Risk Management 2020

Danske Bank Group

Danske Bank

Contents

The objective of Risk Management 2020 is to inform shareholders and other stakeholders of the 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 danskebank.com/investor-relations.

2020 in brief

1.

1.1 COVID-19 impact

In many ways, 2020 was an unpredictable year because of the outbreak of the coronavirus pandemic, affecting both customers and employees of Danske Bank. The first and last months of the year were especially challenging as a result of comprehensive lockdowns and governmental restrictions in Danske Bank's strategic core markets. The majority of employees had to work from home, branches closed for physical customer service, many customers faced a significant impact on their daily lives and the macro economic environment was rapidly changing.

For credit matters, Danske Bank's customer portfolios – apart from existing portfolios that are challenged – saw only a limited volume of new non-performing loans in 2020, with total gross non-performing loans (NPL) decreasing only slightly from the level at the end of 2019.

To remediate some of the effects of the COVID-19 crisis, Danske Bank also supported selected state initiatives launched by local governments to provide business customers with advice and solutions.

Although the effects on personal customers were limited and credit quality remained strong, Danske Bank implemented many initiatives to manage the risk and help personal customers through the crisis, for example by offering payment holidays or interest-only payments.

The effects of the COVID-19 crisis on credit quality are expected to materialise in 2021. Overall credit quality weakened slightly in 2020, and the exposure-weighted probability of default was slightly higher at the end of 2020 than at the end of 2019.

On the basis of timely estimates applied in the Group's impairment model, loan impairments included a charge of DKK 2.4 billion to cover the effects of the COVID-19 crisis.

Corporates & Institutions reported loan impairments primarily against single-name exposures, mainly in the oil and gas industry and, to a smaller extent, in the retailing industry. Banking Nordic was affected by an increase in total impairments following charges against single-name exposures and the changed macroeconomic outlook. At Banking DK, impairments were driven by the continued limited visibility relating to the effects of the COVID-19 crisis, but little credit deterioration was observed.

The Group's Operational Resilience Programme was further developed through collaboration between the Group's main resilience functions (Business Continuity Management, Crisis Management, IT Service Continuity Management and Site Emergency Response). The resources from all the functions were used to the fullest in handling the COVID-19 situation and the Group's response, and the programme remained on track and its scope was expanded with continuous progress in enhancing the Group's operational resilience.

In order to support the initiatives aimed at minimising the economic consequences of the COVID-19 crisis, the Board of Directors proposed to the general meeting on 20 April 2020 that no dividends be paid for 2019. The proposal was adopted at the annual general meeting on 9 June 2020. However, with respect to its capital targets, the Group has an ambition of paying out ordinary dividends within the range of 40-60% of its net profit.

The Board of Directors will continue to adapt the capital targets to the regulatory developments and revise the ambitions for capital distribution in order to ensure that the Group continues to have a strong capital position.

1.2 Increased focus on compliance culture and remediation of legacy issues

In recent years, Danske Bank has systematically improved compliance, risk and control capabilities and processes and sought to foster a management culture that allows potential issues to be raised and addressed and employees to speak up. As a result, the Group has identified a number of legacy issues in which errors may have led to poor outcomes or losses for customers.

In October 2020, the Group established a central unit, Remediation Office, to handle the identified legacy issues in a timely, decisive and proactive manner. The Remediation Office oversees the remediation of the legacy issues, and the new unit reports directly to the Executive Leadership Team.

The identified legacy issues are at different stages. In some cases, the root causes and effects are still being investigated, while compensation to affected customers is in progress in other cases. The Group has the ambition of communicating directly to affected customers as quickly as possible and continues to keep relevant authorities, including the Danish Financial Supervisory Authority (the Danish FSA) and other stakeholders, informed on an ongoing basis.

The Group has invested heavily in improving controls and has encouraged the reporting of cases and issues, while making sure that the lessons learned from the legacy issues are proactively applied within the organisation in order to minimise the risk of future issues.

1.3 Enhancements to sustainability risk management

In 2020, the Group continued to enhance its risk management of sustainability-related risks by strengthening internal governance frameworks and risk assessments. After the summer period, a central team was set up to address the cross-cutting nature of sustainability-related risks. In this way, the responsibility is anchored within the existing risk management frameworks, while a central team is in place to ensure coherent assessment, prioritisation and regulatory engagement.

The main focus is to continue to advance and assess the impact from ESG risks on existing financial risks and further mature sustainability risk management in current processes where this is deemed significant. In particular, the Group implemented a new ESG risk assessment tool for credit exposures in the fourth quarter of 2020, and this tool is now used for assessing new lending and existing credit exposures, with most of the loan book expected to be covered in 2021.

In 2020, the Group also focused on testing and applying a variety of standardised climate scenarios and on developing methodologies for using longer time horizons in risk assessments and stress testing. Climate stress test scenarios for market risk were also developed.

Furthermore, integrating and collecting relevant ESG risk data remain a top priority to ensure the best basis for forward-looking risk management, especially when it comes to risk monitoring and reporting. While regulatory guidance in 2020 helped shed light on many uncertainties in respect of sustainability risk management, much of the necessary methodology is still in its infancy. In 2020, the Group continued to support sector-wide efforts to mature risk management methods and will continue to do so – for example, through industry partnerships.

1.4 Financial risks

The day-to-day trading income from the Group's trading operations saw increased fluctuations during the first quarter of 2020 as a result of markedly higher interest rate volatility in particular, but income volatility decreased considerably during the rest of the year. However, the Group managed to navigate safely through these turbulent times by maintaining a low risk in its trading operations and making every effort to ensure that earnings prospects were commensurate with the market risk taken. In the non-trading portfolio, the sensitivity to falling and rising interest rates was reduced by half in 2020 from the interest rate sensitivity level seen in 2019.

At the end of 2020, the Group continued to have a strong capital position, mainly supported by the cancellation of dividends for 2019 and the release or decrease of national countercyclical buffer rates in core markets. However, the Group saw significant REA increases related to the initial implementation of EBA guidelines, which were partly countered by the early implementation of the CRR II SME supporting factor in the second quarter of 2020.

At the end of 2020, the Group's liquidity coverage ratio was 154%, up from 140% at the end of 2019. The ratio increased over the year, mostly due to increasing deposits. These were, in turn, due to injections of liquidity by monetary and fiscal authorities in response to the volatile market and uncertain outlook in March and April.

1.5 Non-financial risks

In 2020, the Group continued to strengthen its non-financial risk culture and awareness through mandatory training and continued to recruit staff at Group Non-Financial Risk and Group Compliance to ensure that the necessary expertise and skills are in place.

The Group redesigned frameworks and policies aimed at simplification and strengthened compliance with internal and external requirements. In 2020, the non-financial risk tolerances were developed at a more granular level in alignment with the ERM taxonomy. This was a major milestone in strengthening the Group's non-financial risk management framework with implementation in early 2021.

The Group's change risk management, especially with respect to new product introduction, is fundamental in supporting the Group's ambition to create value for all of its stakeholders. In 2020, the Group further strengthened its governance procedures for new and amended product approvals.

In 2020, enhancements to the Group's risk management, awareness and culture initiatives led to better identification of legacy issues. There was a substantial focus on strengthening the control environment across the Group through a number of programmes to address a combination of the orders issued by the Danish FSA and observed control weaknesses and to adhere to regulatory requirements. As stated in section 1.2 above, a new central unit, Remediation Office, was established with the task of overseeing the remediation of identified legacy issues and ensuring transparent and timely communication to customers and other stakeholders.

In 2020, the Group proactively made a group-wide disruptive risk assessment of the COVID-19 situation to ensure an adequate and rapid response to the continued crisis. The crisis management structure has proven sufficiently robust and flexible to handle the dynamic nature of the ongoing pandemic.

In response to the IT inspection by the Danish FSA in 2019, the Group mobilised a multi-year transformation programme across the first and second lines of defence to remediate the identified material gaps in the Group's IT risk framework and control activity. Plans were shared with the Danish FSA in April 2020 with no deviances to the plans to date. The IT remediation programme has already led to several improvements.

Cyberattacks are a global threat that continues to grow, especially in light of the COVID-19 crisis and its negative effect on the financial industry and society. As cybersecurity risks develop rapidly, the Group focuses continuously on its control environment to proactively manage these risks. The Group has mobilised a multi-year transformation process with the Executive Leadership Team to continue to mature its ability to mitigate the risks posed by cyber-related threats.

In 2020, the Group also launched the Governance, Risk and Compliance (GRC) platform in order to strengthen its risk management and regulatory compliance controls through effective data analytics. The new platform will consist of seven applications that span all three lines of defence and the first application was implemented at the end of 2020.

In 2020, the Group continued to make progress on its 2023 ambition plan, Better Bank. As part of this plan, the Group ensures that risks related to organisational changes are identified, assessed and managed in line with the Group's standards. For the purpose of strengthening the Group's strategic and commercial transformation, the Transformation Office is currently overseeing the Better Bank plan.[1]

1.6 Better Bank transformation from a risk perspective

The Better Bank transformation was launched as a multi-year programme at the end of 2019 for the purpose of making Danske Bank become a simpler and more competitive bank. The Group aims to become more integrated into the lives of customers and society, whilst addressing a number of industry- and Danske Bank-specific challenges. At the same time, the Group defined strong ambitions towards 2023 for its stakeholders as stated below:

- **Customers:** To be among the top two in customer satisfaction
- **Employees:** To ensure that at least 90% of its employees are engaged
- **Society:** To operate sustainably, ethically, and transparently – and have a positive impact on the societies that the Group is part of
- **Shareholders:** To achieve a 9-10% return on shareholders' equity and a cost/income ratio in the low 50s

As part of its transformation programme, the Group defined and initiated more than 20 Better Bank initiatives in 2020, some of which with a group-wide scope while others targeted to specific customer segments. The accounting year of 2020 was a year of investment in the Group's future financial performance with about DKK 1.5 billion allocated to transformation initiatives to pave the way for the Group's ambitions. Four focus areas were identified for 2020 and they were also the focal points for investments: (1) Better Ways of Working, (2) Purpose, Brand, Culture and Engagement, (3) Group-wide Cost Programme and (4) Compliance under Control.

Although 2020 witnessed challenges that affected both the industry and the Group, some progress was made in relation to the organisational transformation. The ongoing global COVID-19 crisis continues with tightened restrictions across the Group's markets, causing continued uncertainty as to how the Group's business will be affected. The main outcomes of the transformation in the four focus areas for 2020 were as follows:

- **Better Ways of Working:** The Group transformed its entire development organisation to work agilely, thus creating the foundation for a step forward towards a more scalable, digital and better customer experience
- **Purpose, Brand, Culture & Engagement:** The Group engaged its employees and leadership across the organisation to define a new internal culture and a purpose to act as the Group's "North Star"
- **Costs:** The Group achieved a decrease in its cost base in 2020 and expects a further cost reduction in 2021
- **Compliance under Control:** The Group established an effective and efficient compliance function and improved progress on core themes such as conduct, trade surveillance and transaction monitoring

Risk assessments related to Better Bank initiatives were independently reviewed and challenged by Group Non-Financial Risk in Group Risk Management in 2020, and ongoing risk assessment in this regard will take place in the next few years.

For more information about the progress of the Better Bank transformation plan, see the Strategy Execution section of Annual Report 2020.

[1] The Transformation Office will transition to Group Strategic Steering Unit from January 2021.

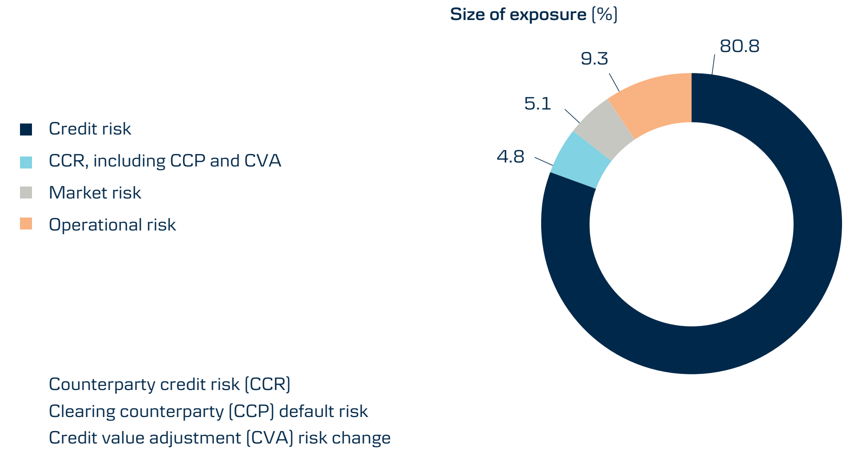
1.7 *Key ratios and risk figures*

Key ratios and risk figures for the Danske Bank Group

(At 31 December)	2020	2019	2018
Capital			
Common equity tier 1 capital ratio (%)	18.3	17.3	17.0
Tier 1 capital ratio (%)	20.5	20.4	20.1
Total capital ratio (%)	23.0	22.7	21.3
Leverage ratio, transitional rules (%)	4.5	4.7	4.6
Leverage ratio, fully phased in (%)	4.4	4.6	4.5
Funding and liquidity			
Liquidity coverage ratio (LCR) (%)	153.5	140	121
Asset encumbrance (DKK billions)	1,376	1,224	1,278
Asset encumbrance ratio (%)	40	40	44
Issuer rating and outlook – S&P Global	A/stable	A/stable	A / negative
Issuer rating and outlook – Moody's	A3/stable	A3/stable	A2 / negative
Issuer rating and outlook – Fitch Rating	A/negative	A/negative	A / negative
Asset quality			
Risk exposure amount, total (DKK billions)	784.2	767.2	748.1
Expected loss (DKK billions)[1]	14.5	15.1	13.4
Impairment charges, loans, total, full year (DKK millions)[2]	7,001	1,516	-650
Loan loss ratio, full year (%)[2]	-	-	-
Non-performing loans, gross exposure (DKK billions)[2]	31.8	34.7	29.9
Non-performing loans, net exposure (DKK billions)[2]	18.8	21.3	16.9
Non-performing loans as % of total gross exposure (%)	1.2	1.4	1.2
Non-performing loans coverage ratio (%)[3]	75.2	77.6	85.0
Loans defaulted on, gross (DKK billions)[2]	14.6	17.6	16.0
Loans defaulted on, net (DKK billions)[2]	6.7	9.4	7.3
Forborne loans (DKK billions)	37.4	22.4	24.5
Other			
Core net credit exposure, lending activities (DKK billions)	2,728	2,444	2,392
Non-core net credit exposure, lending activities (DKK billions)	4.1	10.4	18.4
Exposure at default (DKK billions)[4]	3,161	2,589	2,574
Total assets (DKK billions)	4,109	3,761	3,578
Assets under management (DKK billions)	1,765	1,651	1,575

[1] Expected loss figure (downturn-adjusted amount according to regulatory requirements).
[2] At the group level, core portfolios, excluding Non-core.
[3] Accumulated expected credit losses (IFRS 9) as a percentage of gross exposure net of collateral (after haircut).
[4] Excluding counterparty credit risk.

REA broken down into material risk types at the end of 2020



REA figures

In 2020, credit risk was by far the largest risk type among the Group's risk categories as it amounted to 80.8% of the Group's total REA. Counterparty credit risk, market risk and operational risk constituted the remaining 19.2% of the total REA. The relative proportions between risk types were largely unchanged from 2019. The total amount of all risk types calculated in the chart shown above is 100%.

Risk strategy and governance

2.

2.1 *Risk strategy*

The risk objective of the Danske Bank Group is to keep Danske Bank safe and secure for the benefit of society, customers and employees. To meet this objective, the Group applies an enterprise risk management (ERM) framework that sets common standards for risk management across all risk types.

The ERM framework defines how the Group manages risk and specifies how risk governance and risk responsibilities are structured to ensure appropriate oversight and accountability. Furthermore, it defines the Group's risk taxonomy and approach to risk appetite setting. The ERM framework is supported by policies approved by the Board of Directors.

Risk culture

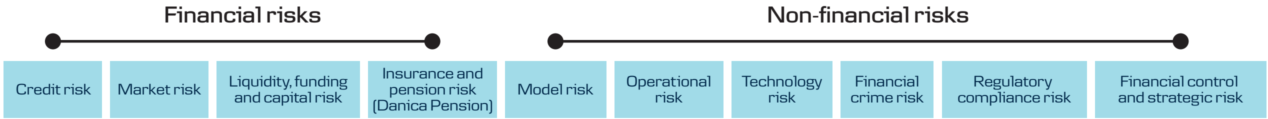
The Group recognises the importance of having a strong risk and compliance culture in everyday work to ensure that Danske Bank creates value for all of its stakeholders and lives up to its responsibility as one of the largest financial institutions in the Nordic region. The process of building and maintaining a strong risk and compliance culture across the Group involves ensuring a high level of risk awareness and enforcing sound risk-taking behaviour aligned with the risk appetite. This work is underpinned by the Group's core values and by governing documents, communications, remuneration structure and staff training.

The performance agreements of all Executive Leadership Team (ELT) members and of executives two levels below the ELT level include risk and compliance performance targets. The Group develops and maintains risk skills and a risk understanding through tailored risk and compliance training to ensure that risk management expertise is embedded in daily work routines. All employees, including Executive Leadership Team members, participate in annual compulsory eLearning courses on competition law, anti-money laundering, whistleblowing, GDPR and information security awareness, for example.

In 2020, the head of Banking Financial Crime & Welcoming was appointed the Group's Anti-Money Laundering (AML) responsible person in Denmark. This role entails the authority to make decisions regarding the approval of AML policies, procedures and controls and to give acceptance in respect of specific customer relationships. The country managers for Sweden, Norway and Finland are responsible within their separate branches to ensure that the AML and counter-terrorism financing procedures are updated appropriately, compliant with local regulatory requirements, and are well documented.

Risk taxonomy

The risk taxonomy is a common set of risk categories and definitions intended to ensure adequate risk identification and ownership across the Group. The risk categories cover both financial and non-financial risks, and roles and responsibilities are defined for each identified risk category to ensure continued risk assessment and monitoring. The taxonomy is reviewed on an annual basis to ensure that the risk categories reflect the Group's current main risks.



Group risk appetite

The Group's risk appetite specifies the types and the maximum level of risk that the Group is willing to accept in order to meet its strategic objectives, be a better bank committed to serving its customers through the economic cycles, and ensure an adequate balance between risk and return. The Group's risk appetite is aligned with the financial and strategic planning processes for the purpose of ensuring that both risks and opportunities are considered during the strategic decision-making process.

The Group's risk appetite is owned by the Board of Directors and sets the direction for the Group's overall risk-taking by specifying metrics and group-wide statements that aggregate the effects of financial and non-financial risks acceptable to the Group. As part of the risk appetite setup, the Group defines tolerance levels for non-financial risks. These specify the level of non-financial risks that the Group is prepared to accept in pursuit of its business strategy.

2.2 Risk management organisation

The Group's risk management practices are organised in line with the principles of the three-lines-of-defence model. The three lines of defence segregate duties between (1) units that enter into business transactions with customers or otherwise expose the Group to risk (risk ownership), (2) units in charge of risk oversight and challenge in respect of risk owners (risk oversight), and (3) Group Internal Audit (risk assurance).

2.2.1 Three lines of defence

The first line of defence owns and manages the business activities and related risks. It consists of frontline and direct support functions and the following entities: business units; COO Area; CFO Area; Group Legal; Group HR; and Group Communications, Brand & Marketing. These entities are responsible for identifying and managing risks across national borders, including designing, implementing and operating effective controls.

Risks must be managed in line with delegated responsibilities and policies as set by the second line of defence and approved by the Board of Directors. The mandate of the business units is governed by risk policies, instructions, risk committees, risk appetite targets and limits.

The second line of defence provides the risk management framework and performs risk oversight. It consists of Group Risk Management and Group Compliance. These units are responsible for setting the standards, policies and methods under which the first line of defence operates with respect to risk management and compliance. The second line of defence supports, challenges and is responsible for the risk oversight of the first line of defence and operates independently of the first line of defence.

The head of Group Risk Management has the title of chief risk officer (CRO) and is a member of the Executive Leadership Team. In cooperation with and under responsibility of the chief executive officer (CEO) of Danske Bank, the CRO reports to the Board of Directors. The CRO may file reports to and contact the Board of Directors directly. Furthermore, the CRO has the authority to veto any decisions that affect Danske Bank's exposure to risk.

Group Risk Management is organised in a matrix structure in which units have individual risk type oversight responsibility, while business unit CROs have business unit oversight responsibility across risk types. The following units are part of Group Risk Management: Risk Analytics, Market & Liquidity Risk, Group Non-Financial Risk, COO Risk Functions, Retail Credit Risk Management, and Wholesale Credit Risk Management. Each business unit has been assigned a CRO who has oversight responsibility across all risk types for the unit in question. In most cases, business unit CROs are also heads of Group Risk Management units and have group-wide responsibility for specific risk types. Finally, country CROs in Norway, Sweden, Finland and Northern Ireland are responsible for overseeing all types of risk in the respective countries.

The head of Group Compliance has the title of chief compliance officer (CCO) and is a member of the Executive Leadership Team. In cooperation with and under responsibility of the chief executive officer (CEO) of Danske Bank, the CCO reports to the Board of Directors. The CCO may file reports to and contact the Board of Directors directly.

Group Compliance is responsible for regulatory compliance and financial crime risks and for providing advice and guidance to the first line of defence. This includes providing support and creating awareness. Group Compliance monitors the adherence to processes and controls at the business units and staff areas and monitors whether controls are properly designed and operating as intended. Group Compliance has independent oversight of regulatory compliance risk and financial crime risk management and maintains the Group's framework in this regard.

Group Compliance consists of the follwing units: Regulatory Compliance, Financial Crime Compliance, Central Compliance, and Regulatory Affairs & Compliance Governance. In addition, country compliance officers in Norway, Sweden, Finland, and Northern Ireland are responsible for all compliance-specific risk types in the respective countries.

The third line of defence is made up by Group Internal Audit (GIA). GIA is an independent and objective unit evaluating and improving the effectiveness of risk management, control and governance processes in relation to the control environments of the first and second lines of defence. GIA is headed by the chief audit executive (CAE), who reports directly to the Board of Directors.

2.3 *Risk governance*

The Group has a structure of decision-making bodies that cover all significant risks and perform control and oversight of risk decisions. The committee structure is designed to support an effective information and escalation path to the Group's senior management and to provide a consistent approach to risk management and decision-making.

Risk governance: two-tier management and committee structures

The Group's Escalation Policy constitutes an overall framework for internal escalations. The policy lays down the general principles and standards for timing, responsibility, processes, etc. in relation to escalating matters to the Executive Leadership Team and the Board of Directors.

2.3.1 Board of Directors and Executive Leadership Team

The Group's rules of procedure for the Board of Directors and the Executive Leadership Team specify the responsibilities of the two bodies and the division of responsibilities between them. The two-tier management structure and the rules of procedure 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 throughout the Group.

The Board of Directors appoints members to the Executive Leadership Team, the chief audit executive and the secretary to the Board of Directors. In accordance with the rules of procedure, the Board of Directors approves the Group's overall business model, strategy, risk appetite, risk profile, policies and instructions, including mandates to the Executive Leadership Team. In addition, the Board of Directors receives regular reports, monitors the main risks and reviews the largest credit exposures.

The Executive Leadership Team is responsible for the Group's day-to-day management. It supervises the Group's risk management practices, oversees developments in Group Compliance's methods (for example, in respect of anti-money laundering), approves credit applications up to a defined limit and ensures that bookkeeping and asset management are sound and in accordance with the Group's business model, strategy, policies and instructions established by the Board of Directors and in compliance with applicable legislation. The Executive Leadership Team consists of the chief executive officer, the heads of the business units and the heads of CFO Area, COO Area, Group Compliance, Group Risk Management and Group HR.

2.3.2 Board of Directors and Executive Leadership Team committees

The Board of Directors has established five committees to supervise risks and prepare cases for consideration by the full Board.

Committees established by the Board of Directors

Risk Committee Convenes at least six times a year Number of meetings in 2020: 9	The Risk Committee operates as a preparatory committee for the Board of Directors with respect to risk management and related matters. The committee advises the Board of Directors on the Group's risk profile, risk culture, risk appetite, risk strategy and risk management framework.
Audit Committee Convenes at least four times a year Number of meetings in 2020: 9	The Audit Committee operates as a preparatory committee for the Board of Directors with respect to accounting and auditing matters, including relevant risk matters. The Audit Committee addresses Internal Audit (the third line of defence) and external audit matters.
Remuneration Committee Convenes at least twice a year Number of meetings in 2020: 6	The Remuneration Committee operates as a preparatory committee for the Board of Directors with respect to matters concerning remuneration. Its main focus is on the remuneration of the members of the Board of Directors and the Executive Leadership Team, material risk takers, key employees and executives in charge of control and internal audit functions. Another focus area is incentive programmes. The committee monitors trends in the Group's salary and bonus policies and practices. It also monitors the incentive programmes to ensure that they promote ongoing, long-term shareholder value creation and are in compliance with the Remuneration Policy.
Nomination Committee Convenes at least twice a year Number of meetings in 2020: 4	The Nomination Committee operates as a preparatory committee for the Board of Directors with respect to the nomination and appointment of candidates to the Board of Directors and to the Executive Leadership Team and with respect to the evaluation of the work and performance of the Executive Leadership Team and the Board of Directors, including individual evaluation of each member of the Board of Directors. The committee also submits proposals to the Board of Directors on policies for succession planning as well as diversity and inclusion.
Conduct & Compliance Committee Convenes at least four times a year Number of meetings in 2020: 8	The Conduct & Compliance Committee operates as a preparatory committee for the Board of Directors with respect to conduct and reputational risk, compliance and financial crime. The committee oversees Danske Bank's conduct in relation to its corporate and societal obligations and monitors Danske Bank's systems and processes to ensure compliance with rules and regulations applicable to Danske Bank.

The Executive Leadership Team has established four committees that act on behalf of the Executive Leadership Team with respect to risk monitoring and decision-making in certain areas.

Committees established by the Executive Leadership Team

Group All Risk Committee Convenes at least nine times a year	The Group All Risk Committee acts on behalf of the Executive Leadership Team with respect to the Group's risk management practices. The committee makes decisions on and monitors all material risks associated with the Group's business model and activities. It covers all risks across risk categories, business units, functions and geographical regions in alignment with the Group's ERM framework. Specific reviews on compliance-related risks are managed directly by the Executive Leadership Team and not by the Group All Risk Committee. All members of the Executive Leadership Team are permanent members of the Group All Risk Committee. The Group All Risk Committee has established and delegated parts of its responsibilities to a number of sub-committees. Each sub-committee oversees a specific risk category or all risks related to a specific business area. Delegation of responsibilities does not relieve the Group All Risk Committee of its responsibilities, and the sub-committees must report any decisions and issues to the Group All Risk Committee.
Group Credit Committee Convenes with the aim to meet twice a week	The Group Credit Committee reviews and decides on individual credit applications on behalf of the Executive Leadership Team. The Group CEO, CRO, CFO and the heads of the business units are permanent members of the Group Credit Committee.
Business Integrity Committee Convenes at least four times a year	On behalf of the Executive Leadership Team, the Business Integrity Committee decides on ambition levels and develops and oversees the implementation of the Societal Impact and Sustainability strategy and related Group policies. All members of the Executive Leadership Team are permanent members of the Business Integrity Committee.
Group Impairment Committee Convenes at least four times a year	On behalf of the Executive Leadership Team, the Group Impairment Committee oversees the implementation and maintenance of the group-wide framework for assessing the Group's credit impairment charges. The Group CEO, CRO, CFO and the heads of the business units are permanent members of the Group Impairment Committee.

2.4 *Risk monitoring and reporting*

The Group has an enterprise-wide approach to risk reporting. This approach is supported by the monthly CRO letter, which covers analyses across risk types, core geographical regions and key subsidiaries.

Risk reporting	Content	Frequency	Sent to
CRO letter	A comprehensive overview of the Group's risk profile across risk types, core geographical regions and key subsidiaries.	Monthly (quarterly in respect of the Board of Directors; the Board of Directors receives verbal reports in-between the quarterly written reports)	Group All Risk Committee Risk Committee (Board of Directors) Board of Directors
Risk profiles	Detailed portfolio and industry analyses focusing on exposure, risk factors, structural trends, performance and forward-looking developments, including portfolio stress tests. Risk profiles cover all material portfolios.	Annually	Group All Risk Committee Risk Committee (Board of Directors) Board of Directors
Risk reviews	Reviews based on a risk-based approach; they cover specific risks related to selected portfolios and all material portfolios. Ad hoc reports are made when relevant.	At varying intervals; high-risk portfolios are reported more frequently, and at least annually	Group All Risk Committee
Impairment report	An overview of detailed developments in the Group's impairment charges.	Quarterly	Group Impairment Committee Audit Committee (Board of Directors) Risk Committee (Board of Directors) Board of Directors
Risk management report (this report)	A description of the Group's risk strategies and profile, capital management, risk management organisation and risk frameworks and policies. The report is prepared annually and published on Danske Bank's website along with the Additional Pillar III Disclosures spreadsheet.	Annually	Risk Committee (Board of Directors) Board of Directors Public
Group compliance quarterly report	An overall assessment of the Group's compliance risk management and control environment.	Quarterly	Executive Leadership Team Conduct & Compliance Committee (Board of Directors) Board of Directors
ICAAP report	An assessment of the adequacy of the Group's short-term and long-term capital levels as measured against its risks and business strategy. The assessment includes upcoming regulatory changes and stress testing results.	Quarterly	Group All Risk Committee Risk Committee (Board of Directors) Board of Directors Danish FSA

Capital and REA report	An assessment of developments in the underlying parameters affecting the Group's overall capital position, including an analysis of the risk exposure amount (REA).	Monthly	Chief financial officer Chief risk officer
ILAAP report	A description of the Group's liquidity situation and liquidity management, including its funding profile and plan. The report assesses liquidity risk indicated by liquidity stress tests and similar analyses and also describes the minimum amount of liquidity reserves required by the Group.	Annually (reports on liquidity are regularly issued outside the ILAAP reporting cycle)	Group All Risk Committee Risk Committee (Board of Directors) Board of Directors Danish FSA

Credit risk

3.

3.1 Credit risk management

Credit risk is the risk of losses because debtors fail to meet all or part of their payment obligations to the Danske Bank Group. Credit risk includes counterparty credit risk.

The Group manages credit risk in accordance with its Credit Policy, Credit Risk Appetite and related governing documents (including ESG data). The purpose of these elements is to ensure a consistent approach to credit risk management and clear roles and responsibilities across markets and business units, while making sure that risk-taking remains supportive of the Group's business strategy.

3.1.1 Governance and responsibilities

Credit risk is managed in line with the principles of the three-lines-of-defence model. This means that the first line of defence is responsible for the risks assumed, while the second line of defence is responsible for risk oversight and risk challenge.

In credit risk management, the frontline functions as well as business risk and control functions at the business units make up the first line of defence, while Group Risk Management serves as the second line of defence. In particular, Retail Credit Risk and Wholesale Credit Risk facilitate the implementation of sound credit risk management throughout the Group and are responsible from an oversight and challenge perspective for identifying, monitoring, analysing, measuring, managing and reporting on risks and forming a holistic understanding of risks on an individual and consolidated basis.

The Group ensures compliance with the Credit Policy and related governing documents through the credit control environment, while portfolio monitoring ensures alignment with the Credit Risk Appetite. Credit exposures are monitored so that credit action plans can proactively be made and/or forbearance measures be taken for distressed loans and impairment charges be calculated for non-performing loans.

