrics. The operational limit structure is sufficiently granular to facilitate effective control of market risk and to provide a continuous overview and understanding of activities undertaken by the various business units.

### 6.3.3 Risk identification

The Group markets, trades and takes positions in products entailing a variety of market risk components. Most of the Group's market risks involve relatively simple products. The Group does not take on risk exposure to complex securitisation instruments for which it cannot measure and monitor the embedded market risks.

New initiatives and products are systematically reviewed in relation to the current product and market risk models. New products and business proposals are evaluated with regard to current risk management practices and IT systems (that is, how risks are measured, managed and reported). New metrics are then added to the limit framework, if necessary.

Furthermore, the Group may identify a need to take into account new risk factors through a review of the strategy. If the Group wants to expand its business into specific product or instruments, there may be a need for additional metrics and limits. Additionally, changes in market conditions may entail new risk factors, such as basis risk, which was added after the financial crisis in 2008.



### 6.3.4 Risk management and mitigation

The Group actively manages market risk in its trading in financial markets. Most notably, C&I hedges market risk by taking positions in financial assets that offset the market risk produced by market-making activities with customers.

## 6.4 Monitoring and reporting

The Group carries out market risk controlling and reporting on a daily basis. The controlling process is embedded in continuous intraday monitoring of limit utilisations performed with a full portfolio update every 30 minutes. The monitoring system is linked directly to front office trading systems and automatically flags limit excesses. Business units must comply with limits at all times. In the event of a limit excess, the business unit responsible must document the reason for the excess and submit a plan of action to rectify the situation. All limit breaches are reported to the relevant party within the limit structure.

In other words, any Board limit excesses are reported to the Board of Directors and other relevant stakeholders (e.g., All Risk Committee and Executive Board). Similarly, All Risk Committee limit excesses are reported to the Executive Board, the All Risk Committee and other relevant stakeholders, including the business units. Excesses of lower-level limits are reported to the head of Market Risk.

The Group produces a range of internal market risk reports and provides input to other reports in which market risk figures are presented. The reports contain sufficient market risk information to create transparency about the Group's market risk.

The Board of Directors and senior management receive regular reports that provide an understanding of the Group's portfolio, main risk drivers, stress testing results and regulatory capital in order to support decision making. This also includes information on risk and regulatory capital attributed to various trading activities and business units. Furthermore, regular detailed reporting (weekly and daily) provides granular metrics to senior management at C&I and Group Treasury for day-to-day risk management.

## 6.5 Data and systems

IT systems pertaining to market risk are highly integrated in the Group. Traders and customers book trades directly in the relevant trade-entry systems. The trade-entry systems are connected to the operational systems and enriched with additional static, market and reference data. The operational systems feed both risk and finance systems. The Group performs an extensive set of regular reconciliations across the system portfolio.

### 6.5.1 System integration

The Group's front office trade-entry systems are designed to capture all trade types in which the Group is active. Only necessary trade-related data are entered into the trade-entry systems. Product, customer and other related static data are maintained in the Group's Master Files. Trade data are automatically fed into the Group's operational layers of other related systems (straight-through processing). Since all systems and their processes have been designed to support straight-through processing, only exceptions need to be manually handled.

In addition, trades from systems configured for straight-through processing are regularly monitored in order to verify trades that require manual intervention. The monitoring is part of the back office processes, and regular reports are sent to a broad group of stakeholders across the Group. An extensive programme of reconciliations between the Group's internal systems and reconciliations against external accounts are performed on a regular basis.

Risk systems use the Group's pricing models in order to ensure high-quality risk analytics. The architecture, specifically the linkage between front office trade-entry systems and risk and monitoring tools, also allows the Group to perform certain other activities, for example intraday limit monitoring, at a high standard.

## 6.6 Trading-related market risk

The trading-related activities at C&I cover trading in fixed income products, derivatives, foreign exchange, money markets, debt capital markets, equities and commodities as well as emerging markets. C&I acts mainly as a market maker processing large client flows. Fixed income products represent by far the largest notional-trading and position-taking volumes. C&I is the leading Nordic provider in this segment, with a strong presence in Scandinavian and northern European products in both primary and secondary markets. The market-making activities entail keeping an inventory

of assets to support the secondary market and short-term holdings of new issues at Capital Markets. As a result, the market-making activities involve both outright market risk exposure and spread risk from imperfect hedges.

The table below shows the VaR calculated at a 95% confidence level and a one-day horizon for the trading-related activities at C&I. The VaR estimates for the various risk types are calculated on a stand-alone basis, while the total VaR includes diversification effects.

#### Value-at-Risk for trading-related activities at C&I (confidence level of 95%, 1-day horizon)

At 31 December (DKK millions)	2015	2014
Bond spread risk	51	56
Interest rate risk	60	32
Foreign exchange risk	2	4
Equity risk	7	14
Diversification effects	-62	-35
<b>Total VaR</b>	<b>58</b>	<b>71</b>

The Group reduced its trading-related market risk from DKK 71 million at the end of 2014 to DKK 58 million at the end of 2015. Throughout the period, the risk related chiefly to fixed income products, giving rise to interest rate risk and bond spread risk. Because of substantial diversification, however, the two main risk factors hedged each other, resulting in a total VaR that was less than the sum of the stand-alone estimates.

Stand-alone interest rate risk rose in 2015 owing mainly to significantly higher market volatility during the first part of the year. Although market volatility increased, bond spread risk declined marginally because of a considerable reduction in bond holdings over the year. Foreign exchange risk and equity risk also fell because of reduced risk taking.

#### 6.6.1 Other market risks

In addition to the types of transaction subject to market risk listed above, the Group also trades in and takes positions in commodity instruments. Commodity risk is not included in the internal VaR model, but it is kept at an insignificant level and is also subject to limits.

## 6.7 Non-trading-related market risk

Most of the Group's exposure to non-trading-related market risk originates from the Group's funding and liquidity management activities at Group Treasury. In addition, the Group holds a portfolio of unlisted shares that relates mainly to private equity funds and banking-related investments. These activities involve mainly interest rate risk and bond spread risk as well as risk on unlisted shares.

#### 6.7.1 Interest rate risk in the banking book

Non-trading-related interest rate risk is included in the Group's overall interest rate risk calculations and thus in day-to-day monitoring and risk management. Non-trading-related interest rate risk is related primarily to the Group's funding activities, and it is hedged and treated according to fair value hedge accounting rules. The interest rate risk derives, to a lesser extent, from the Group's banking activities, which offer fixed rate deposits, loans and other interest rate products. The interest rate risk on the following remaining fixed rate items is thus not hedged in the accounting process but is managed on a daily basis:

- A legacy portfolio of fixed rate mortgage loans in Denmark (estimated according to historical prepayment rates)
- Fixed rate loans and advances provided by Personal Banking and Business Banking in Finland, Northern Ireland and the Baltics
- Operating leases
- Positions resulting from payments in advance on Realkredit Danmark loans (monthly payments that are not passed on to bondholders until the end of the quarter or year)
- Positions related to asset/liability management
- Bonds in the hold-to-maturity portfolios
- Interest rate risk exposure on demand deposits (unencumbered core funds are modelled with an average maturity of 2.5 years)

The Group's total interest rate sensitivity in the banking book is shown in the table below.

#### Interest rate risk in the banking book (parallel yield curve shift of 100 basis points)

At 31 December (DKK millions)	2015		2014	
	+100bp	-100bp	+100bp	-100bp
DKK	-1,903	1,975	-1,105	1,155
EUR	-1,004	1,033	-1,308	1,360
SEK	-150	156	-10	10
GBP	20	-20	-12	15
NOK	-4	4	-8	8
USD	-1	1	1	-1
Other	-2	2	-1	1
<b>Total</b>	<b>-3,044</b>	<b>3,151</b>	<b>-2,443</b>	<b>2,548</b>

The interest rate risk in the banking book increased in 2015, mainly because of the acquisition of longer-dated bonds in order to increase the average maturity of the hold-to-maturity bond portfolio to match the risk on the liabilities more closely. The Group established this portfolio in 2013 in order to stabilise the Group's net interest income by hedging its liabilities.

At the end of 2015, the book value of the hold-to-maturity bond portfolio totalled DKK 100 billion, against DKK 92 billion at the end of 2014. After the increase in average maturity, the interest rate risk in the portfolio rose to DKK 2.8 billion on a 100 basis point increase in the yield curve at the end of 2015.

#### 6.7.2 Investments in unlisted equities

For unlisted shares, the Group distinguishes between ordinary open positions (including position in associated companies), exposure to private equity funds (including exposure in the form of commitments), and banking-related investments. Banking-related investments consist of equity holdings primarily in financial infrastructure businesses.

At the end of 2015, the total value of the portfolio was about DKK 3.0 billion, against DKK 3.4 billion at the end of 2014. The reduction was owing mainly to value adjustments and the sale of the Group's shares in DADES A/S and Bluegarden Holding A/S.

## 6.8 Backtesting of the internal VaR model

Regulatory backtesting is conducted on a daily basis to document the performance of the internal VaR model. The backtesting procedure compares 1-day VaR calculated on trading book positions with the actual and hypothetical profit or loss.

#### Definition of actual and hypothetical profit and loss

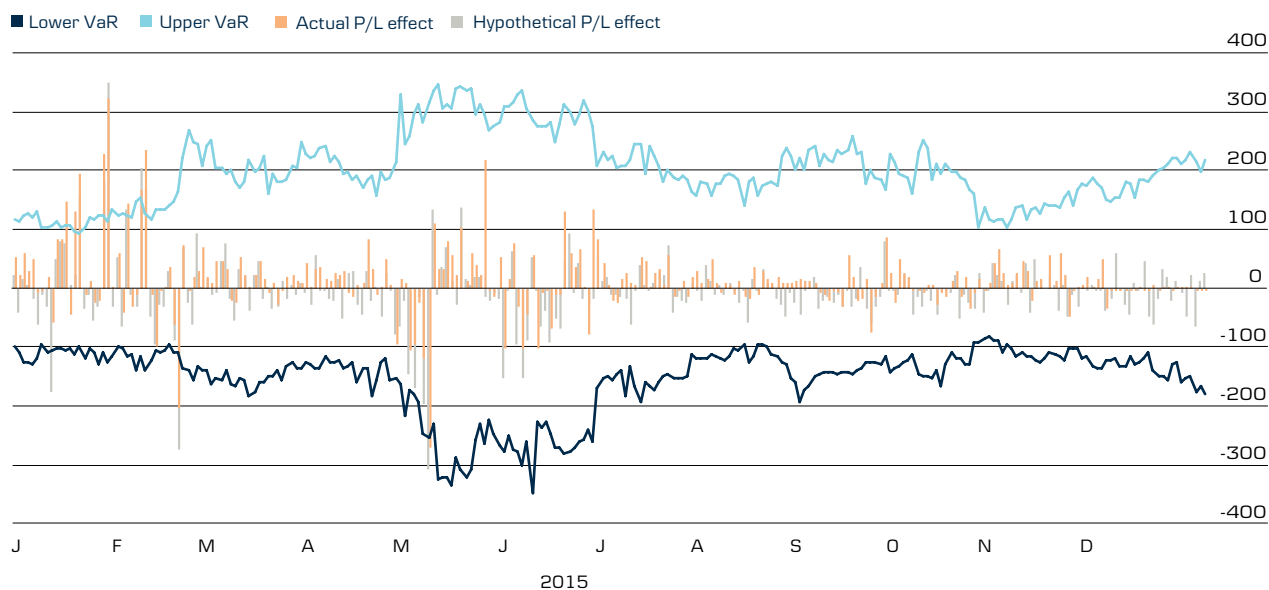
**Actual P&L** is defined as the loss or gain from actual changes in the market value of the trading book when daily closing values are compared with the subsequent business day's closing values (that is, intraday trades on the subsequent business day are included).

**Hypothetical P&L** is defined as the loss or gain calculated within the model framework resulting from keeping the portfolio unchanged for one business day (that is, no intraday trading is included, although market prices change).

If the hypothetical or actual loss exceeds the predicted possible loss (VaR), an exception has occurred. Since the VaR figures used for backtesting are based on a confidence level of 99% (as in the calculation of regulatory capital), the expected number of exceptions per year is two to three. The backtest results for 2015 are shown in the chart below.

### Backtest results and P/L effect

(DKK millions)



The backtest of the internal VaR model showed two exceptions in the actual P/L in 2015 and three exceptions in the hypothetical P/L. All the exceptions occurred in H1 2015, before the internal VaR model was expanded to include bond spread risk.

The exception in the hypothetical P/L in January was caused by the Swiss National Bank's removal of the 1.20 CHF/EUR cap, which sent the CHF 17% higher against the EUR. The exceptions in the actual and hypothetical P/L in February were caused by a combination of widening spreads between DKK and EUR rates and widening credit spreads on bonds. The exceptions in the actual and hypothetical P/L in May were caused by a combination of relatively large increases at the long end of the yield curves for EUR, NOK, SEK and DKK and widening credit spreads in the Danish mortgage bond market.

# *Liquidity risk*

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# 7.

## 7.1 Review of 2015

After a strong start in the financial markets in 2015, sentiment deteriorated somewhat in Q2 because of the Greek situation, jittery Chinese equity markets and uncertainty about regulation. Monetary policy and buying programmes at central banks continued to support liquidity in the market, however.

