



# Conference call

Interim report – first half 2018

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Investor Relations

## CORPORATE PARTICIPANTS

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Danske Bank - Interim CFO

**Claus I. Jensen**

Danske Bank - Head of IR

## SPEECH

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**Operator**

Good day, and welcome to the Danske Bank financial results for the first half of 2018. Today's conference is being recorded. At this time, I would like to turn the conference over to Thomas Borgen, CEO. Please go ahead, sir.

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**Thomas Borgen - Danske Bank - CEO**

Thank you, operator, and thank you all for taking the time to listen in on this call today. With me today I have the interim CFO, Morten Mosegaard, and Head of IR, Claus Ingar Jensen.

Slide 1, please. In today's call, we have the pleasure of presenting the bank's financial results for the first half of 2018. We aim to keep this presentation to around 15 minutes. After the presentation, we will open up for a Q&A session as usual and spend as much time as needed. Afterwards, feel free to contact our IR department if you have any more questions.

Slide 2, please. With a net profit of DKK 9.1 billion, the first half of 2018 represents a period of mixed financial results for Danske Bank. The result for the first half of the year represents a return on shareholders' equity of 11.9%. The result came in lower than in the first half of 2017 when we benefited from strong trading income in FICC in particular.

The financial results for the period were based on stable Nordic economies. The significantly lower income from trading in the financial markets can be attributed to geopolitical events, turbulent stock markets and a high degree of uncertainty regarding the direction of interest rates. This resulted in challenging market conditions and, thereby, a negative impact on trading income in particular. However, our customer-driven business model in FICC has a solid track record, which we expect to benefit from once market conditions become more benign.

The stable business momentum in the Nordic economies led to an increase in lending of 2%, or 3% adjusted for currency effects, from the same period the year before. The underlying momentum was good, based on good customer activity in most markets. In Sweden in particular, we continue to see strong growth in our corporate lending activities and positive developments in our Personal Banking activities, supported by the partnership agreements. In Finland, where the increase in corporate lending continued, we have also started to see the positive effects from the expanded partnerships with Akava. Also, in Denmark, we have started to see a more notable uplift in corporate lending.

In Denmark, we have now completed our acquisition of SEB Pension Danmark, which has added 200,000 new customers and approximately DKK 100 billion of assets under management, thus enabling Danica Pension to have an even stronger product offering going forward.

Expenses come in slightly lower than in the same period last year, primarily as a result of lower performance-based compensation and a continued reduction of expenses.

Our capital position remains strong. The CET1 capital ratio of 15.9%, which is above our target level, is net of the total share buy-back programme of DKK 10 billion we are currently executing. The continuation of benign macroeconomic conditions had a positive impact on credit quality and the financial result as the development in the first half of the year resulted in net reversals now for the seventh consecutive quarter.

We're happy to see that customer satisfaction was at the same level as in the surveys at the end of 2017. In most of the markets, we are on target, that is among the top two in customer satisfaction. A high level of customer satisfaction can only be achieved if we are able to provide the best possible customer experience.

As part of our ongoing efforts to do so, we announced new strategic initiatives in the first half of 2018 to become the Nordic Integrator in the financial sector. Our new strategic initiatives encompass a new organisation structure and a wide range of initiatives, with the aim of moving even closer to our customers, our employees and the societies we are part of. The new organisation structure, which will serve as a strong facilitator for the Nordic Integrator strategy, was implemented at the beginning of May, and we will start reporting in line with this from the third quarter of this year.

All in all, in the first half of 2018, we continued to see a positive underlying trend in our business, characterised by good customer activity. Despite the lower contribution from trading activities, we continued to see a solid and well-balanced inflow of new business from personal and business customers across all the Nordic markets.

Finally, I would like to comment on the announcement we publicised this morning in relation to the Estonian AML case. The investigations into the issue related to the now closed down non-resident portfolio at our Estonian branch between 2007 and 2015 continue to progress according to plan. The investigations are comprehensive, covering a period of nine years and a large quantity of data. While it is too early to conclude as to the extent of suspicious transactions, it is clear that Danske Bank has failed to live up to our own standards and expectations of our stakeholders in terms of preventing our Estonian branch from being used for potential illegitimate activities.

As well as being committed to transparency with respect to the findings of the investigations, including a clear account of the issue, causes and accountabilities, the Board of Directors and Executive Board have also determined that Danske Bank should not benefit financially from suspicious transactions in the Estonian non-resident portfolio. Consequently, it is Danske Bank's intention to make the gross income generated from such transactions in the period from 2007 to 2015 available for efforts that support the interest of the societies in which we operate, such as, for example, combating international financial crime.

It is a comprehensive investigation and is anchored with the Board of Directors, it has not yet been finalised, so it is too early to determine the amount to be made available. For reference, the total gross income for the non-resident portfolio between 2007 and 2015 has been estimated at around DKK 1.5 billion. Conclusions from the investigations will be reported by September 2018. The amount and the way in which it will be made available will be decided after we have concluded on the investigations.

Overall, we maintain our guidance for the full year of a net profit in the range of DKK 18 billion to DKK 20 billion. However, on the basis of lower trading income in the first half of the year, we now expect net profit to be at the lower end of the range. At this point, the net profit outlook for 2018 does not reflect a provision for waiving income from suspicious transactions in Estonia. The impact will be presented once conclusions from our internal investigations become available.