Delegated lending authority

The mandate for approving credit risk is cascaded from the Board of Directors to the Executive Leadership Team (Group Credit Committee) and further down the organisation via delegated lending authorities. The authorities are delegated on the basis of powers and at levels appropriate for the risk profile and nature of the exposures considered by the mandate giver/holder. If a credit application exceeds the delegated lending authority of the individual mandate giver/holder, the application is submitted to a lending officer with the necessary authority. The second line of defence must be involved in the approval of credit applications and renewals above a certain materiality threshold, while both the Executive Leadership Team and the Board of Directors are involved in the approval process for credit applications of a reputational or material financial nature.

The Delegated Lending Authorities System handles the administration and control of lending authorities.

3.1.2 Monitoring and reporting

At the group level, Group Risk Management oversees the Group's credit activities and reports on developments in the credit portfolios. Portfolio reports are presented to the Executive Leadership Team (via the Group All Risk Committee) on a monthly basis and to the Board of Directors (via the Board of Directors' Risk Committee) on a quarterly basis.

3.1.3 Credit risk appetite and concentration frameworks

The Group's credit risk appetite is set to support the Group's ambition of limiting impairment volatility through the business cycle and managing credit concentrations (including single names, assets and/or credit type concentrations). The appetite allows the Group to take on credit risk in areas that are within its strategic core.

The credit risk appetite applies at business unit/country and product levels. Supporting risk limits and risk metrics are in place at various levels to help measure credit risk further.

Subsidiaries and legal entities owned by the Group set independent credit risk appetites in alignment with the Group's principles.

Monthly and quarterly risk reporting enables ongoing monitoring of the Group's credit risk profile to ensure that it is in line with its credit risk appetite.

Limiting impairment volatility

The Group has set maximum loss limits to enable it to manage the risk of credit losses in times of economic stress. The maximum loss is calculated as the largest one-year loss expected under a three-year severe recession scenario. The maximum loss limits also make it possible to monitor the credit quality of the portfolio and factor in all key credit quality drivers such as customer ratings/scores, collateral and loan maturity.

Managing credit concentrations
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

Single-name concentrations
Single-name concentrations are managed according to two frameworks:

1. Large exposures: This framework is based on the regulatory definition of large exposures in part 4 of the CRR (Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013). The Group has 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 2020, two single-name exposures exceeded 10%)
- The sum of single-name exposures equal to 5-10% of the total adjusted capital may not exceed 150% of the total adjusted capital (at the end of 2020, this segment represented 80% of the total adjusted capital against 44% at the end of December 2019)

2. Single-name concentration: The Group has also implemented a risk-sensitive internal framework.[1] In order to limit losses on single names, the framework sets limits on the following:

- Exposure
- Loss given default
- Expected loss

The largest exposures are monitored daily under the large exposures framework and are reported on a quarterly basis to the Group All Risk Committee, the Board of Directors' Risk Committee and the Board of Directors. At the end of December 2020, the Group was well within the regulatory limits for large exposures.

Single-name concentrations are monitored monthly and reported on a quarterly basis to the Group All Risk Committee, the Board of Directors' Risk Committee and the Board of Directors.

Industry concentrations
The Group manages industry concentrations as part of its credit risk appetite framework by setting exposure limits on selected industries. For commercial property, this also includes reducing the number of low-quality customers in order to ensure creditworthiness within the concentration limits. The industry concentrations are updated on an ongoing basis and at least once a year. The Group accepts the risks on material concentrations in accordance with industry-specific guidelines that outline the use of Danske Bank's Credit Policy covering the industry. For personal customers, the Group also manages key concentrations in relation to high LTV ratios and short-term interest loans, for example.

Geographical concentrations
Credit reporting includes a breakdown by country. For exposures outside the Group's home markets, limits are applied to sovereigns, financial institutions and counterparties in derivatives trading. Limits are approved by the Group Credit Committee on the basis of the expected business volume and an assessment of the specific country risk.

3.1.4 Risk identification and assessment
The Group has a high focus on early collection activities for personal and small business customers, and early signs of inability to repay are addressed by dedicated teams specialised in identifying and mitigating such issues. This allows the Group to work with customers to remediate issues in a timely manner and to reduce the volume of non-performing loans to personal and small business customers.

Similarly, the Group uses early warning indicators for business customers in order to identify behavioural signals that historically have indicated poor performance. This enables relationship managers and credit departments to proactively target activities to a higher extent than previously, including taking forbearance measures where relevant.

The Group engages in work-out processes with customers in order to minimise losses and help healthy customers in financial difficulty. During the work-out process, the Group makes use of forbearance measures to assist non-performing customers. 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.

[1] The framework is aligned with the large exposure framework and includes the total exposure limit of consolidated entities less senior covered bonds, intraday lines, clearing services and Realkredit Danmark credit lines.

Because of the length of the work-out processes, the Group is likely to maintain impairment charges for these customers for years.

Forbearance plans must comply with the Group's Credit Policy and 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. The purpose of the plans is therefore to minimise loss in the event of default and to help customers through a difficult period.

In 2020, the Group increased its use of concessions to customers affected by the COVID-19 crisis, and a significant number of the concessions were considered forbearance measures (see section 3.2.1 below for figures). If it proves impossible to improve a 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.

The credit process ensures that loans are granted to customers within their financial capacity and also that distressed and non-performing loans are identified at an early stage and managed proactively. Assessing a customer's financial capacity is a key element of the credit approval process. The Group pursues a policy of mitigating credit risk by means of guarantees and/or collateralisation.

Sustainability risk

The Group carefully assesses the financial situation of customers to ensure that loans granted are suited to their needs and financial capacity and that customers understand their financial obligations. Besides providing loans in a responsible manner, the Group has spent the past few years integrating sustainability risk and ESG considerations into its lending practices.

At the customer level, the Group initiated a project in 2020 to implement a digital solution to improve the process for ESG risk assessments. This solution was not launched until the autumn of 2020 for the majority of business customers in Denmark, and it is expected to be rolled out to other segments across market areas in 2021.

At the portfolio level, sectors that are recognised to have elevated ESG risks are also outlined in the Credit Policy and are subject to periodic review in line with the Group's Position Statements. The Group has limited exposure to elevated risk sectors (for example, metals and mining (0.1%), forestry (0.4%), fossil fuels (0.6%)), and detailed instructions specify minimum requirements for managing ESG risks for these sectors and for how to perform ESG assessments at the customer level.

Furthermore, annual industry reviews are made in respect of the largest industries to which the Group is exposed as a lender. The primary recipients of these industry reviews are the Group All Risk Committee and the Board of Directors' Risk Committee, but the target group is broader as the reviews provide input on the industry risk appetite that the Group wishes to assume. ESG risk identification and assessment are integral parts of these annual reviews, and both sub-industries and large customers within the industries are screened using external data providers, among other sources. The aim is to identify the material ESG risks facing the individual industry and to assess the financial or operational impact of such risks on the Group's customers within that industry. In the industry reviews, such analysis is combined with a list of recommendations to guide further action.

In 2019, the Group started to include an assessment and quantification of the financial impact of climate-related risks in these industry reviews in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This means reviewing relevant sectors using climate scenarios to measure the sensitivity of the portfolio to climate-related risks with the aim of covering key sectors over time. Sectors are prioritised in accordance with a climate risk heat map to ensure a risk-based approach. The Group will cover more sectors over time in step with the development in data and methodology. These methodologies are developed to ensure sound risk management and to support the Group's strategic goals on sustainable finance. In 2020, an assessment of transition risks in the oil and gas portfolio showed some exposure to the risk of stranded assets. Action plans to achieve a portfolio in alignment with the Paris Agreement are being put in place to support the Group's strategic goals towards 2023. With respect to physical risk assessment, a preliminary analysis reveals that flooding risk is the most significant risk for the Danish real estate portfolio. More assessments will need to be made for the full Nordic real estate portfolio to assess the risk. Furthermore, a standalone report on climate change published by the Group's Danish mortgage credit arm (Realkredit Danmark) can be found on Realkredit Danmark's website at rd.dk.

Overall, the work on both ESG integration in general and assessments in accordance with TCFD recommendations is well-aligned with the Group's commitment to the Principles for Responsible Banking developed by the United Nations Environment Programme Finance Initiative. For more information about and a full disclosure of TCFD recommendations, see the Group's Sustainability Report 2020.

3.1.5 Stress testing

The credit risk appetite is set annually and assessed on an ongoing basis using both top-down and bottom-up stress testing in alignment with IFRS 9 methodology.

When setting the overall credit risk appetite at the group and business unit levels, the Group stress-tests the total portfolio using the severe recession scenario that is also the foundation for the ICAAP stress tests. The credit risk appetite is thus based on forward-looking parameters.

The Group also conducts bottom-up stress tests on selected industries, typically the largest portfolios (reviewed at least once a year). These stress tests form part of extensive sector and portfolio reviews (risk profiles), and they are used for the assessment of specific risk strategies for individual sectors. For relevant sectors, stress tests using climate scenarios are made to assess climate risk exposure at the portfolio level. The bottom-up stress tests help set the risk appetite for industry concentrations and also help validate top-down stress testing.

3.1.6 Rating and scoring processes

Group Risk Management is responsible for the overall rating and scoring processes, including the underlying rating models. Customer ratings are reassessed periodically on the basis of new information that affects a customer's creditworthiness.

While rating all large customers, the Group uses fully automated and statistically based scoring models for small customers such as personal customers and small businesses. Credit scores are updated monthly in a process subject to automated controls.

Risk classification distribution

Scoring and rating are integral elements of the credit approval and the overall credit risk management processes. The Group's classification scale consists of 11 main categories, with category 11 comprising customers in default. Most of the categories are divided into two or three sub-categories, making up a total of 26 classification categories.

The internal PD rating scale is not directly comparable with the rating scales used by international rating agencies.[2] The Group's internal ratings are based on point-in-time (PIT) parameters, and the ratings reflect the probability of default within a year. In order to benchmark the Group's internal rating models, the Group uses Standard & Poor's and Moody's data as benchmarks.

3.1.7 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 to obtain collateral.

The market value of collateral is monitored and reassessed by advisers, internal or external assessors, or automatic valuation models. Automatic valuation models are validated annually and monitored quarterly. The Group regularly evaluates the validity of both the internal and 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 to reflect the fact that the Group may not be able to obtain the estimated market value upon the sale of the individual asset in a distressed situation, and thus it includes a forced sale reduction, price volatility during the sales period, realisation costs and maintenance costs. The haircut applied depends on the type of collateral. For regulatory purposes, the Group also applies more conservative haircuts in order to capture the risk of an economic downturn.

For more information, see section 3.2.2 below.

3.1.8 Support systems

The Group has a number of systems for measuring and controlling credit risk. Among the most important systems are the Credit System (including the Risk Profile, the Credit Exposure System, and 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 and timely default registration based on risk events
- 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 hub of the credit process. It contains all relevant details about credit facilities, financial circumstances and customer relationships. 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 properly.

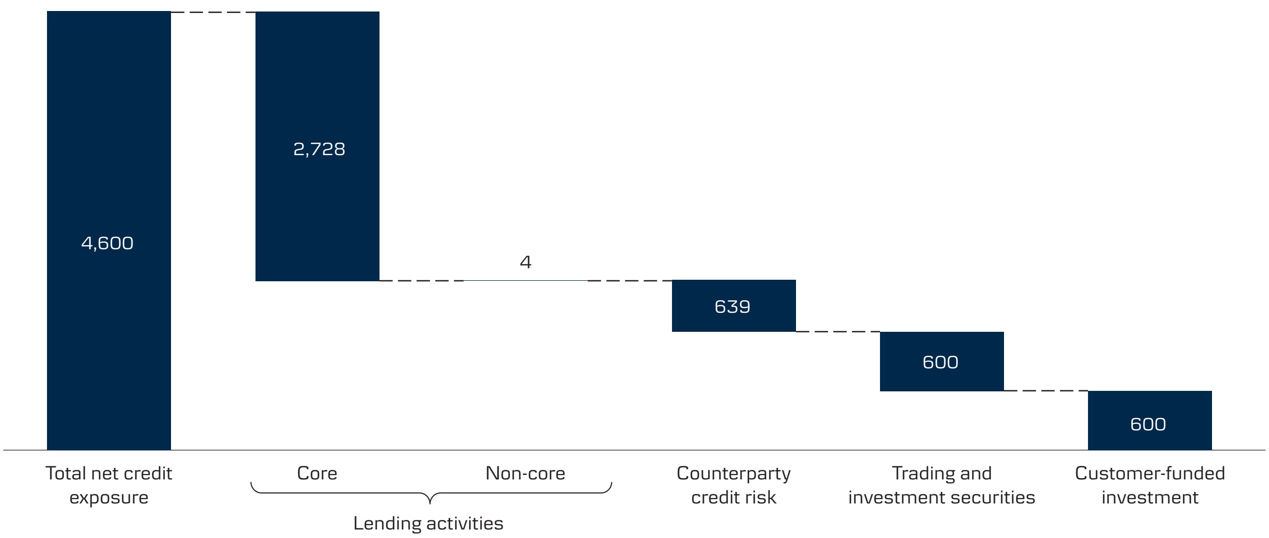
---

[2] Ratings 1-5 are comparable to investment grades; ratings 9 and 10 designate highly vulnerable customers; and rating 11 represents customers in default.

3.2 *Credit risk profile*

The Danske Bank Group's total net credit exposure is defined as on-balance-sheet and off-balance-sheet items net of impairment charges that carry credit risk. At the end of 2020, the Group's total net credit exposure for accounting purposes was DKK 4,600 billion (2019: DKK 4,153 billion).

Breakdown of net credit risk exposure
(DKK billions)



Net credit exposure from lending activities accounts for most of the Group's net credit exposure, and it is the focus of this section. Counterparty credit risk is explained in sections 3.4 and 3.5, while risk arising from trading and investment securities and customer-funded investment is described in section 4, Market risk. Net credit exposure from lending activities includes amounts due from credit institutions and central banks, loans, guarantees and irrevocable loan commitments.

At the end of 2020, net credit exposure from core lending activities amounted to DKK 2,728 billion (2019: DKK 2,444 billion). The increase in credit exposure was attributable mainly to an increase in deposits with central banks and amounts due from central banks and credit institutions and increased loans and loan commitments. Net credit exposure from Non-core lending activities came to a total of DKK 4 billion, down from DKK 10 billion at the end of 2019.

At the end of 2020, the Group's counterparty credit risk[3] amounted to DKK 639 billion, slightly up from DKK 637 billion at the end of 2019.

Net 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 risk type is described in the credit risk notes to the Danske Bank Group's financial statements.

The Group's credit risk exposure from assets in customer-funded investment pools, unit-linked investment contracts and insurance contracts (customer-funded investments) came to DKK 600 billion at the end of 2020 (2019: DKK 575 billion). The risk on assets under pooled schemes and unit-linked investment contracts is assumed solely by customers, while the risk on assets under insurance contracts is assumed primarily by customers. The credit risk on customer-funded investments and insurance contracts is described in the notes on credit risk and insurance contracts to the Danske Bank Group's financial statements.

From section 3.2.1 onwards, net credit exposure from lending activities (referred to as 'net credit exposure') excludes Non-core exposure (unless otherwise stated).

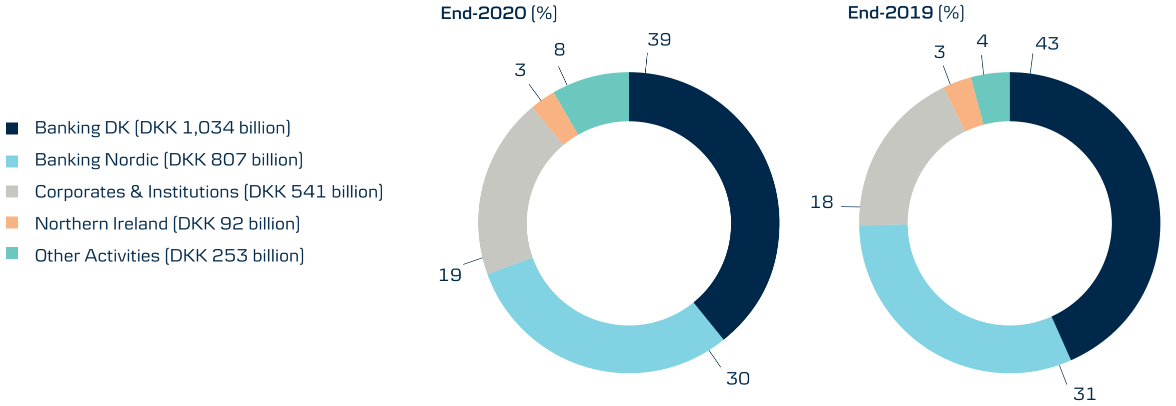
3.2.1 Net credit exposure from lending activities

Overall net credit exposure from lending activities increased by DKK 284 billion from the end of 2019. In 2020, loans increased by DKK 14 billion, loan commitments grew by DKK 98 billion, and guarantees fell by DKK 3 billion. At the same time, the Group also saw an increase of DKK 169 billion in deposits with central banks and amounts due from central banks and credit institutions.

[3] In this respect, counterparty credit risk consists of reverse transactions and other loans at fair value (loans at the trading units of Corporates & Institutions) as well as derivatives with positive fair value. The figure in section 3.5 below covers only derivatives with positive fair value.

At the business unit level, credit exposure increased at Banking Nordic (up DKK 43 billion) and decreased at Banking DK (down DKK 20 billion), while C&I saw an increase of DKK 98 billion that was driven by the COVID-19 crisis (loan offers and commitments to large customers increased by DKK 58 billion). Other Activities increased by DKK 154 billion due to higher deposits with central banks and amounts due from central banks and credit institutions.

Breakdown of net credit exposure by business unit (core lending activities)



Overall, the corporate and sovereign portfolios are well-diversified across various industries with public institutions and commercial property representing the two largest exposures. The credit exposure to personal customers consists mostly of home financing secured on real property.

For more information about the trends in selected portfolios, see the sections below.

Breakdown of industry credit exposure

	Net credit exposure (DKK billions)		
	End-2020	End-2019	Index
Public institutions	364	194	188
Financials	128	106	121
Agriculture	71	71	99
Automotive	31	38	82
Capital goods	76	70	109
Commercial property	329	316	104
Construction and building materials	50	50	99
Consumer goods	68	66	103
Hotels, restaurants and leisure	16	17	92
Metals and mining	13	12	112
Other commercials	23	21	109
Pharma and medical devices	50	40	126
Private housing co-ops and non-profit associations	208	198	105
Pulp, paper and chemicals	40	33	122
Retailing	26	25	102
Services	62	59	104
Shipping, oil and gas	43	57	76
Social services	28	31	90
Telecom and media	21	19	110
Transportation	15	16	95
Utilities and infrastructure	68	47	145
Personal customers	999	959	104
Total	**2,728**	**2,444**	**112**

3.2.2 Credit quality

Net credit exposure broken down by rating category

Despite a slight weakening mainly related to the COVID-19 crisis, credit quality remained strong in most segments in 2020. However, the effects of COVID-19 are expected to materialise in the coming quarters. Overall credit quality measured by exposure-weighted PD was 0.76% at the end of 2020, against 0.68% at the end of 2019.

Overall lending activities – net credit exposure by rating category

	PD scale (%)		Net credit exposure (DKK billions)		Net credit exposure (% accumulated)	
Rating category	Upper	Lower	End-2020	End-2019	End-2020	End-2019
1	0.00	0.01	271	152	10	12
2	0.01	0.03	240	199	19	22
3	0.03	0.06	538	471	38	38
4	0.06	0.14	577	566	60	60
5	0.14	0.31	508	490	78	78
6	0.31	0.63	302	282	89	89
7	0.63	1.90	172	188	96	96
8	1.90	7.98	53	44	98	98
9	7.98	25.70	11	10	98	98
10	25.70	99.99	44	29	100	99
11	100.0	100.0	10	13	100	100
Total			**2,728**	**2,444**	**100**	**100**

Impairment charges, non-performing loans and forborne exposures

Loan impairments in core activities amounted to DKK 7.0 billion in 2020 (2019: DKK 1.5 billion). On the basis of timely estimates applied in the Group's impairment process, loan impairments included a charge of DKK 2.4 billion to cover the effects of the limited visibility caused by the COVID-19 crisis. The impairments were a combination of specific adjustments for industries likely to be affected by the COVID-19 crisis and charges due to the updating of macroeconomic scenarios. Impairments relating to specific customers amounted to DKK 4.6 billion. This included charges in respect of customers in the oil and gas industry, due mainly to continued uncertainty in the offshore segment, which was also hit early in 2020 by the Russia-Saudi Arabia oil price war. Despite the above factors, overall credit quality remained strong.

Corporates & Institutions reported loan impairments primarily against single-name exposures, mainly in the oil and gas industry and, to a smaller extent, in the retailing industry. Banking Nordic was affected by an increase in total impairments following charges against single-name exposures and the changed macroeconomic outlook. At Banking DK, impairments were driven by the continued limited visibility relating to the effects of the COVID-19 crisis, but only little credit deterioration was observed.

Non-performing loans (NPL) and impairment charges broken down by business unit

	End-2020				End-2019			
(DKK millions)	Gross NPL = a+b	Expected credit loss b	Net NPL exposure a	Net NPL exposure, ex collateral	Gross NPL = a+b	Acc. individual impairment charges b	Net NPL exposure a	Net NPL exposure, ex collateral
Banking DK	12,295	5,864	6,430	1,105	15,588	7,282	8,306	767
Retail	3,983	2,293	1,690	183	4,636	2,486	2,150	294
Commercial	8,312	3,572	4,740	922	10,953	4,797	6,156	472
Banking Nordic	10,061	3,383	6,679	2,910	5,985	2,420	3,565	154
Sweden	3,905	1,103	2,801	726	1,384	493	892	97
Norway	2,213	466	1,747	2,015	2,083	545	1,539	-
Finland	3,227	1,413	1,814	169	2,125	1,106	1,019	56
Other	717	401	316	-	392	276	116	-
C&I	7,394	3,011	4,383	52	11,853	3,155	8,698	2,718
Wealth Management	-	-	-	-	-	-	-	-
Northern Ireland	2,014	668	1,346	214	1,281	508	773	227
Other	12	8	3	-	6	2	4	2
Total	**31,776**	**12,934**	**18,842**	**4,281**	**34,713**	**13,367**	**21,346**	**3,867**

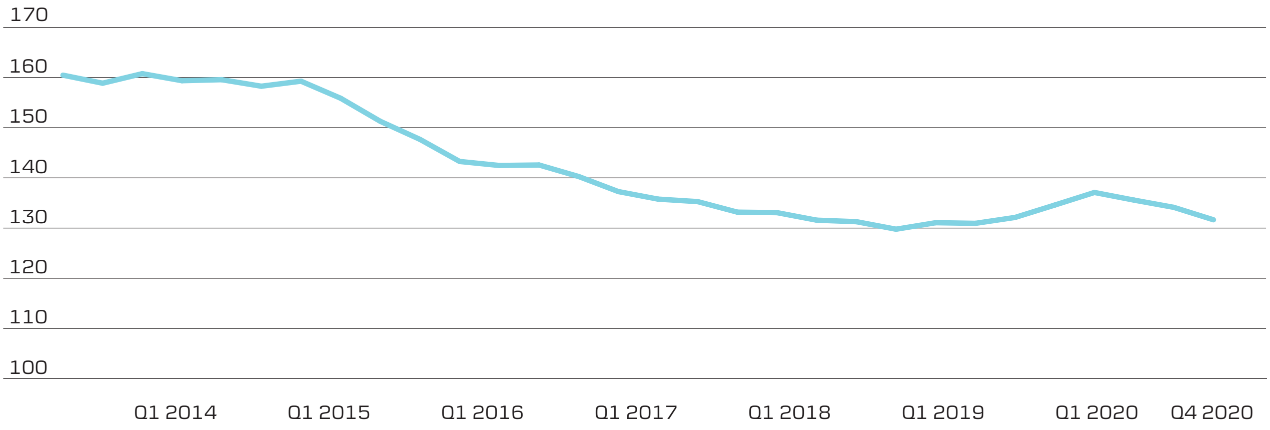
The Group defines non-performing loans as stage 3 exposures as defined in IFRS 9.[4] However, for non-retail exposures with one or more non-performing loans, the entire amount of a customer's exposure is considered to be non-performing. For retail exposures, only impaired facilities are included in non-performing loans. The Group excludes exposures in stage 3 with no impairment charges or where the allowance account is considered immaterial to the gross exposure.

Annual Report 2020 includes detailed information about definitions, approaches, methods, etc. in respect of expected credit losses (specific and general credit risk adjustments), IFRS 9 staging, past due facilities, etc.

Total gross non-performing loans (NPL) decreased by DKK 2.9 billion from the end of 2019. The decrease was due to a few single-name exposures in the capital goods and the shipping, oil and gas industries at Corporates & Institutions, with the effect being mostly offset by an increase in NPLs relating to single-name exposures in the following industries: hotels, restaurants and leisure; transportation; and consumer goods at Banking Nordic and retailing at Corporates & Institutions.

Gross non-performing loans (excluding Non-core)

(DKK billions)



[4] At 1 January 2018, the Group implemented the expected credit loss impairment model in IFRS 9. The impairment charge for expected credit losses depends on whether the credit risk has increased significantly since initial recognition and follows a three-stage model: 1) If the credit risk has not increased significantly, the exposure remains in stage 1 and the impairment charge equals the expected credit losses resulting from default events that are possible within the next 12 months. 2) If the credit risk has increased significantly, the loan is transferred to stage 2 and an impairment charge equal to the lifetime expected credit losses is recognised. 3) If the customer has defaulted on loan repayments or the loan is otherwise credit-impaired, it is transferred to stage 3 and the impairment charge continues to equal the lifetime expected credit losses, but with interest income being recognised in the net carrying amount.

Non-performing loans and impairment charges broken down by industry

	End-2020				End-2019			
(DKK millions)	Gross NPL = a+b	Expected credit loss b	Net NPL exposure a	Net NPL exposure, ex collateral	Gross NPL = a+b	Acc. individual impairment charges b	Net NPL exposure a	Net NPL exposure, ex collateral
Public institutions	-	-	-	-	1	-	1	1
Financials	199	199	-	-	338	263	75	-
Agriculture	3,156	1,410	1,746	440	3,452	1,708	1,744	412
Automotive	480	163	317	113	190	91	99	43
Capital goods	1,793	672	1,121	779	4,043	565	3,478	2,241
Commercial property	3,371	1,016	2,356	111	3,610	1,257	2,353	9
Construction and building materials	1,520	658	862	303	2,207	864	1,343	181
Consumer goods	1,452	575	878	173	886	441	446	34
Hotels, restaurants and leisure	1,563	410	1,153	683	145	81	64	12
Metals and mining	100	42	58	23	42	34	8	2
Other commercials	19	8	11	1	13	10	3	-
Pharma and medical devices	52	11	41	17	30	19	11	-
Private housing co-ops and non-profit associations	715	231	484	84	803	321	482	49
Pulp, paper and chemicals	418	180	237	62	368	119	249	78
Retailing	2,137	1,030	1,108	422	1,379	662	717	-
Services	941	526	415	182	664	402	262	50
Shipping, oil and gas	6,509	2,270	4,239	95	9,230	2,938	6,292	-
Social services	872	323	549	-	739	252	487	-
Telecom and media	177	106	71	9	220	110	109	32
Transportation	866	129	737	523	126	98	28	-
Utilities and infrastructure	47	47	-	-	59	34	25	12
Personal customers	5,388	2,931	2,457	261	6,167	3,095	3,072	714
Total	**31,776**	**12,934**	**18,842**	**4,281**	**34,713**	**13,367**	**21,346**	**3,867**

In 2020, the Group increased its use of concessions to customers affected by the COVID-19 crisis. The concessions granted by the Group represented an increase in gross exposure of approximately DKK 44 billion, of which around DKK 6 billion was considered forbearance measures.[5] The concessions related primarily to personal customers and the following industries: shipping, oil and gas; commercial property; transportation; and consumer goods.

Exposures subject to forbearance

	End-2020		End-2019	
(DKK millions)	Performing	Non-performing	Performing	Non-performing
Active forbearance	11,973	10,481	9,143	8,828
Under probation	14,962	-	6,482	-
Total	**26,934**	**10,481**	**15,625**	**8,828**

3.2.3 Credit risk mitigation

The main method used by the Group to mitigate credit risk is to obtain collateral with a focus on the customer's ability to repay. The most important collateral types, measured by volume, are real property, vessels, aircraft and equipment. Personal customers' real property accounted for 53% of the total collateral base after haircuts in 2020 (2019: 53%). For more information about haircuts, see section 3.1.7 above.

[5] See note G1(b), the section on 'Accounting treatment of the impacts on expected credit losses from the corona crisis', in Annual Report 2020 for a definition of when such concessions are considered to be forbearance measures.

Collateral value by type (after haircuts)

At 31 December (DKK billions)	Total		Portion from: Banking DK		Banking Nordic		Corporates & Institutions		Wealth Management		Northern Ireland		Other	
	2020	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**	**2020**	**2019**
Real property	1,357.6	1,322.7	842.5	828.6	451.6	432.1	29.9	26.6	-	-	32.9	34.8	0.7	0.6
- Personal	804.0	785.1	489.2	487.1	292.6	276.1	-	-	-	-	21.5	21.6	0.6	0.3
- Commercial	501.6	484.2	313.0	299.8	151.4	149.1	28.1	24.8	-	-	9.1	10.3	-	0.3
- Agricultural	52.0	53.4	40.3	41.7	7.5	7.0	1.8	1.8	-	-	2.4	2.9	-	-
Bank accounts	2.4	2.1	1.2	1.1	1.1	0.9	0.1	0.1	-	-	-	-	-	-
Custody accounts & securities	18.3	26.3	8.8	9.0	3.6	3.4	6.0	10.8	-	3.1	-	-	-	-
Vehicles	24.2	22.9	1.4	1.6	21.6	20.5	1.2	0.7	-	-	-	-	-	-
Equipment	20.3	23.8	2.1	3.1	13.9	15.8	1.2	1.5	-	-	3.1	3.5	-	-
Vessels and aircraft	24.1	29.6	2.0	1.7	2.5	2.6	19.6	25.2	-	-	-	-	-	-
Guarantees	31.2	14.8	1.7	1.9	8.3	7.2	18.2	5.8	-	-	3.0	-	-	-
Amounts due	4.5	4.7	0.0	0.0	3.8	4.0	0.4	0.2	-	-	0.3	0.5	-	-
Other assets	37.3	35.1	0.2	0.3	31.0	29.3	4.8	4.0	-	-	1.3	1.4	-	-
Total collateral	**1,520.0**	**1,481.9**	**860.0**	**847.3**	**537.3**	**515.8**	**81.4**	**74.9**	**0.0**	**3.1**	**40.7**	**40.2**	**0.7**	**0.6**

3.2.4 Trends in selected portfolios

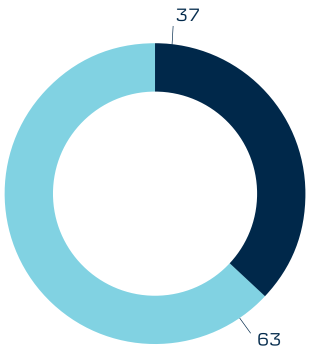
The sections below describe the trends in the credit quality of selected lending portfolios. These portfolios either have an elevated credit risk or represent a significant portion of the Group's total lending portfolio.