All funding markets generally remained open to Danske Bank. The US CP market became more accessible to the Group after Moody's upgraded its short-term rating in June. A five-year senior bond series for USD 1.0 billion marked our return to the domestic US medium-term market, and it was a key step in diversifying our funding base.

The main market movers for Danske Bank were the second-quarter earnings report, with an upward adjustment of the full-year guidance; the rating upgrade from Moody's to A2 from A3; and the stable outlook from Standard & Poor's. The rating upgrade was not a major market mover at the time, but anticipation of the decision played a big part in the general tightening of our spreads.

The Group maintained its liquidity reserves throughout 2015 and adhered to its funding plan, including its plan for subordinated debt.

In the first half of the year, the Group took advantage of benign market conditions and continued to adjust its capital structure to the new requirements with the issue of EUR 750 million AT1 capital.

In 2015, Group Risk Management also conducted the second Internal Liquidity Adequacy Assessment (ILAA) in accordance with the forthcoming regulation from the European Banking Authority (EBA). The first ILAA report was submitted to the college of supervisors in 2014 and approved in 2015 as part of the SREP.

### 7.1.1 Rating situation

In November 2012, Danske Bank announced a strategic goal of improving its ratings to the A level, where they had been previously. The A/A/A2 ratings from Standard & Poor's, Fitch and Moody's, respectively, ensure both operational and financial flexibility. The Group reached this goal at the end of July 2015.

This improvement came despite the fact that the rating agencies had removed expected extraordinary government support from bank ratings in Denmark when the Bank Recovery and Resolution Directive (BRRD) was implemented in Danish law.

In June 2015, Moody's Investor Service raised its long-term senior debt and deposit ratings for Danske Bank to A2 from A3 and its short-term ratings to P-1 from P-2. The main driver behind the rating action was the introduction of its new "loss given failure" methodology, which was designed to capture bank balance sheet risks under the BRRD regime.

In July 2015, Standard & Poor's affirmed its A long-term senior debt ratings and A-1 short-term rating. At the same time, it revised its outlook for Danske Bank to Stable from Negative after the implementation of its "additional loss absorbing capital" methodology, which was also designed to capture bank balance sheet risk after the introduction of the BRRD. Standard & Poor's also cited the improved financial performance of the Group relative to its peers as a factor supporting its rating action.

Finally, in September 2015, Fitch Ratings affirmed its A long-term senior debt and deposit ratings and its F1 short-term rating, stating that the Group's improved financial performance had been expected and was already incorporated in the ratings. Fitch also removed all government support from Danske Bank's ratings and lowered its Support Floor ratings to "No Floor" from "a-". This had no effect on the Group's rating, however, because its viability rating of "a" (its stand-alone credit assessment) was higher.

### Danske Bank's ratings, end-2015

Rating agency	Long-term rating	Short-term rating	Outlook	Danske Bank's covered bonds
S&P	A	A-1	Stable	AAA
Moody's	A2	P-1	Stable	Not rated
Fitch	A	F1	Stable	AAA

Danske Bank's and Realkredit Danmark's covered bond ratings from both Standard & Poor's and Fitch were unchanged.

In addition, Danske Bank Plc (Finland) is rated A/A-1/Stable by Standard & Poor's and A2/P1/Stable by Moody's. Danske Bank Plc's covered bond programme also has an "Aaa" rating from Moody's.

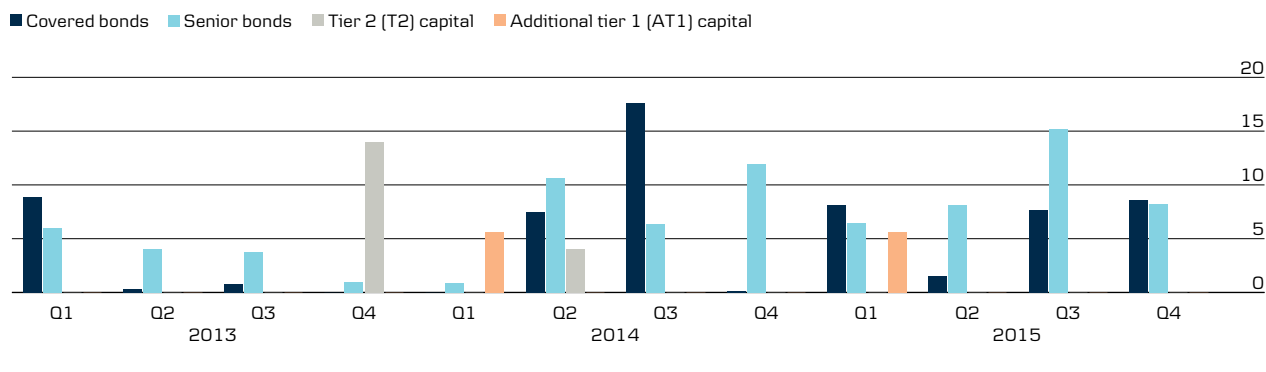
#### 7.1.2 Funding

In 2015, Danske Bank issued covered bonds for DKK 25.9 billion, senior debt for DKK 38.0 billion, and subordinated debt for DKK 5.6 billion. The Group redeemed DKK 61.9 billion of long-term debt.

At 31 December 2015, the total amount of outstanding long-term funding, excluding mortgage bonds and senior debt issued by Realkredit Danmark, was DKK 338 billion, against DKK 332 billion at the end of 2014.

#### Debt issuance, by quarter

(DKK billions)

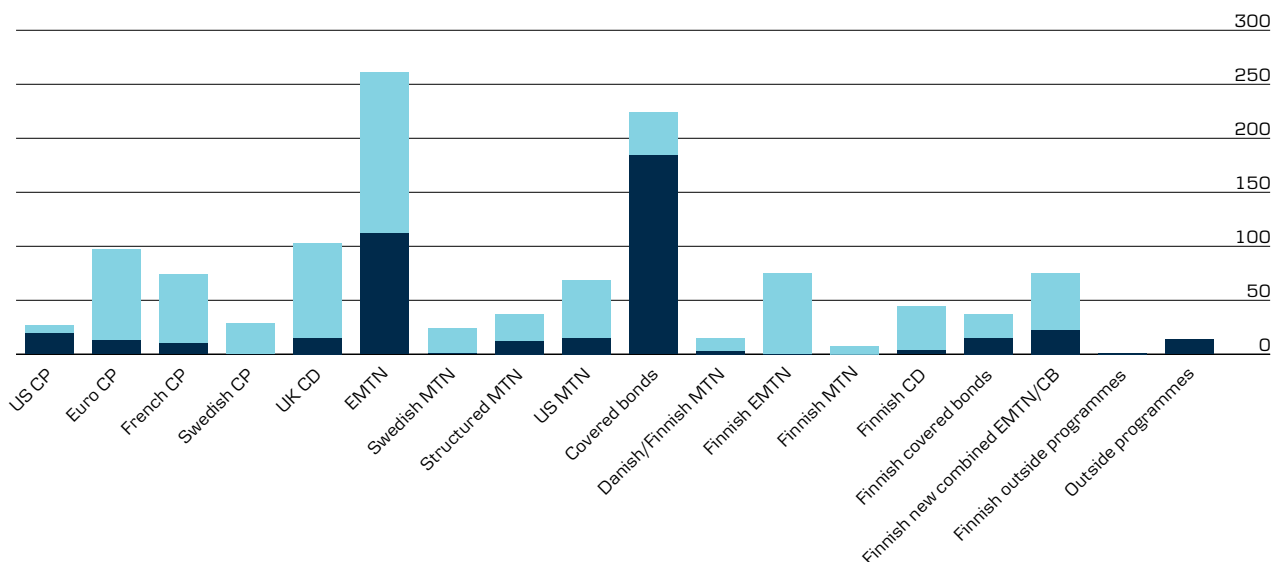


In 2016, Danske Bank will raise funding through medium- and long-term funding programmes. For long-term funding, the most important programmes are the European and the US medium-term note (MTN) and covered bond programmes, including a programme at the Bank's subsidiary in Finland. Covered bonds are generally used for longer maturities, while senior funding is used for shorter maturities.

## Utilisation of long- and short-term programmes available, end-2015

(DKK billions)

■ Utilised ■ Not utilised



## 7.2 Liquidity risk management

### 7.2.1 Governance of liquidity risk management

The Group manages its liquidity on a daily basis, and liquidity risk is managed through a combination of risk indicators, risk triggers and risk policy. Two documents lay the foundation for the Group's liquidity risk management: (1) Liquidity Policy and Appetite and (2) Liquidity Instructions. The former document contains the overall principles and standards of the Group's liquidity risk management. It covers both the liquidity risk profile and the governance structure. The latter document defines limits and the methods of calculation. Both documents are issued by the Board of Directors.

The Group Liquidity Risk Committee (GLRC) is the committee responsible for overseeing group-level liquidity risk management and funding. The GLRC is chaired by the chief risk officer (CRO) and consists of representatives of Group Risk Management, CFO Area, and the three business units. The GLRC has broad authority to challenge the way in which the Group manages its liquidity risk profile and funding position.

Group Treasury is responsible for Danske Bank's liquidity and funding. This includes executing the funding plan and managing the liquidity reserve. Short-term liquidity is managed by FICC under the supervision of Group Treasury.

Group Risk Management, headed by the CRO, oversees liquidity risk management at the group level and compliance with the liquidity risk appetite framework.

Danske Bank's liquidity management is centralised and conducted on a consolidated basis to ensure regulatory compliance at the group level as well as compliance with internal requirements. Regulatory compliance and the maintenance of adequate liquidity reserves at subsidiaries are managed locally. Realkredit Danmark and Danica Pension conduct their own liquidity risk management. Realkredit Danmark, which issues mortgage bonds, is substantially self-financing, and its liquidity management is conducted separately from the rest of the Group's. Danica's balance sheet includes long-term life insurance liabilities and assets, and much of them are investments in readily marketable bonds and shares. Both companies are subject to statutory limits on their exposures to Danske Bank A/S. In the following sections, "Group" refers to the banking units only; that is, it does not include Realkredit Danmark and Danica Pension.



### Liquidity risk appetite

Taking on liquidity risk is an integral part of the Group's business strategy. The Board of Directors determines the overall approach to the liquidity risk appetite, including the Group's liquidity risk exposure profile and liquidity risk limits.

### Concerns addressed by the liquidity risk appetite

Key concern	Explanation
Distance to default	Management must have sufficient time to respond to events and developments in order to avoid financial or regulatory default.
Market reliance	The Group's reliance on wholesale funding and liquidity reflects its loan-to-deposit shortfall and maturity transformation profile. Excessive reliance makes the Group vulnerable to investor sentiment, market stress and market dysfunction.

The Liquidity Policy states that the Group's liquidity risk appetite is conservative and that the Group must maintain a strong liquidity and funding position. The liquidity risk appetite is an articulation in both general and specific terms of the Group's desired risk profile, and it provides the overall framework and guidance for liquidity management.

### 7.2.2 Liquidity risk measures

Liquidity risk management focuses on the monitoring and management of all the Group's liquidity risks – both short-term and long-term risks.

#### Survival horizon

The Group's short-term risk management is intended to ensure that the Group always has a liquidity reserve that, in the short term and medium term, is sufficient to absorb the net effects of known future receipts and payments from current transactions as well as unexpected volatility. To account for the potential risk of drawings under committed lines of credit, the Group factors in the unutilised portion of the facilities in the calculation of liquidity risk.

For liquidity management purposes, the Group distinguishes between liquidity in Danish kroner and liquidity in other currencies. This is because of the Group's strong position in the Danish market and because the Group has a net deposit surplus in Danish kroner (deposits exceed lending) and a net deposit shortfall in other currencies (lending exceeds deposits). The net deposit surplus in Danish kroner is a valuable, stable funding source for the Group. Because of this discrepancy, the Group uses limits to manage short-term liquidity risk both for total liquidity and for liquidity in non-Danish currencies. In addition to limits set by the Board of Directors and the All Risk Committee, the GLRC has set overnight targets for each key currency.

#### Liquidity reserve

The Group must at all times maintain a liquidity reserve to cover the need for liquidity that may arise under both normal and stressed conditions.

The Group's liquidity reserve is defined as the assets available to Danske Bank's Group Treasury in a stressed situation. All assets must be unencumbered, and securities received in reverse repo transactions are included, while securities used as collateral for repo transactions are not.

The table below shows the nominal value of the Group's liquidity reserve without haircuts. The haircuts applied to determine the liquidity values for regulatory purposes are defined by regulators, whereas the haircuts used for internal stress testing purposes are defined on the basis of a set of parameters reflecting the specific scenario in question.

## Nominal value of the liquidity reserve available to the Group

At 31 December (DKK billions)	Market value
Cash and holdings at central banks	55
Securities issued or guaranteed by sovereigns, central banks or multilateral development banks	124
Covered bonds (including mortgage bonds)	242
Issued by other institutions	209
Own issued	33
Other	31
<b>2015 total</b>	<b>452</b>
<b>2014 total</b>	<b>399</b>

The liquidity reserve consists of liquid bonds, most of which fall into the level 1a and 1b categories under the LCR framework and are eligible for repo transactions with central banks. Central bank eligibility is vital for intraday liquidity needs and overnight liquidity facilities and also for defining liquidity in financial markets during stressed periods. Besides central bank eligibility, the external credit rating is an important factor in determining the liquidity value of the assets in the reserve.

The minimum size of the reserve is determined by several requirements, including an LCR of at least 100%, certain minimal operational survival horizons, and liquidity levels determined by stress testing.

