Translation from Danish by Danske Bank of a statement dated 29 September 2016 from the Danish Financial Supervisory Authority (*Finanstilsynet*). In case of discrepancies, the Danish version prevails.

M E M O R A N D U M

The Danish Financial Supervisory Authority
29 September 2016

Statement on themed inspection of Danske Bank A/S (new lending for owner-occupied and cooperative dwellings in growth regions)

Introduction
During the first six months of 2016, the Danish Financial Supervisory Authority (the FSA) conducted a themed inspection of Danske Bank A/S.

The purpose of the inspection was to look into the bank's risk appetite in relation to new lending to fund purchases of owner-occupied and cooperative dwellings in growth regions and to assess the bank's basis for decision-making and compliance with its credit policy and business procedures.

Growth regions are limited to Copenhagen, its neighbouring municipalities and the City of Aarhus. The themed inspection took place as part of a cross-sector review of the five largest banks (SIFI banks) in Denmark.

Summary and risk assessment
The FSA had selected 350 approvals of newly established or increased home loans secured on owner-occupied and cooperative dwellings, and the bank was asked to go though the credit approvals itself according to detailed instructions. On the basis of the bank's registrations, the FSA randomly selected 50 credit approvals for review.

In January 2016, the FSA issued guidelines on prudent credit assessment in relation to the approval of home loans in growth regions. All the loans inspected had been approved in the period from 1 January to 31 October 2015, that is, before the guidelines were issued.

The very low level of interest rates and the increases in house prices in growth regions over the past few years imply a risk of substantial price drops for such dwellings. When approving home loans in growth regions, banks must therefore pay close attention to the robustness of customer finances. The inspection of the credit approvals gave the FSA the impression that the bank had not paid enough attention to this in 2015.

According to the FSA, the bank's risk appetite in 2015 was equal to the average of the banks inspected.

The bank's credit policy was of an overall nature and generally did not contain explicit requirements for customers' key figures and ratios. The bank's guidelines for customer risk profiles were described primarily in the form of a few main rules in business procedures. These main rules were not adequate for the risk profiles.

Although the bank had relatively few main rules, the credit approvals deviated from one or more of these rules in more than half of the cases. For example, in many cases, Danske Bank – like the other banks inspected – accepted a debt-to-income ratio that was higher than recommended by the business procedures. The debt-to-income ratio expresses a customer's total debt divided by annual gross income. The large number of deviations implies a risk that, because of the competitive situation in the growth regions, the bank approved credit facilities that deviated from the desired level set by the board of directors. It should be noted, however, that the number of credit approvals deviating from the main rules would have been lower if all the bank's new credit approvals had been included in the inspection. The reason for this is that the FSA had removed the most robust customers before the selection.

The FSA found that the credit policy issued by the board of directors did not sufficiently define the desired risk profile and that, in practice, the few main rules were not followed. The bank was therefore ordered to ensure that its credit policy reflects the desired risk profile.

The FSA found that there were many errors and omissions in the bank's basis for decision-making and that these were material in 19% of the credit approvals. Errors and omissions were observed in relation to the calculation of net assets and the amount available for consumption, for instance. As a consequence, the bank was also ordered to ensure that its basis for decision-making is improved so that credit decisions are made on a true and accurate basis.