Personal customers

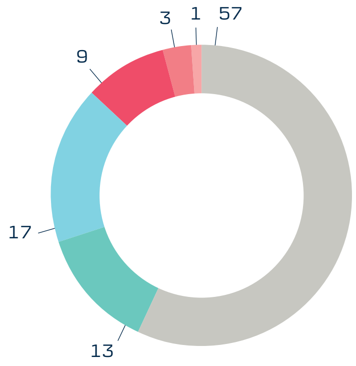
Measured by gross credit exposure, the personal customer portfolio is the Group's largest portfolio. At the end of 2020, gross credit exposure amounted to DKK 1,005 billion (2019: DKK 965 billion), with DKK 455 billion at Realkredit Danmark (2019: 455 billion) reflecting the Group's position as one of the leading Danish mortgage finance providers. The exposure to personal customers covers loans secured on customer assets, consumer loans and fully or partly secured credit facilities. Mortgage loans represent most of the exposure to personal customers at 85% (2019: 86%).

Personal customers

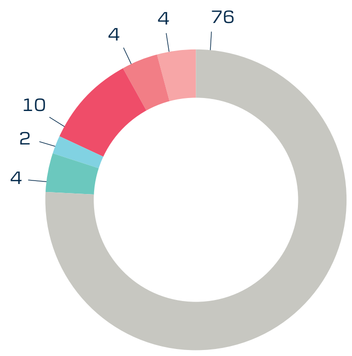
Gross credit exposure to personal customers as % of total lending portfolio



Gross credit exposure by country (%)



Expected credit loss by country (%)



■ Personal customers ■ The rest

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

Overall, the personal customer portfolio increased by DKK 40 billion from the end of 2019 to the end of 2020. This growth was driven by a significant increase in loans and loan commitments at Banking Nordic Sweden and Norway.

Taking a selective approach to growth enables the Group to grow in the Nordic markets without increasing its overall risk level. The credit quality of new lending to the Group's partnership customers in the Nordic region is generally higher than for comparable portfolios. In 2020, the credit quality of the personal customer portfolio continued to benefit from low interest rates and favorable macroeconomic conditions. Generally, increases in historically low interest rates could put pressure on customer affordability. Even though a stress test of the portfolio shows that customers with floating interest rates are exposed to changes in current interest rates, stress levels are highly acceptable and interest rate vulnerability is decreasing.

The COVID-19 crisis disrupted the economy in 2020, but the effects on personal customers have been limited so far and credit quality remains strong. Danske Bank implemented many initiatives to manage the risk and help customers through the crisis, for example by offering payment holidays or interest-only payments. Danske Bank continues to expect lagged effects from the COVID-19 crisis on personal customers such as increased unemployment rates and payment holidays/interest-only payments expiring, which will lead to higher delinquencies and defaults once the government support packages expire.

Developments in the personal customer portfolio

	Key figures					Non-performing loans		
(DKK millions)	Gross credit exposure	Expected credit loss	Write-offs	Impairment charges (bp)	Collateral (after haircuts)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2019	964,884	6,008	500	2	807,574	6,167	0.64	81
End-2020	1,004,763	6,203	497	7	826,582	5,388	0.54	92

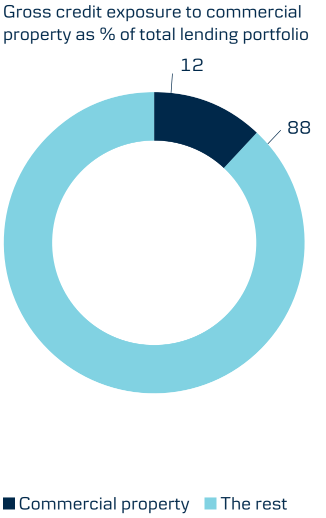
Commercial property

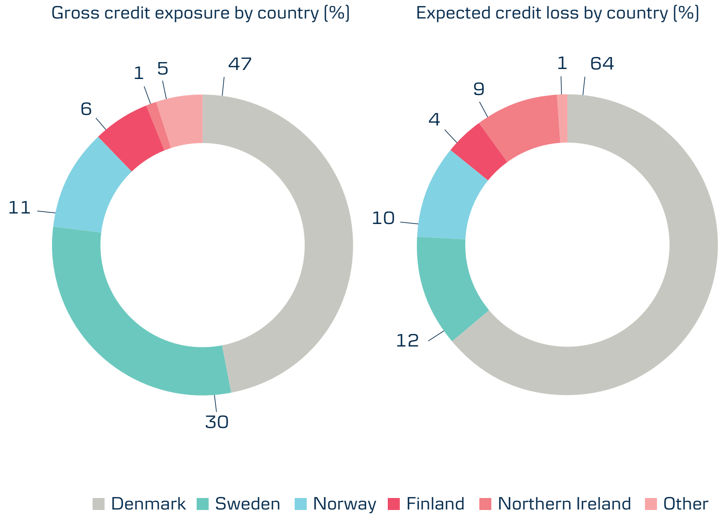
The commercial property portfolio consists primarily of secured property financing to owners of property let to third parties.

At the end of 2020, gross credit exposure amounted to DKK 331 billion. The allowance account for the portfolio, which amounted to DKK 2.6 billion, represented less than 1% of gross credit exposure.

In 2020, the credit quality of the portfolio remained stable even though some credit deterioration was observed in terms of negative rating migrations between mainly the better classifications. Overall, the outbreak of the coronavirus pandemic did not have any major effect on the portfolio's credit quality. However, the consequences were quite different for the individual property segments. While the retail and hotel property segments were mostly affected by the lockdown of communities, the residential, public, and office segments were much less hit. Given the more pessimistic outlook, Danske Bank maintained conservative underwriting standards in 2020.

Commercial property





Developments in the commercial property portfolio

	Key figures					Non-performing loans		
(DKK millions)	Gross credit exposure	Expected credit loss	Write-offs	Impairment charges (bp)	Collateral (after haircuts)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2019	317,794	2,175	203	-4	248,560	3,610	1.1	99
End-2020	331,344	2,629	92	23	258,791	3,371	1.0	90

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

Commercial property – net credit exposure by rating category

	PD scale (%)		Net credit exposure (DKK billions)		Net credit exposure (% accumulated)	
Rating category	Upper	Lower	End-2020	End-2019	End-2020	End-2019
1	0.00	0.01	0.1	0.1	-	-
2	0.01	0.03	2.3	2.5	1	1
3	0.03	0.06	7.2	9.0	3	4
4	0.06	0.14	33.5	59.0	13	22
5	0.14	0.31	144.5	131.3	57	64
6	0.31	0.63	92.5	71.7	85	87
7	0.63	1.90	35.7	32.9	96	97
8	1.90	7.98	6.8	3.8	98	98
9	7.98	25.70	0.5	0.8	98	99
10	25.70	99.99	5.0	3.7	100	100
11	100.00	100.00	0.8	0.8	100	100
Total			**328.7**	**315.6**	**100**	**100**

In 2020, the commercial property portfolio saw an overall increase in gross exposure of approximately DKK 13.5 billion, mainly driven by increases in respect of residential customers in Denmark and non-residential customers in Sweden.

Commercial property by property type and geography

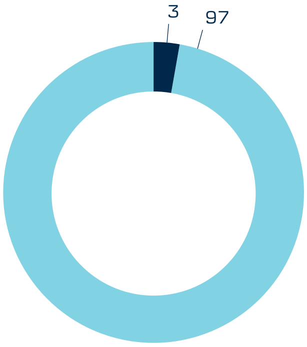
	End-2020			End-2019		
(DKK millions)	Gross credit exposure =a+b	Expected credit loss b	Net credit exposure a	Gross credit exposure =a+b	Expected credit loss b	Net credit exposure a
Non-residential	191,845	1,767	190,077	187,421	1,550	185,871
Denmark	84,777	1,081	83,696	85,519	1,029	84,490
Sweden	53,329	168	53,162	42,397	93	42,305
Norway	26,000	233	25,767	29,029	248	28,781
Finland	10,609	88	10,522	12,184	59	12,124
Northern Ireland	3,889	178	3,711	3,900	83	3,817
C&I etc.	13,239	20	13,219	14,392	37	14,355
Residential	139,499	861	138,638	130,374	625	129,749
Denmark	70,744	588	70,155	64,058	413	63,645
Sweden	46,611	141	46,470	42,061	86	41,974
Norway	9,574	43	9,532	10,019	43	9,976
Finland	8,685	27	8,658	7,966	38	7,929
Northern Ireland	1,065	49	1,016	1,427	38	1,389
C&I etc.	2,821	14	2,807	4,843	8	4,835
Total	**331,344**	**2,629**	**328,715**	**317,794**	**2,175**	**315,619**

Agriculture

The agriculture portfolio includes customers within traditional agricultural segments, such as dairy products, pigs, cereals and other crops, as well as 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.

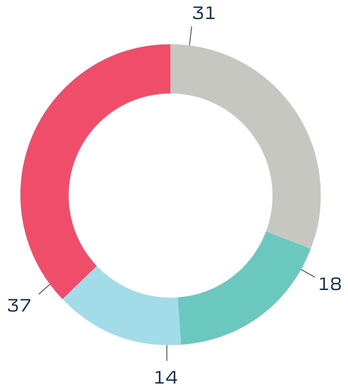
Agriculture

Gross credit exposure to agriculture as % of total lending portfolio

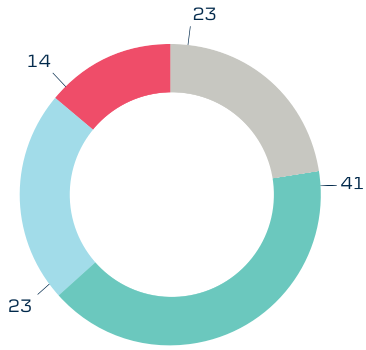


■ Agriculture ■ The rest

Gross credit exposure by segment (%)



Expected credit loss by segment (%)



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

At the end of 2020, gross credit exposure amounted to DKK 73.1 billion, slightly down from the level at the end of 2019. Banking DK accounted for 67% of gross exposure, of which Realkredit Denmark had a share above 82%. At Realkredit Danmark, the LTV limit at origination is 60%. Credit quality was weakest among pig producers and dairy farmers.

Developments in the agriculture portfolio

	Key figures					Non-performing loans		
(DKK millions)	Gross credit exposure	Expected credit loss	Write-offs	Impairment charges (bp)	Collateral (after haircuts)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2019	74,043	2,915	336	-37	57,042	3,452	4.7	81
End-2020	73,143	2,447	333	-25	56,406	3,156	4.3	76

The credit quality of the portfolio has improved over the past few years, recovering from legacy exposures from the financial crisis. In 2020, the portfolio was supported by average milk prices and beneficial pork prices as a consequence of the spread of African swine fever (ASF) in Asia and Europe. However, wild boars within German borders were confirmed as having ASF in early September, so many Asian countries closed down imports of all German pork meat. Danish pork prices fell back to an acceptable level (just below a long-term average), but half of the Danish piglet and pig stock was exported for breeding and slaughtering, so Danish producers were facing severe challenges from reduced German output prices. The expected credit loss figure included a large probability of a spread to Germany already before the outbreak of ASF, and it was further adjusted upwards after the outbreak. The Group's gross exposure to mink farmers was DKK 0.5 billion at the end of 2020.

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

Agriculture portfolio – net credit exposure by rating category

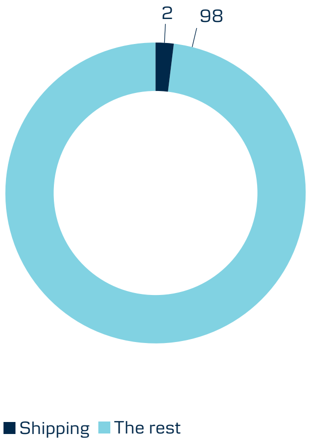
	PD scale (%)		Net credit exposure (DKK billions)		Net credit exposure (% accumulated)	
Rating category	Upper	Lower	End-2020	End-2019	End-2020	End-2019
1	0.00	0.01	-	-	-	-
2	0.01	0.03	0.7	0.4	1	1
3	0.03	0.06	1.2	0.9	3	2
4	0.06	0.14	5.9	5.3	11	9
5	0.14	0.31	11.0	8.5	27	21
6	0.31	0.63	22.4	22.9	58	53
7	0.63	1.90	18.4	20.1	85	82
8	1.90	7.98	5.2	7.1	92	92
9	7.98	25.70	0.2	0.8	92	93
10	25.70	99.99	4.0	2.7	98	97
11	100.00	100.00	1.5	2.4	100	100
Total			**70.7**	**71.1**	**100**	**100**

Shipping, oil and gas

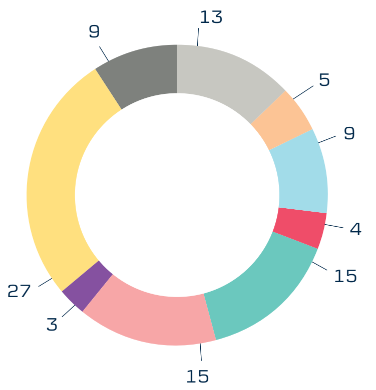
The shipping, oil and gas portfolio includes customers in standard shipping segments (such as container, tank, bulk, gas freight and offshore-related activities like rigs/FPSO units) and suppliers and customers in the oil and gas segment covering exploration and production and oil services. Exposure to shipping customers relates primarily to vessel financing secured by vessel or fleet mortgages.

Shipping, oil and gas

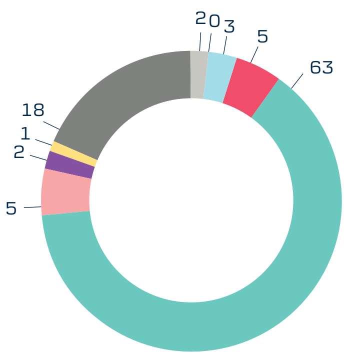
Gross credit exposure to shipping as % of total lending portfolio



Gross credit exposure by segment (%)



Expected credit loss by segment (%)



At the end of 2020, gross credit exposure amounted to DKK 46 billion, down from DKK 60 billion at the end of 2019, driven by a weaker US dollar, loan repayments and write-offs. The shipping sub-segment decreased from DKK 41.5 billion to DKK 29.5 billion with the largest decreases in following segments: rigs/FPSO units, container vessels and other shipping. The oil and gas sub-segment decreased from DKK 18.5 billion to DKK 16.5 billion during the same period.

Developments in the shipping, oil and gas portfolio

	Key figures					Non-performing loans		
(DKK millions)	Gross credit exposure	Expected credit loss	Write-offs	Impairment charges (bp)	Collateral (after haircuts)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2019	60,060	3,149	499	139	29,798	9,230	15	100
End-2020	46,018	2,942	3,335	906	23,408	6,509	14	96

In 2020, the portfolio was negatively affected by lower and more volatile oil prices, introduced by increased supply met by lower demand. The lower demand can partly be explained by the outbreak of the coronavirus pandemic. The majority of affected companies were within the segments supplying the oil majors, including the offshore supply, drilling and oil service industries. These industries were already under pressure due to overcapacity from the latest oil crises in 2014 and 2015. The increased pressure resulted in impairment charges of DKK 3.4 billion in 2020. This makes the shipping, oil and gas portfolio the most negatively affected portfolio since the outbreak of the coronavirus pandemic.

Shipping, oil and gas portfolio – net credit exposure by rating category

	PD scale (%)		Net credit exposure (DKK billions)		Net credit exposure (% accumulated)	
Rating category	Upper	Lower	End-2020	End-2019	End-2020	End-2019
1	0.00	0.01	-	-	-	-
2	0.01	0.03	-	-	-	-
3	0.03	0.06	2.7	3.5	6	6
4	0.06	0.14	5.4	11.4	19	26
5	0.14	0.31	11.3	12.4	45	48
6	0.31	0.63	7.2	10.5	62	66
7	0.63	1.90	8.0	9.4	80	83
8	1.90	7.98	0.5	0.2	82	83
9	7.98	25.70	0.0	0.1	82	83
10	25.70	99.99	5.5	7.6	94	97
11	100.00	100.00	2.5	1.9	100	100
Total			**43.1**	**56.9**	**100**	**100**

3.2.5 Lending to small and medium-sized enterprises (SMEs)

In 2020, the Group provided detailed data on its SME portfolio for the first time. Amounting to DKK 592 billion at the end of 2020, the net credit exposure to SMEs was up by DKK 20 billion from the level at the end of 2019. SME lending accounted for 22% of the Group's total net credit exposure at the end of 2020. Mortgage lending to SMEs increased by DKK 9 billion to DKK 280 billion, and guarantees and loan commitments also grew by DKK 9 billion to DKK 86 billion. At the same time, bank lending increased slightly from DKK 224 billion at the end of 2019 to DKK 226 billion at the end of 2020. Around 60% of the net credit exposure to SMEs related to Banking DK and 31% to Banking Nordic, while Corporate & Institutions and Northern Ireland accounted for the remaining exposure.

Net credit exposure to SMEs by industry (core lending activities)

	Net credit exposure (DKK billions)		
	End-2020	End-2019	Index
Financials	27	13	204
Agriculture	59	61	97
Automotive	4	5	93
Capital goods	10	11	92
Commercial property	193	194	100
Construction and building materials	13	13	100
Consumer goods	10	10	94
Hotels, restaurants and leisure	6	7	88
Metals and mining	1	2	83
Other commercials	1	1	59
Pharma and medical devices	1	1	95
Private housing co-ops, and non-profit associations	199	187	106
Pulp, paper and chemicals	8	7	112
Retailing	6	6	88
Services	14	16	90
Shipping, oil and gas	2	3	93
Social services	15	14	108
Telecom and media	3	2	114
Transportation	6	6	102
Utilities and infrastructure	8	8	101
Personal customers	6	6	113
Total	**592**	**572**	**103**

3.3 IRB framework and model development

In 2008, the Danish Financial Supervisory Authority (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 December 2020, the Group's exposure at default (EAD) was DKK 3,161 billion, with 68% calculated according to the advanced IRB approach, 2% according to the foundation IRB approach (F-IRB) and 31% according to the standardised approach.

The decrease in the EAD percentage for the advanced IRB approach from 2019 to 2020 was driven by an increase in sovereign exposures calculated according to the standardised approach.

EAD broken down by credit risk measurement approach

Measurement approach	2020	2019	2018
Advanced IRB (%)	67.5	72.7	71.6
Foundation IRB (%)	1.7	1.9	2.2
Standardised (%)	30.8	25.4	26.2

3.3.1 Organisation of the IRB framework

The IRB framework is organised in teams dedicated to specific roles. This means that there are specific teams that consider the following:

- probability of default (PD) model development (for scoring and rating models, respectively)
- loss given default (LGD) and conversion factor (CF) model development
- maintenance of data availability and quality
- rating of large customers
- credit REA calculations

These teams are anchored in organisational units that have no direct involvement in credit granting. Control mechanisms are incorporated in their processes, while deep-dive controls are described in section 3.3.4.

3.3.2 IRB exemptions

The Danish FSA has granted the Group exemptions for the following exposure types:

- exposure to the sovereign exposure class
- exposure to local/regional authorities
- exposure to public-sector entities
- exposure to churches and religious communities that raise taxes
- exposure to equities
- exposure to covered bonds in the banking book
- exposure to purchased receivables
- exposure to LR Kredit A/S
- exposure through branches in Estonia, Latvia and Lithuania[6]
- exposure within the Group (internally)
- exposure to the retail exposure class through branches in the Republic of Ireland
- exposures at the following legal entities: Northern Bank Limited (Northern Ireland), Danske Bank International (Luxembourg) and Danske Finance Plc (Finland)
- exposure to housing companies in Finland

3.3.3 Models in the IRB framework

The Group classifies customers by means of PD models and uses LGD models to estimate the loss on facilities in case of default. The CF models express a conservative estimate of EAD.

The Group uses the PD models to assess the probability of default of customers in various segments. Corporate and financial customers[7] are classified by rating models, while small business customers and personal customers are classified by scoring models. The rating models rely mainly on financial data and qualitative company characteristics. Rating officers may choose to adjust the modelled ratings if they have relevant information that is not covered by the models. In contrast, behavioural data is, to a wider extent, used as input in scoring models, which are therefore updated at a higher frequency than rating models. Most data originates from internal sources, but sometimes acquired from external vendors. This includes external credit scores used as model input in some models. No models depend exclusively on external credit scores. In general, the PD model framework generates highly conservative estimates – a significant factor contributing to this result is the benign economic environment seen in recent years.

[6] Danske Bank's branches in the Baltic states no longer provide customer services.
[7] Customers with facilities exceeding DKK 2 million and customer groups with facilities exceeding DKK 10 million.

The PD trend of the scored segments has been quite stable during the COVID-19 crisis. An analysis of the Danish segment suggests that the factors behind this stability are limited macroeconomic responses partly driven by government support packages. Customers classified by rating models are currently manually adjusted to reflect the COVID-19 outlook. Furthermore, the temporary relief of forbearance registrations during 2020 introduced by the Danish FSA and the European Banking Authority (the EBA) put a damper on the PD trend.

For regulatory (REA) purposes, in the majority of the models, point-in-time (PIT) PDs are converted into through-the-cycle (TTC) PDs by means of a scaling mechanism that ensures fixed-target levels while preserving the customer rankings. TTC PDs take into account regulatory floors where applicable.

IRB PD models by exposure class

Exposure class		Classification process	Key model characteristics
Central governments and central banks		Permanent exemption from IRB	Permanent exemption from IRB
Institutions		1 rating model (hybrid)	Bank
Corporates excluding SMEs		13 rating models (1 hybrid)	Several sub-segments with different characteristics; e.g. models differentiate between agriculture, non-profit customers, large corporates, insurance and property rental
Corporate SMEs		2 rating models	Sole proprietorships are handled separately from other corporate SME customers
Retail	SMEs Personal	11 scoring models 10 scoring models	Country-specific models
Equities		Permanent exemption from IRB	Permanent exemption from IRB

Two models use a hybrid PD approach in which PDs are not scaled to fixed-target levels – the hybrid models serve specifically to accommodate the low-default characteristics of banks and large corporates.

The Group's LGD models are primarily statistically driven, but parameters for low-default portfolios rely, to a high degree, on benchmarks, external data and expert opinions. CF models are statistically driven for the credit cards and credits portfolios, while other portfolios are based on expert opinions and relevant input. For regulatory purposes, downturn LGDs and CFs are used, and they include regulatory floors and additional prudential margins. The downturn LGD parameter incorporates ongoing adjustments from collateral movements to ensure a stable level that reflects downturn conditions. The Group's analysis shows that the COVID-19 crisis did not affect the macroeconomic environment in Denmark as much as projected, and collateral levels remained stable in LGD models.

For more information about the use of models, see sections 3.1.6 and 3.1.7.

3.3.4 IRB framework monitoring

Group Risk Management reviews and follows up on compliance with the IRB minimum requirements in CRR/CRD IV.

The IRB governance structure and the modelling framework are evaluated regularly.

Reports on all changes and ongoing activities in relation to the IRB framework are prepared and shared with the committee structure. Furthermore, the Board of Directors discusses and agrees on the IRB framework status and plans. Several independent units also monitor the IRB framework, as described below.

Validation of credit risk models

The Group has an internal, independent framework for validating models.[8] This framework comprises a set of processes and activities intended to verify that the models perform as expected. All new models are subject to initial validation, while models in the production environment are validated at least annually, independently of the business units and of the team that develops the models.

The validation is the main component for identifying model risk in the IRB framework. As part of the validation, models are assessed for purposes other than the IRB framework, such as the calculation of expected credit losses and the application for risk appetite calculations.

Model Risk Management owns the validation process and methodology. To ensure that the units remain independent, reporting and escalation take place through the committee structure and the CRO.

[8] A model refers to a quantitative method, system or approach that applies statistical, economic, financial or mathematical theories, techniques and assumptions to process input data into quantitative estimates.

The validation process plays an important role for the adjustment and development of the models. The current validation scope encompasses PD models for the rating and scoring of customers as well as LGD, CF and collateral value models. The validation scope also includes the framework across models, such as TTC calibration and downturn adjustment. Validation includes both a quantitative and a qualitative aspect.

Changes to the IRB framework and the IRB audit process
The Group has a governance structure for all changes made to the IRB framework to ensure the right level of attention. Depending on the materiality of the individual changes, a minimum level of evaluation, challenge and signoff is required from the relevant committees and the oversight and risk assurance units, i.e. Model Risk Management and Group Internal Audit. Internal approval lies with the unit appointed as the model owner.

Group Internal Audit, the Group's third line of defence, performs the independent audit of the IRB framework. The audit scope is a risk- and control-based approach set out by Group Internal Audit. Group Internal Audit reports directly to the Board of Directors' Audit Committee and to the Board of Directors.

The Danish FSA and/or the local supervisory authority must approve material changes to the IRB framework. The Group is required to notify authorities of less material changes.

3.4 Counterparty credit risk management

Counterparty credit risk is the risk that the counterparty to a transaction defaults before the final settlement of the transaction's cash flows. It is a combination of credit risk (a deterioration in the creditworthiness of a counterparty) and market risk (the potential value of derivatives contracts). The financial loss will be the current exposure, that is, the cost of replacing an existing transaction by a new transaction with similar characteristics but at current market prices while taking into account the value of mitigating collateral.

The Danske Bank Group takes on counterparty credit risk when it enters into:

- over-the-counter (OTC) derivatives
- securities financing transactions (SFTs)
- exchange-traded derivatives

The transaction types listed above derive their value from the performance of an underlying asset and have an associated future market value that may generate an exchange of payments or financial instruments depending on the terms of the transaction. The potential future value (PFE) of those instruments fluctuates since the market value is related to the underlying market factors and may thus shift between positive and negative levels.

The Group mitigates counterparty credit risk through pre-deal controls, post-deal monitoring, clearing, close-out netting agreements and collateral agreements. The Group incurs a financial loss if a counterparty defaults and the market value of the derivatives transactions is not covered after netting and the realisation of collateral.

At the customer level, counterparty credit risk is managed by means of PFE lines on a set of maturity buckets. Prior to trading, PFE lines are approved by the relevant credit unit. At the portfolio level, the Group uses additional metrics to help set and monitor counterparty risk appetite, including current exposure and exposure at default.

The Group has set limitations and introduced portfolio-level monitoring mechanisms. This includes monitoring wrong-way risk (the risk that arises when credit exposure to a counterparty increases while the counterparty's creditworthiness deteriorates), concentration risk and stress tests. The limitations cover the product range, the counterparty rating and the rating of the underlying securities.

The Group also manages its exposure to market risk on fair value adjustments (xVA), including credit value adjustments (CVA), under separate limits in the xVA framework as described in section 4, Market risk.

3.4.1 Governance and responsibilities

The Group organises its counterparty credit risk activities in line with the principles of the three-lines-of-defence model as defined in its enterprise risk management (ERM) framework.

Senior management oversees all financial risks in relation to trading activities and ensures that these risks remain within the Group's appetite. Furthermore, senior management serves as a platform between the first and the second lines of defence to discuss and escalate financial risks, if necessary.

3.4.2 Methodologies and models

The Group uses a number of metrics to capture counterparty credit risk, including current exposure (CE), potential future value (PFE) and exposure at default (EAD).

Current exposure is a simple measure of counterparty credit risk exposure that takes into account only current mark-to-market values and collateral.

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

The Group uses simulation-based models to calculate the potential future counterparty credit risk exposure. The models simulate the potential future market value of each counterparty portfolio of transactions while taking netting and collateral management agreements into account. For transactions not included in the internal simulation model (about 6%), the potential change in market value is determined as a percentage (add-on) of the nominal principal amount. The size of the add-on depends on the transaction type, maturity, currency and collateral coverage and is determined using a conservative approach to ensure estimation adequacy.

The Danish Financial Supervisory Authority (the Danish FSA) approved the Group's simulation model for calculating the regulatory capital requirement for counterparty credit risk in 2015.

More advanced measures such as EAD, which is a regulatory measure, express potential future losses and are based on internal models for future scenarios of market data. EAD figures are provided in the Additional Pillar III Disclosures spreadsheet, which is accessible at danskebank.com/investor-relations.

3.4.3 Monitoring and reporting
The Group carries out daily counterparty credit risk measurement and monitoring as well as intraday line utilisation monitoring. An overview of counterparty credit risk exposure is reported to the Executive Leadership Team and other senior management on a monthly basis.

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

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

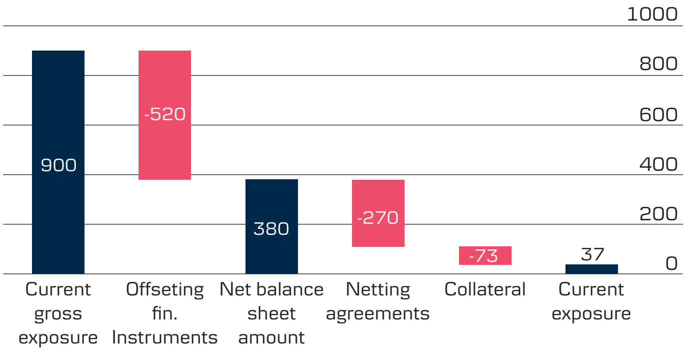
Internal management and monitoring of counterparty credit risk are performed in the Group's line system. The system covers all aspects of the internal counterparty credit risk management process, including the assignment of lines, monitoring and control of line utilisations, registration of master agreements,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

3.5 Counterparty credit risk profile

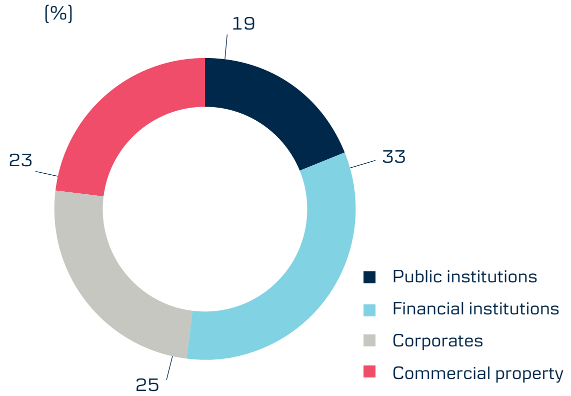
Exposures were higher in December 2020 than at the end of 2019. Current gross exposure is the total of all positive market values from transactions made before balance-sheet netting (netting effect) and collateral reduction (collateral effect). It is equivalent to the total amount of derivatives with positive fair value on the balance sheet. At the end of December 2020, the Group's current gross exposure to derivatives was DKK 900 billion (2019: DKK 637 billion). When netting effects and collateral received are taken into account, the current exposure to derivatives was DKK 37 billion in 2020 (2019: DKK 26 billion). The increase in the current exposure from 2019 was due mainly to a change in calculation methodology.

Counterparty credit risk, current exposure

Mitigation of counterparty credit risk (derivatives only)
(DKK billions)



Breakdown of current exposure by segment
(%)

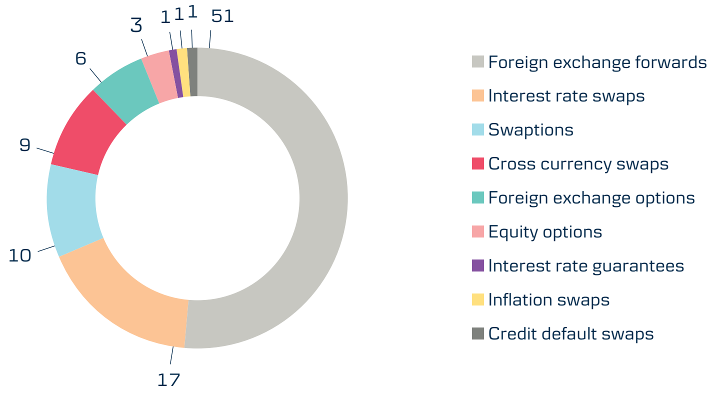


At the end of December 2020, the financial institutions segment represented the Group's highest level of exposure, while exposures to commercial property companies, corporates and public institutions were slightly lower.

