Comments on "Report on inspection of Danske Bank Denmark (retail customers)" issued by the Danish Financial Supervisory Authority on 29 June 2010

The Danish Financial Supervisory Authority (FSA) regularly inspects Danish banks and mortgage credit institutions. The FSA prepares a report on each inspection. According to the "Danish Executive Order on the Duty of Banks and Mortgage Credit Institutions to Publish the Danish FSA's Assessment of the Institution", which came into force on 1 April 2010, the banks and credit institutions must publish the report.

Danske Bank has the following comments on the first Danish FSA reports issued on 29 June 2010:

The Danish FSA inspected retail customers in Denmark in March 2010. It assessed 367 random samples of a total of some 400,000 loan exposures. Danske Bank's lending to retail customers in Denmark represents some 7.9% of the Group's total lending.

The assessment resulted in two *orders*:

1. *In some cases, the bank's own risk classification of customers was too positive. The FSA has therefore ordered the bank to improve its model for assessing the risk on retail customers so that it is better at taking account of any deterioration in the value of the loans.*

The Danish FSA did not find grounds to stipulate that Danske Bank make further impairment charges.

For most of its retail customers, Danske Bank calculates loan impairment charges on the basis of models. Model-based impairment charges are affected by changes to risk classifications and by defaults.

Danske Bank has adjusted its risk assessment models on an ongoing basis to ensure that they identify signs of weakness in customer exposures and activate changes to customer risk classifications at an early stage.

Danske Bank has thereby met the requirements of the Danish FSA.

2. *The basis for the bank's lending and the bank's credit management of retail customers, particularly follow-up, appears incomplete. The bank was therefore ordered to improve the basis for its lending and its credit management, particularly for the purpose of identifying weaknesses and ensuring an appropriate level of follow-up on exposures that exhibit signs of weakness.*

To some extent, the favourable economic conditions until 2008 resulted in some customers being granted loans in the expectation that the positive trend would continue. The economic downturn, with rising unemployment and declining property prices, has weakened a number of retail exposures.

Danske Bank has subsequently tightened its procedures and changed its system for registration of risk events thus adding focus on the quality of the individual registrations.

Danske Bank has thereby met the requirements of the Danish FSA.

Danske Bank notes that the FSA finds that the credit quality of loans that the bank has provided in 2009 and 2010 is significantly better.

In addition to the orders, the FSA comments that *although a very large proportion of the loan portfolio had a normal level of risk, the overall credit quality was below the level for retail lending at other large banks.*

Danske Bank finds it inadequate to compare loan portfolios for retail customers across banks by means of small samples and by focusing on credit quality exclusively. Other factors, such as differences in customer composition and earnings, should also be taken into account. Danske Bank is the banker of one third of all Danes, and its share of the broad retail market, which is particularly hard hit by a recession, is larger than those of other banks. The average interest margin in the broad retail customer segment is higher and compensates for the slightly higher losses that this segment is expected to generate. Moreover, Danske Bank has a strong position in large cities, which have seen the steepest falls in property prices.

The report also states that *the bank to a great extent has provided loans without an agreed-upon repayment schedule on the basis of short-term interest rates.*

Since mid-2009, Danske Bank has changed its conditions for granting interest-only loans and raised the requirement for disposable income. Housing-related loans account for two thirds of the portfolio of retail loans in Denmark. Despite the fall in housing prices, loan-to-value ratios are generally low with an average ratio of 75%. Arrears remain at a modest level. Danske Bank's Risk Management report (page 61 onwards) explains in greater detail the quality of the portfolio of property loans.

Danske Bank calculates its ICAAP result (solvency need) in accordance with the Executive Order on Capital Adequacy. It also sets aside capital to cover future risks on customer segments, including capital to cover potentially higher losses on retail customers. Danske Bank's solvency is assessed on a regular basis through stress tests.

At 31 March 2010, Danske Bank's ICAAP result (solvency need) was 10.3%. Its actual solvency ratio was 17.9%.

30 June 2010