Morten, could you please proceed?

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#### **Morten Mosegaard Christensen - Danske Bank - Interim CFO**

Thank you, Thomas, and slide 3, please. Let's take a look at the main items of our financial results. Net interest income for the first half of the year came in at DKK 11.8 billion. This was a 2% increase from the level seen in the same period last year. Excluding currency effects, NII was up 3%, and it is driven mainly by lending growth, which is also 3%. Net interest margins were affected by lower deposit margins.

Looking at fee income, it came in at DKK 7.5 billion, down 3% from last year. Fee income was stable in the Nordic banking units, but lower customer activity in our capital market business reduced fee income at C&I and Wealth Management from the level in the strong first half of 2017.

Net trading income came in at DKK 2.5 billion. It is down 40% from the same period last year when income was very high. Income in the first half of the year was affected by challenging market conditions caused by a high degree of uncertainty in the financial markets.

Operating expenses came in at DKK 11.4 billion. It is down 1%, reflecting lower activity and a continued focus on efficiency measures but also a continued increase in costs for regulatory compliance as well as new strategy initiatives.

Finally, we saw net loan impairment reversals of DKK 0.7 billion as a result of improved credit quality, in particular at Business Banking.

Slide 4, please. Looking at the banking units. In the first half of the year, we continued to see good business momentum in our two Nordic banking units, Personal Banking and Business Banking. Both business units saw increased lending based on higher customer activity than last year and a good inflow of new business in Norway and Sweden in particular.

In Finland, the economic recovery has been followed by increasing demand for credit, primarily from corporates. At Business Banking

Finland, lending rose 11% from the level in the same period last year. In Northern Ireland, the business momentum was good, with an increase in both volume and income.

Let's look more closely at these units. Looking at Personal Banking, it delivered a stable result with profit before loan impairment charges almost unchanged at DKK 2.5 billion. Total income was down 4% but mainly due to the sale of Krogsveen. The effect from an increased lending volume was offset by negative currency effects and margin pressure.

Expenses were down 6% due to the sale of Krogsveen and efficiency measures. Impairment charges showed a net reversal and reflect overall strong credit quality. The return on allocated capital was 21.2%. Total lending volume was up 2%, owing to the growth in Norway and Sweden, where lending volumes, measured in local currency, rose 6% and 14%, respectively.

The depreciation of the Swedish krone led to lower reported growth rates in Danish kroner. These strong gains came primarily from our partnership agreements, under which we continue to see an inflow of new clients, especially in Sweden. In Denmark, where lending volume was up 2%, the trend towards higher mortgage lending and lower lending within conventional loan products continued to slow down. In Finland, lending volume was up 1%.

Looking at Business Banking, we continued the solid progress in all markets. Overall, profit before loan impairment charges was up 6%. Measured in local currency, lending volume was up in all markets and most notably in Sweden and Finland, where volume rose 13% and 11%, respectively. In Norway, growth in lending was up 7% from the year before. In Denmark, lending rose 2% in the first half of the year. However, the trend was somewhat stronger in the second quarter.

Total income was 5% higher than last year due to higher customer activity. The improvement was driven by net interest income in particular. Expenses were up 4%, owing to IT investments and higher regulatory costs but also expenses related to the reorganisation following new strategic initiatives. Impairment charges showed a reversal of DKK 0.5 billion as a result of strong credit quality. The return on allocated capital was 19.4%.

Finally, Northern Ireland profit before loan impairment charges rose 9%, measured in local currency, and is supported by good underlying performance and customer activity despite the continued uncertainty we have around Brexit.

Total income was up 1%. Adjusted for currency, it was up 2% as lending and deposit volumes grew 9% and 11%, respectively. Expenses fell 4%, 2% in local currency, reflecting the effect of the restructuring initiatives. Impairment charges showed an expense, owing to a few cases in the first quarter. The return on allocated capital was 10.3%.

Slide 5, please. C&I and Wealth Management, let's have a look at those. C&I profit before impairments declined 35% from the level in the same period last year when income was at a very high level in FICC, in

particular. In the first half of this year, C&I experienced challenging market conditions due to geopolitical events and uncertainty about the direction of interest rates. Activity in Debt Capital Markets was based on good issuance activity, exceeding the level in the year-earlier period.

Within General Banking, income rose as a result of refinancing activity and increased lending, excluding collateral management agreements in Denmark and Norway. Total income declined 23% from the level in the same period last year, mainly because of lower fee and trading income, whereas NII benefited from an increase in lending, also excluding collateral management agreements. Expenses were down 3% due to lower activity and lower performance-related costs. Impairments showed a net reversal of DKK 85 million as the credit quality of the oil-related exposure continued to stabilise.

Looking at Wealth Management. Profit before tax was down 24% from the level in the first half of last year. The negative development was due mainly to adverse development in the health and accident business. Danica Pension saw a positive development, driven by strong premium growth in Denmark and Sweden in particular. Fee income was down 2% from the level in the first half of last year. Fee income in the first half of last year benefited from product launches and higher customer activity. Trading income came in lower than last year, adversely affected by a lower investment result in the health and accident business.

Other income showed a small negative result in the first half of the year due to a lower risk result in the health and accident business. Expenses were up 5% due mainly to increased regulatory costs and operating expenses from the acquisition of SEB Pension Danmark.