In 2020, the Group cleared around 67% of the total notional amount of derivatives transactions through central clearing counterparties and used collateral agreements to support around 96% of non-cleared transactions.

The Group's trade count for all non-cleared OTC derivatives at the end of 2020

Breakdown of current exposure by segment
(%)



At the end of 2020, the Group's non-cleared OTC derivatives were concentrated in interest rates and foreign exchange contracts since foreign exchange forwards accounted for just above half of the trade count, cross currency swaps for 9% and interest rate swaps for about 17%. The remainder consisted of a broad range of primarily other plain vanilla products.

The following table shows the Group's current exposure to derivatives and SFTs after netting and collateral.

Current gross exposure and current exposure after netting and collateral

	2020			2019		
At 31 December (DKK millions)	Total	Derivatives	SFTs	Total	Derivatives	SFTs
Current gross exposure	905,600	899,739	5,862	644,338	637,073	7,265
Current exposure after netting	114,248	109,601	4,647	81,391	76,361	5,030
Current exposure after netting and collateral	43,430	37,027	6,403	29,738	25,631	4,107

Note: Current exposure figures for SFTs include both assets (reverse repo) and liabilities (repo). Furthermore, the current gross exposure figure for SFTs is net of the underlying securities. Consequently, the figures are not directly comparable with the exposure figures shown in Annual Report 2020 and in section 3.2 of this report.

At the end of December 2020, some 80% of the Group's collateral agreement holdings consisted of cash. The remainder consisted mainly of Danish mortgage bonds and government bonds issued by Denmark, France and Germany.

The following table breaks down the Group's current exposure after netting and collateral by rating category.

Current exposure by rating category

	2020			2019		
At 31 December (DKK millions)	Total	Derivatives	SFTs	Total	Derivatives	SFTs
1	9,224	7,815	1,408	6,235	5,230	1,005
2	5,690	3,319	2,371	4,218	2,375	1,843
3	11,376	8,878	2,498	4,434	3,631	804
4	4,975	4,942	33	5,031	4,601	430
5	6,540	6,452	87	7,012	7,001	11
6	3,426	3,421	5	1,591	1,576	15
7	1,309	1,309	-	865	865	-
8	409	409	-	98	98	-
9	27	27	-	21	21	-
10	375	375	-	175	175	-
11	81	81	-	60	60	-
Total	**43,430**	**37,027**	**6,403**	**29,738**	**25,631**	**4,107**

At the end of December 2020, the credit quality of the Group's counterparty credit risk remained strong with around 87% of the exposure relating to counterparties having a classification comparable to investment grade.

Market risk

4.

4.1 Market risk management

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 on-balance-sheet and off-balance-sheet items: some of the Group's financial instruments, assets and liabilities are valued on the basis of market prices, while others are valued on the basis of market prices and valuation models developed by the Group. In addition, net interest income generated through the non-trading portfolio will be affected by the level of interest rates.

The Group's market risk management is intended to ensure proper oversight of all market risks, including both trading-related market risk and non-trading-related market risk as well as market risk in relation to fair value adjustments. The market risk framework is designed to systematically identify, assess, monitor and report market risk.

The Group manages its market risk by means of three separate frameworks for the following areas:

- Trading-related activities at Corporates & Institutions (C&I)
- Fair value adjustments (xVA) at Corporates & Institutions
- Non-trading portfolio at Group Treasury

The Group manages the market risk associated with its trading activities in the financial markets. In particular, the Group hedges the market risk incurred from market-making activities and client flows by taking positions in financial instruments, assets and liabilities that offset this market risk. In addition, the Group uses financial instruments to hedge the fair value adjustments (xVA) in relation to derivatives trading.

Group Treasury manages interest rate risks and other market risks associated with the assets and liabilities of the non-trading portfolio. Group Treasury also manages risks associated with the Group's defined benefit pension plans.

The market risk at Danica Pension is managed separately. For more detailed information, see section 6, Insurance and pension risk.

4.1.1 Governance and responsibilities

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 supplemented by the Market Risk Instructions set by the Board of Directors. The latter document defines the overall limits for various market risk factors and additional boundaries within which trading activities are performed.

Market risks are managed by C&I and Group Treasury (the first line of defence) through implementation of the Market Risk Policy and the Market Risk Instructions into standard operating procedures and the control environment. Interest rate risks in relation to other business units are transferred to and managed by Group Treasury. The units own, identify and manage the market risks and perform operational and managerial controls in the day-to-day risk management.

Market & Liquidity Risk (the second line of defence) within Group Risk Management owns the market risk framework and is in charge of market risk oversight and control of the first-line-of-defence units. Market & Liquidity Risk is accountable for developing and maintaining the Market Risk Policy, the Market Risk Instructions and the market risk framework. The Group's market risk appetite is incorporated in the Market Risk Policy and Market Risk Instructions.

Oversight and control processes at Market & Liquidity Risk encompass current and emerging risk monitoring, limit control, portfolio analysis, stress testing, reporting to senior management and challenging the risk management practices performed by the first-line-of-defence units. Group Finance is accountable for the independent price verification (IPV) framework, prudent valuation and profit and loss (P/L) control.

4.1.2 Market risk appetite

The Group operates with a market risk appetite for its trading-related activities. The market risk appetite determines how much the Group is prepared to lose on its trading-related market risk exposure over a period of one year in a severely stressed market environment. The risk appetite is based on the Group's business strategy, the expected future market environment as well as the expected earnings. The market risk appetite for trading-related activities is approved by the Board of Directors and reassessed at least once a year. In addition, the Board of Directors has defined a risk mandate that allows the Group's trading units to take on own market risk positions in keeping with the above-mentioned risk appetite.

The Group's exposure to the risk on fair value adjustments is managed under separate limits. Such limits are based on an xVA risk appetite that expresses the maximum expected net value adjustment in a severely stressed environment arisen from risk factors that cannot be hedged or which the Group has deliberately chosen not to hedge.

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

4.1.3 Limit framework

Market risk limits are set in terms of 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, xVA-related and non-trading portfolio 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. This document defines overall limits for material risk factors. The overall limits are supplemented by Value-at-Risk (VaR) and Stressed Value-at-Risk (SVaR) limits for trading-related market risk. The Group All Risk Committee delegates the Board limits to business units and assigns additional limits for less significant risk factors. Detailed operational limits for trading-related market risk are set at business unit and trading section levels for relevant risk categories and metrics. The operational limit structure is sufficiently granular to facilitate effective control of market risk and to provide an overview and understanding of activities undertaken by the various units under the three distinct market risk frameworks.

4.1.4 Risk identification and assessment

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 assessed in relation to current risk management practices and IT systems.

Furthermore, the Group may identify a need to take into account new risk factors (through a review of its strategy) or financial market developments like the current IBOR reform. If the Group wants to expand its business into specific products or instruments, there may be a need for additional metrics and limits.

4.1.5 Monitoring and reporting

The Group carries out market risk controlling and reporting on a daily basis. The controlling process involves continuous intraday monitoring of limit utilisations with a full portfolio update every 30 minutes. The monitoring system is linked directly to front-office trading systems and automatically flags any limit excess. The business units and trading sections must comply with limits at all times. If a limit is breached, the unit responsible must document the cause and submit an action plan to rectify the situation. All limit breaches are reported to the relevant authority within the limit structure.

The Group produces a range of internal market risk reports and provides input to other internal and external reports in which market risk monitoring is presented.

The Board of Directors and senior management regularly receive reports that provide an overview of the Group's portfolios, main risk drivers and stress testing results for decision-making purposes. Furthermore, detailed reporting (on a daily and weekly basis) provides granular metrics to senior management at Corporates & Institutions and Group Treasury for day-to-day risk management purposes.

4.1.6 Portfolio analysis and stress testing

The Group performs market risk portfolio analyses and stress testing on a regular basis and in relation to specific events in trading and financial markets.

On a monthly basis, the Group analyses the relationship between market risk and income for the trading sections at Corporates & Institutions. The market risk stress testing programme is designed to underpin prudent market risk management. Efforts are made to ensure that the net effect under various stressed conditions is taken into account in the risk assessment and monitoring processes.

The purpose of market risk stress testing is to:

- assess the adequacy of the Group's financial resources for periods of severe stress and develop market-risk-related contingency plans for the Group if the need arises
- promote risk identification and add further insight into the need for adjusting existing or adding new limits
- provide a supplement to the ongoing quality assurance for market risk management practices

The complexity of the methodologies ranges from simple sensitivity analyses to complex scenario stress testing proportionally suited to the purpose of the stress test.

4.2 Methodologies and models

The Group uses a range of measures forming a framework that captures the material market risks to which the Group is exposed. Both conventional risk measures, such as sensitivity and market value, and mathematical and statistical measures, such as VaR, are used in day-to-day 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.

4.2.1 Value-at-Risk

The current internal market risk model was approved by the Danish Financial Supervisory Authority (the Danish FSA) in 2007 and has since then been used for the calculation of regulatory capital for the Danske Bank Group and Danske Bank A/S. The model covers interest rate risk, equity market risk and exchange rate risk. At the end of 2011, the model was approved to cover interest rate basis risk, interest rate volatility risk and inflation risk. In 2015, the model was further approved to include bond-specific risk and equity-specific risk. At the same time, the Group's incremental risk model (see section 4.2.2) was significantly enhanced and subsequently included in the framework. Consequently, the Group's internal model is enhanced on an ongoing basis to cater for new risk factors and products, for example.

VaR is a quantitative measure that shows, with a certain probability, the maximum potential loss that the Group may suffer within a specified holding period.

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 assuming unchanged positions for one day.

In general, a VaR model estimates 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, and the Group has a comprehensive stress testing programme in place to mitigate these limitations.

The stress testing programme provides additional perspectives on market risk by applying multiple methodologies with various severities. The complexity of the methodology ranges from simple sensitivity analyses to complex scenario stress testing proportionally suited to the purpose of the individual stress test. In general, the Group's stress testing practices can be divided into the following three categories: 1) risk factor stress testing, which stresses risk factors on an individual and collective basis (single-factor and multiple-factor stress tests); 2) scenario stress testing, which assesses the consequences of specific scenarios covering hypothetical as well as historical shocks to multiple risk factors simultaneously; and 3) reverse stress testing, which identifies extreme but plausible single- or two-factor scenarios that could result in significant adverse outcomes.

Value-at-Risk model

Value-at-Risk	Risk monitoring VaR limit	Risk monitoring: stressed VaR limit	Capital requirement: VaR	Capital requirement Stressed VaR	Backtesting
Percentile	95	99	99	99	99
Holding period	1 day	10 days	10 days	10 days	1 day
Historical data used	2 years	2 years	2 years	1 year	1 year
Period	Recent	Recent	Recent	1-year period of significant financial stress relevant to the Group's portfolio	Recent

All figures are calculated and reported internally on a daily basis. Figures are calculated using full revaluations in all their details by using primarily the front-office valuation models.

The VaR used for risk monitoring and capital requirement calculations is based on 2-year sliding historical data, and each calculation is based on 1,000 scenarios using bootstrapping of 1-day returns. Scenarios are time-weighted – 70% of all scenarios are based on the most recent 1-year period.

Risk-factor returns are calculated as absolute returns for spreads and volatilities and as proportional returns for equities and foreign exchange. A mixed approach is used for interest rates.

Stressed VaR used for regulatory capital purposes is calculated using a holding period and historical data from a continued 12-month period of significant financial stress for the relevant portfolio. Scenarios are equally weighted. A structured approach is used for identifying the historical period representing a significant stress on the current trading book. The historical period is identified by running the full VaR model over a comprehensive historical period to identify the 12-month period since 2008 that produces the highest VaR for the current portfolio. On this basis, the periods with the highest level of stress are identified and analysed in more detail in order to validate the period to be used for calculating stressed VaR. From the beginning of 2020, the Group calculated stressed VaR on the trading book on the basis of the period from September 2008 to September 2009. However, the COVID-19 crisis meant that the period was changed in June 2020 to run from June 2019 to June 2020. This period was maintained during the rest of the year.

Beyond the above-mentioned stressed VaR, the Group calculates stressed VaR for internal limit purposes on the basis of the period from September 2008 to September 2009.

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 calculated1-day VaR on trading book positions with actual and hypothetical P/L results.

Definition of actual and hypothetical profit and loss

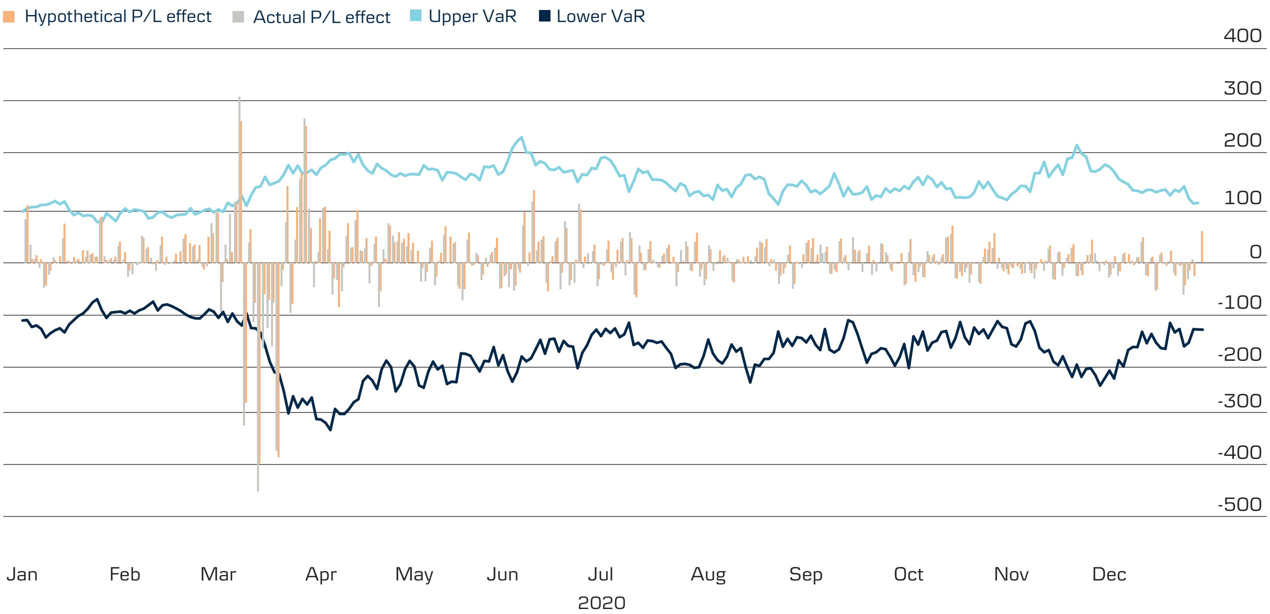
Actual P/L is defined as the loss or gain from actual changes in the market value of the trading book when daily closing values are compared with the subsequent business day's closing values (that is, intraday trades on the subsequent business day are included).

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 trades are 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. Backtesting results for 2020 are shown in the chart below.

Backtest results and P/L effect

(DKK millions)



The backtesting of the internal VaR model showed four exceptions in hypothetical P/L and three exceptions in actual P/L in 2020. All exceptions occurred during March following primarily large increases in interest rates and significant movements in Danish mortgage spreads.

4.2.2 Incremental risk

The incremental risk model captures rating migration and default risk on a one-year horizon for all instruments subject to specific interest rate risk: bonds, mortgage-backed securities, bond futures and options, mortgage bond futures and credit default swaps (CDS).

The model estimates a P/L distribution through Monte Carlo simulations of credit events for all issuers based on transition matrices. A total of 200,000 scenarios are used.

The correlation between issuers is captured by using a one-factor Gaussian copula. The correlation parameter is estimated quarterly on the basis of pairwise correlations of bond and CDS spread time series.

Ratings and transition matrices used in the model are based on information from the major rating agencies. Ratings are updated on an ongoing basis, while transition matrices are updated annually. A constant liquidity horizon of one year is used for all instruments.

A cross-sectional model including factors such as rating, sector, region and maturity is used for the translation of simulated rating migrations to corresponding spread changes. The model is recalibrated quarterly.

4.2.3 Regulatory capital for market risk

The minimum capital requirement for market risk is measured on the basis of positions in the trading book. Approved by the head of Market & Liquidity Risk and subsequently endorsed by the Group Asset & Liability Committee (Group ALCO), the Regulatory Trading Book Instructions ensures that market risk positions at the Danske Bank Group are labelled and handled either as regulatory trading book positions or as regulatory banking book positions in accordance with the regulatory requirements. The trading book covers trading-related market risk at Corporates & Institutions and hedging in relation to fair value adjustments of interest rate risk and the part of the CDS spread hedges not included in the risk exposure amount calculations for credit value adjustment (CVA) risk (see below).

The Group mainly uses the internal model approach (IMA) to measure the risk exposure amount (REA) used for determining the minimum capital requirement for market risk in the trading book. The IMA comprises the Value-at-Risk (VaR) capital charge, the Stressed Value-at-Risk (SVaR) capital charge and the incremental risk charge (IRC). The Group uses the internal VaR model to calculate the VaR and SVaR capital charges, whereas the IRC is calculated on the basis of the incremental risk model. No diversification effects between capital charges are taken into account.

The VaR and SVaR components of the REA are measured as the maximum of the period-end value and the average value of the preceding 60 business days multiplied by a VaR multiplier. The VaR multiplier is dependent on the number of backtesting exceptions in the preceding 250-business-day window. When the number of exceptions is larger than four, the multiplier increases gradually from three to a maximum of four when 10 exceptions occur within the 250-business-day window. As of 31 December 2020, the multiplier was three as the Group did not experience any regulatory backtesting exceptions. This was in agreement with a decision made by the Danish FSA that exceptions occurring during the COVID-19 crisis could be disregarded. In addition, the Danish FSA has set a model multiplier of 0.5 that must be added to the VaR multiplier to accommodate any uncertainties or imperfections in the Group's internal VaR model. In total, the multiplier used in the VaR and SVaR capital charges was 3.5 at the end of 2020.

The IRC component is measured as the maximum of the most recent IRC value and the average of the IRC number during the preceding 12 weeks.

The REA for the Group's minor exposures to commodity risk and collective investment undertakings is calculated according to the standardised approach.

The REA for CVA risk is measured mainly using the internal VaR model based on exposure calculations from the counterparty risk exposure model and allocated CDS spread hedges. The risk exposure amount for CVA risk from the Group's minor exposures to transactions not included in the counterparty credit risk exposure model is calculated according to the standardised approach.

4.2.4 Model validation

The Group conducts a variety of activities to ensure well-performing models in the market, counterparty credit and liquidity risk areas. The activities can be divided into the following:

- Validation of models used for the valuation of over-the-counter (OTC) products and calculation of market risk sensitivities for fair value positions
- Validation of behavioral models used for the calculation of interest rate risk in the banking book (IRRBB), initial margin models and liquidity risk models (performed by the Market & Liquidity Risk department)
- Validation of internal models used for the calculation of regulatory capital for market and counterparty credit risks (performed by the COO Risk department)

The purpose of the validation process is to assess, independently of the model owner and developer, whether the accuracy of the model is satisfactory and the model meets all regulatory requirements.

In addition to initial validation and annual re-validation, the Group has established ongoing monitoring processes, such as backtests of the initial margin model and controls of the continued validity of model assumptions, in which the crossing of specific thresholds triggers targeted review activities and escalation.

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 major model assumptions.

Moreover, the Group conducts a number of activities to monitor the internal VaR model on an ongoing basis. These activities include an annual review of the model in accordance with regulatory requirements, quarterly risk factor reviews and daily backtesting 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 for risk monitoring contains all significant risk factors.

The Group primarily validates its models internally. However, external validation may be considered in the event of introducing new complex models or complex amendments to existing models as it enables the Group to benchmark the models against those of international peers, for example.

The validation and ongoing control processes are anchored internally in the Group's Model Risk Policy, which sets out the principles and standards for model risk management at the Danske Bank Group.

4.3 Data and systems

IT systems pertaining to market risk are highly integrated within 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.

4.3.1 Systems integration

The Group's front-office trade-entry systems are designed to capture all trade types used by the Group. Only necessary trade-related data is entered into the trade-entry systems. Product, customer and other related static data is maintained in the Group's Master Files. Trading data is 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 handled manually.

In addition, trades from systems configured for straight through processing are regularly monitored in order to identify trades that require manual intervention. Monitoring is part of the back and middle office processes, and regular reports are sent to a broad selection of stakeholders across the Group. Extensive reconciliation between the Group's internal systems and external accounts is performed on a regular basis.

4.4 Market risk profile

4.4.1 Trading-related market risk at Corporates & Institutions

The activities that involve market risk in the trading portfolio derive mainly from the Group's initiatives to provide investment and hedging products to the full range of customers. In particular, principal risk-taking is a key element in serving the Group's largest corporate and institutional clients. The Group operates mainly in the Nordic markets and in selected international markets in the eurozone.

The strategic focus is to provide global fixed income, currency and capital market products to institutional and corporate clients in the Nordic countries and to offer local Nordic products to global customers. Principal risk-taking takes place mainly in fixed income products. Advanced derivatives are traded mainly with professional customers, while simple products are distributed to retail and commercial customers.

The Group's business activities involve a natural flow of various currencies. These are primarily currencies related to the Group's domestic markets in the Nordic region. They include all major currencies in support of Nordic customers and, to a lesser extent, other currencies requested by customers in these areas. However, taking on foreign exchange risk is limited relative to the market risk derived from interest rates.

One business objective is to provide liquidity and engage in market-making in equity-related assets. The objective is to have a leading market position in the Nordic equity market. The Group's equity market risk is limited relative to the market risk derived from interest rates. The Group is currently winding down a legacy commodity OTC derivatives book. As part of this process, the Group has reduced market risk to an insignificant level since it does not want to take on material commodity market risk. In the long term, the Group wants to assume only very limited market risk in oil futures as a hedging tool for the inflation trading book. The Group is not allowed to take physical positions in any commodity.

Value-at-Risk for trading-related activities at Corporates & Institutions

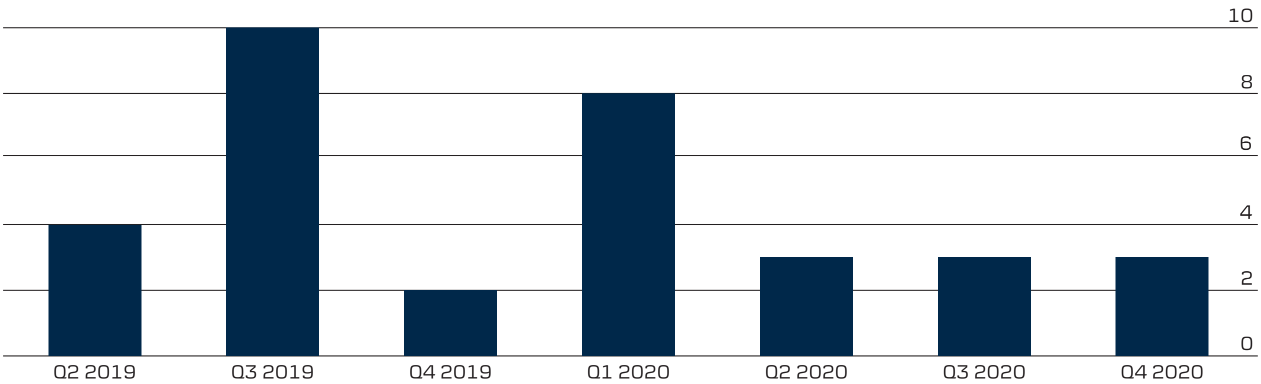
	2020		2019	
(DKK millions)	Average	31 December	Average	31 December
Bond spread risk	24	27	17	13
Interest rate risk	26	26	23	25
Equity risk	12	14	5	12
Foreign exchange risk	3	12	2	2
Diversification effects	-36	-51	-21	-26
Total VaR	**29**	**28**	**26**	**26**

Note: VaR is calculated at a confidence level of 95% for a 1-day horizon.

The Group continued to maintain a low risk in its trading operations in 2020, with average trading-related market risk increasing from 26 million in 2019 to DKK 29 million in 2020. Throughout the period, the risk related chiefly to fixed income products, which gave rise to interest rate risk and bond spread risk. Because of substantial diversification, however, the two main risk factors hedged each other well.

Both average interest rate risk and average bond spread risk as well as equity risk increased in 2020 from 2019 levels. In addition, foreign exchange risk was more or less unchanged.

Days with negative income exceeding EUR 1 million in trading-related activities at Corporates & Institutions



Day-to-day income from trading-related activities at Corporates & Institutions showed increased fluctuations during the first quarter of 2020 as a result of markedly higher interest rate volatility, but income volatility decreased considerably during the rest of the year. The number of days with losses exceeding EUR 1 million in 2020 remained at the same level as in 2019.

4.4.2 Market risk in relation to fair value adjustments

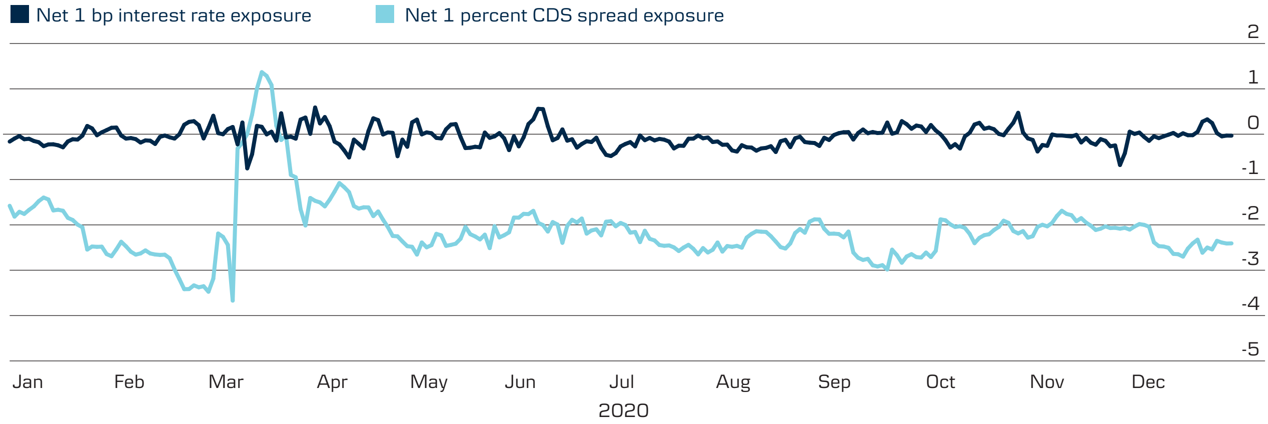
The Group's fair value adjustments (xVA) cover funding value adjustments (FVA), credit value adjustments (CVA) and debt value adjustments (DVA). The Group applies a market-implied approach that is in line with industry best practice. When managing xVA, the Group focuses on managing economic risk rather than regulatory capital. This means that the Group recognises market risk on all counterparties and not just counterparties in scope for the CVA risk charge. The Group's strategy is to continue developing the xVA model so that it remains in line with best market practice.

For the purposes of reducing P/L volatility caused by xVA, the Group pursues a strategy of hedging the most significant risk in the financial markets in order to maintain income stability and predictability under this framework. In practice, the Group buys a hedge of offsetting interest rate swaps and CDS contracts in the financial markets. The Group hedges open foreign exchange risk under this framework. Due to the non-linear nature of both CVA and FVA, the Group has a significant interest rate vega exposure, which is only partially hedged. The FX vega exposure is limited and not hedged at the moment. The main risk of FVA is the funding spread risk (the funding spread is set by Group Treasury). This part cannot easily be limited and hedged, but the Group nevertheless endeavours to mitigate some of the funding spread risk through own debt issues. In addition, the Group may maintain exposures to sovereign spread risk.

In 2020, the xVA hedging strategy contributed to a 65% reduction in actual daily income volatility as compared with the volatility of an unhedged portfolio.

xVA-related market risk

(DKK millions)



The chart illustrates the sensitivity to credit spread risk and interest rate risk. The sensitivity to interest rate changes fluctuated around zero for most of 2020 and ended slightly lower than the level at the end of 2019. The exposure to credit spreads increased markedly during the first quarter of 2020 as a result of deteriorating credit conditions. However, in March, credit spread sensitivity decreased markedly as a result of risk hedging. During the rest of the first half of 2020, credit spread sensitivity increased in the light of further developments in credit indices and a stabilisation of the financial markets. Credit spread sensitivity was fairly stable during the second half of 2020.

In addition to the fair value adjustment, further adjustments have to be made to ensure that prices are not only fair but also prudent. The applied methodology and the adjustments based on the methodology ensure that positions can be exited at a given price at a confidence level of 90%. Adjustments are made for multiple sources of uncertainty such as market price uncertainty, close-out costs, model risk, unearned credit spreads, concentrated positions, future administrative expenses and operational risk. Whenever possible, the calculation of the adjustments is based entirely on market data, but when such data is insufficient, individual input may be based on expert opinions. When market data is unavailable in their entirety, the application of methodologies such as the costs of hedging and generic haircuts will ensure prudence in prices as well as compliance with regulatory standards.

4.4.3 Market risk in relation to the non-trading portfolio

The Group’s exposure to market risk in the non-trading portfolio originates mainly from interest rate risk in the banking book. Such risk derives from providing the Group’s core banking customers with conventional banking products and from the Group’s funding and liquidity management activities at Group Treasury. In addition, the Group holds a small portfolio of unlisted shares relating mainly to private equity funds and banking-related investments.

Interest rate risk in the banking book

The day-to-day management of the interest rate risk associated with the Group’s banking book activities is overseen by Group Treasury.

Interest rate risk in the banking book (IRRBB) is driven by a number of factors: repricing mismatches between assets and liabilities, client behaviouralisation, optionality within client products booked within the banking book, and interest rate floors and options on assets and liabilities held by the Group.

Annually, the Board of Directors determines the Group’s interest rate risk appetite. This framework is translated into a limit framework used for risk management purposes. The Group ALCO is responsible for monitoring and managing the Group’s IRRBB exposure, while the Group Balance Sheet Risk Committee discharges the second-line-of-defence obligations in overseeing the implementation and maintenance of the group-wide framework for managing the non-trading portfolio market risk.

Group Treasury provides the first line of defence for IRRBB. This involves day-to-day management of the actual risk against the limit framework. Market & Liquidity Risk provides the second line of defence and maintains the risk management systems used for calculating the economic value-based IRRBB measures. In addition, Market & Liquidity Risk maintains the limit framework and monitors adherence to the limits. On a monthly basis, the Group ALCO reviews IRRBB utilisation against a series of risk measures. These cover prescribed regulatory metrics, the risk appetite as determined by the Board of Directors and other risk measures that are considered appropriate. The Group ALCO reviews IRRBB-related issues and monitors the levels of Economic Value, Earnings-at-Risk and Credit Spread Risk utilisation.

The Group regularly reviews its IRRBB framework in order to make sure that it continues to have the capacity to capture banking book risks. Such reviews encompass new regulatory requirements and are aligned, where possible, with industry best practice. This framework seeks to identify scenarios that are generated by the following stressed situations: a short rate shock, a parallel shift in interest rates, a non-parallel shift in interest rates, contractual floors on customer products and debt issued by the Group, as well as customer behaviour. The latter is an important component and encompasses the ongoing assessment of non-maturing demand deposits (NMDs). The volume of NMDs is recalibrated each month, while the duration is reviewed annually. The Group ALCO approves the NMDs and endorses the sensitivity of the duration (any increase or decrease).

The Group's total interest rate sensitivity in the banking book (economic value-based measure) is shown below.