### Stress testing

The Group conducts stress tests to measure its immediate liquidity risk and to ensure that it has sufficient time to respond to potential crises. The stress tests are conducted for various scenarios, including three standard scenarios: a scenario specific to the Group, a general market crisis and a combination of the two. A “stress-to-failure” test is also conducted.

All stress tests are based on the assumption that the Group does not reduce its lending activities. This means that existing lending activities continue and require funding. The degree of possible refinancing of the Group’s funding base varies depending on the scenario in question as well as on the specific funding source. To assess the stability of its funding, the Group considers maturity and makes behavioural assumptions.

In the scenarios, the Group uses the liquidity reserve to cover cash outflows. Scenario-specific haircuts are applied to the bond portfolio.

### Additional contractual obligations

Through a number of mutually binding agreements, the Group is under an obligation to provide collateral if the fair value of current transactions changes to its detriment. The assets provided as collateral do not count as part of the Group’s liquidity reserve.

The table below shows the loss of liquidity for the Group under four scenarios involving downgrades of the Group’s long- and short-term debt. It also shows how much the Group would have to prepay under the contracts or provide in supplementary collateral under the various scenarios. The number in parentheses after the rating indicates the number of notches by which the rating is reduced from its current level in the scenarios.

### Loss of liquidity if the Group's current ratings are downgraded, end-2015

	Moody's (short-term)	S&P (short-term)	Fitch (short-term)	Moody's (long-term)	S&P (long-term)	Fitch (long-term)	Supplementary collateral (DKK billions)
Present rating	P-1	A-1	F1	A-2	A	A	-
Scenario 1	P-1	A-1	F1	A-3 (▼1)	A- (▼1)	A- (▼1)	1.7
Scenario 2	P-2 (▼1)	A-2 (▼1)	F2 (▼1)	A-3 (▼1)	A- (▼1)	A- (▼1)	2.2
Scenario 3	P-2 (▼1)	A-2 (▼1)	F2 (▼1)	Baa1 (▼2)	BBB+ (▼2)	BBB+ (▼2)	2.5
Scenario 4	P-2 (▼1)	A-2 (▼1)	F2 (▼1)	Baa2 (▼3)	BBB (▼3)	BBB (▼3)	3.2

Note: Scenario 1 is required by regulations and gives insights about the effects of isolated rating changes, but it does not necessarily represent a realistic rating combination.

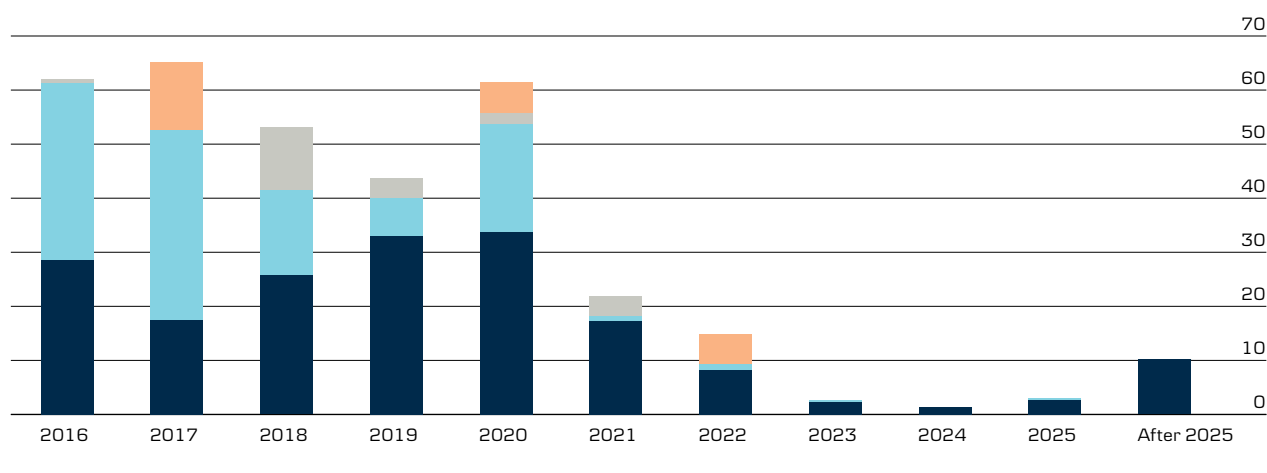
### Market reliance

The Group monitors the diversification of its funding sources by product, currency, maturity and counterparty to ensure that its funding base provides the best possible protection even if financial markets come under pressure. The maturity profile of long-term funding is monitored particularly to ensure that the portions of long-term funding that mature within one year and one quarter are kept at an acceptable level.

### Redemption profile of long-term funding, end-2015

(DKK billions)

■ Covered bonds    ■ Senior bonds    ■ Tier 2 (T2) capital    ■ Additional tier 1 (AT1) capital



Retail deposits are a valuable, stable funding source for the Group. Most of the Group's retail deposits are covered by a deposit insurance scheme, and despite financial crises and intensified competition, they have been very stable over time.

Wholesale funding is another important funding source, although its stability sometimes varies over time, especially when markets are strained.

### Breakdown of wholesale funding by contractual maturity

At 31 December (DKK billions)	0-1 month	1-3 months	3-12 months	1-5 years	> 5 years	2015 total	2014 total
Deposits from credit institutions and central banks	247	60	27	3	0	336	368
CDs and CP	17	28	15	-	-	61	26
Senior unsecured MTNs	0	7	25	79	2	113	103
Covered bonds	-	7	21	138	54	221	212
Subordinated liabilities	-	-	-	30	5	35	39
<b>Total</b>	<b>264</b>	<b>102</b>	<b>88</b>	<b>250</b>	<b>61</b>	<b>766</b>	<b>747</b>
<b>Breakdown</b>							
Secured	114	46	22	3	-	184	233
Unsecured	150	56	66	247	61	582	514

Note: Wholesale funding is measured at nominal value as opposed to the treatment in section 7.1, where it is measured at amortised cost. Covered bonds issued to enhance the Group's liquidity reserve are included. Repo transactions are not netted.

Danske Bank also analyses the survival horizon if it does not have access to funding markets. The market-reliance analysis assumes the following:

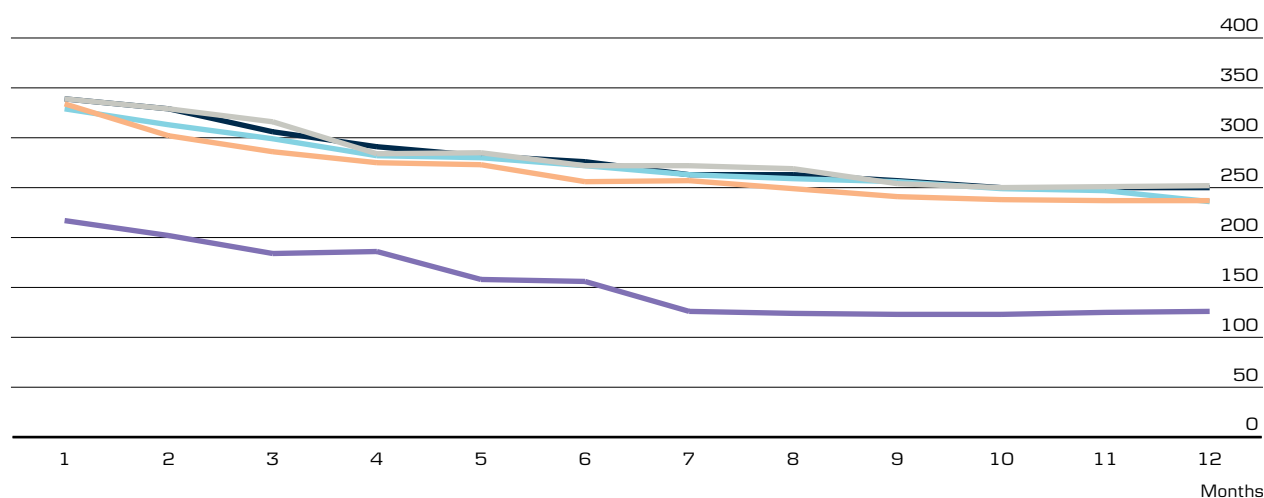
- The Group is cut off from capital markets, and refinancing in the markets is not possible. That is, deposits from credit institutions, CDs and CP, covered bonds, senior unsecured MTNs and subordinated debt cannot be refinanced at maturity.
- Most of the stable deposit base will remain available as a funding source, while some unstable deposits will run off.
- A moderate reduction in business activities will take place.
- Off-balance-sheet items are included until their actual maturity dates.

Stress tests show that the Group's liquidity reserve is sufficiently large to close any liquidity gap if all capital markets are closed and refinancing is impossible. The Group monitors its liquidity reserve continually to ensure a survival period of at least 12 months in this scenario.

### Twelve-month liquidity

(DKK billions)

■ 31 December 2015 ■ 31 December 2014 ■ 31 December 2013 ■ 31 December 2012 ■ 31 December 2011



### Asset encumbrance

Asset encumbrance, or the percentage of assets pledged or mortgaged as collateral, and the resulting structural subordination of senior unsecured creditors and depositors, are drawing increased attention from regulators, rating agencies, investors and others.

The Group's asset encumbrance comes mainly from three sources:

- Loans and securities serving as collateral for covered bond issuance. Covered bond issuance is a strategic long-term funding measure that entails ring-fencing assets according to statutory regulation.
- Securities provided as collateral in repo and securities-lending transactions. The Group's repo activities consist of business-driven transactions that can be wound up relatively quickly and transactions for short- or long-term funding purposes. In repo transactions, the securities remain on the Group's balance sheet, and the amounts received are recognised as deposits.
- Cash and securities provided as collateral for derivatives and clearing transactions when pledging or mortgaging collateral is an operational requirement to support business activities.

Danske Bank's asset encumbrance reporting follows the method described in the EBA's "Implementing Technical Standards". The table below shows the encumbrance of assets on the balance sheet and the encumbrance of collateral received, broken down by source of encumbrance.

### Asset encumbrance and encumbrance ratio

(DKK billions)	Danske Bank A/S	Danske Bank Group*
<b>Assets on balance sheet</b>		
Derivatives	68	72
Deposits (repos)	232	229
Covered bonds	179	979
- portion from RD	-	776
Other	23	38
<b>Total encumbrance</b>	<b>502</b>	<b>1,17</b>
<b>Total assets</b>	<b>2,037</b>	<b>3,017</b>
<b>Collateral received</b>		
Derivatives	22	20
Deposits (reverse repos)	215	192
<b>Total encumbrance</b>	<b>237</b>	<b>212</b>
<b>Total assets</b>	<b>486</b>	<b>452</b>
<b>Asset encumbrance ratio</b>	<b>29%</b>	<b>44%</b>

\* Includes Realkredit Danmark.

In 2014, the Group implemented a policy to monitor the level of encumbrance and ensure that it does not increase significantly from the current level.

### 7.2.3 Regulatory measures

The year 2015 brought the important introduction of the Liquidity Coverage Ratio (LCR) from the Capital Requirements Directive and Capital Requirements Regulation (CRD IV/CRR); the measure originated from the 2010 Basel Accord (Basel III).

### International regulations

New capital requirements regulation will establish a consistent and integrated regulatory framework for many aspects of bank management, including liquidity, and it will provide a uniform standard under a unified set of prudential rules. The LCR, which has received much attention, became binding for all EU credit institutions in October 2015. The components of the Net Stable Funding Ratio (NSFR) have been monitored since 2013 with a view to introducing a binding requirement in 2018.

The LCR regulation stipulates that banks must have a liquidity reserve that ensures a survival horizon of at least 30 calendar days in case of a severely stressed liquidity situation. The final requirement from the EBA allows Danish mortgage bonds to be classified as level 1 liquid assets, almost on par with Danish government bonds. Danske Bank has satisfied the LCR requirement since 1 October 2015.

<b>Liquidity Coverage Ratio</b>		
At 31 December 2015 (DKK billions)	Danske Bank Group <sup>1</sup>	Danske Bank A/S
HQLA level 1	411	314
HQLA level 2	14	14
Limits due to cap	-	-
<b>A. Liquid assets total</b>	<b>425</b>	<b>328</b>
Customer deposits <sup>2</sup>	98	76
Market funding <sup>3</sup>	182	136
Other cash outflows <sup>4</sup>	162	130
<b>B. Cash outflows total</b>	<b>442</b>	<b>342</b>
Lending to non-financial customers	4	3
Other cash inflows	98	52
Limit on inflows	-	-
<b>C. Cash inflows total</b>	<b>102</b>	<b>55</b>
Liquidity Coverage Ratio [A/(B-C)]	125%	115%

<sup>1</sup> Includes Realkredit Denmark.

<sup>2</sup> Includes retail deposits, operational deposits, correspondent banking/prime brokerage accounts, and non-operational deposits covered by deposit guarantee.

<sup>3</sup> Includes non-operational deposits, unsecured debt issuances, and secured funding.

<sup>4</sup> Includes RD's additional outflow requirement, equal to 2.5% of lending.

The NSFR is intended to ensure a sound funding structure by promoting an increase in long-dated funding. The NSFR regulation stipulates that at all times banks must have stable funding equal to the amount of their illiquid assets for one year ahead.