Assets under management was up 10%, due mainly to the acquisition of SEB Pension Danmark. In the first half of this year, net sales at asset management amounted to a negative DKK 3.5 billion because of outflow from a few large customers. Premiums in Danica Pension amounted to DKK 22.9 billion, against DKK 20.4 billion in the first half of last year, due mainly to positive developments in Denmark and Sweden and that includes premiums from SEB Pension Danmark.

Slide 6, please. Moving to expenses. Total expenses for the first half of the year amounted to DKK 11.4 billion, which is down 1% from the level last year. The decrease reflects lower activity and lower IT expenses but also costs related to the acquisition of SEB and cost for the reorganisation following our new strategy. The sale of the real estate broker, Krogsveen, also contributed to the decline in expenses. Expenses continue to be affected by higher costs for regulatory compliance and digitalisation. We now expect expenses for the full year to be higher than in 2017, due mainly to the inclusion of operating costs in SEB Pension Danmark.

Slide 7, please. Credit quality continued to be strong in the second quarter. Net reversals for our core activities amounted to DKK 0.4 billion. The loan loss ratio for the quarter, excluding Non-core activities, was minus 8 basis points. With a net reversal of DKK 0.3 billion in the second quarter, Business Banking continued to provide the most significant contribution to the net reversals we have had now for seven consecutive

quarters. The reversals were driven by positive macroeconomic conditions in Denmark and the continuation of positive outcomes of work-out cases.

At C&I, impairment charges amounted to a net reversal in the second quarter as the credit quality of the oil-related exposure continued to be stable. In Northern Ireland, we had a small net reversal in the second quarter after charges related to a few cases in the first quarter.

Slide 8, please. Our capital position remained at a strong level. We reported a common equity Tier 1 capital ratio of 15.9%, well above our target range of 14% to 15%. The figure includes the full effect of the acquisition of SEB Pension Danmark of 0.5%. We consider the effect to be of a temporary nature, subject to capital optimisation, which is expected to reduce the capital effect to less than 0.1% later this year. The total capital ratio was 21.6%, down 0.1% from the preceding quarter. The REA level came in slightly lower, owing to lower market risk. The leverage ratio was 4.3% according to the transitional rules. If you take the fully phased-in rules, the leverage ratio was 4.2%.

The minimum core Tier 1 requirement increased from 12.3% to 12.6%, due mainly to an increase in the Pillar II add-on of DKK 5 billion for higher compliance and reputational risk as a result of the orders issued to Danske Bank by the Danish FSA on the 3rd of May.

Slide 9, please. And now then finally, the outlook for 2018. We continue to expect net interest income to be higher than in 2017 as we will benefit mainly from volume growth. This is unchanged from our previous outlook. The outlook for fee income has been revised. We now expect fee income to remain strong, including the effect from the acquisition of SEB Pension Danmark and subject to customer activity.

The outlook for expenses has also been revised. We now expect expenses to be higher than in 2017, due mainly to the effect from the acquisition of SEB Pension Danmark. The outlook for impairments has also been revised. We now expect loan impairments to be at a low level.

And finally, we are conserving the net profit outlook to be in the range of DKK 18 billion to DKK 20 billion. However, on the basis of the trading income we saw in the first half of this year, we now expect net profit to be at the lower end of the range.

And then as Thomas mentioned, at this point, the net profit outlook for 2018 does not reflect the provision for waiving income from suspicious transactions in Estonia. This income will be presented once conclusions from our internal investigations become available.

Slide 10 please, and over to you, Thomas.

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**Thomas Borgen - Danske Bank - CEO**

Those were our initial comments and messages. We are now ready for your questions. Please limit yourselves to two questions. And if you're listening to the conference call from our website, you are welcome to ask questions by e-mail.

Operator, we are ready for the Q&A session.

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**Operator**

(Operator Instructions) We will now take our first question from Jakob Brink from Nordea.

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**Jakob Brink - Nordea**

I have two questions, please. The first one is regarding net interest income. Looking at your presentation, there is your maturing and issued funding in the quarter. It seems like you paid 87 basis points for non-preferred. Also looking at the screens, it looks like your current senior debt with 5-year maturity is trading close to 80. So I just want to hear, what is your issuance sort of target for the rest of the year? Should we expect you to -- the DKK 20 billion of senior debt that will be redeemed, will that be replaced by senior non-preferred at that price? Or basically, what is your ambitions or targets regarding funding? And then secondly, now with SEB Pension on board, could you then give us a bit more detail on what we should expect with regard to revenues and costs of the SEB?

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

Thank you, Jakob, for the question. If I could comment on the first question on our funding plan for the year. We have communicated that we expect to issue funding of DKK 60 billion to DKK 80 billion for the full year, and we stand by that announcement. We have issued already close to the bottom range now, in the first half of the year, and we intend to stick to the range. The basic issue for us is basically transferring into the new non-preferred senior as we roll out of the existing old funding.

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**Jakob Brink - Nordea**

If I can come back -- sorry, if I can just ask one more on that. So basically, you have DKK 20 billion more of senior to issue this year, and you're saying you want to issue that as senior non-preferred. Is that correctly understood?

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

You should not expect us to issue more standard senior unless the price is comparable to the corporate bond rates. So the main issuance will be in the non-preferred senior space.

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**Jakob Brink - Nordea**

Okay. Even though it seems relatively expensive, wouldn't you agree, at 87?

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

We have seen the market widen, obviously. And it has been a more difficult market for issuance in general in Q2.