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

	2020		2019	
At last business day (DKK millions)	+100bp	-100bp	+100bp	-100bp
DKK	4,055	-6,456	4,540	-6,135
EUR	-1,356	4,228	-299	3,309
SEK	-677	1,499	-49	506
NOK	331	-506	367	-504
GBP	-28	108	-82	99
USD	-52	59	-43	44
Other	-3	3	-	-
Total	**2,269**	**-1,064**	**4,433**	**-2,681**

The sensitivity to falling interest rates decreased from a loss of DKK 2,681 million in 2019 to a loss of DKK 1,064 million at the end of 2020, while the sensitivity to rising interest rates decreased from a gain of DKK 4,433 million in 2019 to a gain of DKK 2,269 million at the end of 2020.

Earnings-at-Risk (EaR) is a regulatory measure that seeks to stress net interest income under a number of different scenarios using defined parameters. A constant balance-sheet approach is used for creating a base scenario over a 12-month time horizon. A number of different scenarios are then applied for the purpose of assessing the EaR sensitivity. The EaR measure complements the Economic Value interest rate measure, which measures the long-term effect. Assuming a parallel downward yield curve shift of 1%, the Group's Earnings-at-Risk would be DKK 1.593 million higher than a base scenario calculation at the end of 2020.

Based on a 10-day 99% VaR, the Group's credit spread risk in the banking book was DKK 195 million at the end of December 2020, up from DKK 99 million end of 2019.

The Group hedges interest rate risk on fixed rate loans and deposits mainly during the accounting origination process, while managing the risk on the following fixed rate items on a daily basis according to the limit framework:

- Fixed rate mortgages in Denmark and other fixed rate loans that are not hedged as part of the accounting setup, including operating leases sold by the Group's leasing operations.
- Positions related to asset and liability management, including payments that are made in advance on Realkredit Danmark loans (monthly payments that are not passed on to bondholders until the end of the quarter or year).
- Bonds held in the hold-to-maturity and available-for-sale portfolios established by the Group in 2013 to stabilise net interest income by hedging its fixed rate liabilities.
- Interest rate risk exposure from NMDs.
- Other interest rate risk exposures, that is, embedded contractual interest rate floors on assets (such as lending contracts) and fluctuations in risk from changes in the core banking balance-sheet composition as well as risk migration from changes to behavioural assumptions.

IRRBB is capitalised as a Pillar II risk.

Equity investments
At the end of 2020, the total value of the portfolio was about DKK 1.3 billion, against around DKK 2.2 billion at the end of 2019.

Structural foreign exchange risk
The Group's CET1 capital is denominated in its domestic currency (DKK), while some of its assets and liabilities are denominated in foreign currencies. Although a fully matched foreign currency position will protect Danske Bank against

losses from movements in exchange rates, the Group's CET1 capital ratio will fall if the domestic currency depreciates because of the imbalance between the CET1 capital in a particular foreign currency and the CET1 capital required to support the REA denominated in that same currency. This risk is labelled structural foreign exchange risk.

The Group's objective is to manage structural foreign exchange risk in order to reduce the potential effect of fluctuations in exchange rates on the CET1 capital ratio in a manner that avoids income statement volatility, while at the same time acknowledging potential increased volatility in other comprehensive income. The Group pursues a strategy of hedging the foreign exchange sensitivity of the CET1 capital ratio stemming from the allocated capital that reflects credit and operational risk REAs in the three most significant balance-sheet currencies (NOK, SEK and EUR). By nature, structural foreign exchange (hedge) positions are long-term and non-trading positions, and they also remain relatively stable over time.

4.5 *Internal pension risk management*

Internal pension risk arises from the Danske Bank Group's liability for defined benefit pension plans established for current and former employees. For accounting purposes, defined benefit pension plans are valued in accordance with IFRSs (IAS 19).

The Group's defined benefit plans are funded by contributions from the Group and by individual contributions from employees. Each pension plan is managed by a separate supervisory board. The Group monitors interest rate sensitivities and manages them within set boundaries. It uses derivative instruments as an additional tool to manage interest rate risks.

The Group 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 stress the individual plans' net obligations calculated on the basis of swap rates rather than actuarial discount rates. These levels are used in the Group's VaR model.

4.5.1 Internal pension risk profile

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 plans are closed to new members.

Overview of the Group's pension plans

At 31 December 2020 (DKK millions)		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 liabilities		10,289	3,951	999	2,303
Assets at fair value		12,097	4,643	558	2,165
Net assets (net liabilities)		1,808	691	-441	-138
Number of members:	Active	-	24	82	600
	Deferred	1,941	617	-	1,411
	Pensioners	2,572	591	151	783
	Total	**4,513**	**1,232**	**233**	**2,794**

Note: In Norway, Finland and the Baltic states, the Group operates defined contribution plans under which it pays fixed contributions into separate, legally independent entities and afterwards has no further obligations. The Group wound up its Norwegian defined benefit plan in 2005, but still has an early retirement pension obligation. The obligation amounted to DKK 16 million at 31 December 2020.

At the end of December 2020, the Group's VaR was DKK 1,480 million (2019: DKK 1,671million).

4.5.2 Liability recognition

The Group's defined benefit pension plans are recognised as a balance-sheet liability subject to valuation. As pension benefits will typically be payable for the rest of the individual employee's life, this increases the Group's uncertainty about the amount of future obligations since the liability and pension expenses are measured actuarially.

Various assumptions need to be made. Some are financial (such as the discount rate used for calculating the net present value of the pension cash flows and rates of salary and pension increases), while some are demographic (such as rates of mortality, ill health, early retirement and resignation).

The Group calculates the market risk on defined benefit plans on a quarterly basis. The risk is expressed as VaR at a confidence level of 99.97% and on 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, which is also used by the Danish Financial Supervisory Authority (the Danish FSA), among others.

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 the Group's net obligation

(DKK millions)	Change	Effect, 2020	Effect, 2019
Equity prices	-20%	-284	-360
Interest rates	+1%/-1%	+119/+315	+260/-146
Life expectancy	+1 year	-398	-356

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

Liquidity, funding and capital risk

5.

The Group is exposed to many different risks so it is unavoidable that some of them materialise, usually as financial losses. The Group must be able to deal with such losses, even if they are large, as in an economic downturn. This means that capital must be held to absorb the losses and that liquidity must be available to ensure that all obligations and commitments can be met, even if the losses are accompanied by weakened investor confidence. This, in turn, requires stable funding.

In other words, the overall structure of the balance sheet must be managed to mitigate risks. Capital must be adequate, funding must be stable and a liquidity buffer must be maintained through the economic cycle to allow the Group to serve its customers and contribute to financial stability in the economy at large. Capital, liquidity and funding are all subject to regulatory requirements. This section describes the Group's risk strategy, which aims to ensure adequate liquidity, funding and capital.

5.1 Liquidity risk management

Liquidity risk is the risk that a lack of funding leads to excessive costs or prevents the Group from maintaining its business model or fulfilling its payment obligations. The Group manages this liquidity risk by holding sufficient liquidity reserves to meet its obligations and to support its strategies, business plans and rating ambitions even in stressed situations.

5.1.1 Risk governance and responsibilities

Like other risk types, liquidity risk is governed in line with the principles of the three-lines-of-defence model. Group Treasury is in charge of liquidity management and is therefore the first line of defence for liquidity risk. It must keep the liquidity risk profile within the risk appetite. The responsibility for short-term liquidity management is delegated to FI&C within certain limits and as outlined in Group Treasury guidelines.

Group Risk Management is the second line of defence. In particular, Liquidity & Capital Risk Management reviews and challenges the methodologies and metrics and monitors compliance with applicable limits. It is also in charge of the Internal Liquidity Adequacy Assessment Process (ICAAP) and submits reports on this process to the Board of Directors and the supervisory authorities.

Liquidity risk management uses a combination of risk indicators, risk triggers and risk policies. Two documents lay the foundation for this process: the Liquidity Policy and the Liquidity Instructions. The first document sets out the overall principles for the Group's liquidity risk management. The second document sets out the governance structure and defines limits and methods for calculating liquidity risk. Both have been issued by the Board of Directors.

Liquidity risk issues are discussed by two separate subcommittees of the Group All Risk Committee. The Group Asset & Liability Committee (Group ALCO) is anchored in the first line of defence, while the Group Balance Sheet Risk Committee (BSRC) is anchored in the second line of defence. Members of the Group ALCO and the BSRC come from the Executive Leadership Team, Group Treasury, Group Finance, FI&C and Group Risk Management.

The Group ALCO has a strategic focus on asset and liability management components, such as net interest income, funds transfer pricing as well as interest and foreign exchange risks on the balance sheet, in accordance with the Liquidity and Market Risk Policies.

The BSRC oversees the risk framework for liquidity, funding and capital risks at the group level. The BSRC monitors and challenges the management of the risks covered by the committee.

Liquidity management is coordinated centrally to ensure regulatory compliance at the group level and compliance with internal requirements. Regulatory compliance and the maintenance of adequate liquidity reserves at subsidiaries are managed locally, but subject to coordination to ensure consistency across the Group.

5.1.2 Liquidity risk appetite and limit framework

Liquidity risk arises from the basic activities of banks such as deposit-taking and lending. The transformation of short-term deposits into long-term loans exposes banks to maturity mismatches.

Liquidity risk can be seen conceptually as consisting of two key elements, both of which are addressed by the Liquidity Policy.

Key element	Risk appetite
Distance to default	A sufficient distance to default should be maintained at all times: In case of a crisis, there must be sufficient time to respond to events and avoid financial or regulatory default.
Market reliance	Market reliance should be limited: if the Group relies on its ability to issue debt when needed, it becomes vulnerable to investor sentiments, market stress and market dysfunctionalities. The size and maturity profile of debt instruments must therefore be prudently adapted to funding needs.

By ensuring sufficient time to respond in case of a prolonged crisis, management will be able to adjust to changed conditions in a controlled manner, thus avoiding any hasty reactions to short-term market volatility. By reducing market reliance, the Group reduces the effects of market volatility and ensures the sustainability of its long-term business model. This allows it to serve customers at any time during the business cycle.

Realkredit Danmark and Danica Pension manage their own liquidity risks. Realkredit Danmark is subject to special mortgage bank legislation and is largely self-financing. As a result, it manages its liquidity separately from the rest of the Group. Danica Pension's balance sheet includes assets and long-term life insurance liabilities. A large part of Danica Pension's assets are readily marketable securities. Both companies are subject to statutory limits on their exposures to Danske Bank A/S.

For liquidity management purposes, the term "Group" does not include Danica Pension because it is not a credit institution. This means that Danica Pension is not subject to the same liquidity regulations as credit institutions and therefore not part of the prudential consolidation. Realkredit Danmark, on the other hand, is included in the prudential consolidation of the Group. Because of its particular funding structure, however, it is not always relevant to include Realkredit Danmark in Group aggregates. As a consequence, Realkredit Danmark is sometimes excluded from Group figures. It is explicitly stated when this is the case.

The Group monitors the two key elements through a set of key and supplementary risk indicators (KRIs and SRIs) that make up the Group's liquidity risk profile. The Board of Directors has set internal limits for each indicator, as shown below. A set of further limits and targets ensures that these limits are not breached.

Distance to default

Indicator	Requirement	Frequency	Monitoring unit
KRI 1	The most severe internal stress tests must be positive three months ahead.	Monthly	Group Risk Management
KRI 2	The Group's LCR must be 110% or higher, and each legal entity must comply with local liquidity requirements.	Daily	Group Risk Management
SRI 1	The Group's total liquidity in all currencies may not fall below DKK 100 billion four weeks ahead, and total liquidity in all currencies except DKK must be positive two weeks ahead.	Daily	Group Risk Management

Market reliance

Indicator	Requirement	Frequency	Monitoring unit
KRI 3	The Group's funding ratio must be below 0.8.	Monthly	Group Treasury
SRI 2	Long-term funding maturing within 12 months may not exceed DKK 90 billion.	Daily	Group Risk Management
SRI 3	Twelve-month liquidity must be positive one year ahead.	Monthly	Group Treasury

5.1.3 Stress testing

Stress tests are a core element of the models and methodologies used for managing liquidity risk. Three of the six risk indicators making up the risk profile are based on stressed liquidity scenarios.

Stress tests are carried out for the Group and for Danske Bank A/S to measure their immediate liquidity risks and detect signs of possible crises. The stress tests use three different standard scenarios: a scenario specific to Danske Bank, a general market crisis scenario and a combination of the two scenarios. A "stress-to-failure" test is also conducted.

The setup makes it possible to analyse any time horizon up to one year, but a period of three months is standard for internal stress tests.

All stress tests are based on the assumption that the Group does not reduce its lending activities. This means that an unchanged volume of lending will continue to require funding. The availability of funding varies depending on the scenario in question and the funding source. The assessment of funding stability is based on the maturity structure for debt and behavioural data for deposits.

5.1.4 Methodologies and models

The Group uses regulatory indicators such as the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) as tools for asset liability management. A crucial implementation tool is the Funds Transfer Pricing (FTP) model.

Liquidity

A number of metrics are used for monitoring liquidity. The key regulatory requirement is the LCR (see section 5.2) using stress scenarios defined by the regulator. Other scenarios may be analysed in liquidity stress tests. A three-month modified version of the LCR is also calculated as part of the supervisory process. Finally, liquidity curves based on contractual liquidity flows are also monitored.

Intraday liquidity is monitored and reported by currency in accordance with the guidelines issued by the Basel Committee. Overall, these measures have reduced cross-currency liquidity risk.

Liquidity by currency

The LCR regulation is not explicit about the currency composition of the liquidity buffer. It merely requires the denomination of the liquid assets in the buffer to be “consistent” with the currency distribution of net liquidity outflows.

In Denmark, these requirements are more specific. As a SIFI, Danske Bank is subject to quantitative currency-specific liquidity requirements for EUR and USD. In addition to these requirements, Danske Bank also balances the general composition of the liquidity buffer to ensure consistency with the outflow profile, as required by the Capital Requirements Regulation (CRR).

To maintain the availability of the relevant currencies in the medium-to-long term, the Group’s funding plan seeks to balance long-term commitments with stable funding in each of the relevant currencies.

NSFR

While the LCR focuses on short-term liquidity risk, the NSFR addresses the balance between funding needs due to assets and the stability of funding sources. The NSFR was formally adopted by the EU in May 2019 and will enter into force on 28 June 2021 and apply to all individual banking units within the Group and to the Group as a whole.

Funds transfer pricing

The Group’s Funds Transfer Pricing (FTP) model is the central management tool used by the Group to adjust and manage the balance-sheet composition of its business units. Their business activity is guided by assigning internal funding prices based on the matched-maturity principle. The FTP model applies charges to loans and credits to deposits and other funding on the basis of the characteristics of the individual balance-sheet items, such as product type, customer type, maturity, currency, amortisation profile, modelled behaviour and interest rate risk. Some charges and credits are based on behavioural data, such as the expected stressed deposit run-off and expected amounts drawn on committed facilities.

FTP links the balance-sheet composition directly to the income statement, and it is a key component in determining the Group’s overall funding position. It links liquidity risk assessment, product pricing, balance-sheet valuation and profitability analysis.

Mortgage loans provided through Realkredit Danmark are excluded from FTP because they are match-funded.

The Group’s trading activities are also subject to FTP. Trading activities require funding and increase the needed liquidity buffer because they create new potential collateral outflows.

5.1.5 Monitoring and reporting

Liquidity Risk Management reports on indicators to the relevant parties and committees. Indicators set by the Board of Directors are monitored and reported back to the Board and to other relevant stakeholders (such as the BSRC and the Executive Leadership Team via the Group All Risk Committee). Indicators set by the BSRC or at lower levels are reported back to the BSRC and to the head of Liquidity & Capital Risk Management.

Liquidity risk reporting consists of overviews, analyses and forecasts for the most critical risk indicators such as the LCR. They outline the drivers and causes of changes in liquidity and give senior management a clear understanding of the Group’s day-to-day liquidity risk profile.

Monitoring and reporting are conducted separately in line with the principles of the three-lines-of-defence model. As the first line of defence, Group Treasury and Group Finance report on the risk measures. The second line of defence, Group Risk Management, monitors compliance with internal limits. Furthermore, Group Risk Management reviews and validates the models and assumptions used by the first line of defence.

Liquidity & Capital Risk Management monitors compliance with the risk limits set in the Liquidity Instructions. The LCR figures and operational liquidity are monitored and reported on a daily basis, while the other risk indicators are reported on a monthly basis to the BSRC and the Group All Risk Committee. Risk indicators are reported to the Board of Directors on a quarterly basis.

5.2 Liquidity risk profile

5.2.1 Risk indicators

Distance to default

The risk indicators used for managing the distance to default allow the Group to adjust the size and composition of its liquidity reserve to meet its obligations in a stressed liquidity situation. The indicators are the LCR, internal stress tests, and the operational two-week and four-week liquidity curves. The LCR covers a 30-day stressed period, while the internal stress tests cover a three-month stressed period.

Liquidity coverage ratio

At 31 December 2020 (DKK billions)	Danske Bank Group	Danske Bank A/S
HQLA level 1	695	607
HQLA level 2	14	14
Limits due to cap	-	-
A. Liquid assets, total	710	621
Customer deposits[1]	202	194
Market funding[2]	146	141
Other cash outflows[3]	177	182
B. Cash outflows, total	525	517
Lending to non-financial customers	5	4
Other cash inflows	58	63
C. Cash inflows, total	62	67
Liquidity coverage ratio [A/(B-C)]	**154%**	**138%**

[1] Includes retail deposits, operational deposits, correspondent banking/prime brokerage accounts and non-operational deposits covered by deposit guarantees.
[2] Includes non-operational deposits, unsecured debt issuance and secured funding.
[3] Includes Realkredit Danmark's additional outflow requirement, which is equal to 2.5% of lending.

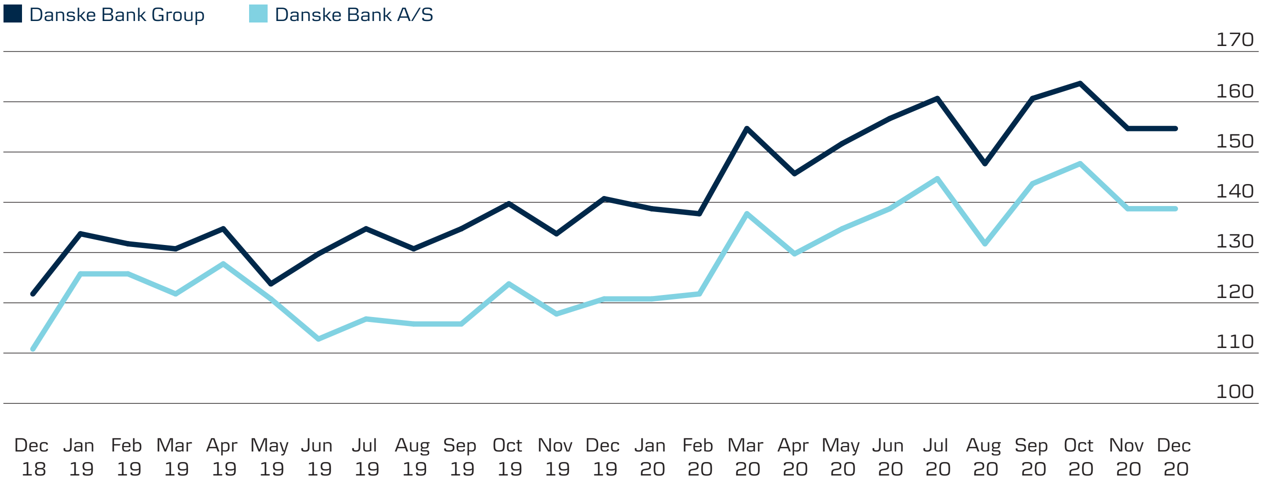
The LCR increased markedly over the year for both Danske Bank A/S and for the Group as a whole, especially in March 2020, when the COVID-19-related turmoil began in financial markets. As concerns mounted over the economic impact of the pandemic, many customers felt a need to build up liquidity buffers to cope with a potentially difficult situation. In particular, large corporate customers increased their deposits significantly.

The outflow factors of the LCR for such deposits are often quite high, but lower than 100%. Therefore, the LCR will increase if the Group retains the liquidity. Under a prudent approach to liquidity management, uncertainty about the stability of such deposits means that they are not suitable as funding for long-term commitments. A significant portion of the funds must be held as liquid assets.

During the autumn and towards the end of 2020, it was becoming increasingly clear that a second wave of coronavirus contagion was under way and that further lockdowns would be necessary. The market reaction to this was rather calm, especially compared with the reaction in the spring. This may have been related to the announcement of vaccines in November and to the availability of improved therapies.

The level of deposits therefore remained high, and this in turn meant high LCR levels at the end of 2020: 154% for the Group and 138% for Danske Bank A/S.

LCRs of the Danske Bank Group and Danske Bank A/S, 2020
(%)

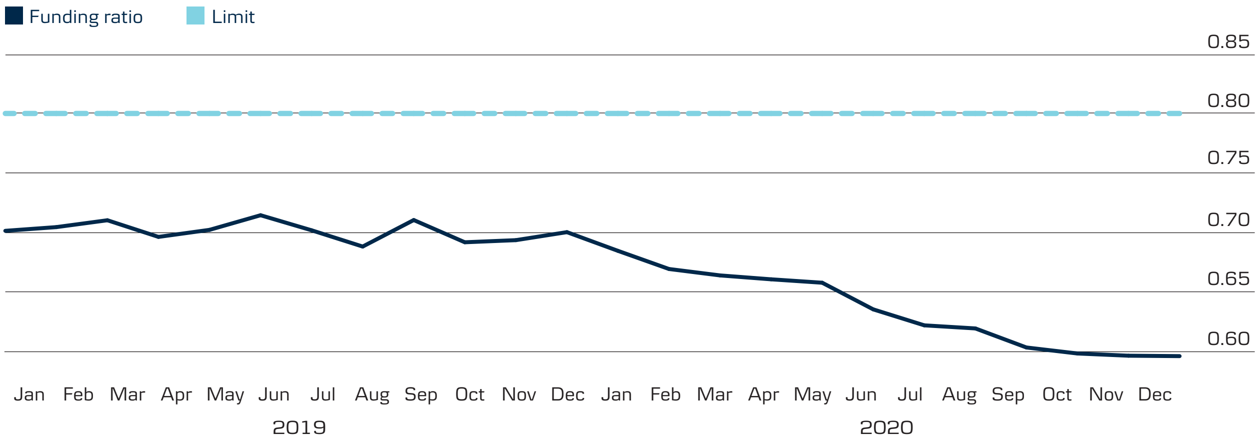


Market reliance
The risk indicators addressing market reliance are effective management tools that enable the Group to maintain an adequate level of stable funding for its long-term commitments on the asset side. This reduces any pressure on the Group during a liquidity crisis.

The NSFR takes effect in June 2021 and is set to become the key indicator and management tool for funding stability and market reliance. For a while, Danske Bank has been making internal calculations of the NSFR for relevant entities to encure compliance. At the end of 2020, the NSFR stood at 130.8% for the Group as a whole and at 125.7% for Danske Bank A/S.

Until then, however, the authorities rely on the somewhat simpler funding ratio, which is lending relative to working capital. The latter, in turn, is defined as equity, deposits and debt with a remaining maturity of more than one year. Danske Bank is required to keep the funding ratio below 0.8. The Group meets this requirement with a comfortable margin. This margin grew significantly in 2020 due to the increase in deposits. The effect is particularly strong because the funding ratio does not distinguish between stable and unstable deposits.

The Danske Bank Group's funding ratio*



* Not including Realkredit Danmark.

The Group also monitors the diversification of its funding sources by product, currency, maturity and counterparty to ensure that its funding base provides the best possible protection.

Special attention is devoted to the NOK and SEK markets. Danske Bank has a deposit gap in the Norwegian and Swedish markets, meaning that the Group must obtain market funding. Covered bonds in NOK are issued by Danske Bank A/S, whereas covered bonds in SEK are issued by Danske Hypotek AB.

5.2.2 Ratings and their potential liquidity effects

Danske Bank's ratings were unchanged in 2020 as shown in the table. Rating upgrades and downgrades have liquidity implications because they affect the Group's ability to obtain market funding and the cost of such funding. They may also lead to changes in the amount of collateral needed in certain transactions.

Danske Bank's credit ratings, 31 December 2020

	Fitch	Moody's	S&P
Counterparty rating	A+	A1/P-1	A+/A-1
Deposits	A+/F1	A2/Negative/P-1	-
Senior debt	A+/F1	A3/P-2	A/A-1
Issuer rating	A/F1	A3/P-2	A/A-1
Outlook	Negative	Stable	Stable
Non-preferred senior debt	A	Baa3	BBB+
Tier 2	BBB+	-	BBB
AT1	BBB-	-	BB+

The following table shows the Group's loss of liquidity under four scenarios involving downgrades of the Group's long- and short-term debt. The number in brackets after each individual rating indicates how many notches the rating would drop from its current level.

The right-hand column shows the liquidity effect due to extra collateral requirements after downgrades under the various scenarios. Most contracts do not contain rating triggers but instead aim to eliminate or reduce credit exposures regardless of the rating, but some triggers remain.

Compared to 2019, the liquidity effect in scenarios 1-3 is now much smaller. The assumptions underlying the calculations were reviewed recently. The review resulted in considerable reductions because non-mandatory outflows in favour of mortgage subsidiaries in order to maintain their covered bond ratings were excluded from the calculations. The change brings the calculations better in line with the intended purpose. No change of strategy for covered bond ratings is implied.

Loss of liquidity in case of rating downgrades, November 2020*

	Short-term			Long-term			
Assumed rating	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Liquidity effect (DKK billions)
Present rating	F1	P-2	A-1	A+	A3	A	
Scenario 1	F1	P-2	A-1	A (-1)	Baa1(-1)	A-(-1)	0.4
Scenario 2 (mild crisis)	F2(-1)	P-3(-1)	A-2(-1)	A (-1)	Baa1(-1)	A-(-1)	2.3
Scenario 3	F2(-1)	P-3(-1)	A-2(-1)	A-(-2)	Baa(-2)	BBB+(-2)	3.0
Scenario 4 (severe crisis)	F2(-1)	P-3(-1)	A-2(-1)	BBB+(-3)	Baa3(-3)	BBB(-3)	3.7

* Not including Realkredit Danmark.

5.2.3 Funding

In 2020, Danske Bank issued long-term debt in the amount of DKK 79 billion, down from DKK 100 billion in 2019. The reduction was largely due to the fact that part of the debt issues planned for 2018 had been postponed to early 2019 because of a difficult market situation. The reduction did not reflect any change of funding strategy.

The minimum requirement for own funds and eligible liabilities (MREL) continued to have a significant effect on the composition of long-term funding in 2020. This requirement means that a certain amount of non-preferred senior (NPS) debt needs to be issued each year, particularly during the phase-in period. The new Bank Recovery and Resolution Directive (BRRD), which is currently under implementation, is less stringent with regard to subordination requirements than the current phase-in in Denmark. In the light of the difficult funding situation, the Danish Financial Supervisory Authority (the Danish FSA) decided to implement a relaxation of the rules earlier than planned (in May 2020). As a consequence, NPS issues did not need to be as large as would otherwise have been the case.

The NPS issues meant that the need for other funding was reduced correspondingly. The total amount for 2020 was DKK 24 billion. This was much less than the unusually large issues of DKK 60 billion in 2019. The remainder of the long-term funding needs was funded with covered bonds and senior debt. A small amount of tier 2 capital was also issued. This should be seen as part of the Group's capital planning and not solely from a liquidity and funding perspective.

Realkredit Danmark's funding

Realkredit Danmark funds its mortgage lending activities by issuing covered bonds. Mortgage finance in Denmark is subject to asset-liability balance requirements, and Realkredit Danmark complies with these requirements by applying a pass-through structure. This implies that

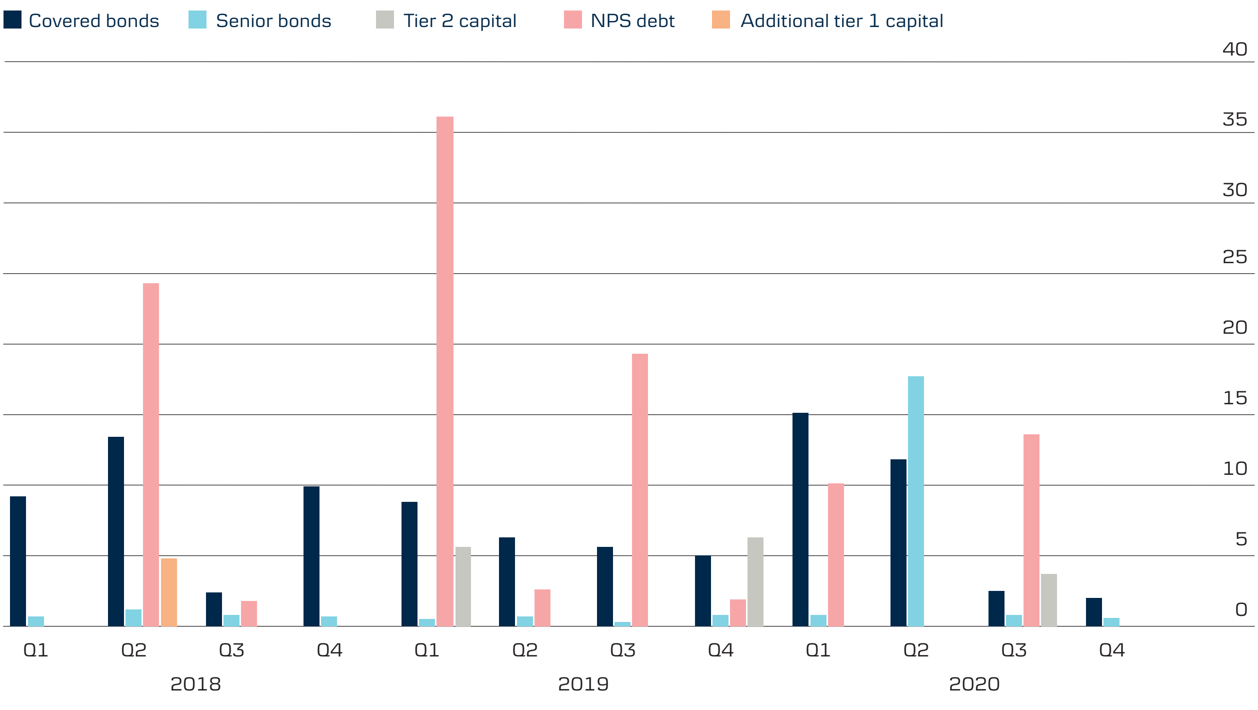
- all mortgages are funded by means of covered bonds with a matching cash flow
- all funding costs are absorbed by borrowers
- amounts of interest, redemptions and margins from borrowers fall due in advance of interest payments and principal repayments to bondholders
- covered bonds are issued on tap when the mortgages are originated

The pass-through structure allows for interest-reset loans with maturities ranging up to 30 years, while the underlying bonds are typically issued with maturities ranging from one to five years. The refinancing risk is mitigated by caps on the volume of interest-reset loans to be refinanced each quarter and each year. As a last resort, Realkredit Danmark is required by law to extend the maturity of maturing covered bonds in case of a refinancing failure.

The Group monitors the maturity profile of its long-term funding to ensure that the portions of long-term funding maturing within a year and within a quarter are maintained at acceptable levels.