### National regulations

Since October 2015, Danish national regulations have required that SIFI banks have an LCR of 100%. Banks that fulfil this requirement no longer need to meet the external national liquidity requirements in section 152 of the Danish Financial Business Act. The Danish FSA wishes to continue monitoring the section 152 requirements as part of the Supervisory Diamond, however, until the Supervisory Diamond is revised.

Section 152 states that a credit institution's liquidity reserve must equal or exceed both of the following:

- 15% of the debt obligations that, regardless of any disbursement conditions, the institution must pay on demand or at less than one month's notice
- 10% of the institution's total debt and guarantee obligations, excluding subordinated loan capital infusions that can be counted as part of the total capital

Liquidity includes cash on hand, fully secured and liquid demand deposits at other credit institutions and insurance companies, and holdings of secure, readily negotiable, unencumbered securities and credit instruments.

In 2010, the Danish FSA introduced the Supervisory Diamond, which includes benchmarks for liquidity and funding for the parent company. The benchmark for liquidity states that banks must have a liquidity ratio that is 50% above the regulatory requirements in section 152 of the Danish Financial Business Act. At the end of 2015, Danske Bank A/S's liquidity ratio was 193% above the regulatory requirements and Danske Bank Group's was 152% above.

The benchmark for funding (the "funding ratio") stipulates that a bank's lending may not exceed stable funding (deposits as well as issued bonds and subordinated debt with a maturity exceeding one year). This means that banks must have a funding ratio of less than 1.00. At the end of 2015, Danske Bank A/S's ratio was 0.69.

### *7.3 Funds transfer pricing*

The Group's Funds Transfer Pricing (FTP) model for assigning internal funding prices adheres to the matched-maturity principle. The FTP charged on loans and awarded to deposits reflects the distinct characteristics of the individual balance sheet items, with a focus on product and customer type, including maturity, currency, amortisation profile, modelled behaviour and underlying interest rate risk. Credits are reduced by any charges against contingent commitments, such as expected stressed deposit run-off, and specific charges apply to contingent commitments, such as committed facilities.

FTP links the balance sheet composition directly to the income statement, and it is a key component driving the Group's overall funding position. FTP is fundamental in evaluating the profitability of the Group's balance sheet composition, and it has therefore been embedded in the profitability analysis at the customer level in order to facilitate consistency between liquidity risk assessment, product pricing and balance sheet valuation.

The Group's trading activities at FICC and Capital Markets are also subject to FTP in a model that assigns term funding costs to trading and collateral management activities in order to ensure LCR compliance.

# *Operational risk*

72	8.1	Policy
72	8.2	Process, measurement and control
75	8.3	Group compliance





Danske Bank Group is exposed to operational risk in the form of possible losses resulting from inadequate internal procedures, human or system errors, or external events. Operational risk includes legal risk and IT risk.

Model risk is a subtype of operational risk that is defined as the risk of losses resulting from decisions based mainly on output from internal models because of errors in the development, implementation or use of the models.

Operational risk can often be associated with one-off events, such as failure to observe business or working procedures, defects or breakdowns of the technical infrastructure, criminal acts, fire and storm damage, and litigation. Operational risk is thus non-financial risk.

The Group's risk appetite and tolerance for operational risk, including operational risk thresholds, are set forth in seven risk appetite statements based on the Basel II event categories: Internal fraud; External fraud; Employment practices and workplace safety; Clients, products and business practices; Damage to physical assets; Business disruption and system failures; and Execution, delivery and process management.

The Group's operational risk management process involves a structured and uniform approach across the Group. It includes risk identification; risk assessments; and the monitoring of risk indicators, the control environment and risk mitigation plans for key operational risks in accordance with its risk appetite.

In its qualitative approach to operational risk management, Danske Bank Group has chosen to include the likelihood, consequence and reputational effects of an event and the adequacy of key internal controls in its assessment of whether a given operational risk event may materially affect Danske Bank. This approach improves the basis for assigning priority to the key risks identified.

At the end of 2015, operational risks accounted for 8.7% of the Group's total risk exposure amount. In 2015, the Group focused on the adequacy and timely implementation of key controls to mitigate group-wide operational risks. It also continued to expand day-to-day operational risk management at all subsidiaries, business units, support functions and foreign branches. Additionally, the Group further strengthened its controls against card, online and payments fraud.

The chief risk officer is the chairman of the Operational Risk Committee. The committee's general responsibilities are, on behalf of the Executive Board, to set the direction for the group-wide operational risk management framework and to oversee the implementation of the framework. Danske Bank's Board of Directors is involved in important decisions about operational risks, including approving the Operational Risk Policy and the operational risk appetite and receiving notification of significant operational losses. The Board of Directors receives reporting on the Group's operational risk profile at least once a year.

Each subsidiary, business unit and support function is responsible for the day-to-day monitoring of its operational risks and for reducing and preventing losses caused by operational risks.

## 8.1 Policy

The Operational Risk Policy and operational risk instructions are approved by the Board of Directors and set the principles and standards of operational risk management in the Group. The Group's Operational Risk Policy covers the following:

- The definitions of operational risk and operational risk appetite, the operational risk governance structure, and the objectives of the Group's framework for operational risk management
- The methodology for the operational risk framework, including identifying, assessing, monitoring and managing the Group's current and potential operational risk exposure
- Informing the Executive Board and Board of Directors of issues that involve the Group's operational risks

The Group also has policies addressing security and outsourcing that are part of the operational risk management framework.

In addition, the Group has policies regulating other operational risk areas, such as a policy for using insurance as a risk mitigation measure.

## 8.2 Process, measurement and control

Once a year, the Group conducts a risk identification and assessment process at its subsidiaries, business units and support functions and compiles a list of the key operational risks. The subsidiaries, business units and support functions – in collaboration with the Group Operational Risk department – assess the likelihood, consequence and reputational effects of risk events before and after the implementation of key controls. Some of the largest risks fall into the Basel II event categories for operational risks: Execution, delivery and process management; Clients, products and business practices; and Business disruption and system failures.

The Group monitors its risk profile on an ongoing basis throughout the year. It manages operational risks in a process that includes strengthening key controls, risk mitigation and monitoring of risk indicators. Operational risk considerations are included in the Group's daily work in accordance with its risk appetite.

Danske Bank received and accepted one administrative fine from the Danish Financial Supervisory Authority (FSA) in 2015 for failing to disclose securities holdings in a company in a timely manner. Danske Bank discovered the error by itself and informed the FSA.

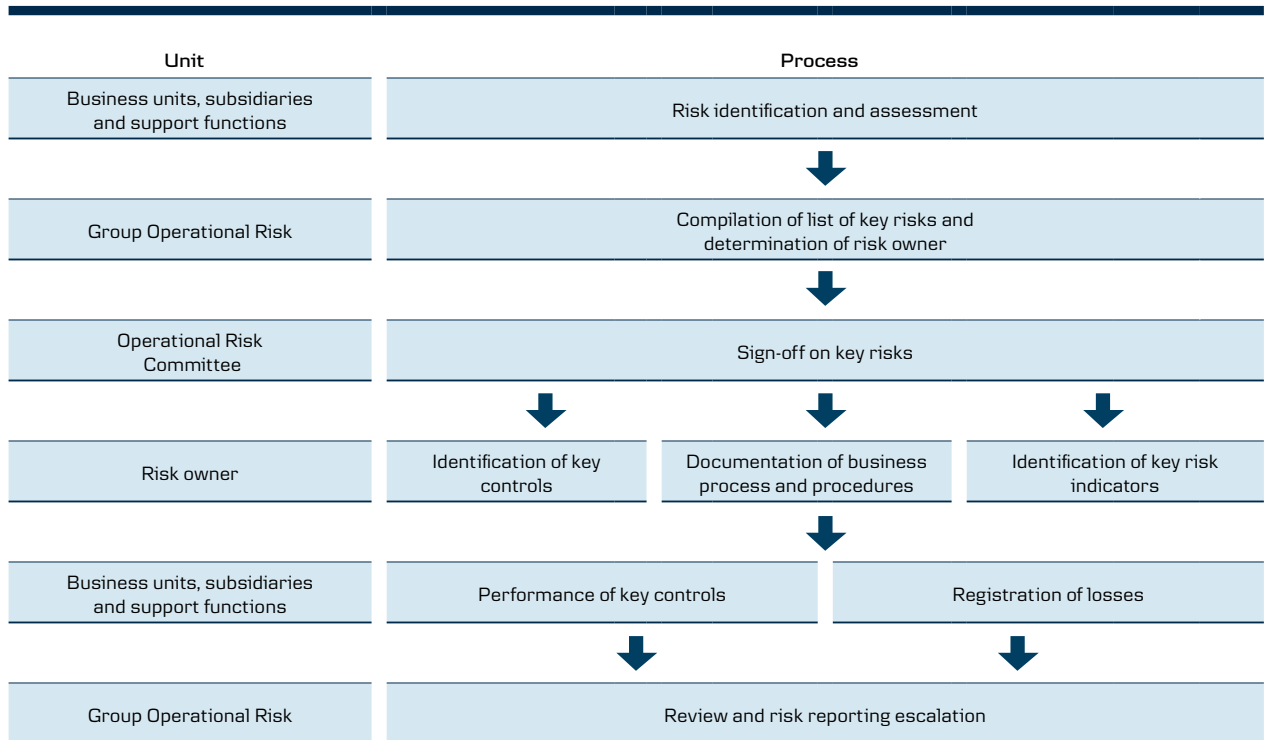
On 7 February 2014, the Danish Public Prosecutor for Serious Economic and International Crime (SØIK) brought accusations of price manipulation of a particularly serious nature against Danske Bank A/S. Danske Bank had found that in 2009 four employees from the banking operation and Realkredit Danmark had violated internal rules and had possibly manipulated prices. On 26 February 2015, all the accusations of price manipulation brought against Danske Bank A/S by SØIK were dropped.

Business line management, subsidiaries and support functions are responsible for identifying and managing the risks inherent in the products, activities, processes and systems for which they are accountable on the basis of the Group's risk framework, since the local risk owners have expert knowledge about area-specific risks.

Group Operational Risk (part of Group Risk Management) is responsible for the independent oversight of operational risk management and governance, for the establishment of the group-wide risk management framework, and for performing a controlling and reviewing role in the operational risk identification and assessment process to ensure consistency in the framework applied.

The chart below shows the process from risk identification and assessment to the ongoing monitoring of the Group's key operational risks.

### Risk assessment process from risk identification to response



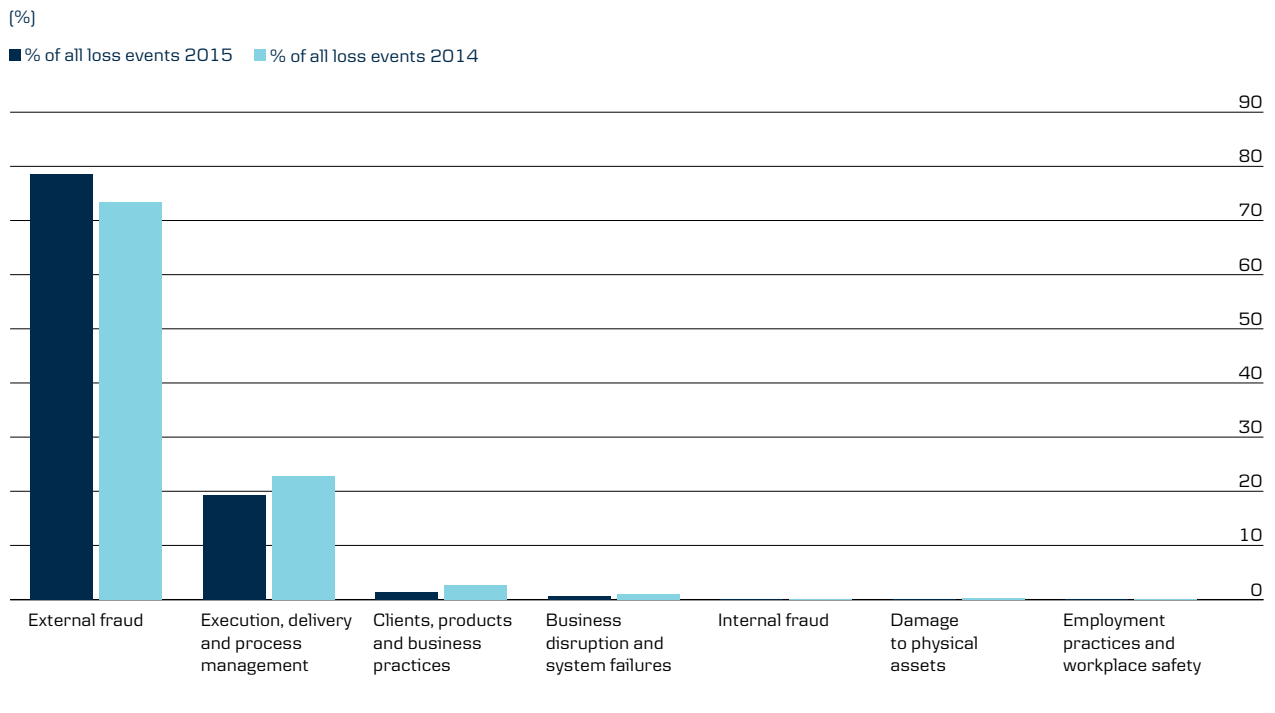
The process starts with risk identification and assessment, which lead to the compilation of a list of the Group's key operational risks, which is signed off by the Operational Risk Committee. The adequacy of the control environment for each key risk is evaluated, and key risk indicators are identified as part of the ongoing monitoring of operational risks. Key risks are monitored, and their status is documented in a quarterly report to the Operational Risk Committee that includes significant indicators of changes in the Group's risk profile, including loss data, risk management governance, audit remarks, and other relevant risk indicators.