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**Claus I. Jensen - Danske Bank – Head of IR**

But I can add to it, the non-preferred senior issuance we have done so far, the pricing on that has been more or less in line with what we have suggested previously as a spread towards the ordinary senior loans.

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**Jakob Brink – Nordea**

Yes. But they have come up as well. So okay.

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

Okay. And then the question on SEB and the cost related to SEB. You should bear in mind that there are basically two costs, the standard operating costs related to running SEB Pension, which are roughly between DKK 30 million and DKK 40 million per month, and then you have the amortisation of goodwill, which relates to the customer part of the goodwill, which is DKK 1.3 billion in total that will be amortised over 10 years. So that will also be part of the cost base going forward.

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**Jakob Brink – Nordea**

So when you said in your presentation back in -- was it December when you made the announcement to acquire SEB Pension? You said, I think, DKK 600 million to DKK 650 million in annual profits. Is that then after the DKK 130 million annually as well? Or will -- is that to be taken out of the DKK 600 million to DKK 650 million?

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

So the guidance we gave you on fully phased-in income from SEB Pension was before any deductions of goodwill.

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**Operator**

We will now take our next question from Pawel Dzedzic from Goldman Sachs.

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**Pawel Dzedzic – Goldman Sachs**

So the first question is just a follow-up on your guidance. You're now aiming for the lower end of the DKK 18 billion to DKK 20 billion range. And after half a year, you're roughly halfway there. You have removed reference to cost of risk and, obviously, showed much better reversal in the first half. But should we expect that to continue? Do you see asset quality being capable of essentially offsetting this trading -- weaker trading income, or actually, you expect a pickup in trading activity in the second half? That would be my first question. And then I have a few questions on AML, if you -- or clarifications, if you don't mind. So you basically outlined the potential provision related to the case that you will be willing to take. Would you take it in one go? Or could it be spread over time? And perhaps if you can comment, I know the investigation is ongoing, but can you share with us if you have received or if you're aware of any information request regarding the case from U.S. authorities?

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**Thomas Borgen - Danske Bank - CEO**

Okay. Let me go through those two questions. First of all, our guidance for 2018 with -- in the lower end of the range is -- includes all known information for the present time, and it's in the lower range as we have had more difficult trading conditions. To be more specific, the cost of risk has surprised us to the positive in the first half of 2018 and more than we expected when we entered the year. We expect the cost of risk also to be very subdued in the second half, but it is very difficult to predict exactly. But at a certain point of time, we have to move toward zero. At a certain point of time, it will have a cost. We don't see a major change in the second half, but I think it's fair to assume that we will slowly and surely move towards 0. When it comes to the trading, we are probably the market leader when it comes to FICC business in the Nordic market, at least in Denmark. And when there is subdued or difficult trading conditions, particularly in the interest rate environment, we will also be impacted by that. That also means that if it remains subdued, it will not generate substantial income. And if it's normalised, it's a substantial income, and if it's like 2017, it's a very high number. I think it's fair to say that we have a very solid platform, very solid team, and nothing has changed that. But as you would see on the numbers and as you had probably seen in the market, the rate environment has been very difficult to earn money on during the first half. So I think we have to wait to see how the second half turns out. To your second question on AML, yes, we have today announced that we'll forego any profit on the non-resident portfolio on suspicious transactions. The investigation, as you said, is ongoing. And when we have some more clarity, we will communicate that to the market. Your question is, do we want to take it in one go. If we have clarity in September, I would expect that the Board will take that decision. But at this point in time, it's too early to conclude anything more on that issue. Your second point in that investigation, we have no insights into any potential fine. And if we have, we will note it to yourself and the contingent liability in footnote number 10.

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**Pawel Dzedzic – Goldman Sachs**

All right. That's very clear. Can I have just one follow-up on the trading? And you mentioned that part of the weakness is related maybe to weaker customer activity. In your presentation, you mentioned that there were small AuM outflows this quarter and partially levered by institutional clients. Can you comment on that? And maybe, more broadly, does the AML case and overhang -- the visibility in media impact in any way your day-to-day business?

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**Thomas Borgen - Danske Bank - CEO**

Yes. What I alluded to was only the FICC business, which is kind of the trading income. The AuM business is more a fee-based issue. I'll ask Claus to be more specific on the AuM. But on a generic comment, I will say that we are not impacted on the day-to-day operations due to the Estonia case. We can see that we have good customer inflow in all markets, in all segments. We can see that we have good underlying growth on the asset side and requests. It does mean that certain clients may leave us, and that's regrettable. But overall, the business is performing actually very well as you can see on the underlying numbers. I'll ask Claus to just give some more flavour on AuM.

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**Claus I. Jensen - Danske Bank – Head of IR**

Yes. Your question on the drop in AuM, I think we have seen a trend for a while in the asset management industry that some funds are insourcing mandates, and that is affecting not only us but many asset managers. And that is the primary reason why there is a drop in net sales in Wealth Management.

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**Operator**

We will now take our next question from Per Grønberg from SEB.