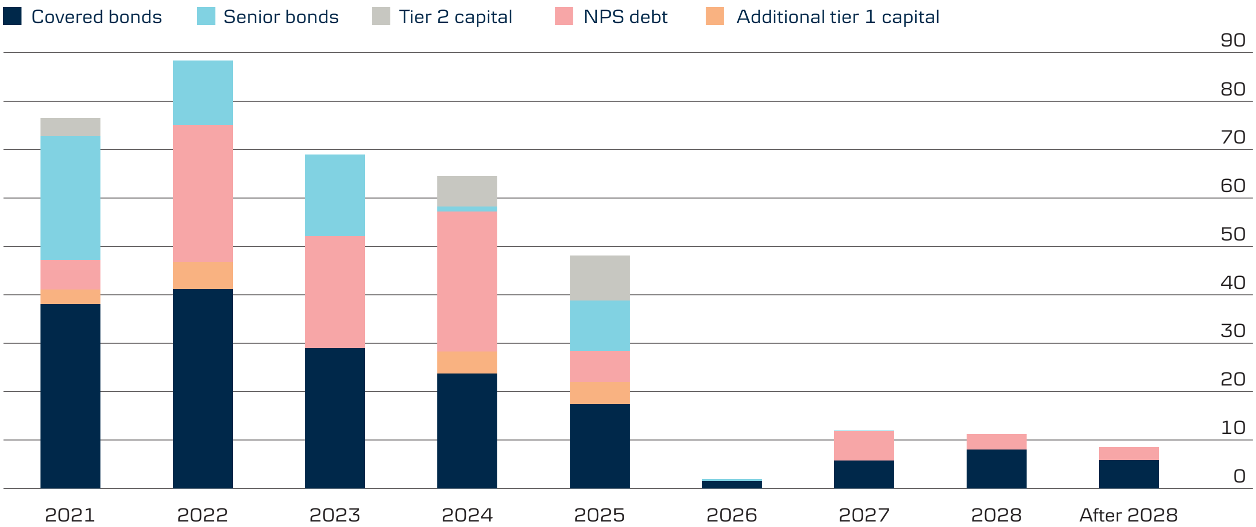
Long-term debt issuance, by quarter*

(DKK billions)



* Not including Realkredit Danmark.

The Danske Bank Group's redemption profile, 31 December 2020*
(DKK billions)



* Not including Realkredit Danmark, Maturity dates for T2/AT1 capital and NPS debt are first call dates.

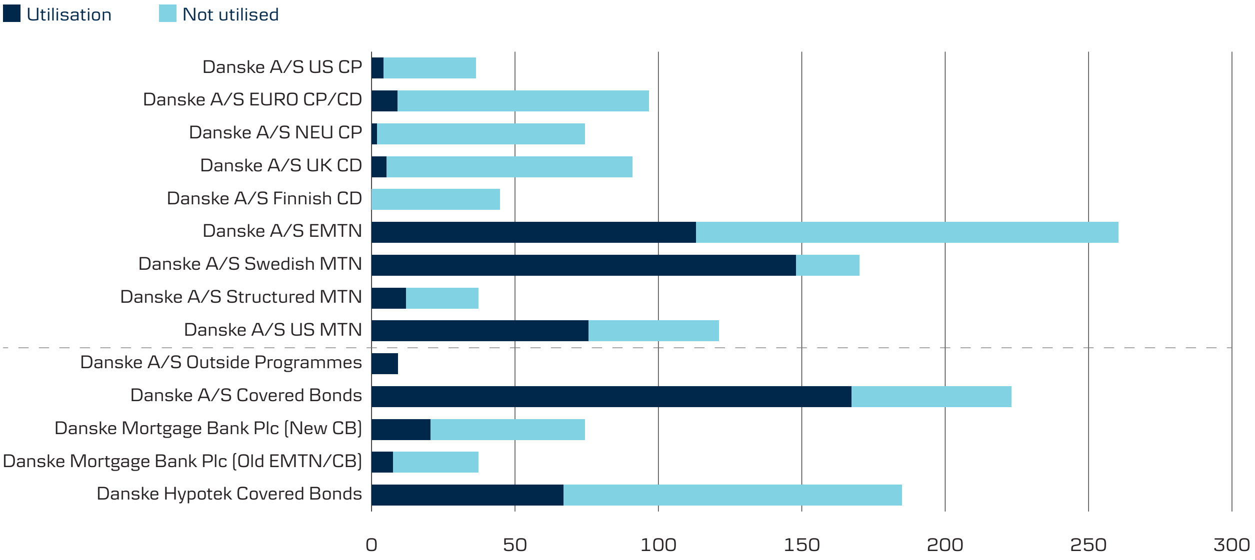
Total wholesale funding consists of debt issues and deposits received from credit institutions and central banks. A detailed breakdown is shown below. In 2020, overall wholesale funding increased by DKK 80 billion. Increased deposits from credit institutions accounted for more than DKK 50 billion of this amount. The funding from central banks was relatively long-term, while the bulk of the funding from other credit institutions was short-term. The increase was attributable to the ample liquidity available since central banks responded to the downturn with more quantitative easing. The remainder of the increase was due to an increase in the amounts of covered bonds and NPS debt issued under the Medium Term Note (MTN) programme.

Breakdown of wholesale funding[1] by contractual maturity

At 31 December 2020 (DKK billions)	0-1 month	1-3 months	3-12 months	1-5 years	> 5 years	Total 2020	Total 2019
Deposits from credit institutions	190	23	9	36	-	259	184
CDs and CP	3	8	9	2	1	23	11
Senior unsecured MTNs[2]	1	7	22	128	12	170	165
Covered bonds	1	8	37	180	36	262	238
Subordinated liabilities	-	-	4	16	0	19	28
Total	**195**	**45**	**82**	**362**	**49**	**733**	**626**
Portion from							
secured instruments	60	16	9	36	-	122	116
unsecured instruments	135	29	73	326	49	611	510

[1] Not including Realkredit Danmark.
[2] Net outstanding amount. It consists of NPS and senior debt.

Utilisation of available long- and short-term programmes, end of 2020*
(DKK billions)



* Not including Realkredit Danmark.

Danske Bank has a number of funding programmes as shown above. Each programme is approved by the Board of Directors along with a limit. Several programmes, especially for short-term funding such as CP/CDs, are barely used at all, primarily due to the lack of investment opportunities that are both profitable and consistent with the Liquidity Policy and its emphasis on stable funding. Covered bonds remain an important funding source. The Euro Medium Term Note (EMTN) programmes are used for NPS issues and minor volumes of capital instruments.

5.2.4 Liquidity reserve

The Group's liquidity reserve is defined as all unencumbered liquid assets that are available to the Group in a stressed situation. Assets received as collateral are included in the reserve, whereas assets used as collateral are excluded.

The following table shows the liquidity reserve broken down according to the LCR framework. The large increase in liquid assets during 2020 was partly due to the relatively low level of liquidity at the end of 2019. Three quarters of the additions to the liquidity buffer were central bank reserves, while government bonds (that is, level 1a assets) accounted for almost all of the remainder.

The Group's liquidity reserve – LCR definition

At 31 December (DKK billions after haircut)		2020	2019
Total high-quality liquid assets		**710**	**432**
Level 1a assets	Central bank reserves	345	87
	Central government debt	112	55
	Other level 1a assets	43	42
Level 1b assets	Extremely high-quality covered bonds	**196**	**232**
Level 2a assets	High-quality covered bonds	9	12
	Other level 2a assets	5	4
Level 2b assets		**0.3**	**0.1**

Most of the bonds held in the reserve are central-bank-eligible instruments, and they are important for intraday liquidity needs and overnight liquidity facilities.

The amounts of liquidity are calculated using haircut values mandated for each asset category in the LCR regulation. Some assets are excluded entirely. The amounts shown in the table may differ from actual market values and repo liquidity values. In internal stress tests, valuations closer to actual market values are generally used.

5.2.5 Asset encumbrance

Asset encumbrance implies structural subordination of senior unsecured creditors and depositors. Therefore, regulators, rating agencies and investors monitor Danske Bank's asset encumbrance ratio – that is, the percentage of assets pledged or mortgaged as collateral.

The Group's asset encumbrance has three main sources:

- Loans and securities serving as collateral for covered bond issuance.
- Securities provided as collateral in repo and securities-lending transactions. Such securities remain on the balance sheet and cash amounts received are recognised as deposits.
- Cash and securities provided as collateral to support business activities, such as clearing services and counterparty credit risk mitigation.

The Group's reporting follows the method set out in the EBA's implementing standard on asset encumbrance. The table 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

At 31 December 2020 (DKK billions)	Danske Bank A/S	Danske Bank Group
Assets on balance sheet		
Derivatives	66	64
Deposits (repos)	278	245
Covered bonds	99	1,048
portion from Realkredit Danmark	-	-
Other	20	20
Total encumbrance	**462**	**1,376**
Total assets	2,575	3,550
Collateral received		
Derivatives	18	16
Deposits (reverse repos)	239	203
Total encumbrance	257	219
Total assets	506	479
Asset encumbrance ratio (%)	**23**	**40**

5.3 Capital risk management

Capital risk is the risk of not having enough capital to cover all material risks arising from the Group's chosen business strategy.

The Group manages its capital risks through prudent planning, thus ensuring a sufficient level of capital to support its growth ambitions and to absorb unexpected losses even in severe downturns without breaching regulatory capital requirements. The Group's capital management practices are designed to support its rating ambitions, while ensuring access to funding markets under all market conditions.

Capital management involves executing the Internal Capital Adequacy Assessment Process (ICAAP), setting capital targets and dividend ambitions, capital planning, performing stress tests, allocating capital as well as monitoring and reporting.

The Group's Capital Policy set by the Board of Directors lays the foundation for the Group's capital management. The Capital Policy contains the Group's overall principles and standards for capital management, including the governance process for all of the principles.

5.3.1 ICAAP

The ICAAP is an integral part of the Group's capital management practices. The purpose of the process is to assess, on an ongoing basis, the material risks that are inherent in the Group's business activities. The solvency need is determined as part of the ICAAP, and this ensures adequate capitalisation based on the Group's risk profile. Forward-looking by nature, the ICAAP includes both group-wide and portfolio-specific stress testing. The conclusions from the ICAAP serve as input to the Supervisory Review and Evaluation Process (SREP), and they are submitted to the supervisory authorities once a year, along with the conclusions from the Group's Internal Liquidity Adequacy Assessment Process (ILAAP). Quarterly updates are presented to the Board of Directors.

5.3.2 Capital targets and capital distribution

In 2020, the Group's capital targets were unchanged from the increased levels set by the Board of Directors in 2019. The target for the CET1 capital ratio was kept at above 16% in the short term to ensure a sufficiently prudent buffer in relation to the capital requirement. The target for the total capital ratio was kept at above 20%. The target for the CET1 capital ratio includes a management buffer of at least 2.8%.

In order to support the initiatives aimed at minimising the economic consequences of the COVID-19 crisis, the Board of Directors proposed to the general meeting on 20 April 2020 that no dividends be paid for 2019. The proposal was adopted at the annual general meeting on 9 June 2020. However, with respect to its capital targets, the Group has an ambition of paying out ordinary dividends within the range of 40-60% of its net profit.

The Board of Directors will continue to adapt the capital targets to the regulatory developments and revise the ambitions for capital distribution in order to ensure that the Group continues to have a strong capital position.

5.3.3 Capital planning

The Group's ongoing 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 Group's expected capital performance based on budgets and takes pending regulation into account when future capital requirements are assessed. The Group's capital planning is also based on stress tests and takes rating ambitions into consideration. The Group's capital planning and the Group's funding planning are integrated in the same process.

5.3.4 Input from stress testing

The Group uses macroeconomic stress tests in the ICAAP for the purpose of projecting its capital requirements and actual capital levels under 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 undesirable events on the Group's capital.

When the Group uses stress tests in its capital planning, it applies stress to risks, income and the cost structure. Stressing income and costs affects the Group's capital, while stressing risk exposures affects its capital requirement.

Results from stress testing are used as input for setting capital targets, and they ultimately feed into the Group's capital planning.

Internal stress tests

The Group's internal stress tests are based on various scenarios, each consisting 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 if deemed necessary. The Group evaluates the main scenarios and their relevance on an ongoing basis and at least once a year. New scenarios are added when necessary. The scenarios are submitted to the Board of Directors for approval.

Regulatory stress tests

Because the Group has permission to use internal ratings-based (IRB) models, it participates in the annual macroeconomic stress test conducted by the Danish Financial Supervisory Authority (the Danish FSA). In the latest stress test performed in the spring of 2020, the Group did not breach capital requirements during the projected period.

The Group also participates in the EU-wide stress test conducted by the European Banking Authority (the EBA) every second year. As a consequence of the outbreak of the coronavirus pandemic, the EBA decided to postpone the stress test exercise from 2020 to 2021 to allow banks to ensure continuity in their core operations.The purpose of the EBA stress test is to assess the health of the European banking sector and the ability of the individual institutions to absorb losses. The latest exercise was conducted in 2018 and included a highly adverse macroeconomic scenario in the Group's core markets. Even under such severe conditions, the Group met its projected capital requirements by a satisfactory margin.

The Group's most important stress test scenarios

Scenario	Description and use
Severe recession	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.
	The Group uses the severe recession scenario in its capital planning to determine whether the capital level is satisfactory. If management concludes that the level of excess capital is too low in the scenario's worst year, it will consider changing the risk profile or raising capital.
COVID-19 downturn	The world is hit by a large second wave of coronavirus infections in the winter of 2020-21, triggering another round of nationwide lockdowns. This leads to lower GDP growth, higher unemployment as well as declining property prices and falling stock prices. However, this scenario assumes that the global economy is not thrown into a deep financial crisis as a vaccine is developed and made widely available to the public. This implies that society returns to normal.
	The Group uses the COVID-19 downturn scenario to asses the potential implications of a second wave of coronavirus infections.
Extreme recession	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.
	The Group uses the extreme recession scenario for recovery plan purposes to test the credibility and effectiveness of its actions to restore its capital and liquidity positions.
Regulatory scenarios	Base cases and adverse scenarios of the Danish Financial Supervisory Authority and the European Banking Authority.
	The Danish Financial Supervisory Authority uses the regulatory scenarios for the Supervisory Review and Evaluation Process (SREP).
Other scenarios	Besides the main scenarios listed above, the Group also uses various specialised or portfolio-specific scenarios that give management an understanding of how specific events will affect the Group.

In conclusion, the results of both internal and external regulatory stress tests show that the Group is robust in the event of unfavourable economic developments in the selected stress test scenarios.

For more information about the stress test process, see the ICAAP report, which is updated quarterly and published along with the Group's interim and annual reports at danskebank.com/investor-relations.

5.3.5 Capital allocation

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 models. The Group is constantly improving its capital allocation framework to ensure that it reflects as closely as possible the effects of new regulation and the risk entailed in its business activities. The principles for allocating capital across the business units are fully aligned with the regulatory requirements. As a result, the capital consumption of the Group's individual business units is closely aligned with the Group's total capital consumption.

5.3.6 Risk governance and responsibilities

The Group's capital management practices are organised in line with the principles of the three-lines-of-defence model. Day-to-day monitoring and management of the Group's capital position and risks are handled by Group Finance in the Group's CFO Area. As the first line of defence, Group Finance is responsible for monitoring and managing the Group's capital position on the basis of the principles set out in the Capital Policy and specified in the Capital Instructions, including stress testing, setting capital and payout targets, capital planning and allocating the cost of capital. Group Finance is also responsible for the annual ICAAP and for providing quarterly updates to the Board of Directors.

Group Risk Management serves as the second line of defence. For capital risks, Liquidity & Capital Risk Management is responsible for reviewing and challenging the methods applied and the results produced.

Group Internal Audit (GIA) serves as the third line of defence for the Group's management of capital, performing independent reviews of the main processes, such as the calculation of the risk exposure amount (REA), the ICAAP, capital levels and stress testing, and addressing risk assessments performed and control setups applied.

Subsidiaries have local responsibility for capital management, but work closely with Group functions to ensure consistent application of methodologies and principles.

The overall principles for the Group's capital management and recommendations based on these principles are approved by the Board of Directors and endorsed by the Group All Risk Committee and the Board of Directors' Risk Committee.

5.3.7 Monitoring and reporting

The Group monitors risks related to its capital and capital position and submits risk reports to the chief financial officer, the chief risk officer and the Board of Directors. Capital management risk reporting consists of a monthly report on the Group's capital position (the Capital and REA Report) and an overview of the Group's capital position against trigger levels (the Indicator Dashboard). In addition, the Group prepares quarterly reports on its capital position (on a short- and long-term basis) measured against its risk and business strategy as part of the ICAAP. See section 2.4 for an additional description of risk reporting.

5.4 Capital profile

At 31 December 2020, the Group's CET1 capital amounted to DKK 143.7 billion, or 18.3% of the total REA, and its tier 1 capital amounted to DKK 161.0 billion, or 20.5% of the total REA. The Group's total capital amounted to DKK 180.1 billion, and its total capital ratio was 23.0%.

5.4.1 Total capital

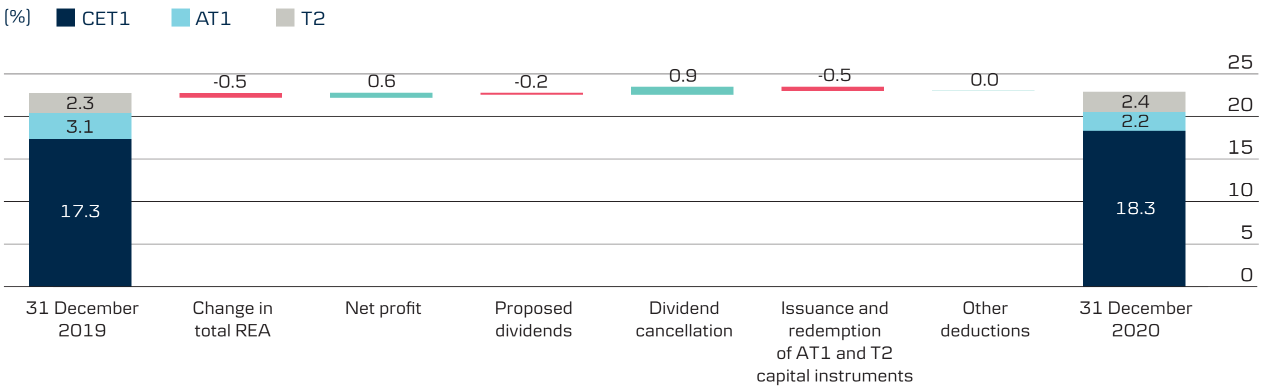
The high-level components of total capital are shown in the following table (a more detailed breakdown appears in the Group's Annual Report 2020). The figures reflect the Group's capital subject to the transitional rules of the CRR (including the phase-in of IFRS 9) at 31 December 2020.

The Danske Bank Group's total capital and ratios

At 31 December (DKK millions)	2020	2019
Total equity	168,678	170,508
Adjustment to total equity	158	233
Total equity calculated according to the rules of the Danish FSA	168,836	170,741
Additional tier 1 (AT1) capital instruments included in total equity	-8,415	-14,070
Adjustments for accrued interest and tax effect on AT1 capital	-93	-130
Common equity tier 1 (CET1) capital instruments	160,329	156,541
Deductions from CET1 capital	-16,602	-23,878
Portion from goodwill	-5,354	-6,339
Portion from statutory deductions for insurance subsidiaries	-8,992	-8,439
CET1 capital	143,727	132,664
AT1 capital	17,282	23,944
Tier 1 capital	161,009	156,608
Tier 2 capital instruments	19,108	17,598
Total capital	180,117	174,206
Total risk exposure amount	**784,184**	**767,177**
Common equity tier 1 capital ratio (%)	18.3	17.3
Tier 1 capital ratio (%)	20.5	20.4
Total capital ratio (%)	23.0	22.7

The following chart shows the change in the Group's total capital ratio from 31 December 2019 to 31 December 2020. The main drivers were the Group's net profit after dividend, dividend cancellation, and redemption and issuance of subordinated capital instruments as part of the Group's ongoing work to optimise its capital structure.

Change in total capital ratio, the Danske Bank Group, 2020



Common equity tier 1 capital
Starting with total equity under International Financial Reporting Standards (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 the estimated fair value. Revaluation to a value above the cost of acquisition is recognised as CET1 capital. The revaluation of domicile property is not affected by the implementation of IFRS 16, which concerns leased assets on the balance sheet rather than domicile property owned by the Group.
- The CRR-compliant additional tier 1 capital instruments issued in the period 2014-2016 count as equity under accounting rules, but do not qualify as equity under capital and solvency rules. The additional instruments are therefore excluded from CET1 capital and instead categorised as additional tier 1 capital. The additional tier 1 capital instruments issued in March 2017 and June 2018 are not recognised as equity under accounting rules.

In addition to the adjustments listed above, total equity is also subject to certain deductions to determine CET1 capital in accordance with the CRR. These are the main deductions:

- Adjustment to eligible capital instruments
- Deferred tax assets that rely on future profitability
- Defined benefit pension fund assets
- Intangible assets of banking operations, including goodwill
- Proposed dividends
- Prudential filters
- Statutory deduction for insurance subsidiaries

Furthermore, the IFRS 9 transitional arrangements, as stipulated in the CRR, were extended by two years from 2023 to 2025 in the light of COVID-19. In addition, institutions were allowed to fully add back to their CET1 capital any increase in new expected credit loss provisions recognised in 2020 and 2021 for financial assets that are not credit-impaired. At the end of 2020, those changes increased the Group's CET1 capital by around DKK 0.6 billion. The fully phased-in effect of IFRS 9 will lower the Group's CET1 capital ratio by 0.3 percentage points.

At the end of 2020, the Group's CET1 capital amounted to DKK 143.7 billion, an increase of DKK 11 billion from 2019. The Group's net profit increased its CET1 capital by DKK 4.6 billion in 2020, but this was partly offset by a deduction for proposed dividends of DKK 1.7 billion.

Additional tier 1 capital and tier 2 capital
At the end of 2020, the Group's additional tier 1 capital amounted to DKK 17.3 billion, or 2.2 percentage points of its total capital ratio. In 2020, the Group redeemed additional tier 1 capital in the amount of DKK 5.6 billion. No issues were made in 2020. At 31 December 2020, all of the Group's additional tier 1 capital instruments were fully CRR-compliant.

At 31 December 2020, the Group's tier 2 capital amounted to DKK 19.1 billion, or 2.4 percentage points of its total capital ratio. In 2020, the Group redeemed tier 2 capital in the amount of DKK 2.2 billion. In 2020, the Group issued CRR-compliant tier 2 capital in the amount of DKK 3.7 billion. At 31 December 2020, all of the Group's tier 2 capital instruments were fully CRR-compliant.

For a description of the terms and conditions applicable to the Group's outstanding issues of individual additional tier 1 and tier 2 capital instruments, see notes G22 and G25 in Annual Report 2020.

Consolidation methods and statutory deductions for insurance companies and significant investments
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 on a line-by-line basis, 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 December 2013, the Danish FSA designated the Group as a financial conglomerate because of its ownership of Danica Pension. Consequently, the Group is subject to supplementary supervision as a financial conglomerate (at the group level). For this reason, the Group performs its solvency calculations using the deduction method.

In rare circumstances, companies taken over by the Group because they in default are consolidated in the financial statements and sold as soon as possible. The holdings are included in the calculation of the total REA. The following table shows the differences between the ordinary consolidation principles used in the financial statements and those used in solvency calculations for subsidiaries and significant investments in credit institutions.

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

	Consolidation of solvency calculations		Consolidation in IFRS accounts	
Subsidiaries and other holdings of Danske Bank A/S	Full	Capital deductions	Full	One line
Credit institutions	√		√	
Significant investments in credit institutions		√		√
Insurance operations (consolidated*)		√	√	
Foreclosed companies (risk-weighted)			√	

* Insurance operations are consolidated using the capital deduction method.

As a financial conglomerate, the Group has obtained permission to use the Danish FSA's deduction method for investments in subsidiaries carrying out insurance operations in line with the conglomerate method stated in the CRR. The Group's statutory deduction for Danica Pension is calculated as 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.

The statutory deductions for insurance companies were previously divided equally between tier 1 and tier 2 capital. Since 2018, the deductions for subsidiaries carrying out insurance operations have been fully deducted from CET1 capital in accordance with the transitional rules of the CRR. At the end of 2020, the total capital deduction for Danica Pension was DKK 9.0 billion.

Total capital deductions for insurance subsidiaries

At 31 December (DKK millions)	2020	2019
Capital requirement at Danica Pension	14,278	13,343
Less the difference between		
Danica Pension's capital base	27,209	25,317
Danske Bank's capital holdings	22,377	20,887
Total difference	4,832	4,430
Less Danica Pension's holding of Danske Bank shares etc.	453	472
Total deductions for insurance subsidiaries	**8,992**	**8,439**
Deductions from common equity tier 1 capital	8,992	8,439

Note: The carrying amount of Danske Bank's capital holdings in Danica Pension less the total deduction for Danica Pension from the Group's total capital is included in the total REA calculation at a weight of 100%.

The CRR defines capital holdings in other credit and financial institutions that represent more than 10% of the share capital of such institutions as significant investments. Significant investments in financial sector entities, excluding subsidiaries, are subject to a deduction from CET1 capital if the total sum of significant investments is higher than a threshold defined in the CRR. Holdings below the threshold will be risk-weighted at 250%. At the end of 2020, the sum of significant investments held by the Group in financial sector entities was below the threshold, and the deduction was thus not applicable.

5.4.2 Capital and solvency requirements for Danica Pension

The prudential supervision of Danica Pension is governed by the Solvency II framework, which provides for EU-harmonised solvency rules in the insurance sector. Under these rules, Danica Pension's capital requirements are DKK 14.3 billion, and its solvency coverage ratio is 191%, up from 190% at the end of 2019.

Danica Pension's solvency coverage ratio

At 31 December (DKK millions)	2020	2019
Shareholder's equity	22,377	20,887
Differences in valuation between accounts and Solvency II	904	486
Subordinated liabilities	3,958	3,950
Foreseeable dividends		
Eligible own funds for covering the solvency capital requirement	27,239	25,322
Solvency capital requirement	14,278	13,343
Solvency coverage ratio (%)	191	190

5.4.3 Total capital requirement

The total capital requirement is determined as the solvency need ratio plus the combined buffer requirement. The solvency need ratio consists of the 8% minimum capital requirement for risks covered under Pillar I and an additional capital requirement under Pillar II for risks not covered under Pillar I.

At the end of 2020, the Group's solvency need ratio was 12.6%, and the combined buffer requirement was 5.6%. When fully phased in, the buffer requirement will be unchanged as no increases in the countercyclical buffer rates in core markets are intended to take effect in 2021. This implies that the fully phased-in CET1 capital requirement was 13.2% and the fully phased-in total capital requirement 18.2%. Assuming fully phased-in rules, the Group would have excess CET1 capital of 4.7% of the total REA at the end of 2020.

Capital ratios and requirements

(percentage of total risk exposure amount)	31 December 2020	Fully phased-in[1]
Capital ratios		
CET1 capital ratio	18.3	18.0
Total capital ratio	23.0	22.6
Capital requirements (incl. buffers)[2]		
Minimum CET1 capital requirement (Pillar I)	4.5	4.5
Capital add-on to be met with CET1 capital (Pillar II)	3.1	3.1
Combined buffer requirement	5.6	5.6
portion from countercyclical capital buffer	0.1	0.1
portion from capital conservation buffer	2.5	2.5
portion from SIFI buffer	3.0	3.0
CET1 capital requirement	13.2	13.2
Minimum capital requirement (Pillar I)	8.0	8.0
Capital add-on (Pillar II)	4.6	4.6
Combined buffer requirement	5.6	5.6
Total capital requirement	18.2	18.2
Excess capital		
CET1 capital	5.1	4.7
Total capital	4.8	4.4

[1] Based on fully phased-in CRR and CRD IV rules and requirements.
[2] The total capital requirement consists of the solvency need ratio and the combined buffer requirement. The fully phased-in countercyclical capital buffer is based on the buffer rates announced at the end of 2020.

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, counterparty credit risk, market risk and operational risk.

Credit risk amounted to 80.8% of the total REA, making it the Group's largest risk type. In collaboration with other national financial supervisory authorities, the Danish FSA has approved the Group'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 of Northern Bank Limited (Northern Ireland) and Danske Bank International (Luxembourg) and to retail exposures in the Non-core Ireland portfolio. For these exposures, the Group currently uses the standardised approach. A complete list of exemptions and approvals is available in section 3.3.

At Danske Mortgage Bank Plc (Finland), the Group has permission to use the F-IRB approach for credit risk exposures to corporate customers. In December 2016, the Group obtained permission to calculate the REA at Danske Mortgage Bank Plc using the F-IRB approach for the institutions asset class and using the A-IRB approach for the retail asset class. Implementation took place in January 2017.

Counterparty credit risk (CCR), including central clearing counterparty (CCP) default risk and the credit value adjustment (CVA) risk charge, amounted to 4.8% of the total REA.

Market risk amounted to 5.1% of the total REA. The Group uses an internal VaR model both for market risk on items in the trading book and for foreign exchange risk on items outside the trading book.

Operational risk amounted to 9.3% of the total REA. The Group uses the standardised approach for the calculation of operational risk.

Risk exposure amounts and risk weights

	2020		2019	
At 31 December (DKK millions)	REA	Weight* (%)	REA	Weight* (%)
Credit risk				
A-IRB approach:				
Institutions	4,092	27	3,924	22
Corporates	275,912	29	269,782	30
Exposures secured by real property	161,509	17	156,946	17
Other retail	19,677	23	18,217	23
Securitisations	1,017	39	1,206	45
Other assets	9,458	81	11,214	76
A-IRB approach, total	471,666	24	461,289	24
F-IRB approach, total	23,139	50	26,347	53
Standardised approach, total	139,047	16	128,842	19
Credit risk, total	633,852		616,478	
Counterparty credit risk	32,680	11	32,010	10
Central counterparty (CCP) default risk	498	6	858	7
Credit value adjustment (CVA) risk charge	4,536		4,361	
Counterparty credit risk (incl. CCP and CVA)	37,715		37,228	
Market risk, total	39,906		40,071	
Operational risk, total	72,711		73,400	
Total risk exposure amount	**784,184**		**767,177**	

* The average risk weight is determined as the REA relative to the EAD for each exposure class.

During 2020, the total REA increased by DKK 17.0 billion to DKK 784.2 billion. The main cause was an increase in credit risk in 2020.

The REA for credit risk increased by DKK 17.4 billion, due mainly to increased credit exposure and preperation for the implementation of DoD in April 2021.

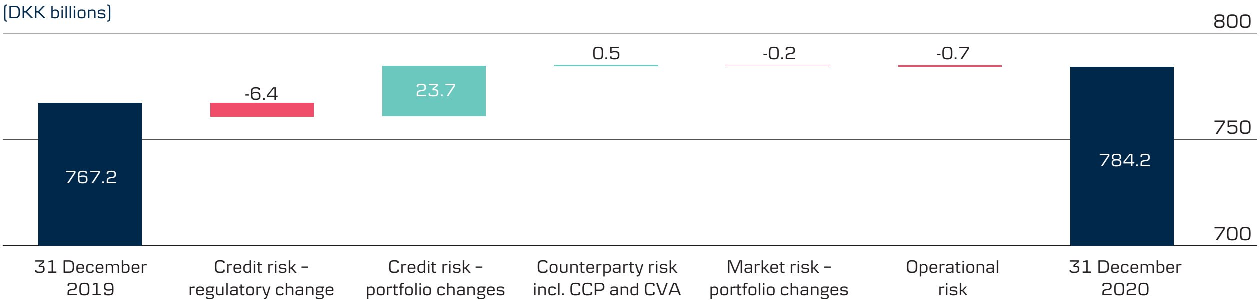
The REA for market risk decreased by DKK 0.2 billion from the 2019 level.