The risk identification and assessment process is updated once a year. New operational risks may be identified, and risks that have become irrelevant are removed from the list of key risks.

The Group's operational risk losses are recorded in a database. Losses are categorised according to the Basel II event categories for operational risk. Operational risk events that entail losses of DKK 10,000 or more are recorded.

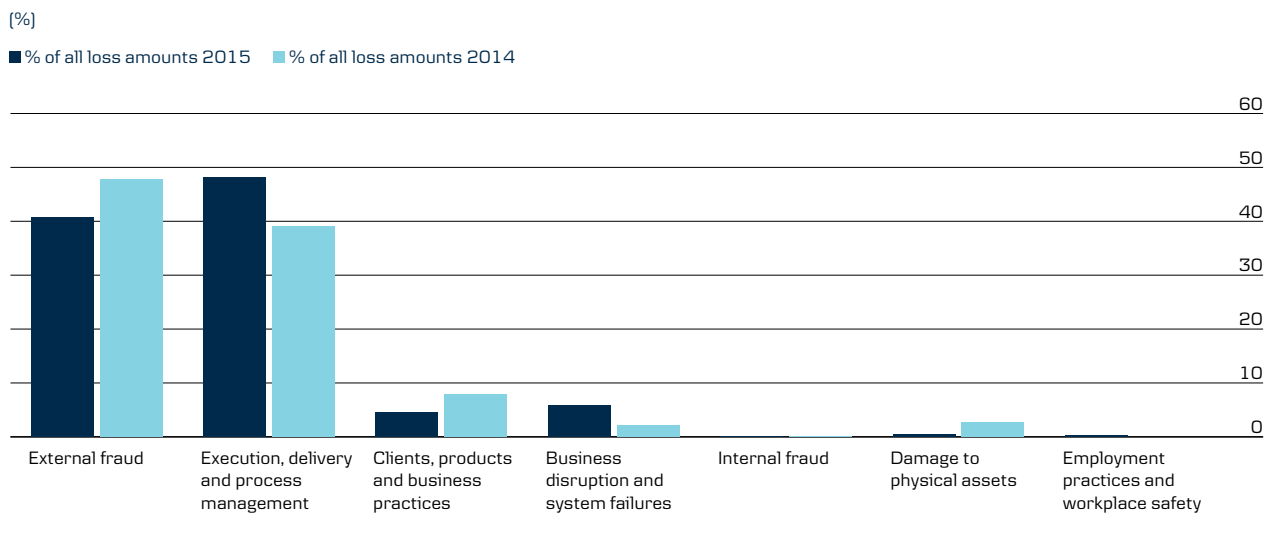
Measured by the number of loss events, the two categories External fraud and Execution, delivery and process management accounted for most of the losses in 2015. External fraud accounted for 79%, and Execution, delivery and process management accounted for 20% of total loss events, against 73% and 23%, respectively, in 2014. A large portion of these risk events involves low financial costs. External fraud consists of events such as card fraud, eBanking fraud, bank robberies, card skimming and document falsification. Execution, delivery and process management includes losses because of erroneously processed transactions and losses related to routine manual input.

### Breakdown of loss events



Measured by amount, Execution, delivery and process management accounted for 48%, External fraud for 41%, and Clients, products and business practices for 5% of the total operational risk loss in 2015, against 39%, 48% and 8%, respectively, in 2014.

### Breakdown of loss amounts



## 8.3 Group compliance

Group Compliance at Danske Bank Group is an independent function that is responsible for assessing and monitoring whether the Group complies with applicable laws, regulations and ethical standards as well as being responsible for providing advice to the Group on the mitigation of compliance risks.

On 1 January 2015, Group Compliance was split off from Group Legal and became a centralised function with group-wide responsibility for compliance.

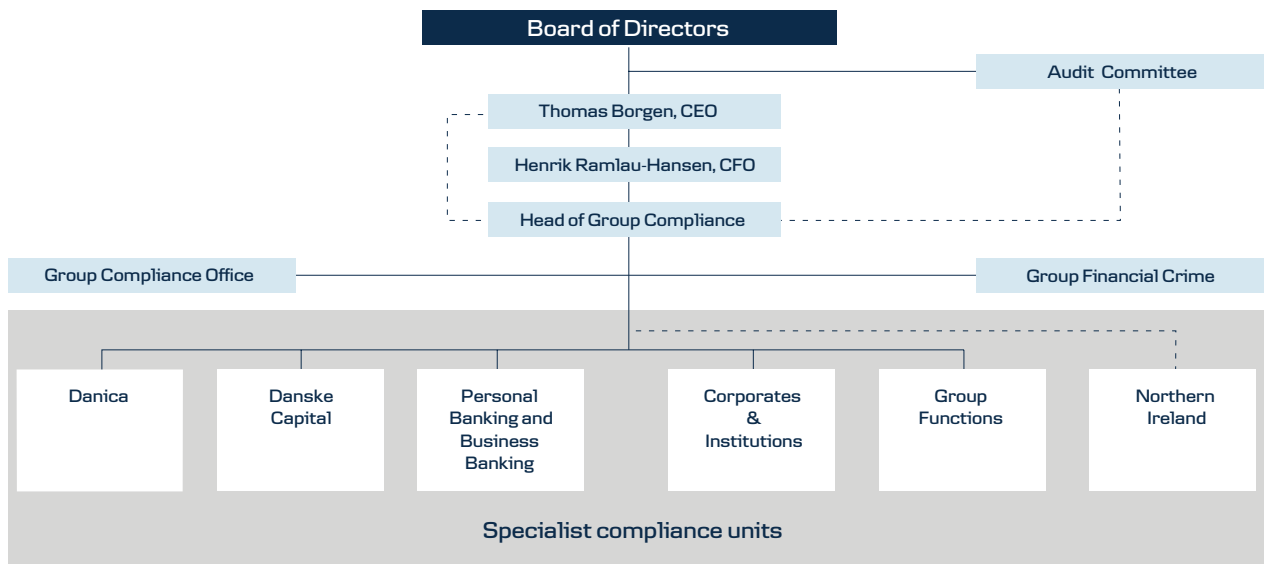
This change was intended to strengthen the compliance culture in the Group and to support the Group's pursuit of its vision of becoming the most trusted financial partner.

Group Compliance is headed by the chief compliance officer, who reports to the Group CFO with a dotted reporting line to the Group CEO and the Audit Committee of Danske Bank's Board of Directors.

Group Compliance's operating model reflects Danske Bank Group's operating model. It entails a division of roles and responsibilities into separate units of compliance specialists for Personal Banking, Business Banking, Danica Pension and Danske Capital. Group Compliance also has units of compliance specialists for Group functions, for Financial Crime (anti-money laundering, countering terrorism financing and sanctions), and for the compliance framework and compliance awareness and training.

Group Compliance is now organised and operates in such a way that it meets the high standards of the European banking industry. The combination of a centralised function and specialists in each of the Group's business areas enables Group Compliance to develop the proper awareness and understanding of compliance among managers and employees in the Group in an effective manner.

### Compliance organisation



Danske Bank Group has a risk management and control system based on three lines of defence. Group Compliance is part of the second line of defence and fulfils its responsibilities in coordination with other second line units in the Group, primarily Group Risk Management.

First-line units own the compliance risks associated with their functions.

Group Compliance's key activities are the following:

- Identifying and assessing compliance risks
- Providing advice on risk mitigation to compliance risk owners in the first line of defence
- Monitoring the adequacy of risk mitigation and controls in the first line of defence
- Reporting on the compliance risk management and control environment at Danske Bank Group (Danske Bank A/S and subsidiaries) directly to the Executive Board, the Audit Committee of the Board of Directors and the Board of Directors
- Involvement in selected major projects, such as the compliance with new legislation at Danske Bank Group

To meet the increasing requirements from regulators, the Group has launched a compliance certification programme to be conducted under the auspices of the International Compliance Association in association with the University of Manchester, and it will be offered to most of the employees in Group Compliance.

In 2015, Group Compliance focused on building its organisation and compliance framework, and this work will continue throughout 2016. Group Compliance contributes to the Group AML programme. One of the contributions in 2015 was issuing a new AML directive, which will be implemented in 2016. The supervisory authorities conduct ongoing inspections of compliance with anti-money laundering laws that can lead to supervisory actions. Group Compliance was also involved in the Group MiFID II Implementation Project, and this involvement will continue throughout 2016.

In 2015, a college of regulators led by the Danish Financial Supervisory Authority conducted an inspection of Group Compliance. The inspection occasioned no reprimands, penalties or orders.

# *Insurance Risk*

77	9.1	How Danica's results affect the Group's income statement
77	9.2	Key risk factors
79	9.3	Control and management
79	9.3.1	Market risks
80	9.3.2	Life insurance risks
80	9.3.3	Operational risks and business risks
80	9.4	Stress testing
82	9.5	Capital requirement



Danske Bank Group's insurance risk consists of all risks at the companies of the Danica group. The main risks are market risk and life insurance risk. Market risk involves the risk of losses on investments of Danica's own equity ("own investments") and the risk of losses on investments of customer funds from insurance policies with guaranteed returns. The risk of losses on policies concerns mainly *Danica Traditionel* insurance policies. Life insurance risk involves life insurance and pension products, and it is affected by changes in longevity, mortality, disability, critical illness and the like.

In 2015, the financial markets generally saw rising equity prices and volatile interest rates. Low interest rates kept Danica's bonus potential of paid-up policies low and left little room for risky assets in Danica's investment portfolio. To improve its investment returns, Danica changed its investment approach, implementing a new strategy that included managing much of the investment portfolio in-house. Danica's Risk Management staff monitors and conducts stress tests involving interest rates as well as equities, bond spreads and other factors on a daily basis to manage the risk of losses for Danica's own equity.

## 9.1 How Danica's results affect the Group's income statement

Danske Bank owns Danica, and Danske Bank's financial results are affected by Danica's financial position through the "Net income from insurance business" item in the financial highlights. This item consists mainly of the risk allowance and the investment return on Danica's equity capital. If there is a shortfall in the investment return that cannot be absorbed by the collective bonus potential and the bonus potential of paid-up policies, funds will be allocated from equity. The funds allocated will be transferred to a shadow account, and the booking will be deferred until a year when the technical basis permits.

The risk allowance is the annual return that Danica Pension may book from its with-profits business. As of 1 January 2016, it can be booked to income if it does not exceed the sum of all individual and collective buffers. If the risk allowance for the year cannot be booked, it is lost - that is, from 2016, it can no longer be transferred to the shadow account. The remaining shadow account at year-end 2015 may still be booked to income over a five-year period. If it cannot be booked, it will be written off over the next five years.

According to the Contribution Principle, which states that policyholders' funds must be ring-fenced in groups with generally the same technical rate of interest, insurance risk and expenses, Danica has individual investment and hedging strategies for each group. The risk allowance is also determined for each group individually.

## 9.2 Key risk factors

As shown in the table below, the key risk factors for Danica are market risks, life insurance risks, operational risks and business risks. They are discussed in the section below.

### Main risk factors affecting Danica Pension

Market risks	Life insurance risks	Operational risks	Business risks
Interest rate	Longevity	IT	Reputation
Equity	Mortality	Legal	Strategy
Credit spread	Disability	Administrative	
Currency	Concentration	Fraud	
Liquidity		Model	
Counterparty			
Concentration			

Insurance risk at Danica is related mainly to life insurance and pension products and to a lesser extent to insurance against critical illness and health insurance. Most of the risk on life insurance and pension products derives from with-profits policies in Denmark, with unit-linked policies in Denmark, Sweden and Norway accounting for a smaller share.



## Two types of life insurance product in Denmark

### With-profits policies

Danish with-profits policies have a guaranteed benefit based on a *technical rate of interest* (currently 0.5%). The policyholders earn interest at a rate that is set for each year at the discretion of the life insurance company and that can be changed at any time.

The difference between the actual (set) rate of interest and the return on policyholders' savings in a given year is added to the collective bonus potential and can be used as a buffer.

At Danica, the with-profits policies are called *Danica Traditionel*.

### Unit-linked policies

Unit-linked policies are policies in which investments are allocated to the policyholders, who can decide how to invest their pension savings themselves or let the life insurance company invest the savings.

For unit-linked policies, the policyholders receive the actual return on their investments rather than a fixed rate of interest. The policyholders carry the entire investment risk unless a guarantee is attached to their policies.

Danica offers two types of guarantee to holders of unit-link policies: a minimum 0% return guarantee in *Danica Balance* and a watermark-based guaranteed benefit in *Danica Link*.

Risks related to unit-linked business are considered minor because most of the risks are carried by the policyholders or hedged by means of financial derivatives.

Danica's foreign activities account for about 15% of its total provisions, and they offer mainly unit-linked products without guarantees. The risk on these activities is thus very small. The remainder of this section concerns Danica's activities in Denmark. The table below shows the trend in life insurance provisions.