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**Per Grønberg – SEB**

Yes. Two questions from my side. First, on capital. Your minimum requirement is now at 12.6%. A year ago, it was 12%. Your Group target remains at 14% to 15%. Is this something you will have to evaluate later in the year? Or have you seen other developments, for instance, regulation that you regard as a lower risk today compared to how you saw it a year ago? My second question, trading. There has been a lot of discussions about trading. You're talking about a market environment that has been difficult to earn money in. What changes do you need in the market environment to have your markets, especially your FICC operations, starting to perform again? As far as I'm aware, there's been plenty of volatility in the market and -- but that has seemingly not been enough even in Q1 and especially not in Q2. When we look at peer companies' reporting, they have half of them as soft as your FICC businesses.

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**Thomas Borgen - Danske Bank - CEO**

Okay. Let me answer those two questions. To the first one, there is no change to our capital target to stay between 14% and 15% as we have communicated.

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**Per Grønberg – SEB**

This implies that there are other risks that have been reduced by 0.5% during that period. Or is that too simple to put it up that way?

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**Thomas Borgen - Danske Bank - CEO**

And just so I understand, Per, could you please explain?

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**Per Grønberg – SEB**

A year ago, your legal minimum requirement was 12%. Now it is 12.6%. This 60 basis point increase is not reflected in how much capital you think you need to have to operate the bank. This must be reflecting that there is other risk that has put a downward pressure on the needed management buffer.

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**Thomas Borgen - Danske Bank - CEO**

I think it's fair to say that we are probably one of the banks with the largest management buffer, and we still have a very large management buffer, even though the requirement has increased, as Morten went through.

We also need to take into account that our capital is also impacted by the short-term effect of the SEB acquisition on the upside here. So we're very comfortable with the present number. So there's no reason, as we see it now, to change our targets. Your second question is about FICC. And you, in particular, probably know this, that FICC in Danske is skewed to being one of the leaders in the interest rate environment, and the interest rate environment has not had the same volatility or the steepness of the curve as the equity market, in particular, have had or the foreign exchange market. We can see that we are taking our clear and fair portion of the trades, but that is lower, so it's a bit harder to generate earnings. We have the same business model. We have the same team in place. So there's nothing fundamentally changed in it, but it's one quarter, which has been very difficult. We also need to take into account that in 2017, there was very high volatility in the interest rate market, and there we benefited substantially. So your second question, I think I kind of answered that in the previous question. But just to reiterate, we will always be a reflection of the interest rate market in the Nordics. And if it remains low volatility or flat curves or low trading, it will impact us. But when and if it resumes, we will benefit from that as we've done for many, many years, which history has showed us.

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**Operator**

We will now take our next question from Johan Ekblom from UBS.

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**Johan Ekblom – UBS**

Just two follow-up questions on the AML case. I guess, first of all, this initiative or this proposal to take the proceeds from potentially suspicious transactions and donate them, can you talk a little bit about how that -- is this the response to the comments from the new Danish business minister? It seems a bit odd to announce that now rather than wait until we have the report, given it's been a sort of no comment for 10 months. Why not just wait two months and be able to present it all at once? And then secondly, going back to your comments on the contingent liabilities note, I think there, it's very clear that you say that not only no legal processes but also none of the discussions or interactions you have with regulators give you any reason to believe that there'll be anything that can have a material financial impact. And yet, I think there were some headlines on Bloomberg earlier today where you were quoted as saying that you didn't want to speculate on how big the fine could be. Can you just talk a little bit about the wording in the contingent liability note? What does that actually mean? I mean, I would assume that those are carefully considered words. So I just want to know if we can read into that, that in all of your relations with regulators, there is nothing to make you think that you will face fines that are material?

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**Thomas Borgen - Danske Bank - CEO**

Yes. Morten will deep dive into footnote 10. I will just say that I have been presented now with what Bloomberg has said, and it can be misunderstood if you want to misunderstand it. But what you should read is I have no insight into any potential fine. And the point is, we have no insight into any potential fine. So that's, I think, what is the key message. And then footnote 10, Morten will go through.

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

Yes. So what happens if we get into a lawsuit is, obviously, that we will evaluate what the outcome is and potentially make a provision. If we are in an early stage of a suit or in a dialogue that we feel could result in a provision, then we're obliged to, obviously, inform you through the contingent liability section of the report that you have in front of you. So what we have stated here is that there is nothing in the pending lawsuits, disputes or anything like that, that makes us believe that it will have a material effect on our financial position. That is what we have stated in the note, and that is what Thomas just pronounced before.

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**Thomas Borgen - Danske Bank - CEO**

Does that answer your question?

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**Johan Ekblom - UBS**

As a follow-up, I mean, so I can take from that, that it's not only lawsuits and disputes. I mean, it very clearly says "and dialogues with public authorities or inspections of compliance with AML legislation". So that means that even if it's not an actual lawsuit or an official investigation, there is nothing in your conversations with regulatory authorities that leaves you thinking that there is a material financial impact.

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

Well, I think you just read the note, so we can only agree.

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**Johan Ekblom - UBS**

Okay. No. That's fine. I just wanted to make sure because it seemed inconsistent with what Bloomberg was quoting, and I just wanted to make sure that I had understood things correctly.

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**Thomas Borgen - Danske Bank - CEO**

Yes. My apologies that I didn't read exactly those three words, which could not have been misread if you were to do it. So my apologies, Ekblom.

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**Johan Ekblom - UBS**

And just on the decision to announce the sort of potential DKK 1.5 billion, I don't know what we should call it, but why not wait until the AML investigation is finished? I mean, it seems like it's just creating more confusion because you're only allowed -- sort of able to tell half of the story.