The REA for operational risk decreased by DKK 0.7 billion from the 2019 level. The main cause was a decrease in income.

The REA for counterparty credit risk, including CCP default risk and the CVA risk charge, increased by DKK 0.5 billion from the 2019 level.

Change in total risk exposure amount in 2020

(DKK billions)



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 a financial institution is exposed. As stated in Danish legislation, the solvency need ratio is the solvency need divided by the total REA as determined under Pillar I.

The Group assumes risks as 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 ten main categories of the Group's enterprise risk management (ERM) framework. These risks can be mapped to the risk types listed in the Danish Executive Order on Calculation of Risk Exposures, Own Funds and Solvency Need.

Risk identification by Danish FSA risk type

	Danske Bank Group risk categories									
	Financial risks				Non-financial risks					
Danish FSA risk types	Credit risk	Market risk	Liquidity, funding and capital risk	Insurance and pension risk	Model risk	Operational risk	Technology risk	Financial crime risk	Regulatory compliance risk	Financial control and strategic risk
Earnings		√	√	√						
Credit growth	√									√
Credit risk	√				√	√				
Concentration risk	√	√	√							
Market risk	√	√	√	√	√	√				
Interest risk outside the banking book		√	√							
Liquidity risk			√							
Operational risk	√	√	√	√	√	√	√	√	√	√
Gearing	√	√	√							
Other risk*	√	√	√	√		√	√	√	√	√
Control environment	√	√	√	√	√	√	√	√	√	√

* Includes strategy risk, reputational risk, external risk, group risk and settlement risk.

After identifying the risks, the Group determines how and to what extent they will be mitigated. Mitigation usually takes place by means of business procedures and controls, contingency plans and other measures. Finally, the Group determines the risks to 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.

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. An important part of the process of determining the solvency need is to evaluate whether the calculation takes into account all material risks to which the Group is exposed. The Group uses its internal models as well as expert judgement and Danish FSA benchmark models to quantify whether the regulatory framework indicates that additional capital is needed.

The Group's ICAAP also forms the basis for the Supervisory Review and Evaluation Process (SREP), which is a dialogue between a financial institution and the relevant financial supervisory authority on the institution's risks and capital needs.

At the end of 2020, the Group's solvency need was DKK 98.6 billion, or 12.6% of its total REA. The solvency need increased by DKK 1.3 billion.

For information about the general methods of calculating the solvency need and the solvency need ratio, see the ICAAP report, which is updated quarterly and published along with the Group's interim and annual reports at danskebank.com/investor-relations.

Combined buffer requirement

CRD IV introduced a combined buffer requirement that applies in addition to the solvency need ratio, and it was fully phased in from the beginning of 2019. The combined buffer requirement consists of a countercyclical buffer, a capital conservation buffer and a SIFI buffer and must be funded with CET1 capital.

The capital conservation buffer and the countercyclical capital buffer are designed to ensure that credit institutions accumulate a sufficient capital base during periods of economic growth to absorb losses during periods of stress. The capital conservation buffer is now fully phased in at a level of 2.5%. The countercyclical buffer requirement is calculated as a weighted average of the national buffers in effect in the jurisdictions in which an institution has credit exposures. As a result of the economic effects of the COVID-19 crisis, national authorities announced either reductions or a full release of their respective countercyclical buffers. The Group's countercyclical buffer rate of 0.1% at the end of 2020 was based primarily on the countercyclical buffer rate in Norway (1.0%). The Group takes into account announced national buffer rates when determining its fully phased-in capital requirement.

The Group was designated as a SIFI in Denmark in 2014. Consequently, the Group is subject to higher capital requirements than non-SIFIs. The Group's SIFI buffer requirement is 3%.

Breaching the combined buffer requirement will restrict the Group's capital distribution, including the payment of dividends, payments on additional tier 1 capital instruments, and variable remuneration.

As stated in the CRR, any dividends on CET1 and additional tier 1 capital instruments must be paid from distributable items. These are primarily retained earnings. At the end of 2020, Danske Banks A/S's distributable items amounted to DKK 123.9 billion.

Distributable items for Danske Bank A/S

At 31 December (DKK billions)	2020	2019
Retained earnings	123.1	114.1
Proposed dividends	1.7	7.3
Interest on AT1 capital instruments, not distributed	0.1	0.1
Foreign currency translation reserve	-1.0	-0.4
Distributable items	**123.9**	**121.1**

5.4.4 Leverage ratio

The leverage ratio represents a non-risk-adjusted capital requirement implemented to serve as a further backstop measure for risk-based capital. Since January 2014, the CRR/CRD IV rules have required that a credit institution calculate, monitor and report on its leverage ratio (defined as tier 1 capital as a percentage of total leverage exposure). On the basis of the implementation of the revised CRR, a leverage ratio of 3% will become a minimum requirement in the second quarter of 2021.

Even though the leverage ratio is not yet a regulatory binding capital requirement, the Group still takes it into consideration in its capital management process. The Group's overall monitoring of leverage risk is performed in the ICAAP, which also includes an assessment of changes in the leverage ratio under stressed scenarios. On a monthly basis, the Group determines and monitors its leverage ratio. To ensure sound monitoring, the Group has set forth policies for the management and control of each component that contributes to leverage risk.

At the end of 2020, the Group's leverage ratio was 4.5% under the transitional rules and 4.4% under the fully phased-in rules.

Leverage ratio

At 31 December (DKK billion)	2020	2019
Total exposure for leverage ratio calculation	3,616.3	3,359.7
portion from derivatives	143.0	125.6
portion from securities-financing transactions	267.6	359.0
portion from exposure to central banks, institutions and cash in hand	352.1	180.0
Reported tier 1 capital (transitional rules)	161.0	156.6
Tier 1 capital (fully phased-in rules)	158.2	155.3
Leverage ratio (transitional rules) (%)	4.5	4.7
Leverage ratio (fully phased-in rules) (%)	4.4	4.6

Under the transitional rules, the leverage ratio decreased by 0.2 percentage points during 2020, driven mainly by increased exposures to central banks and credit institutions.

5.4.5 Minimum requirement for own funds and eligible liabilities

As a consequence of the Bank Recovery and Resolution Directive (BRRD), credit and financial institutions in the EU are required to hold a certain amount of bail-in-able resources to fulfil the minimum requirement for own funds and eligible liabilities (MREL). The purpose of the MREL is to ensure that institutions can absorb potential losses and be recapitalised with no recourse to public funds.

The national resolution authorities are required to set an MREL for each institution on the basis of the institution's resolution plan. Danske Bank's resolution plan is based on a single-point-of-entry (SPE) approach at the group level. The requirement for the Group is calibrated in accordance with the Danish FSA's resolution strategy. This strategy states that a systemically important financial institution (SIFI) is to be recapitalised in order for the entire institution to be able to continue its activities post resolution.

For Danish SIFIs, the MREL is set at two times the solvency need plus one time the SIFI buffer and one time the capital conservation buffer. Furthermore, the combined buffer requirement (CBR) must now be met in addition to the MREL. With effect from 28 December 2020, the Danish FSA set the MREL for the Group at 30.5% of the REA (adjusted for Realkredit Danmark). With the addition of the combined buffer requirement of 5.6%, this corresponded to a de facto MREL of 36.1% of the REA. At the end of 2020, the MREL ratio was 42.5%, corresponding to a surplus of DKK 41.6 billion. The MREL is to be met with eligible instruments as defined in the CRR, which includes equity, subordinated debt, non-preferred senior bonds and senior preferred bonds.

In addition, part of the MREL must be met with own funds and liabilities capable of bearing losses before unsecured claims. This is known as the subordination requirement and can be met with subordinated debt, which includes non-preferred senior bonds but excludes senior preferred bonds. The subordination requirement for Danish SIFIs is calibrated as the higher of 8% of total liabilities and own funds and two times the solvency need plus the combined buffer requirement, where the latter is currently binding. For the Group, the subordination requirement is set at 30.6% of the REA (corresponding to the previous requirement). At the end of 2020, the MREL subordination ratio was 36.9%, corresponding to a surplus of DKK 40.8 billion.

Since mortgage credit institutions are exempt from the MREL, Realkredit Danmark figures are excluded in the consolidation for the purposes of determining the MREL. Thus, the calculation of the risk exposure amount to be used for determining the Group's MREL does not include the risk exposure amount for Realkredit Danmark.

The exclusion of Realkredit Danmark figures from this consolidation is shown in the table below. Furthermore, the capital and debt buffer requirements applicable to Realkredit Danmark are deducted from the own funds and liabilities used for the fulfilment of the MREL.

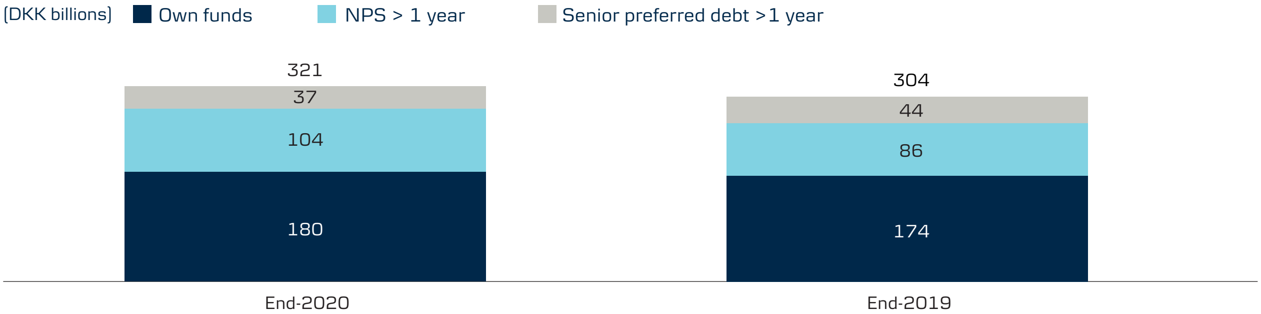
Total REA for the Danske Bank Group excluding Realkredit Danmark figures

At 31 December (DKK billions)	Q4 2020	Q4 2019
Danske Bank Group REA	784	767
Deduction for RD REA contribution to Group REA	-171	-150
REA adjustment for Danske Bank A/S exposure to RD		
Add-on for guarantees	29	30
Add-on for bonds, repos and derivatives	5	3
Add-on for RD equity (100% risk weight)	50	50
Deduction of RD capital and debt buffer requirements	-43	-40
NPS risk-weighted (150% risk weight)	3	
Group REA adjusted for RD	656	661
MREL liabilities - Danske Bank A/S	321	304
Deduction for RD capital requirements	-26	-25
Deduction for RD debt buffer requirement	-16	-14
Available MREL liabilities in DKK	279	264
Available MREL liabilities as % of REA adjusted for RD	42.5	40.0

The Danish FSA's current approach to the MREL is based on the Danish implementation of BRRD I, taking into account certain effects from the Danish implementation of BRRD II (applicable from end-2020). Hence, the framework for setting the MREL might be revised in the light of the Danish implementation of BRRD II.

The following table shows the composition of the Group's own funds and eligible liabilities that may be used for meeting the MREL.

Composition of the Group's own funds and eligible liabilities



5.5 *Future regulatory requirements*

5.5.1 Basel IV

In December 2017, the Basel Committee on Banking Supervision (BCBS) published the final, revised standards for REA calculations. The standards are also known as "Basel IV". As stated by the BCBS, the purpose of revising the standards is to restore credibility in REA calculations and to improve the comparability of the capital ratios of financial institutions. This will be done by

- enhancing the robustness and risk sensitivity of the standardised approaches for calculating the REA
- constraining the use of internal model approaches by introducing parameter floors under the internal ratings-based (IRB) approach and by removing the use of internal model approaches for credit valuation adjustment (CVA) and for operational risk
- introducing a REA output floor of 72.5% of the total REA measured by the revised standardised approaches

The BCBS recommends that the constraints on internal models and the revised standardised approaches be implemented from 2022. The REA floor will be subject to a phase-in period towards 2027. The final EU implementation date is subject to the EU implementation process.

The Group supports the ambition of the BCBS to re-establish confidence in internal models. This is best achieved by addressing key concerns directly in the internal models and maintaining the risk sensitivity of the capital adequacy framework.

The process for its implementation in the EU started in 2019, but has been delayed due to the COVID-19 situation. Consequently, the European Commission is not expected to present a legislative proposal until the second quarter of 2021. The final outcome of EU implementation is thus still subject to uncertainty, but some adjustments taking into account European specificities could be expected.

5.5.2 New directive on covered bonds

In December 2019, the EU covered bonds package was adopted. It outlines requirements for bonds to be recognised as covered bonds under EU law. This includes a requirement for a new cover pool liquidity buffer and stipulates eligible cover pool assets. Furthermore, the package introduces a new requirement of a minimum level of cover pool overcollaterisation. Depending on the transposition of the directive in the individual EU member states, the Group expects the new rules to have a limited effect on the Group since the proposal, to some extent, introduces features that are already part of legislation on covered bonds in Denmark. The Danish implementation of the EU covered bonds package, which was published for consultation in October 2020, is in line with expectations and will thus imply limited changes to the Group's covered bonds activities.

5.5.3 EU risk reduction measures – RRM package

In May 2019, the EU banking package (CRD V, CRR II and BRRD II) was adopted. The implementation of CRD V and BRRD II in Denmark was concluded by the end of 2020 and will apply from 1 January 2021, while CRR II will apply from the end of the second quarter of 2021. The Group expects CRR II and CRD V to have a limited capital and REA effect on the Group.

Among several changes, the package includes the implementation of the leverage ratio (LR), the net stable funding ratio (NSFR) and the fundamental review of the trading book (FRTB) (the latter as a reporting requirement). In addition, the Pillar II framework will be harmonised to ensure alignment with the international standards and to ensure further harmonisation towards a single rule book in the EU. As regards BRRD II, the package introduces changes to the future MREL in relation to the size of the requirement, the composition of eligible liabilities and the phase-in period.

The Danish implementation of CRD V and BRRD II entered into force on 28 December 2020.

As regards the LR, the agreed 3% minimum requirement for non-global SIFIs will not be binding as opposed to the risk-based requirement. Global SIFIs will be subject to an LR add-on equal to 50% of the G-SII buffer. In addition, the Commission is mandated to submit a report to the EU co-legislators on the appropriateness of an LR add-on for domestic SIFIs (O-SIIs). As a non-G-SIFI, the Group will be subject to a 3% leverage ratio requirement.

As regards the FRTB, the changes to the CRR relate only to supervisory reporting standards, so the existing market risk framework will continue to apply as a capital requirement in parallel with new reporting standards. The proposal on the implementation of the Basel FRTB standard has currently been postponed by the European Commission.

In response to the COVID-19 situation, the EU co-legislators adopted a legislative package in June 2020 introducing targeted legislative changes and selected changes to application timing. The most significant changes prolonged the IFRS 9 transitional arrangement (increasing the Group's CET1 capital by around DKK 0.6 billion) and moved forward the application date of the CRR II SME supporting factor (reducing the Group's REA by around DKK 16 billion at the end of the fourth quarter of 2020).

Insurance and pension risk

6.

6.1 *Insurance and pension risk management*

The Danske Bank Group's insurance and pension risk consists of the risks originating from its ownership of Danica Pension. This includes market risk, life insurance risk and non-financial risk. The Group runs its life insurance and pension operations with the aim of providing best-in-class services to customers, while at the same time maintaining a predictable risk profile. The Group is also subject to internal pension risk through its defined benefit plans established for current and former employees. For a description of this particular risk, see section 4.

The insurance and pension risk framework is governed by Danica Pension's Board of Directors. On a daily basis, Danica Pension's Risk Management function monitors the risk and asset-liability management (ALM) limits set by its Board of Directors as well as Danica Pension's solvency capital requirement. The Risk Management function also follows up on investment limits and calculates key risk figures for ALM purposes.

6.1.1 Danica Pension's risks

Operating under Solvency II regulations, Danica Pension provides pensions as well as life and health insurance products in Denmark and Norway. In Denmark, Danica Pension's main products are with-profits policies and unit-linked policies.

Two types of life insurance product in Denmark

With-profits policies
Danish with-profits policies have guaranteed benefits based on a technical rate of interest. The policyholders earn interest at a rate set for each year at the discretion of the life insurance company, and the rate can be changed at any time.

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

At Danica Pension, the with-profits product is called *Danica Traditionel*. The product is closed for new business, and the portfolio is thus in run-off.

Unit-linked policies
Unit-linked policies are policies in which investments are allocated to the policyholders, and they can then decide whether to invest their pension savings themselves or let Danica Pension invest the savings. The offering includes life-cycle products that reallocate to lower-risk assets as the desired retirement date approaches.

In unit-linked policies, the policyholders receive the actual return on the investments rather than a fixed interest rate return. Some of the unit-linked products give the policyholders the option to have their benefits guaranteed.

As part of its product offerings, Danica Pension provides guaranteed life annuities; insurance against death, disability and accident; and guaranteed benefits on retirement. This exposes the Group to insurance risks such as longevity and disability risks as well as to market risk.

At Danica Pension, insurance risks are almost exclusively life and health insurance risks, and they arise naturally out of the business model. Most insurance risks materialise over long time horizons during which the gradual changes in biometric conditions deviate from those assumed in contract pricing.

Lapse risk (customers leaving Danica Pension or ceasing to pay premiums) is the most prominent type of insurance risk since Danica Pension's profitability depends highly on the volume of customers and assets under management. Danica Pension has a large offering of life annuities that will pay fixed pension benefits during a policyholder's lifetime, and this makes longevity risk the second most prominent type of underwriting risk for the Group.

Most pension products come with life and disability insurance, which entails exposure to mortality and disability risk. Health and accident insurance policies are typically shorter, so slowly materialising risks can be handled by means of repricing or contract termination.

In with-profits policies, the policyholders have guaranteed benefits. The return on invested customer savings is allocated to collective buffer accounts owned by the customers. The balance of these accounts is then gradually transferred to the individual customer accounts in subsequent years by means of a bonus allocation mechanism. Negative investment returns or increases in technical provisions due to lower interest rates or other risk factors reduce the balance of the collective buffer accounts. Hence, the market risk on investments is borne by the customers to the extent that the negative returns can be covered by the collective buffer accounts. Once the buffer accounts have been depleted, negative investment returns on customer savings will force Danica Pension to step in with funds to ensure that it is possible to provide the benefits guaranteed to the policyholders. Danske Bank A/S has no obligation to provide capital to Danica Pension to help re-establish its solvency position. Danica Pension can issue and has previously issued capital in the form of restricted tier 1 or tier 2 instruments.

In unit-linked policies, the policyholders bear the investment risk. However, losses may reduce the assets under management and thus deplete future asset management fees in the long term. If a guarantee is attached to an individual policy, Danica Pension bears the risk for this guarantee.

6.1.2 Governance and responsibilities

The general strategic goals and the risk management framework for Danica Pension are decided by its Board of Directors. The risk appetite set by the Board of Directors defines the material risks to which Danica Pension is exposed and sets limits on aggregate measures of these risks. The daily risk management activities are based on Danica Pension's risk management policy issued by its Board of Directors.

Danica Pension's risk management activities are anchored in Danica Pension's All Risk Committee, which is chaired by Danica Pension's chief risk officer (CRO). The All Risk Committee is responsible for maintaining the complete risk picture across all risk types and undertakings.

The All Risk Committee is supplemented by the Asset and Liability Management (ALM) Committee. The ALM Committee coordinates the management of risks arising from differences in exposures between assets and liabilities and also ensures that limits set by the Board of Directors are not breached. The ALM Committee is chaired by Danica Pension's CRO.

Danica Pension's CRO reports to the CEO of Danica Pension and to the Wealth Management CRO at Group Risk Management.

Danica Pension has two other committees: the Investment Committee and the Valuation Committee.

The Investment Committee is chaired by Danica Pension's chief investment officer. It meets on a weekly basis to discuss the developments in the financial markets, risk reporting and asset allocation.

The Valuation Committee is chaired by Danica Pension's chief financial officer and has two additional external members to safeguard independence in respect of the valuations of alternative investments. It meets on a quarterly basis to validate and approve the valuations of alternative investments.

Danica Pension has established a sustainable investment policy based on the Danske Bank Group's policy. Decisions are generally anchored in the Group's Business Integrity Committee, Sustainable Investment Committee and ESG Integration Council and in Danica Pension's Investment Committee and Product committee.

6.1.3 Risk identification and assessment

Risks related to the Danish with-profits product

The main source of risk at Danica Pension is the Danish with-profits pension product. This product offers the policyholders an annuity or a lump sum of a guaranteed minimum amount in nominal terms, which means that they participate in a collective investment pool. High returns may lead to higher benefits than those guaranteed. The mark-to-market value of the guaranteed benefits depends on the level of the discount curve, which is defined under Solvency II and based on market rates. If the value of the assets falls below the value of the liabilities, Danica Pension will have to cover the shortfall. As the only shareholder of Danica Pension, Danske Bank A/S will incur a loss in the form of a decrease in equity holdings, but Danske Bank A/S does not have any obligation to inject further capital into Danica Pension. Managing the with-profits product thus involves a combination of managing the risks on behalf of the policyholders and managing the risk that Danica Pension will have to cover losses.

Danica Pension uses interest rate hedging to manage interest rate risk and maintain customer buffers. The interest rate used for discounting the technical provisions is the Solvency II discount curve. It is based primarily on EUR swap rates and also takes into account yields on Danish mortgage, credit and government bonds. It is not possible for Danica Pension to invest in instruments that provide a complete hedge against movements in the discount curve, so basis risk remains. The level of the long end of the discount curve, for which no reliable market data is available, is determined by the European Insurance and Occupational Pensions Authority (EIOPA).

Derivatives used for hedging may give rise to counterparty credit risk, but this is mitigated by requiring counterparties to provide full collateral and by using many different counterparties with high ratings. Furthermore, Danica Pension uses central clearing.

The guaranteed life annuities included in the with-profits product give rise to longevity risk. This risk is generally not hedged since it is a natural element of the business model, but it is managed through prudent pricing and reserving.

Longevity risk is modelled in the solvency capital requirement calculation and reporting processes by means of a partial internal model approved by the Danish Financial Supervisory Authority (the Danish FSA). This model is based on the Danish FSA's life expectancy benchmark and longevity observations of Danica Pension's policy holders.

Risks related to unit-linked products

Approximately 80% of unit-linked policies have no financial guarantees. In these policies, the policyholders bear the investment risk. In the rest of the unit-linked policies, which consist mainly of Danica Balance policies, the policyholders have investment guarantees.

The risk on these guarantees is managed by de-risking the asset allocation at the individual policy level. This individual hedging strategy aims to ensure that sufficient funds are available to cover the guarantees even after a substantial decline in asset prices.

Danica Pension's activities in Norway accounted for 4% of its total provisions at the end of 2020. In this market, Danica Pension offers mainly unit-linked products without guarantees, which gives rise to relatively limited risk from a group perspective.

6.1.4 Risk monitoring and reporting

Danica Pension's Board of Directors has set overall risk limits on the potential loss in a number of stress scenarios. Danica Pension's Risk Management function monitors these limits on a daily basis. Any breaches are reported by the CRO to the ALM committee and senior management.

Danica Pension's Board of Directors receives quarterly reports on Danica Pension's risk and solvency position, including stress and sensitivity figures. Stress and sensitivity figures are also reported to Danske Bank A/S via Group Risk Management (the Wealth Management CRO organisation) and CFO Area (Capital Management).

To reduce sustainability risks in relation to investments, Danica Pension has introduced a number of restrictions against investing in certain companies. Restrictions apply to the whole investment universe. Danica Pension does not invest in companies whose turnover stems mainly from coal, tar sands or tobacco products. Furthermore, no investments are made in companies that have norm-based violations or are involved in controversial arms production such as nuclear weapons or landmines. Countries on EU or UN sanctions lists are excluded.

Danske Bank A/S owns Danica Pension, and Danske Bank's financial results are thus affected by Danica Pension's financial position. Earnings from Danica Pension consist mainly of the risk allowance from with-profits policies, the investment return on Danica Pension's equity capital, and income from the administration of unit-linked policies.

6.2 *Insurance risk profile*

The Danish market for pension products continues to be competitive, with little prospect of increases in total market volume. The market is dominated by a small number of large commercial and mutual pension insurance companies with similar product offerings. Gross premiums from continuing operations in 2020 amounted to DKK 29.6 billion, a minor drop from DKK 29.9 billion in 2019.

Gross premiums (including investment contracts)

At 31 December (DKK billions)	2020	2019	2018	2017
Denmark	27.9	27.0	24.6	22.4
Norway	2.4	2.6	2.4	2.2
Provisions for insurance and investment contracts	**30.3**	**29.6**	**27.0**	**24.6**

The low-yield market environment does not directly influence the short-term financial stability of Danica Pension because the interest rate risk on all liabilities is hedged, and there are no material differences in the interest rate sensitivities for accounting and solvency purposes. The main difficulty lies in a slow build-up of assets under management and customer buffers, which may adversely affect income in the long run.

Danica Pension's solvency coverage ratio was 191% at 31 December 2020. The table below shows the effect on different risk factors that results in a solvency coverage ratio of 125% and 100%, respectively.

Sensitivities – solvency capital ratio

At 31 December 2020 (DKK millions)	SCR 125% Stress (%)	SCR 125% Own funds	SCR 125% Solvency capital ratio (%)	SCR 100% Stress (%)	SCR 100% Own funds	SCR 100% Solvency capital ratio (%)
Interest rate risk	-135	26,234	125	-179	22,152	100
Equity risk	58	21,261	125	82	16,328	100
Property risk	64	23,888	125	100	19,375	102
Credit spread risk:						
Danish government bonds	15	25,149	125	24	21,353	100
Other government bonds	24	25,201	125	39	21,510	100
Other bonds	39	24,779	125	63	20,264	100
Currency risk						
NOK	100	25,955	138	100	25,955	138
CHF	100	27,128	186	100	27,128	186
GBP	100	27,180	189	100	27,180	189
Counterparty default risk		27,239	175		27,239	175
Longevity risk	42	23,829	125	51	21,496	100
Lapse risk	850	21,177	137	850	21,177	137

Non-financial risk

7.

7.1 Introduction to non-financial risk

Non-financial risk is the risk of financial losses or gains, regulatory impact, reputational impact or customer impact resulting from inadequate or failed internal processes or from people, systems or external events, including legal and compliance risks.

The purpose of this section is to describe the Group's approach to managing non-financial risks. Subsection 7.1 describes the Group's overall approach to non-financial risk management, while subsection 7.2 elaborates on the Group's management of specific non-financial risk categories.

The Group recognises the importance of strengthening its management of non-financial risks. In 2020, the Group dealt with the rapidly changing environment mainly driven by COVID-19, significant events and risk assessments associated with organisational changes within the Group.

During 2020, the Group continued to strengthen its non-financial risk management framework and to increase awareness of non-financial risks across the Group. Important developments were made in the following key areas:

- **Risk and compliance culture:** The Group strengthened its non-financial risk awareness through various mandatory training programmes and team sessions. The Group's internal website, "DoRight", allows employees to share their concerns and direct them to available channels for escalation depending on the issue at hand. The site also provides relevant information about the rules and standards for conducting business at Danske Bank. Additionally, the Group's whistleblower system makes it easier for employees to report their concerns of non-compliance with applicable laws and regulations and report breaches of internal standards, irregularities and criminal offences. The Executive Leadership Team uses a set of key performance indicators (KPIs) to measure the risk and compliance culture. These KPIs are set for each Executive Leadership Team member's areas of activities.
- **Strengthening risk and compliance competences:** Recruitment continued throughout 2020 in the units of Group Non-Financial Risk (GNFR) and Group Compliance to ensure that sufficient skills and expertise are in place. The Group launched the GNFR organisation in 2019 to ensure alignment with the oversight responsibility laid out in the Group's enterprise risk management (ERM) framework. Group Compliance implemented a new organisational structure to strengthen the function and establish clearer roles and responsibilities.
- **Framework and policy:** The Group redesigned frameworks and policies aimed at simplification and strengthened compliance with internal and external requirements. In 2020, the Group made further enhancements to its Outsourcing Policy (to make it compliant with European Banking Authority (EBA) guidelines and recommendations) and its Security Policy and introduced two new policies: IT Risk Management Policy and Third-Party Risk Management Policy. The non-financial risk tolerances were developed at a more granular level in alignment with the ERM taxonomy.
- **Event management and lessons learned:** Enhancements to the Group's risk management, awareness and culture initiatives led to better identification of legacy issues. Such issues were raised and understood in a more thorough manner. In addition, the Group strengthened the follow-up on previously identified events to ensure greater transparency and provide a better overview of the progress of mitigating actions.
- **Operational resilience:** In 2020, operational resilience was a key area of focus for the Group – not least during the COVID-19 crisis. The crisis management structure proved sufficiently robust and flexible to deal with the ever-changing nature of the continued pandemic by ensuring swift and adequate reaction. Although the Group leveraged on resources across all units to handle the COVID-19 situation, the Operational Resilience Programme remained on track and its scope was broadened with continuous progress in strengthening the Group's operational resilience.

The Group has a substantial focus on strengthening the control environment across the organisation through a number of programmes to address Danish Financial Supervisory Authority (FSA) orders and control weaknesses observed and to adhere to regulatory requirements.

Strengthening the management of non-financial risks is a continuous process. In 2019, inspections conducted by the Danish FSA pointed out material gaps in the Group's IT risk framework and control activity. Remediation plans were drawn up to address these gaps through a multi-year transformation programme that was shared with the Danish FSA in April 2020. The remediation programme has already resulted in improvements, and work on the plans continues with no deviations to date.

The Group drew up remediation plans to address significant events in 2020 and is fully committed to their timely implementation as required by the relevant authorities. Remediation of the issues is well underway, and the Group is further strengthening its efforts with the aim of ensuring that all issues are handled in a consistent, timely and proactive manner and that lessons learned are applied across all issues. As part of this process, a new central unit, Remediation Office, was established with the task of overseeing the remediation of the identified legacy issues and ensuring a fully transparent approach along with timely communication to customers and other stakeholders.

The Group will continue its focus on strengthening its risk culture through further training and awareness campaigns.

In 2020, the Group also launched the Governance, Risk and Compliance (GRC) platform. The Group is implementing the new platform in order to strengthen its risk management and regulatory compliance controls through effective data analytics. The GRC platform will help the Group reinforce the identification of immediate actions to ensure regulatory compliance on the basis of increased quality information and process optimisation. When implemented, the new platform will give the Group a transparent overview of risks, controls and compliance efforts and enable it to effectively manage them. The implementation is a multi-year project and will consolidate various existing systems and processes into one platform. Using a shared data model, the new platform will consist of seven applications that span all three lines of defence, and the first application was implemented at the end of 2020.

7.1.1 Non-financial risk management

In accordance with the Group's risk taxonomy as set out in its ERM framework (see section 2), non-financial risk consists of six risk categories:

In addition to the six non-financial risk categories, reputational risk and conduct risk are embedded across the taxonomy and may arise as any or all other risk types materialise. The ERM framework defines reputational risk as the risk arising from failure to meet stakeholders' expectations with possible damage to the Group's brand and reputation. Conduct risk is defined as the risk that the Group's behaviour in supplying financial services causes customer detriment, damages the integrity of financial markets, reduces competition or erodes society's trust in the Group.

The Group's approach to non-financial risk management is set out in a number of governing documents. The Group Non-Financial Risk Policy is the overarching policy and lays down the principles and responsibilities for managing non-financial risks across the three lines of defence. Supplementary policies are in place and reviewed annually to ensure alignment with regulatory developments.