### Danica's policies broken down by business segment

At 31 December 2015 (DKK billions)	With-profits contracts				Unit-linked	Health and accident insurance	Other
	New customers	Low guarantee	Medium guarantee	High guarantee			
Collective bonus potential	1.1	0.2	0.7	1.3	-	-	0.3
Bonus potential of paid-up policies	0.9	0.1	0.1	0.0	-	-	-
Other provisions	39.1	18.7	14.7	71.7	111.3	8.8	1.5
Provisions for insurance and investment contracts	41.1	19.0	15.5	73.0	111.3	8.8	1.7

At 31 December 2014 (DKK billions)	With-profits contracts				Unit-linked	Health and accident insurance	Other
	New customers	Low guarantee	Medium guarantee	High guarantee			
Collective bonus potential	0.5	0.2	0.9	0.5	-	-	0.3
Bonus potential of paid-up policies	0.6	0.1	0.1	0.1	-	-	-
Other provisions	41.9	21.4	15.7	83.7	96.7	8.9	1.5
Provisions for insurance and investment contracts	43.0	21.7	16.7	84.3	96.7	8.9	1.8

## 9.3 Control and management

Danica's board of directors defines the overall principles for Danica's risk management, and management monitors Danica's risks to ensure compliance with these principles. In addition, Danica's board of directors approves Danica's investment strategy and follows up on the results. Management prepares the specific investment plans.

### 9.3.1 Market risks

#### With-profits business

Losses can arise on policies with guarantees because of changes in interest rates, exchange rates, equity prices, the value of alternative investments, property values, credit spreads and market liquidity and as a result of issuer or counterparty defaults that cause changes in the fair value of Danica's assets and liabilities. Liabilities carry interest rate risk owing to the guarantees issued. For example, if market interest rates drop, the market value of liabilities increases.

Danica's liabilities are calculated by discounting expected cash flows at rates defined by the Danish FSA. The FSA's discount curve includes the following constituents: the EUR swap rates, a 250-day moving average of the Danish-German government yield spread, and a Danish mortgage bond spread. It is not possible to hedge the liabilities without a significant element of basis risk.

Since the Danish bond market is not large enough and does not have the necessary duration to allow Danica to hedge the liabilities, Danica must invest in non-Danish fixed income instruments. The bond portfolio therefore consists of a broad range of fixed income assets: Danish and other European government bonds, Danish mortgage bonds, Danish index-linked bonds and a well-diversified portfolio of global credit bonds. This means that Danica is exposed to changes in yield spreads between other European government bonds and EUR swap rates, for example. Interest rate risk that is not covered by the bond portfolio is hedged by means of financial derivatives. Danica conducts internal stress tests to ensure that it can withstand significant losses on its equity and credit exposure and substantial changes in interest rates.

At the end of 2015, about 71% of the bond portfolio consisted of government and mortgage bonds of high quality (AA to AAA ratings from the international rating agencies) or unrated mortgage bonds whose issuers have similarly high ratings. Only 11% of the portfolio was invested in non-investment-grade bonds.

Early transfer or surrender by policyholders may force Danica to sell some of its funds and thus expose Danica to the risk of low sales prices. Danica reduces this liquidity risk by investing a large part of its funds in liquid bonds and shares.

Concentration risk and counterparty credit risk are limited because of internal investment restrictions and the use of collateral agreements for financial derivatives. Most bonds in Danica's portfolio are denominated in DKK and EUR, and almost all non-euro currency risk is hedged.

#### Unit-linked business

Approximately 80% of unit-linked policies have no financial guarantees. For these policies, the policyholders bear all the investment risk.

For the rest of the unit-linked policies, which consist mainly of Danica Balance policies, the policyholders have an investment guarantee. The guarantees do not apply until the time of retirement and are paid for by an annual fee. Danica manages the risk on these Danica Balance guarantees by adjusting the allocation of equities and alternative investments for each individual policy. The adjustments ensure that the investments can withstand a substantial decline in equities and alternative investments without moving the guarantee "into the money". Because of these hedging and risk management strategies, Danica considers the investment risk on guarantees in unit-linked products to be minor.

#### Danica's own investments

Not only are policyholders' savings exposed to market risk; Danica's own investments are also exposed to market risk, as are investments related to health and accident insurance.

Danica's board of directors has set a separate investment strategy for its own investments, which are made primarily in short-term Danish bonds. The investments related to health and accident insurance follow essentially the same investment strategy as the one used for customer funds allocated to with-profits policies, since the benefits are similar.

### 9.3.2 Life insurance risks

Life insurance risks are linked to longevity, mortality, disability, critical illness and similar factors. For example, an increase in longevity lengthens the period during which benefits are payable under certain pension plans. Similarly, changes in mortality, illness and recoveries affect life insurance and disability benefits. Longevity, or increased life expectancy, is the most significant life insurance risk factor for Danica.

Danica subjects its life insurance risks to ongoing actuarial assessment in order to calculate insurance liabilities and make relevant business adjustments. For life insurance policies, Danica calculates the insurance liabilities according to expected mortality rates based on empirical data from its insurance portfolio. The rates reflect a possible future increase in life expectancy and a safety margin to cover uncertainty about expected mortality.

For health and personal accident policies, Danica calculates insurance liabilities on the basis of expectations of future recoveries and re-openings of old claims. The expectations are based on empirical data from Danica's insurance portfolio. To mitigate life insurance risk, Danica uses reinsurance for large individual policy exposures and the risk of losses due to disasters.

### 9.3.3 Operational risks, business risks and model risk

Danica manages operational risk through internal controls and standard operating procedures that are updated regularly to reflect the current business environment. Danica systematically reviews its business areas to minimise the risk of financial losses due to sanctions, claims and reputational damage resulting from non-compliance with legislation, rules and standards. Danica closely monitors the competition in all relevant markets to ensure that its prices are competitive and its customers are satisfied. Danica also monitors model risk by comparing model results with actual market results on an ongoing basis.

## 9.4 Stress testing

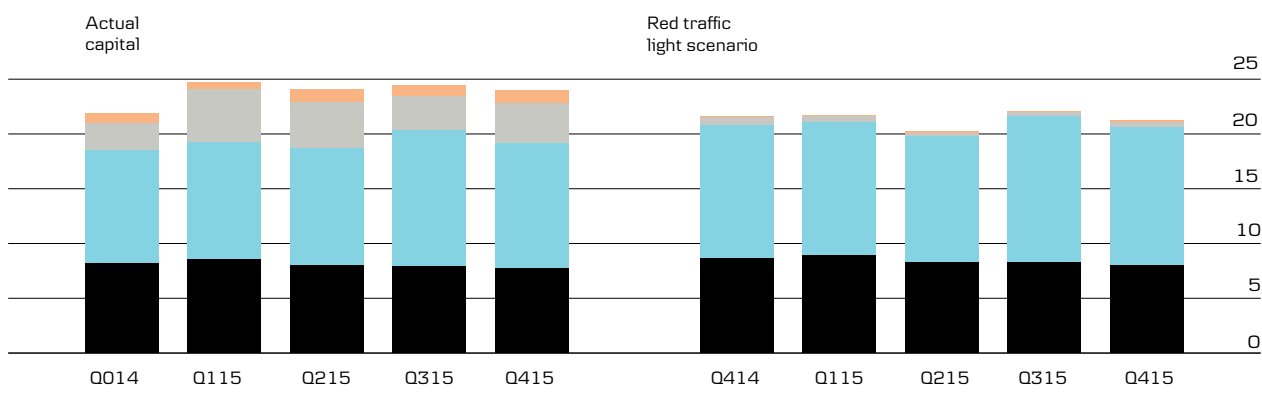
To ensure that insurance companies in Denmark have sufficient capital to withstand significant changes in the market, the Danish FSA requires that they report the results of a set of stress tests commonly known as the red traffic light scenario.

The red traffic light scenario tests the effect of changes in interest rates, equity prices, property prices, exchange rates and counterparty credit risk. A company is said to have red light status if its total capital is less than 1% of its life insurance provisions when it is subjected to all the stresses in the red traffic light scenario at the same time. If a company has red light status, the Danish FSA will become involved in its financial management.

### Red traffic light scenario for the Danica Group

(DKK billions)

■ Solvency requirement ■ Capital buffer ■ Bonus potential of paid-up policies ■ Collective bonus potential



The tables below show the effect on Danica's total capital, as well as on the collective bonus potential and the bonus potential of paid-up policies (the capital buffer), caused by each of the stress tests in the red traffic light scenario. (Risks posed by changes in mortality and disability are not part of the scenario but are shown as supplementary information.)

### Sensitivity analysis for Danica

At 30 June 2015 (DKK billions)	Change in collective bonus potential	Change in bonus potential of paid-up policies	Change in capital base	Total
Interest rate increase of 0.7 of a percentage point	-0.9	1.5	-0.1	0.5
Interest rate decline of 0.7 of a percentage point	-0.5	-0.7	0.1	-1.1
Decline in equity prices of 12%	-1.7	0.0	-0.1	-1.8
Decline in property prices of 8%	-1.2	0.0	-0.3	-1.5
Foreign exchange risk (VaR 99.5%)	-0.2	0.0	0.0	-0.2
Loss on counterparties of 8% of RWA	-1.3	0.0	-0.2	-1.5
Decrease in mortality of 10%	-1.6	0.0	-0.1	-1.7
Increase in mortality of 10%	1.6	0.0	0.0	1.6
Increase in disability of 10%	-0.1	0.0	0.0	-0.1

At 31 December 2014 (DKK billions)	Change in collective bonus potential	Change in bonus potential of paid-up policies	Change in capital base	Total
Interest rate increase of 0.7 of a percentage point	0.1	1.6	-0.1	1.6
Interest rate decline of 0.7 of a percentage point	1.9	-0.1	0.0	1.8
Decline in equity prices of 12%	-1.3	-0.5	-0.1	-1.9
Decline in property prices of 8%	-1.3	0.0	-0.3	-1.6
Foreign exchange risk (VaR 99.5%)	-0.3	0.0	0.0	-0.3
Loss on counterparties of 8% of RWA	-1.3	-0.1	-0.3	-1.7
Decrease in mortality of 10%	-1.0	0.0	-0.7	-1.7
Increase in mortality of 10%	1.6	0.0	0.0	1.6
Increase in disability of 10%	-0.1	0.0	0.0	-0.1

For example, a 12% decline in equity prices results in a total loss of DKK 1.8 billion. The buffer absorbs DKK 1.7 billion, and the remaining loss of DKK 0.1 billion is covered by equity.

## 9.5 Capital requirement

Danica is subject to the capital requirement specified in the solvency rules for insurance companies. At 31 December 2015, Danica's regulatory capital requirement was DKK 7.9 billion, against DKK 8.4 billion at the end of 2014.

In addition to the regulatory capital requirement, which is a risk measure based on volume, Danica must meet its solvency need, which is a risk-based capital requirement that supplements the regulatory capital requirement. All Danish insurance companies are required to maintain total capital equal to or greater than the larger of the regulatory capital requirement and the solvency need. At 31 December 2015, the solvency need was DKK 10.1 billion, against DKK 10.4 billion at the end of 2014.

Danica calculates its solvency need in a standard model based on Solvency II for the stress testing of all relevant risk factors, including equity prices, property prices, interest rates and longevity. The solvency need is calculated as the total capital requirement after stress testing, adjusted for the use of the collective bonus potential and the bonus potential of both paid-up and non-paid-up policies. This model was introduced on 1 January 2014 by the Danish FSA as a pre-implementation of Solvency II.

### Solvency II

On 1 January 2016, the new Solvency II regulations were implemented in Europe. The discount curves for the market valuation of liabilities will be published by the European Insurance and Occupational Pensions Authority (EIOPA) on a monthly basis. The Solvency II interest rate curve is similar to the Danish curve, but some of the technical changes in the construction of the curve introduce further volatility. Danica will mitigate this volatility through its strong interest rate management practices. Danica's SII standard model is ready for use and can calculate the solvency need on a daily basis. Danica's Risk Management department calculates the effects of the new discount curve continually and is prepared for changes in volatility.

Altogether, Danica is well prepared for the new rules.

## *Other risks*

84	10.1	Pension risk
84	10.1.1	Pension plans
85	10.1.2	Control and management
85	10.1.3	Liability recognition
87	10.2	Business risk

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## 10.1 Pension risk

Pension risk arises from Danske Bank Group's liability for defined benefit pension plans that were established for current and former employees.

For accounting purposes, defined benefit pension plans are valued in accordance with IFRSs (IAS 19). Before making the year-end valuation of the pension obligations, the Group conducts a full review of the assumptions and parameters underlying the valuation of the pension plans.

### 10.1.1 Pension plans

The Group's defined benefit pension obligations consist of pension plans in Northern Ireland, the Republic of Ireland and Sweden as well as a number of small pension plans in Denmark. In addition, the Group has unfunded defined benefit pension plans that are recognised directly on the balance sheet. All the plans are closed to new members. The table below gives an overview of the various plans.

Overview of the Group's pension plans					
At 31 December 2015	Northern Ireland	Ireland	Denmark	Sweden	
Pension plan for new employees	Defined contribution	Cash balance	Defined contribution	Defined contribution	
Status of defined benefit pension plan	Closed to new members in 2004	Closed to new members in 2008	Closed to new members	Closed to new members in 2013	
Gross liability (DKK millions)	10,024	3,860	1,602	1,423	
Assets at fair value (DKK millions)	11,079	4,569	1,800	1,593	
Net assets (net liabilities) (DKK millions)	1,055	708	199	170	
Number of members:					
	Active	920	62	5	1,033
	Deferred	1,858	1,274	-	1,322
	Pensioners	2,067	527	189	581
	<b>Total</b>	<b>4,845</b>	<b>1,863</b>	<b>194</b>	<b>2,936</b>

Note: In Norway, Finland and the Baltics, the Group operates defined contribution plans under which it pays fixed contributions into a separate, legally independent entity and afterwards has no further obligations. After winding up the Norwegian defined benefit plan in 2005, the Group still has an early retirement pension obligation. The obligation amounted to DKK 29 million at 31 December 2015.