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**Thomas Borgen - Danske Bank - CEO**

No. Well, my apologies if you think it creates more confusion. We're actually trying to create clarity to all stakeholders because we take a view, and I think we take it on behalf of all stakeholders, that Danske Bank has the view that we should not benefit financially from any suspicious transactions that have taken place in the non-resident portfolio of the Estonian branch. We are, as you know, in the midst of the investigation. But just for reference, we have given you the gross earnings in that

portfolio between 2007 to 2015, which has been estimated to approximately DKK 1.5 billion. So that gives you a reference point, and this is actually to try to be helpful to all stakeholders to be clear on what the view from Executive Board and the Board of Directors is. It gave you a clear indication of the estimate of total earnings in the period. But yes, we have not been able, at this point of time, to quantify the number of suspicious transactions, because it's extensive, a comprehensive analysis, which will take place. And when we have it and we expect it in September, we will give some more clarity on that.

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**Operator**

Our next question comes from Kim Bergoe from Deutsche Bank.

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**Kim Bergoe - Deutsche Bank**

Two questions from me. First, if you could sort of -- if you could talk a little bit about how you see the margin development in different markets and competitive pressures. And then secondly, back to this, we just talked about the DKK 1.5 million. Just to be sure, this is -- so this is the total amount. So this, we could think of as a -- this is the maximum amount, right? And whatever it turns out, is likely to be a smaller amount than that?

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**Thomas Borgen - Danske Bank - CEO**

Morten will do the margins. And I would just respond to your last question first. I would not like to use your wording, but I think it's fair to say when we communicate an estimate of the gross earnings in the whole period, it gives you a good reference point that then I allow all of you to take your own conclusions based on that.

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

And then if I should elaborate a little bit on margins in the various countries and segments, there is overall generally and structurally a more flattish development, but then you will see a couple of notable impacts. The biggest one is what you see in Norway. That is related to Nibor, and it affects the Personal Banking segment in particular. I'm guessing you've also seen that from other banks. That is a movement in Nibor driving the margin down as Nibor goes up. And I think that is normal volatility and not so much a structural trend. You see a little bit of the same in the Stibor in Personal Banking. So overall, it's been a little bit down here on the lending margins in Q2, mainly on the personal segments. In the Business Banking segment, it has been more constructive. There's a little bit of pressure, but overall, I would say the development is much more flattish.

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**Operator**

Our next question comes from Sofie Peterzens from JPMorgan.

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**Sofie Peterzens - J.P. Morgan**

This is Sofie from J.P. Morgan. So I wanted to ask about excess capital. I know your core equity Tier 1 target is unchanged. But how should we think about excess capital going forward, and in particular, your dividend



payout and buy-backs? Is it fair to assume that you will maintain the 40% to 60% dividend payout and also the DKK 10 billion per year buy-backs. So that would be my first question. And the second question is just a follow-up on the margins in the Personal Banking division. How should we think about them going forward? These lending rates, as you mentioned, fell 5 basis points quarter-on-quarter. Given that Nibor has stabilised, is it fair to assume that we'll see a rebound or kind of flat margins going forward in Personal Banking?

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**Thomas Borgen - Danske Bank - CEO**

Thank you. I'll take your first question. Morten will take your second. We have the same capital strategy going forward as we have had. It is - first of all, we have to meet our target, which, as you said, is between 14% and 15%. Then we will distribute a dividend between 40% and 60%, and there is no change on that. And then we will take all the profitable growth we find, which is relevant, in those markets we operate in. And here, we have the track record of growing very well. And if we have any excess capital, we will distribute that back to the shareholders in one way or another. In the last couple of years, that has been done through share buy-backs. So there's no difference in our strategic thinking when it comes to the way we utilise the bank's capital. I would also like to add that the bank's capital position today is very strong, as we alluded to. So we are well prepared going forward.

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

And just to take your questions on margins in Norway. In the short term, we are affected by the movements in Nibor, meaning that if Nibor stabilises and Nibor moves down, then you will see a positive impact on margins. Longer term, structurally, obviously, the market will adapt. It's a rational market, and we will move with it. But we will not move up and down randomly as rates go up and down in the short term.

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**Sofie Peterzens - J.P. Morgan**

Okay. That's great to hear on Nibor. But just very quickly on just the capital comments, so is it fair to assume that DKK 10 billion buy-back will be maintained going forward?

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**Thomas Borgen - Danske Bank - CEO**

I cannot comment on buy-backs. As we have said consistently, buy-backs is not a goal in itself. It's a residual, and it's something which the Board considers at the end of the year with the FSA's approval to adjust the capital structure. But what I can say is there is no change in that strategy we are putting forward. But how it concretely will materialise, it's too early to comment on.

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**Operator**

Our next question comes from Andreas Håkansson from Exane.

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**Andreas Håkansson - Exane BNP Paribas**

Just coming back a little bit to the NII, and I was looking at -- I mean, there was a movement from the other division, Treasury division, to mainly

Personal Banking. Could you tell me was that evenly split between the countries? And what size was it overall?

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**Claus I. Jensen - Danske Bank - Head of IR**

I think I'll take that. That's a little bit of follow-up on what we discussed previously, Andreas. And the majority of the effect is coming into Personal Banking and some in Business Banking. And when we are talking about that we, through the FTP, are compensating the business units with a better compensation for deposits, it would automatically mean that it's Denmark we are talking about, as this is where we have the majority of our deposits in the Personal Banking division.

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**Andreas Håkansson - Exane BNP Paribas**

But if the movement was DKK 100 million in Other, and most of it moved to Personal Banking, that means that underlying NII in Denmark must have been down very significantly?

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**Claus I. Jensen - Danske Bank - Head of IR**

I don't think you can see it that way. There was a move from NII in Other activities, and that reflects an increase in the business units. But you cannot look at the number like-for-like because there are also many other components in the equation.

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**Andreas Håkansson - Exane BNP Paribas**

Okay. And then just secondly, on Realkredit Danmark, the NII fell in the quarter even though volumes were up. Could you tell us what happened with the mortgage margins in Denmark?

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**Claus I. Jensen - Danske Bank - Head of IR**

Well, I think if you are referring to the margins that we disclosed in the fact book, you can see that the number fluctuates and has been fluctuating between 86 and 84 basis points.

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**Andreas Håkansson - Exane BNP Paribas**

No, sir. I was looking at the quarterly report of Realkredit Danmark that was also published today, where the NII was declining in the quarter even though volumes were up. So it's really a contribution margin?

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**Claus I. Jensen - Danske Bank - Head of IR**

I think we will have to look into that, and then we will come back to you after the call. Is that okay?

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**Andreas Håkansson - Exane BNP Paribas**

That's fine.

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**Operator**

(Operator Instructions) Our next question comes from Mads Thinggaard from ABG.

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**Mads Thinggaard – ABG Sundal Collier**

This is Mads from ABG. I have one on costs and, I guess, employees. I can see full-time employees, they are up like a bit more than 2% quarter-on-quarter, and that is despite the move to -- I mean, I guess moving Baltic employees to Non-core. Is this -- I mean, is this compliance-related personnel, regulatory compliance people needed? And is it of a permanent nature, in your view? And then also going a bit back to the, let's say, special donation to society from -- or potential donation to society from the money laundering. I mean, I can understand you're not really, I mean, saying anything about buy-backs here and whether it will come down significantly from last year. But when you kind of set the distributions for 2018, would it then be possible to kind of exclude this donation from, I guess, the cost base when you do that? Or will that be kind of part of the 2018 net profit you would kind of distribute?

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

Okay. So first of all, thanks for the question. And the FTE question, I can take first. First of all, it's not so that the FTEs just disappear because we transfer them into Non-core. What you see on the FTE line is mainly the inclusion of SEB personnel. That is the major part of it. Then we have, over summer, always in Finland, a seasonal uptick in temporary staff. We've seen that for a number of years and then there's a slight increase which is more on the regulatory side, and that is mainly personnel which are in Estonia and, to a certain extent, India. So that's the...

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**Mads Thinggaard – ABG Sundal Collier**

Okay. All right. It's very moderate actually, the compliance part of the...

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

Yes. That is true.

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**Thomas Borgen - Danske Bank - CEO**

Now I think, there was a second question, and I think that was regarding capital distribution. Was that right?

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**Mads Thinggaard – ABG Sundal Collier**

Yes. Sure, on whether you would -- when you kind of set the distributions for 2018, if you would be able to kind of exclude the potential donation to society that we do not yet know how much it will be from, I guess, you will include it in the cost base once you implement it. Could you kind of, I mean, pay out as if that consideration was not part of your P&L?

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**Thomas Borgen - Danske Bank - CEO**

No. I think it is fair to assume that this will go through the expense line, and depending on the size, it will impact the financial performance, and of course, that will be a part of the equation of how the capital distribution will be done.

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**Operator**

The next question comes from Paulina Sokolova from Barclays.

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**Paulina Sokolova – Barclays**

It's just a clarification actually of your updated cost guidance. So you're saying you will now have higher cost in 2018 rather than slightly higher guidance previously. And at the time you made the previous guidance, you had already announced the acquisition of SEB Pension. So I'm wondering what has changed between now and then to make you increase the cost guidance. Is it just mechanically you're now including those costs that you didn't previously? And also if you could just elaborate on the other factors that are driving up the cost guidance besides the acquisition, that would be great.

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

Right. So thank you. And I think what we stated previously regarding the acquisition was that we will have restructuring cost related to the SEB integration of DKK 300 million to DKK 350 million, and then we will have operating cost, which depends on when exactly we would take over SEB, and then we would come back to you once we know that date. And we know that date now. So the difference that you will have to factor in here is mainly that we are now including the operating cost and the goodwill amortisation of SEB Pension. That's the main reason for the change in cost guidance here.

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**Paulina Sokolova – Barclays**

And there are no other kind of factors not linked to the SEB Pension acquisition that are driving up guidance?

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

No. I mean, you saw that we are down 1%. And we have already said that before taking into account SEB, we would be up slightly year-on-year, and we stick to that guidance.

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**Operator**

The next question comes from Jacob Kruse from Autonomous.

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**Jakob Kruse – Autonomous**

Just one question on the cost base. You talk in the Wealth business about the cost for the acquisition of SEB Danmark. So was there an acquisition-related cost rather than an integration of the sort of existing cost base that hit you in this quarter on a temporary basis? I -- yes, I guess that's the question.

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

Okay. Well, very simple, no. We have the DKK 300 million to DKK 350 million, and the majority will be taken later.

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**Operator**

The next question comes from Riccardo Rovere from Mediobanca.