More than half of the Group's pension obligations are attributable to the Danske Bank Northern Ireland pension plan. The plan was closed to new members in 2004, and all new employees have since been enrolled in a defined contribution plan. After a comprehensive review of pension benefits carried out by the Group in 2007, the defined benefit pension plan was subject to a number of benefit changes, including a change in the future accrual basis from final salary to career average. The plan was changed again in 2012, with adjustments to the revaluation of pensions in payment.

Future benefit accruals under the Danske Bank Ireland plan were seized in 2010, when all employees were transferred to a so-called “cash balance” plan. The defined benefit plan had been closed to new entrants since 2008.

The cash balance plan can be thought of as a defined contribution plan with guaranteed investment returns. Employer and employee contributions are invested on behalf of each member, and the investment return is guaranteed at the outset.

The Group's Swedish defined benefit plan was closed to new members in 2013 and replaced by a collectively negotiated defined contribution pension plan established by the Swedish banking association and the employees' union. Employees had previously been eligible to join a “hybrid” defined benefit plan in which benefits accrue on a final-salary basis up to a certain level of earnings and on a defined contribution basis above this level.

The Danish pension obligations reflect a number of plans that have been closed to new members for many years. Because of the maturity of the plans, pensioners account for the vast majority of plan members.

### 10.1.2 Control and management

The Group's defined benefit plans are funded mainly by contributions from the Group and individual contributions from employees. Each pension plan is managed by a separate board of directors that tends to the members' interests in accordance with the prevailing articles of association and provisions.

A key element of the Group's risk management strategy is maintaining a relatively close match between the assets and liabilities of each plan. According to this strategy, the Group uses derivative instruments to mitigate interest rate risk.

Because of the complexity of the pension obligations, the Group does not use its normal limit structure when monitoring pension risk. Instead, it manages market risk on pension plans according to special follow-up and monitoring principles called “business objectives”.

The Group has established procedures to be followed in case of deviations from these objectives. The All Risk Committee has defined risk targets for the Group's pension funds. To follow up on the objectives, the Group prepares quarterly risk reports that analyse the individual plans' net obligations calculated on the basis of swap rates, sensitivity analyses and the VaR measure. It sets specific limits for the acceptable levels of risk exposure.

At the end of 2015, VaR was DKK 2,384 million (end-2014: DKK 2,879 million).

The Group's aggregate net pension obligation at the end of 2015 was DKK -2,107 million (that is, it had net pension assets of DKK 2,107 million), against DKK -1,412 million a year before.

Defined benefit pension plans		
At 31 December (DKK millions)	2015	2014
Present value of unfunded pension obligations	164	188
Present value of fully or partly funded pension obligations	16,770	17,933
Fair value of plan assets	19,041	19,533
<b>Net pension obligation</b>	<b>-2,107</b>	<b>-1,412</b>

The Group's total net pension assets amounted to DKK 2,107 million. This figure is calculated as the sum of individual plans that have net pension assets (DKK 2,337 million) less the sum of individual plans with net pension liabilities (DKK 230 million).

### 10.1.3 Liability recognition

The Group's defined benefit pension plan agreements contain provisions stipulating the pension benefits that the individual employee will be entitled to receive on retirement. The Group's obligation is thus recognised as a balance sheet liability subject to valuation. As the pension benefit will typically be payable for the rest of the employee's life, this increases the Group's uncertainty about the amount of future obligations since the liability and pension expenses are measured actuarially.



To value the liabilities, the actuary receives individual details about the plan's current, retired and deferred members. Data relating to changes in membership since the preceding valuation are also supplied so that a reconciliation of the membership numbers can be carried out and actual experience can be tested against the assumptions of the preceding valuation.

Various assumptions need to be made. Some are financial (e.g., the discount rate used to calculate the net present value of the pension cash flows and rates of salary and pension increases); and some are demographic (e.g., rates of mortality, ill health, early retirement and resignation). The actuary also requires details about the assets held by the plan. These details consist of market values of assets and market-based yields for valuing liabilities, among other things.

The Group uses a number of calculation methods to determine its pension obligations. Each serves a specific purpose, for example compliance with the local authorities' minimum funding requirements and the compilation of the consolidated accounts. These methods include the following valuations:

- The actuarial valuation, which assesses the pension fund's financial status according to local solvency rules and determines the amount of Group cash contributions to be paid in order to satisfy regulatory funding principles. Typically, this involves using a prospective benefits funding method based on the total prospective servicing of the existing members, allowing for salary increases until retirement, resignation or death, as appropriate. The future service contribution rate is adjusted to allow for any past service surplus or deficit.
- The financial reporting valuation, which determines the Group's pension obligations according to IFRSs, including the Group's pension costs and balance sheet liability. IFRSs use an accrued benefit funding method that determines the cost of providing the benefits earned in the year after the valuation date. Pension obligations are recognised at fair value on the balance sheet.
- The risk management valuation, which assesses the market risk of the Group's pension obligations and provides the basis for the Group's general risk monitoring and quarterly follow-up on business objectives.

The Group calculates market risk on defined benefit plans on a quarterly basis. The risk is expressed partly as VaR at a confidence level of 99.97% and a one-year horizon. In this scenario, equity price volatility and the correlation between interest rates and equity prices are set at values reflecting normal market data. The duration of the pension obligations is reduced by half to take into account inflation risk. This is a widely accepted proxy that is also used by the Danish FSA, among others. The calculations are subject to ongoing review in order to ensure that the values of the volatility and correlation parameters are set appropriately.

Danske Bank uses the VaR model when advising life insurance and pension customers. The model discounts expected future pension payments at a "risk-free" swap rate rather than at the high-quality corporate bond yield currently used under IFRSs. The model also incorporates actuarial assumptions about longevity, salary growth and inflation in the calculation. The assets in the plan portfolio as well as their duration and the convexity are included in the model as well.

In addition, for each pension plan, the calculations include the sensitivity of the net obligation to changes in interest rates, equity prices and life expectancy (see the table below).

#### Sensitivity analysis of net obligation

(DKK millions)	Change	Effect, 2015	Effect, 2014
Equity prices	-20%	-866	-1.137
Interest rates	+1/-1%	+722/-479	+681/-380
Life expectancy	+1 year	-396	-563

Pension obligations are measured in the Group's solvency calculation at fair value. Pension risk is covered by the ICAAP, and it is measured by VaR at a confidence level of 99.9% and a one-year time horizon.

## 10.2 Business risk

Business risk is the risk that income will not be able to cover losses caused by events affecting the Group's profit before loan impairment charges, market losses and operational losses. Business risk exists throughout the Group. It reflects possible changes in general business conditions such as market environment, customer behaviour, the Group's reputation and technological progress to which the Group may not be able to adjust quickly enough.

The Group believes that capital for business risk should serve as a buffer only when income cannot cover losses arising from other risk types. This is known as the "absolute loss" approach. Unexpected losses arising from other risk types are already covered by capital allocated for credit, market and operational risks.

The method used to calculate economic capital for the Group's business risk takes place in two stages. First, the quarterly earnings before credit, market, and operational losses over the past five years are used to estimate the likelihood of a loss based on current earnings, the historical volatility of the earnings, and expected losses from other risk types. The second step entails an additional strategic risk estimate of the effects of possible future events. For this purpose, the Group has identified strategic scenarios that could cause the largest declines in earnings.

As the Group expands into new areas of business and technology, it considers the cost of failure in these areas, in terms of both the cost of the failed business and the possible reputational effect on the rest of the business.

When the Group's earnings were stressed according to the absolute loss approach, the result was still positive, and no capital was required for business risk. The assessment that there was no need for business risk capital was endorsed by the Danish FSA in 2015.

# *Definitions*

# *11.*

**Additional tier 1(AT1) capital**

Additional tier 1 capital consists of loans that form part of tier 1 capital. This means that it can be used to cover a loss of shareholders' equity.

**Advanced internal ratings-based approach [A-IRB]**

The advanced internal ratings-based approach entails using parameters that are based on internal and statistical data for PD, LGD and CF.

**Allowance account**

The allowance account comprises all impairment charges against loans at amortised cost, loans at fair value, amounts due from credit institutions and central banks, loan commitments, and guarantees. The total allowance account includes total accumulated individual impairment charges plus total accumulated collective impairment charges.

**Asset encumbrance**

Asset encumbrance is defined as the percentage of a counterparty's assets pledged as collateral.

**Bond spread risk**

A bond spread reflects the additional net return required by an investor on securities with a given credit quality and liquidity compared with the return on liquid securities without credit risk or a reference rate (such as a swap rate). Bond spread risk thus measures the change in a bond's market value due to changes in the market's assessment of credit quality and liquidity.

**Business risk**

Business risk is the risk that income will not be able to cover losses caused by events affecting the Group's profit before loan impairment charges, market losses and operational losses.

**Business unit**

The Group's banking operations are organised in three business units – Personal Banking, Business Banking and Corporates & Institutions – each of them spanning all of the Group's geographical markets. Other business units in the Group include Danica Pension and Danske Capital.

**Collateral**

Collateral is assets provided as security by a debtor to safeguard the interests of the creditor. The Group uses a number of measures to mitigate credit risk, including collateral, guarantees and covenants, and the main method is obtaining collateral. Collateral is monitored and re-evaluated by advisers, internal or external assessors, and automatic valuation models. Danske Bank's Collateral System supports the process of reassessing the market value to ensure that the Group complies with regulatory requirements. The market value of collateral is subject to a haircut. The haircut reflects the risk that the Group will not be able to obtain the estimated market value upon the sale of an asset in a distressed situation. The amount of the haircut depends on the collateral type. For regulatory purposes, the Group also uses a downturn haircut.

**Collective impairment charges**

Collective impairment charges are impairment charges calculated for loans with similar credit characteristics, for example when the expected cash flow from a customer group deteriorates but no adjustment has been made to the credit margin. The charges are based on changes in customers' rating classifications over time. Collective impairment charges are calculated as the difference between the carrying amount of the loans in the portfolio and the present value of expected future cash flows. Management makes judgements to adjust the collective impairment charges if the Group becomes aware of market conditions on the balance sheet date that are not fully reflected in the Group's models.

**Commodity risk**

Commodity risk is the risk of losses caused by changes in commodity prices.

**Company-specific equity risk**

Company-specific equity risk is an unsystematic risk that affects only a small group of assets of a particular company. It thus arises from equity exposure to a specific company as opposed to equity market risk, which arises from general changes in the equity market.

**Conversion factor**

A conversion factor expresses the percentage of an unutilised facility or credit line that will be converted into utilised exposure at the time of default. It thus represents an estimate of the exposure at default (EAD).

**Common equity tier 1 (CET1) capital**

CET1 capital consists of shareholders' equity after certain statutory supplements and deductions.

**Common equity tier 1 capital ratio**

The CET1 capital ratio is defined as CET1 capital as a percentage of the total risk exposure amount (REA).

**Concentration risk**

Concentration risk is the risk of losses arising as a result of a large exposure to a single asset type, a client group or region, among other things. The Group has implemented a set of frameworks to manage concentration risk. The frameworks cover single-name concentrations, industry concentrations and geographical concentrations.

**Counterparty credit risk**

Counterparty credit risk is the risk of losses resulting from a customer's default on over-the-counter (OTC) derivatives contracts and securities-financing instruments.

**CRD**

The European Union's Capital Requirements Directives (2006/48/EC and 2006/49/EC), including amendments (CRD II and CRD III). In Denmark the rules are incorporated in the Danish Financial Business Act and associated executive orders, including the Executive Order on Capital Adequacy, and the Executive Order on the Calculation of the Capital Base. The rules in CRD II and CRD III have been revised (CRD IV 2013/36/EU) as a consequence of the implementation of Basel III. CRD IV was implemented in Denmark in March 2014.

**CRR**

The European Union's Capital Requirements Regulation (No. 575/2013) is based on the Basel III guidelines. The rules took effect on 1 January 2014.

**Credit risk**

Credit risk is the risk of losses arising because debtors or counterparties fail to meet all or part of their payment obligations. The Group uses collateral, guarantees and covenants to mitigate credit risk.

**Credit exposure**

Credit exposure consists of balance sheet items and off-balance-sheet items that carry credit risk. Most of the exposure derives from direct lending activities, including repo transactions; counterparty risk on OTC derivatives; and credit risk from securities positions.

**Credit exposure from lending activities**

Credit exposure from lending activities derives from loans and advances, repo loans, amounts due from credit institutions and central banks, guarantees and irrevocable loan commitments.

**Cure probability**

Cure probability is the probability that a customer in default will return to performing status and the Group therefore will not need to recognise any losses.

**Default**

Customers are designated as being in default when they have a material credit facility that is 90 days past due or when the Group assesses that they are unlikely to comply with their payment obligations to the Group.

**Defined benefit pension plans**

In defined benefit plans, the pension agreement contains a provision stipulating the pension benefit that the employee will be entitled to receive on retirement. The benefit is typically stated as a percentage of the employee's salary immediately before retirement, but it can also be a percentage of the average salary during the entire period of employment. The pension benefit will typically be payable for the rest of the employee's life, and this increases the employer's uncertainty about the amount of the future obligations.