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**Riccardo Rovere – Mediobanca**

Just a clarification from my side. When we talk about -- when you were talking about donating DKK 1.5 billion related to the AML case, the DKK 1.5 billion, this is the amount of kind of proceeds that you think Danske may have, let's say, got from this situation? This amount has nothing to do with any possible fine Danske may be imposed by the various prosecutors or regulators in the various countries? Is that correct?

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**Thomas Borgen - Danske Bank - CEO**

That is correct. So the DKK 1.5 billion is our best estimate of gross income earned on this portfolio between 2007 and 2015.

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**Riccardo Rovere – Mediobanca**

Okay. Okay. Now this is clear. Now on this topic again, why, given that you don't know -- even that you know nothing about what has gone on and what the amount of the fine, if any, the DKK 1.5 billion might be even a lower number, why don't you just stop the buy-back for a while, and then eventually, you start it again or you flex it? What is the point in all this situation to continue to have this buy-back in place with all this uncertainty? Shouldn't this, the buy-back, be a tool that should allow you some kind of flexibility?

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**Thomas Borgen - Danske Bank - CEO**

Thank you for the question. There is no reason whatsoever for us to stop the buy-back with the present capital position, with the present earnings and the present knowledge at hand. So there is absolutely no reason to do that whatsoever.

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**Operator**

Our next question comes from Adrian Cighi from RBC.

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**Adrian Cighi – RBC**

This is Adrian Cighi from RBC. Just one follow-up. A lot of my questions have been answered already. Do you know the accounting treatment of the potential DKK 1.5 billion, let's call it, donation. Is this a tax-deductible, or do you expect it to be?

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**Morten Mosegaard Christensen - Danske Bank – Interim CFO**

First of all, just to make it clear, again, as Thomas said, the DKK 1.5 billion is an estimate of the gross income we have made. So there is no knowledge right now about what the potential size of the donation might be. There is not even knowledge right now on how we're going to do it. So talking about tax deductibility it's a little premature. But what I would say is that we intend to give back the money that we have made, the gross income that we have made on this portfolio like-for-like. So I'm guessing that goes before tax and after tax.

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**Claus I. Jensen - Danske Bank – Head of IR**

And operator, we have a question coming on our web page. So if we may take that question now. The question is from Geoffroy in Deutsche Bank asking, are you already in talks with the U.S. DoJ regarding the money laundering investigation in Estonia? If no, do you believe them to look at the issue?

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**Thomas Borgen - Danske Bank - CEO**

Again, we have nothing more to add than what we have said already. We went through, I think, with all respect, details of how we will communicate if there's anything to communicate to the market, either through direct press release or through footnote number 10.

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**Operator**

(Operator Instructions) Our next question comes from Robin Rane from Kepler Cheuvreux.

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**Robin Rane – Kepler Cheuvreux**

Just a clarification on the so-called donation or -- so if we assume that eventually you would get a fine, would you think this as included in this giveaway? Or would that be additional to this?

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**Thomas Borgen - Danske Bank - CEO**

Okay, thank you. No. What we have said is that if there is any - and against our expectation - any confiscation, it will go against it but not against any fine, if that were to take place.

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**Robin Rane – Kepler Cheuvreux**

Okay. So that would be in addition.

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**Thomas Borgen - Danske Bank - CEO**

That would be in addition, yes.

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**Operator**

Our final question comes from Bruce Hamilton from Morgan Stanley.

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**Bruce Hamilton – Morgan Stanley**

Just two quick clarifications. One, so just on cost to make sure I understood. Previously, you'd guided that there'd be an impact from restructuring of DKK 300 million or DKK 350 million in the '18 cost base related to the deal. And then if I take sort of 6 months' run rate of costs, I think you're guiding to about DKK 400 million, including the amortisation. So is that kind of the increase year-over-year I should be thinking about, have I got that right -- sort of DKK 700 million combined? And then secondly, from what you're saying about the no reason to stop buy-back based on earnings, capital and what you know so far, then the way we should have to think about distribution for this year is that if you were to hit the bottom end of your range of DKK 18 billion to DKK 20 billion, we

take off the DKK 1.5 billion, then DKK 16.5 billion based on a payout of close to 100% including buy-backs would be the start point. Is that the way I should think about it?

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**Morten Mosegaard Christensen - Danske Bank - Interim CFO**

All right. First of all, just to be very specific on the cost guidance. We guided DKK 300 million to DKK 350 million, those are the total costs. They may not be taken in '18. They can also be taken partially in '19, so just to be clear on that. And also we -- our initial cost guidance included guidance slightly up. And then on top of that slightly up, you will add the new cost guidance.

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**Thomas Borgen - Danske Bank - CEO**

Okay. To your second question, I think it's premature to discuss details how we should distribute capital. That's something for the Board to decide when the financial year has closed down. I think what is important, Bruce, is to say that there is no change in our strategy. There is a solid earnings capacity in the bank. It may fluctuate with regards to trading, but that, you know well. And then we need to see how the year ends, and then we'll take it from there. I think you could, to some extent, use history as a good guidance for how we will also proceed going forward.

Okay. Thank you for your kind interest in Danske and for your very good questions. As always, you're welcome to contact our IR department if you have more questions after you have had time to look into the financial results in more detail. A transcript of this conference call will be added to our website and the IR app within the next few days. Have a good afternoon.

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**Operator**

That will conclude today's call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.