**Defined contribution pension plans**

A defined contribution plan is a post-employment benefit plan under which the employer pays fixed contributions into a separate entity and has no further obligations. The pension entitlement accumulated by the employee depends on the size of the contributions agreed upon, the performance of invested pension funds and associated expenses.

**Exposure at default (EAD)**

Exposure at default is the expected utilisation of a given credit facility at the time of default of a borrower, and it is used in the calculation of regulatory capital.

**Economic capital**

Economic capital is the amount of capital, calculated with the Group's internal models, required to cover unexpected losses over the next year. The calculation of economic capital takes into account all relevant types of risk, including concentration and migration risks, as well as diversification within the individual risk types. The aggregation across risk types does not take into account the potential benefit from diversification among various risk types.

**Equity market risk**

Equity market risk is the risk of losses caused by changes in equity prices due to general market changes affecting a large number of assets or the entire market (i.e., it is a systematic risk).

**Forbearance measures**

Forbearance measures are concessions made for a debtor facing or about to face financial difficulties. The Group has implemented the European Banking Authority's (EBA's) definition of loans subject to forbearance measures, which states that a minimum two-year probation period must pass from the date forbore exposures are considered to be performing again. The Group adopts forbearance plans to assist customers in financial difficulty. Concessions granted to customers include interest-reduction schedules, interest-only schedules, temporary payment holidays, term extensions, cancellation of outstanding fees, waiver of covenant enforcement and settlements. Forbearance plans must comply with the Group's Credit Policy. Forbearance leads to objective evidence of impairment (OEI), and impairments relating to forbore exposures are handled according to the principles described in the Group's basis of preparation for the measurement of loans.

**Foreign exchange risk**

Foreign exchange risk is the risk of losses on the Group's foreign currency positions caused by changes in exchange rates.

**Foundation internal-ratings based approach (F-IRB)**

The foundation internal-ratings based approach entails using internal and statistical data only for PD, while LGD and CF are set forth in the CRD.

**Gross credit exposure**

Gross credit exposure is credit exposure before the deduction of any individual impairment charges.

**ICAAP**

The Group's Internal Capital Adequacy Assessment Process (ICAAP) includes an evaluation of the capital needed under Pillar II. In the ICAAP, the Group identifies and measures its risks and ensures that it has sufficient capital in relation to its risk profile. The process also ensures that adequate risk management systems are used and further developed. As part of the ICAAP, the Group calculates the solvency need and performs stress tests to ensure that it has sufficient capital to support the chosen business strategy. Once a year, the full ICAAP report is submitted to the Board of Directors for approval, and the report is updated quarterly in a condensed format for approval.

**IFRSs**

International Financial Reporting Standards.

**Impairment**

Impairment is the reduction in the value of an asset from the value stated on the company's balance sheet. If objective evidence of impairment (OEI) of a loan exists, and the effect of the impairment event or events on the expected cash flow is reliably measurable, the Group determines an impairment charge individually. Loans without OEI are included in an assessment of collective impairment at the portfolio level. An impairment charge equals the difference between the carrying amount of the individual loan and the present value of the most likely future cash flows from the loan. For collectively assessed loans, collective impairment charges are calculated as the difference between the carrying amount of the loans of the portfolio and the present value of expected future cash flows.

**Impairment charges stated in basis points (bp)**

Year-to-date loan impairment charges annualised relative to net loans and guarantees at the beginning of the period.

**Incremental risk**

Incremental risk is the risk of losses caused by the default or credit rating migration of bond issuers and CDS entities.

**Individual impairment charges**

Individual impairment charges are charges booked for individual customers. If a customer facility is past due 90 days or more, the customer is considered to be in default and an impairment charge is recognised for the customer's total exposure. Significant loans and amounts due are tested individually for impairment at the end of each reporting period. Loans without objective evidence of impairment (OEI) are included in a collective assessment of the need for impairment charges. The collective assessment also includes customers with OEI but without a need for impairment.

**Inflation rate risk**

Inflation rate risk is the risk of losses caused by changes in the traded future inflation rates.

**Insurance risk**

Insurance risk is defined as all types of risk at Danica Pension, including market risk, life insurance risk and operational risk.

**Interest rate risk**

Interest rate risk is the risk of losses caused by changing yields in the financial markets.

**Leverage ratio**

The leverage ratio is defined as tier 1 capital as a percentage of total exposure calculated according to the CRR. The leverage ratio does not take into account that various items on credit institutions' balance sheets may have differing degrees of risk.

**Liquidity risk**

Liquidity risk is the risk of losses arising because funding costs become excessive, lack of funding prevents the Group from maintaining its business model, or lack of funding prevents the Group from fulfilling its payment obligations.

**Loss given default (LGD)**

Loss given default is the expected loss on an exposure calculated as the percentage of the expected facility utilisation that will be lost if a customer defaults. Downturn LGD is calculated by making a downturn adjustment that reflects the most severe economic conditions in the estimation period.

**Market risk**

Market risk is the risk of losses because the fair value of financial assets, liabilities and off-balance-sheet items varies with market conditions.

**Model risk**

Model risk is defined as the risk of losses resulting from decisions based mainly on output from internal models because of errors in the development, implementation or use of the models.

**Non-performing loans (NPL)**

The Group defines non-performing loans as facilities with objective evidence of impairment for which individual impairment charges have been booked. For non-retail exposures with any non-performing loans, the entire amount of the customer's exposure is considered to be non-performing. For retail exposures, only impaired facilities are included in non-performing loans. The Group's definition of non-performing loans differs from the EBA's definition by excluding fully covered exposures in default and performing forbore exposures under probation but more than 30 days past due.

**NPL coverage ratio**

The NPL coverage ratio is defined as accumulated individual impairment charges relative to gross NPL net of collateral (after haircuts).

**Net credit exposure**

Net credit exposure is gross credit exposure less individual impairment charges.

**Objective evidence of impairment (OEI) of loans**

Objective evidence of impairment exists if any of the following events has occurred:

1. The borrower is experiencing significant financial difficulty.
2. The borrower's actions, such as default on or delinquency in interest or principal payments, lead to a breach of the contract.
3. The Group, for reasons relating to the borrower's financial difficulty, grants the borrower a concession that the Group would not otherwise have granted.
4. It is likely that the borrower will enter into bankruptcy or another form of financial restructuring.

**Operational risk**

Operational risk is the risk of losses resulting from inadequate internal procedures, human or system errors, or external events. Operational risk includes legal risk and IT risk.

**Option risk**

Option risk is defined as the risk of losses caused by changes in the market's assessment of the implied volatility of underlying market parameters such as interest rates, equity prices and foreign exchange rates.

**Past due**

A payment is considered past due if it has not been made by its due date.

**Pension risk**

Pension risk is the risk that the Group will be liable for additional contributions to defined benefit pension plans for current and former employees. Pension risk includes risks of the following:

- Lower-than-expected returns on invested funds
- Changes in actuarial assumptions, including the assumptions about the discount rate and inflation, that cause an increase in the pension obligations
- Longer-than-expected longevity among members

**Probability of default (PD)**

Point-in-time (PIT) probability of default represents the PD within the next 12 months. This type of PD is cyclical and tends to fluctuate with the underlying business cycle. Through-the-cycle (TTC) PD measures the average annual default rate over the business cycle and tends not to fluctuate much with the underlying business cycle.

**Risk exposure amount (REA)**

The total risk exposure amount (formerly designated as "risk-weighted assets") is calculated for credit risk, market risk and operational risk in accordance with the Danish FSA's rules on capital adequacy.

**Risk policies**

The Board of Directors has adopted overall risk policies regulating the scope of risk-taking by the Group. On the basis of the overall risk policies, detailed risk policies and procedures are prepared for the various business areas.

**SIFI**

Systemically important financial institution.

**Solvency II**

The new risk-based solvency regime for European insurance companies.

**Solvency need**

The solvency need is the amount of capital that is adequate in terms of size and composition to cover the risks to which an institution is exposed.

**Solvency need ratio**

The solvency need as a percentage of the total risk exposure amount (REA).

**Standardised approach**

The term "standardised approach" refers to banks' use of external ratings to quantify the required capital for credit risk. Depending on the external ratings, the risk is subject to a risk weight of either 0%, 20%, 50%, 100% or 150%. For exposures for which an external rating is not available, standard risk weights of 100% for corporates and of 75% for retail customers apply. If covered by eligible collateral, risk weights are reduced to 50% or 35%. Eligible collateral



is restricted to real estate and financial collateral. Unlike the IRB approaches, the standardised approach does not allow the use of internal models or parameters.

**Tier 1 capital (T1)**

Tier 1 capital consists of shareholders' equity after certain statutory supplements and deductions and additional tier 1 capital less statutory deductions.

**Tier 1 capital ratio**

Tier 1 capital as a percentage of the total risk exposure amount (REA).

**Tier 2 capital (T2)**

Tier 2 capital consists of subordinated debt subject to certain restrictions.

**Tier 2 capital ratio**

Tier 2 capital as a percentage of the total risk exposure amount (REA).

**Total capital**

Total capital consists of tier 1 and tier 2 capital, less certain deductions. Tier 2 capital may not account for more than half of the total capital [see section 3 for full descriptions of both types].

**Value-at-Risk (VaR)**

Value-at-Risk is a risk measure used to calculate risk exposure over a defined period at a given confidence level.

**Write-off**

A write-off is the removal of a balance sheet item from the accounts. Loans that are considered uncollectible are written off. Write-offs are debited to the allowance account. Loans are written off after the usual collection procedure has been completed and the loss on the individual loan can be calculated. If the full loss is not expected to be realised until after a number of years, for example in the event of administration of complex estates, the Group recognises a partial write-off that reflects the Group's claim less collateral, estimated dividend and other cash flows.

**Wrong-way risk (WWR)**

Wrong-way risk is defined as the additional risk deriving from an adverse correlation between counterparty credit exposure and the credit quality of the counterparty.

# *Appendices*

95 12.1 Management declaration

# *12.*

## 12.1 Management Declaration

According to section 435(1) of the Capital Requirements Regulation (CRR), Danske Bank must publish a declaration and a risk statement approved by its management body (the Board of Directors):

- **Board Declaration:** a declaration approved by the management body on the adequacy of the risk management arrangements of the institution providing assurance that the risk management systems put in place are adequate with regard to the institution's profile and strategy.
- **Risk Statement:** a concise risk statement approved by the management body succinctly describing the institution's overall risk profile associated with the business strategy. This statement shall include key ratios and figures providing external stakeholders with a comprehensive view of the institution's management of risk, including how the risk profile of the institution interacts with the risk tolerance set by the management body.

### Board Declaration

In accordance with the responsibilities of the Board of Directors as stipulated in the Danish Executive Order on Management and Control of Banks, Danske Bank's Board of Directors assesses the Group's individual and overall risks on an ongoing basis and at least once a year in the form of a comprehensive report from the Executive Board. It is the Board of Directors' assessment that the Group has adequate risk management arrangements in place with regard to the Group's risk profile and strategy.

### Risk Statement

Danske Bank is a Nordic universal bank offering a full range of banking services in the international financial markets to our home market customers. As such, we have a diversified business model spread across several industries, customer types and countries.

At the end of 2015, the Group's total solvency need amounted to 10.7% of the total risk exposure amount (REA).

Credit risk is managed in accordance with the Credit Risk Appetite, which encompasses credit quality (as measured by expected loss) and credit risk concentrations (limits on single names, industries and geographical regions).

The Group's market risk consists mainly of interest rate risk and bond spread risk. Market risk is managed in accordance with risk limits set in the Market Risk Instructions and the levels indicated in the part of the Market Risk Appetite relating to trading.

The Group manages its liquidity on a daily basis by means of risk indicators and risk triggers defined in the Liquidity Instructions and the Liquidity Policy and Appetite, which define the overall principles and standards of liquidity management. The Group maintained its liquidity reserve throughout 2015 and adhered to its funding plan. At the end of 2015, the liquidity coverage ratio was 125.1%, well above the regulatory requirement. The Group achieved its rating targets of A/A2 (S&P/Fitch/Moody's) at mid-2015.

Operational risk management involves a structured and uniform approach across the Group entailing risk identification, risk assessment, monitoring of risk indicators, risk mitigation and event follow-up. Events related to execution, delivery and process management errors and events related to external fraud accounted for the majority of losses.

In accordance with its business strategy, the Group has set capital targets: a total capital ratio of at least 17% and a common equity tier 1 (CET1) capital ratio of at least 13%. With substantial capital in excess of both the regulatory requirements and the internal targets, the Group considers itself well capitalised. At the end of 2015, the Group had the following capital ratios: a CET1 ratio of 16.1% and a total capital ratio of 21.0%.

### BOARD OF DIRECTORS

Ole Andersen <i>Chairman</i>	Trond Ø. Westlie <i>Vice Chairman</i>	Urban Bäckström
Lars Förberg	Jørn P. Jensen	Rolv Erik Ryssdal
Carol Sergeant	Jim Hagemann Snabe	Kirsten Ebbe Brich
Carsten Eilertsen	Charlotte Hoffmann	Steen Lund Olsen



Other Danske Bank Group publications, available at [danskebank.com/ir](http://danskebank.com/ir):



Annual Report 2015



Governance Report 2015



Corporate Responsibility 2015

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