Implementation of the non-financial risk management framework is linked to the process of building and maintaining a strong risk and compliance culture across the Group. All employees (including ELT members) participate in annual compulsory eLearning courses on a variety of risk- and compliance-related topics, including "Everyone is a risk manager at Danske Bank", competition law, anti-money laundering, whistleblowing, GDPR and information security awareness.

The Group's approach to non-financial risk management focuses on risk identification, assessment, mitigation and reporting of operational, financial crime, regulatory compliance, technology, model, and financial control and strategic risks in accordance with the Group's newly defined taxonomy for non-financial risks. The Group also conducts scenario analyses to understand exposure to low-frequency high-severity events. Results from risk assessments and stress tests are used as input for the Group's Internal Capital Adequacy Assessment Process (ICAAP). Moreover, the Group's change risk management, especially with respect to new product introduction, is fundamental in supporting the Group's ambition to create value for all of its stakeholders. In 2020, the Group further strengthened its governance procedures for new and amended product approvals.

The Group takes mitigating actions and learns from materialised non-financial risk events in order to reduce the likelihood and impact of such risk events and ensure that the risk tolerance threshold is not breached.

The non-financial risk tolerance threshold is set for net losses after recoveries for a calendar year. Compliance with this tolerance threshold is monitored and reported in accordance with internal procedures. In 2020, the non-financial risk tolerances were enhanced and defined at a more granular level aligned with the ERM taxonomy with scheduled implementation in the first half of 2021.

7.1.2 Governance and responsibilities

Business units and functions across the Group, including dedicated business risk and control units, are responsible for the management of non-financial risks, acting as the first line of defence. They are in charge of managing non-financial risks in accordance with the Group's risk tolerance threshold (where set). The Group's second line of defence consists of Group Risk Management and Group Compliance, and these functions oversee all non-financial risks.

In order to provide a strong governance structure and effectively cover specific non-financial risk categories, the Group All Risk Committee has a number of non-financial risk sub-committees, including the Operational Risk Committee, the Conduct & Reputational Committee and the Model Risk Management Committee. Furthermore, non-financial risks are overseen by two of the Board of Directors' committees: the Risk Committee and the Conduct & Compliance Committee.

7.1.3 Risk assessment and event management

It is a prerequisite for non-financial risk management that the Group understands and maintains an overview of its organisation and takes ownership of its activities.

In 2020, the Group proactively performed assessments of its non-financial risks. This included a group-wide disruptive risk assessment of the COVID-19 situation to ensure an adequate and timely response to the continued crisis. Crisis management and risk assessments were triggered by the prolonged pandemic and its impact on several areas, and efforts were directed at minimising the long-term negative effects of COVID-19.

The Group's response to the COVID-19 situation from February 2020 until now has provided significant insights into the Group's operational resilience and its ability to handle major disruptive events. The Group's robustness and resilience have been tested and demonstrated in an unprecedented manner by the activation of the Group Crisis Management Team (CMT) and local CMTs (at business unit and country levels), along with substantial external and internal pressure on the organisation and infrastructure.

In 2020, the Group CMT received feedback from both central and local CMTs and from the individual Operational Resilience functions and the Corona Operations (COPS) team. The key findings from the lessons learned will be used as a guidance for the teams and the Operational Resilience functions in the design and adaptation of frameworks.

The Group's standard approach to risk assessment of its non-financial risks and controls is in line with industry standards and comprises the following steps: non-financial risk and control identification, inherent risk assessment, assessment of controls, residual risk assessment and definition of mitigating actions.

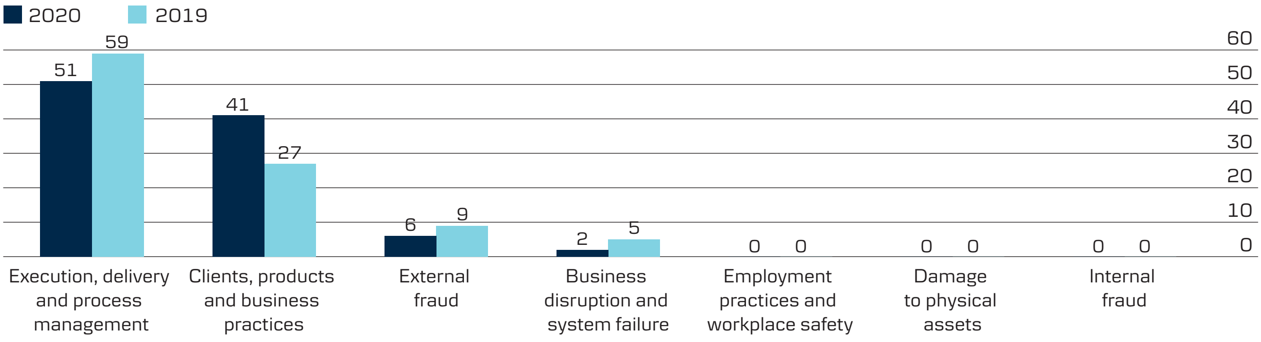
Event management aims to ensure timely and appropriate handling of detected events in order to minimise the potential impact on the Group and its stakeholders and to prevent reoccurrence. Furthermore, event management allows timely, accurate and complete information for both internal and external reporting, including timely notification to relevant supervisory authorities. Non-financial risk events are registered, categorised and handled according to reporting thresholds, and risk assessment and root cause analysis are performed to effectively address underlying risks and provide mitigation plans. The Group strives to learn from materialised events and observed near-misses to continually improve its operational risk management framework.

In 2020, there was an increased focus on event management at Group Non-Financial Risk, the Business Risk & Control teams at the respective business units and at the Executive Leadership Team level. The total number of non-financial risk events increased significantly from the level in 2019.

In 2020, the Group registered materialised events in accordance with defined escalation thresholds and extracted lessons learned to apply them to several appropriate events. Additionally, legacy issues were raised and understood in a more thorough manner. The following chart provides an overview of the Group's materialised losses broken down into seven Basel II event type categories.

Gross losses broken down by Basel event type

(%)



Note: The chart shows gross losses (actual losses sustained by the Group excluding any recovery) for non-financial risks broken down by Basel II event type category, as reported for COREP reporting.

As in 2019, the majority of loss events in 2020 fell into two broad categories: "Execution, delivery and process management" and "Clients, products and business practices". There were losses relating to legacy systems and limitations in manual processes as well as product and services-related events.

On 21 September 2020, the Danish FSA issued four orders to the Group on its conduct in relation to debt collection. The orders related to (i) stopping debt collection, (ii) informing affected customers, (iii) ensuring that debt collection stops upon identification of errors, and (iv) ensuring that potentially affected customers are informed on an individual basis. The Group forwarded a letter to the Danish FSA with a remediation plan to address the four orders.

In October 2020, the Group announced the establishment of a central unit with the responsibility of overseeing the remediation of significant non-financial events across the Group. Furthermore, in November 2020, the Danish FSA ordered the appointment of an impartial reviewer to evaluate the corrective measures related to the Group's debt collection procedures.

7.1.4 Monitoring and reporting

Significant non-financial risk events across the Group are monitored and reported to the Executive Leadership Team, the Board of Directors, the Danish FSA and, where applicable, to relevant local financial supervisory authorities (FSAs).

The Group monitors trends in risk performance data to identify changes within non-financial risk management that may require further analysis and mitigation and/or support risk profile conclusions and managerial decisions.

The Group standards require group-level aggregation and monitoring of its non-financial risk profile against the risk tolerance threshold. Non-financial risk monitoring comprises two core components: financial losses stemming from non-financial risk events and non-financial risk exposure derived from continuous risk assessments.

Reports on the Group's non-financial risk profile, including risks, events and risk tolerance, are submitted on a monthly basis to the Executive Leadership Team and on a quarterly basis to the Board of Directors.

7.2 Non-financial risk categories

In addition to the Group's general approach to non-financial risk management, each non-financial risk category, as defined by the Group's risk taxonomy set out in its ERM framework, is intended to be managed in accordance with specific regulatory requirements and business objectives.

7.2.1 Operational risk management

Operational risk is inherent in the Group's daily operations, and such risk may occur in relation to the Group's products and services, reporting procedures, employment practices, workplace safety, damage to physical assets, outsourcing agreements, third parties dealing with the Group, mismanagement of legal disputes or contractual rights and obligations, or as the result of business continuity events (such as natural disasters, pandemics or power outages).

Operational risk is managed in accordance with the Group Non-financial Risk Policy, which is supported by additional policies and instructions, including but not limited to the following:

- **Product Governance Policy for New and Amended Product Approval (NAPA):** This policy covers the governance of products, services or channels throughout their lifecycles.
- **Product approval governance:** The Group continues its efforts to enhance product approval governance by simplifying the process, ensuring adequate standards and clarifying the mandates of the relevant decision-making committees.
- **Outsourcing and third-party risk:** Third-party arrangements cover services, goods and products provided to the Group by a third party. The key purpose of third-party risk management (TPRM) is to manage risk from outsourcing and other third-party arrangements and to ensure regulatory compliance by identifying, assessing and controlling non-financial risks in relation to a third-party arrangement.

Semi-annually, the Group's non-financial risk loss events are reported to the Danish FSA on the basis of the EBA standards for common reporting (COREP). Significant non-financial risk events across the Group are monitored and reported as described in section 7.1.3. Operational risk is assessed annually within the scope of the Group's ICAAP.

The Basel Committee on Banking Supervision (BCBS) has issued a consultation paper updating its principles on sound operational risk management to address areas such as change management as well as information and communication technology (ICT) risks. The consultation phase of the revision of the principles was completed in November 2020, and final publication of the principles is expected in the first half of 2021.

Operational resilience is a key area of focus for the Group, including incorporation into the decision-making process. The Group defines operational resilience as the ability to prepare for, effectively respond to, and learn from disruptive events and adapt to changing conditions in order to continue providing critical services to customers and society in the presence of operational stress. Furthermore, the Group considers operational resilience as broader-than-traditional business continuity planning and disaster recovery capabilities.

The Group's Operational Resilience Programme is a cross-area collaboration between the following units: i) Crisis Management, ii) Site Emergency Response, iii) Business Continuity Management, and iv) IT Service Continuity Management. In addition, the programme also links to third-party risk management and cybersecurity, for example.

In 2020, the main developments in relation to operational resilience were as follows:

- The Operational Resilience Programme was further developed with the allocation of additional resources to ensure that the necessary levels of expertise and support are in place. Working groups were established to develop integrated reporting, provide internal training, introduce better tracking tools and perform an assessment of existing cross-functional procedures.
- The crisis management structure proved sufficiently robust and flexible to deal with the dynamic nature of the continued COVID-19 crisis by ensuring rapid collection of information, reporting, analysis, decision-making and implementation processes.
- Whilst the Group leveraged on resources across all units to handle the COVID-19 situation and its negative effects, the Operational Resilience Programme remained on track and its scope was expanded.
- Operational resilience was developed into a focal point for all related efforts across the Group. This will ensure the alignment and coordination needed to properly prepare for, respond to, and recover from disruptive events.

The Group is applying the lessons learned from COVID-19 for the purpose of strengthening its operational resilience. Elevation of the programme will be achieved by organisational changes to be implemented in January 2021.

Furthermore, the Group will continue to track and monitor developments to ensure that a solid understanding of regulatory expectations and trends is in place.

7.2.2 Financial crime risk management
Financial crime risk is the risk that internal or external parties misuse the Group's infrastructure and services to steal, defraud, manipulate or circumvent established rules, laws and regulations through money laundering, terrorist financing, sanctions breaches, bribery and corruption, tax evasion or fraud.

The Group's business units and functions constitute the first line of defence and are responsible for identifying financial crime risks and for having appropriate processes and controls in place to ensure that risks are identified, assessed, managed and reported appropriately.

The Financial Crime Compliance function at Group Compliance constitutes the second line of defence and is responsible for designing frameworks and policies and for providing independent oversight and challenges to ensure that financial crime risks are managed effectively.

Strategy
The Group is undertaking a multi-year enhancement programme to materially upgrade its financial crime framework. In the past two years in particular, the pace of progress has been significant. The Group has embarked on a comprehensive transformation covering all aspects of an effective control environment. The programme covers areas such as transaction monitoring, sanctions screening, Know-Your-Customer processes, suspicious activity investigation and reporting, employee training, etc. During 2020, the Group made significant progress in setting out more detailed requirements and standards in relation to financial crime risk management, including issuing a new Anti-Money Laundering & Counter-Terrorist Financing and Sanctions Policy and a new Anti-Bribery & Corruption Policy, which are published at danskebank.com and are in the process of being fully rolled out.

The enhancement programme is tracked through formal governance and monthly status updates are provided to the Group's Executive Leadership team (ELT) and the Danish FSA. Regular updates are also provided to the Group's Conduct & Compliance Committee (CCC) and the Board of Directors. The responsibility for tracking and reporting progress rests with Group Compliance to ensure independent and objective assessments of progress to senior management.

The aim of the enhancement programme is to ensure that the Group has a financial crime control framework which (i) meets the regulatory requirements in the jurisdictions in which the Group operates and (ii) manages the Group's inherent risk in line with the Group's risk appetite, and this will be achieved by leveraging international market practice.

Risk assessment
A group-wide risk assessment of financial crime risk is performed on an annual basis. It identifies and measures the Group's inherent risks, assesses the effectiveness of the controls to mitigate those risks, and generates a residual risk score. The assessment covers all the Group's financial crime risks, including its exposure to customers, products offered, delivery channels, transactions, geographies and organisational risks.

The Group's inherent risks were materially reduced by the exit from the Baltics. The Group has also continued to rationalise some of its historical relationships which do not align with its commercial strategy, terminating its business with some customers located in higher risk jurisdictions outside the EU. The Group's highest inherent risk segments continue to be business areas that offer products such as trade finance and correspondent banking. Within these areas, the Group has continued to enhance its controls in order to reduce the residual risk.

The output of the annual risk assessment is reported to the management of each branch, the ELT, the CCC, the Board of Directors and the Group's regulators. In addition to ensuring that senior management is aware of the areas of the greatest risk, the output is also used for pointing out where further areas of enhancement are required.

Risk management
In 2020, the Group continued to strengthen its oversight and management of financial crime risk in a number of areas:

- Management information and reporting: The Group increased the level of risk management data in 2020 to enable senior management to have a more comprehensive and holistic overview of risk and emerging trends. Examples of new types of data provided include customers with repeated Suspicious Activity Report (SAR) filings, customers located in higher risk jurisdictions and policy violations. Quantitative and qualitative information is reported to senior management in a number of ways, including through the Quarterly Group Compliance Report, which is presented to the ELT, the CCC and the Board of Directors.
- Roles and responsibilities: As part of the Group's broader implementation of a three-lines-of-defence model, roles and responsibilities were further defined across the organisation. Combatting financial crime relies on a number of functions across the organisation (branch staff, technology, dedicated risk managers, Group Compliance and Legal) and it is critical that accountability is clearly delineated.
- Training: All staff across the Group received online training on core financial crime risks and the Group's systems and controls. In addition, the Group provided in-person training to specific business areas tailored to their specific risks (e.g. in Trade Finance). All members of the ELT also received one-to-one, in-person training on financial crime risk, focusing in particular on their roles as senior supervisors.
- Testing: With the implementation of enhanced controls, the Group increased the level of quality assurance and testing in 2020 to ensure that these controls are operating as intended. Additional quality assurance processes were embedded into day-to-day controls (such as reviewing alerts generated through sanctions screening). In addition, Group Compliance performed independent testing of certain higher risk areas. The Group also retained a third-party professional services firm to conduct an independent review and testing of the Group's remediation programme. The findings are reported directly to the ELT. As more of the Group's enhancements enter into a more "business as usual" phase in 2021, the Group anticipates an increased level of testing by this independent third party.

Resourcing
In 2020, the Group continued to hire employees with deep subject matter expertise into key roles, and this enables the organisation to design, implement and manage its control enhancements to a high standard and leverage international practice. These experts also contribute to better risk assessment and act as advisers to the rest of the Group's staff on day-to-day risk management decisions. Significant additional resources were also added for operating the enhanced or newly introduced controls. Despite the high demand for expert resources, the Group continues to be an attractive employer and has been successful in recruiting for vacant positions promptly. As more employees have been hired for permanent positions, the Group's historical dependence on temporary resources has been reduced. The Group continues to invest in these employees to ensure motivation and engagement while operating in a high-paced environment.

In 2020, the Group decided to reorganise its First Line Financial Crime risk management team. Several teams, previously aligned across business units, are to be merged into one consolidated team in order to ensure consistency of standards, approach and clearer accountability in the Group's enhancement programme.

Technology and tools
The Group seeks to leverage on technological innovation as part of its financial crime transformation and control infrastructure. New technology solutions such as robotics are being deployed to increase the speed at which certain high-volume, repeatable and consistent controls are executed. The Group has implemented more analytical software solutions to enable a thorough investigation of potentially suspicious activity with a view to providing law enforcement agencies and management with higher quality SARs. Know-Your-Customer processes are also further integrated into digital customer on-boarding processes for improved customer journeys while also meeting the Group's risk management objectives.

Industry collaboration
Combatting financial crime effectively requires strong industry collaboration in order to ensure the security and soundness of the entire financial system. In 2020, the Group was an active participant in industry initiatives across the Nordic region. These initiatives aim to make the public and private sector, collectively, more effective in reaching the common goal.

7.2.3 Regulatory compliance risk management
Group Compliance is required to develop and implement a structured and well-defined compliance risk management framework setting out its planned activities, including alignment with the Group's strategic business plan. The compliance programme is risk-based and subject to oversight by the chief compliance officer, a member of the Executive Leadership Team, to ensure appropriate coverage across business areas and co-ordination with other risk and control functions.

Regulatory compliance risk is defined as the risk that the Group receives regulatory, criminal or administrative sanctions, incurs material financial losses or suffers a loss of reputation as a result of its failure to comply with laws, rules and standards applicable to its activities as overseen by Group Compliance.

Group Compliance provides primary and independent second-line oversight of regulatory compliance risk, including risks in relation to market integrity, fair treatment of customers, data protection, and is developing its oversight capabilities for IT risks on an ongoing basis.

Group Compliance does not provide day-to–day oversight for all laws, rules and regulations. Specialist functions are in place across the Group to provide appropriate oversight (for example, Group Risk Management oversees credit, market and liquidity risks, Human Resources deals with employment law, and Group Finance oversees accounting and tax rules). Group Compliance assesses the framework in place across other second-line-of-defence units and independent oversight/control functions for the purpose of reviewing their methods and procedures to ensure adherence to applicable laws, rules and regulations.

Over the past few years, the regulatory environment has seen the introduction of a large volume of changes, and this will continue at least in the coming years, for example in the area of sustainable finance. The Group has a key focus on compliance gaps identified in its control environment and on ensuring that risks are proactively managed on an ongoing basis, including risks arising from regulatory change.

During 2020, the Group continued to strengthen its regulatory compliance risk management framework, and important developments were made in the following key areas:

- **Conduct risk.** Conduct risk is the risk that the Group's behaviour in supplying financial services causes customer detriment, damages the integrity of financial markets, reduces competition or erodes society's trust in the Group. Conduct risk occurs across the ERM taxonomy and so can arise as any or all other risk types materialise. To reflect this, the Group's ERM taxonomy has been updated to establish conduct risk as a cross-taxonomy risk.

  The supporting risk management framework is being developed and implemented through the Conduct Programme, established in 2020 as a key strategic initiative under the Group's Better Bank transformation programme. The framework will be developed by Group Compliance but will be tailored and implemented by the business in the first line of defence.

  A new conduct risk policy, instructions and risk tolerance statements are being developed for implementation in 2021. The key areas that will dominate implementation alongside the framework development in 2021 are as follows: i) treatment of vulnerable customers, ii) improving transparency around products and services, and iii) fairness and consistency of the pricing framework.

- **Compliance oversight.** In 2020, significant efforts were made to improve compliance oversight within the Group by increasing the capacity and expertise of the function through recruitment and increased training and by improving the policy framework across management of market abuse and data protection risks. This work included an increased focus on the compliance coverage of branches and regulated subsidiaries through governance, reporting improvements and targeted recruitment. This work will continue in 2021.

- **Trade and communications surveillance.** The Group made significant improvements in its trade and communications surveillance setup, including the deployment of new automated systems, and successfully addressed multiple orders issued by the Danish FSA that highlighted weaknesses in this area. These issues had caused the Danish FSA to refer the matter to the Danish State Prosecutor for Serious Economic and International Crime (SØIK), and the Group continues to cooperate with the authorities, while making improvements in relation to the issues identified.

- **Conflict management.** To support this critical area, a new conflict management team was established by Group Compliance in the second half of 2020 to take the lead in enhancing the framework, awareness and controls in the area of managing conflicts of interest. An enhanced conflicts of interest policy was launched in 2020 and improvements were made to the conflict registration process. Additional oversight and further developments are planned for 2021.

- **Strengthening compliance expertise.** The Regulatory Compliance function significantly increased its headcount in 2020. The function will execute a broader monitoring plan in 2021 than during previous years, including targeted monitoring of compliance at branches and regulated subsidiaries. It will also use its increased scale and expertise to advise and challenge the business to ensure further improvements in the business control environment. The Group Compliance staff increase in the second line of defence will be followed by an increase in the number of resources in Business Risk & Control Management functions in the first line of defence.

- **Risk remediation.** The Group identified and addressed multiple incidents requiring remediation such as those related to debt collection and tools handling investment agreements with customers. These are subject to formal remediation governance, close regulator engagement and public communication through various channels, including press releases. The Group is working on codifying remediation principles in cases where customers have suffered detriment. This forms part of the Conduct Programme book of work.

  A number of these remediation cases also identified the need to improve the Group's data governance and information records management framework. A programme of work was set up in 2020 to make these enhancements and will continue its implementation in 2021. This will improve the regulatory compliance risk profile not least in the areas of data accuracy, retention and deletion. These areas are components of multiple regulatory requirements, including GDPR, and the Group has been approached by the Danish Data Protection Agency in relation to issues identified in the Group's debt collection case.

Because of major organisational changes introduced at the end of 2020 and to be implemented in the first quarter of 2021, the Group will continue to focus on maintaining momentum and ensuring issue ownership in the business. The Group Compliance function has also initiated organisational changes to realign to the new business structure, including developing a model to engage with the Group's new agile way of working, Better Ways of Working (BWoW).

Regulatory compliance risks are reported in the Quarterly Group Compliance Report to the Executive Leadership Team, the Conduct & Compliance Committee of the Board of Directors, and the Board of Directors.

7.2.4 Technology risk management

Technology risk is the potential risk that a given threat will exploit vulnerabilities of an asset or a group of assets and thereby cause harm to the Group. Technology risk includes the risk of disruption to the availability of information, communications or technology; the risk of corruption and loss of data; and the risk of breach of data confidentiality through attacking and exploiting vulnerabilities.

Requirements for the management of technology risk are documented in the Non-Financial Risk Policy, IT Risk Management Policy and Security Policy.

IT units are responsible for the management of their own technology risks in collaboration with business units. The business units are ultimately accountable for the risks, while the security function provides support in identifying, assessing and tracking technology risks. Technology & Services submits monthly updates on the status of technology risk exposure to the CRO. Quarterly reports on technology risk assessments are submitted to Group Non-financial Risk, which undertakes a review of the completeness and accuracy of the risk profile and the effectiveness of the risk management activities performed.

Although control activity is undertaken by individual IT units in their ongoing development and change activities, there are known deficiencies in control activity and gaps in the technology risk profile. This is consistent with the IT inspection conducted by the Danish FSA in 2019. The inspection observed material gaps in the Group's IT risk framework and control activity.

In response, the Group mobilised a multi-year transformation programme across the first and second lines of defence to remediate the issues and also shared its plans with the Danish FSA in April 2020. There are no deviances to the plans to date. The remediation programme has already led to improvements, including the following:

- Strengthening of governance structures, oversight capability and the segregation of duties between the first and second lines of defence, including the reorganisation of the Security function to ensure independence from IT Operations
- Development of a new policy on IT risk management (IT Risk Management Policy) and alignment of the Security Policy with EBA guidelines on ICT and security risk management and the Danish Executive Order on Management and Controls of Banks (Annex 5 on IT security requirements)
- Further development of processes and technologies needed to effectively monitor and manage technology risks, including the rollout of cross-functional information security, physical security and fraud training and awareness across the Group
- Improvement of control procedures within access management, asset management, IT service continuity and security processes
- Further enhancement of capabilities in preventing, detecting and responding to IT and security incidents, including extending the geographical coverage of existing information protection controls, implementing information protection controls and implementing new technologies to enhance endpoint security

In addition, the Group has seen strong performance in respect of system availability, minimising customer impact across all critical services. The introduction of formal service continuity governance for critical IT services and the establishment of failover capabilities have played a significant role in this success.

The IT Risk Council meets on a quarterly basis and provides status updates on risk identification, risk management execution, risk acceptance and risk escalation within Group IT.

The volume and sophistication of cyber-related attacks continue to grow. Information security (including cybersecurity) is identified as a top risk concern across global and Nordic peers, and this trend is expected to continue. Many companies across multiple industries have been negatively impacted by cyber-related attacks, with ransomware attacks in particular being frequently reported in the news. This type of attack remains an effective method for criminals to monetise illicit access into an organisation, resulting in data leaks when an organisation is unwilling to pay.

The Board of Directors and the Executive Leadership Team acknowledge the materiality of the risk posed by cyber-related attacks and continue to invest in the Group's capabilities to prevent, detect, respond to and recover from these attacks. In response to the increasing threat of cyber-related attacks, the Group has mobilised a multi-year transformation sponsored by the Executive Leadership Team to continue to mature the Group's ability to mitigate the risks posed by these threats.

The management of cyber-related risks is covered within the Group's overall risk management framework since these risks may prevent the Group from achieving its objectives. Governance structures and methodologies to oversee, prioritise and undertake risk mitigation activity in relation to cyber-related attacks are in place to ensure that the focus remains on the area.

The following ongoing initiatives will iteratively enhance the Group's current measures to mitigate such risks. They include but are not limited to the following:

- awareness and phishing campaigns to embed a culture of security
- access control measures to protect data, technology and physical assets
- automated vulnerability scanning and detection of malicious activities
- crisis management plans, incident response playbooks, red team exercises and dedicated security teams to prepare, identify and respond to security incidents
- failover testing and root-cause analysis to enhance Danske Bank's resilience

7.2.5 Model risk management
Models form an important part of the Group's strategy to improve customer experience and drive efficiency and agility. Driving digitalisation and providing digital platforms require the automation and use of models. The use of models constitutes model risk, which is the potential risk of adverse consequences resulting from decisions based on incorrect or misused model outputs and reports.

The Group manages model risk in accordance with its Model Risk Policy. The Model Risk Policy sets out standards and principles for the purpose of embedding strong model governance with a comprehensive and holistic approach to model risk, while also supporting the Group's business strategy.

In order to ensure that the amount of model risk acceptable to the Group continues to be aligned with its overall strategic objectives, the Group has defined and implemented a model risk tolerance statement. It supports clear communication of the requirements for mitigating excessive model risk and is included in the group-wide non-financial risk tolerance framework.

Model risk is managed by model owners, and they are responsible for the data quality, implementation and appropriateness of the model and for adherence to the model risk tolerance statement.

The Model Risk Management (MRM) function (the second line of defence) is responsible for developing and maintaining the Model Risk Policy and for model risk oversight. In particular, the MRM function performs independent assessments of model performance and reviews and challenges methodologies.

The Group's model inventory is contained in a system (MRM Tool) that features and tracks key characteristics of the models. In addition to the model inventory, the system contains a reporting module that enables automated reporting of model risk. Model risk monitoring and reporting are provided on a regular basis to the Model Risk Management Committee and the Executive Leadership Team through the Group All Risk Committee.

7.2.6 Financial control and strategic risk management

Financial control risk is the risk of inaccurate or incomplete application of accounting and tax laws. Strategic risk is the potential risk of an opportunity loss of earnings resulting from the failure to account adequately for external forces in the Group's corporate strategy or the potential risk of a loss of market position due to the failure of the Group's corporate strategy (wrong prioritisation or strategic choice, for example).

The consolidated financial statements are prepared in accordance with the International Financial Reporting Standards (IFRSs) as adopted by the EU, while the parent company financial statements are prepared in accordance with the Danish Financial Business Act. Interim and annual reports are prepared in accordance with Danish disclosure requirements for listed financial institutions. The risk of non-compliance with these standards is assessed on a quarterly basis in advance of the preparation of interim and annual reports.

The Group's risk appetite is embedded in its strategic and financial planning processes to ensure that the strategic decision-making process is based on a strong risk culture. Strategic risks are monitored by the owner of each strategic initiative and by business unit heads. Potential strategic risks are reviewed quarterly by the Executive Leadership Team and at least twice a year by the Board of Directors. Significant deviations in strategy execution from the specified goals are escalated to the Executive Leadership Team or to the Board of Directors.

As the first line of defence, Group Strategic Steering is responsible for developing the group-level corporate strategy in co-operation with business units and other Group functions and for ensuring that strategy risks are identified and managed. The Group's corporate strategy is formulated on the basis of both internal and external factors that shed light on the capabilities, challenges and opportunities relevant for the Group. Internal factors relate to past performance, available capacity and capabilities within the organisation. This is supported by analysis performed on external factors such as peer performance and developments, changing consumer demands, trends and market developments and the macro-economic and political environments.

On the basis of the corporate strategy, underlying initiatives are developed to support the achievement of set targets through development activities, such as new products and processes, taking into account associated risks and internal constraints.

In 2020, the Group continued to make progress on its 2023 Better Bank ambitions towards customers, employees, shareholders and society. Risks related to the Better Bank transformation are identified, assessed and managed in accordance with the Group's standards on an ongoing basis. The performed risk assessment ensures that changes are embedded into the risk management process and that potential mitigating actions are identified and implemented. Risk assessments related to Better Bank initiatives were independently reviewed and challenged by Group Non-Financial Risk in Group Risk Management in 2020, and ongoing risk assessment in this regard will take place in the next few years. Business units are in charge of implementing and executing on the strategy and taking corrective action in relation to deviations and risks relating to strategy operationalisation. The implementation approach is tested against the Group's risk appetite to ensure alignment.

Management declaration

8.

8.1 Management declaration

As stated in article 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 placed on a company's board of directors as stipulated in the Danish Executive Order on Management and Control of Banks etc., 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 Leadership Team. The Board of Directors finds 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 financial and banking services to personal, business and institutional customers across the Group's home markets. The Group has a diversified business model which spreads across various industries, customer types and countries.

At the end of December 2020, the Group's solvency need ratio was 12.6%.

As a consequence of increased capital requirements and general uncertainty about future regulation, the Board of Directors decided to change the target for the Group's CET1 capital ratio in 2019. The target for the CET1 capital ratio was set to above 16% in the short term to ensure a sufficiently prudent capital buffer. The target for the total capital ratio was kept at above 20%. At the end of December 2020, the Group's CET1 capital ratio was 18.3% and its total capital ratio was 23.0%.

Credit risk is managed in accordance with the Group's Credit Policy, Credit Risk Instructions, Credit Risk Appetite and credit risk framework. The Group operates with a credit risk appetite to limit impairment volatility and manage credit risk concentrations (limits on single names, industries and geographical regions). Risk reporting enables ongoing monitoring of the Group's credit risk profile to ensure that it remains in line with the credit risk appetite.

The Group's market risk comprises three separate frameworks for the following areas: trading-related activities at Large Corporates & Institutions, fair value adjustments (xVA) at Large Corporates & Institutions and the non-trading portfolio at Group Treasury. Market risk is managed in accordance with the Group's Market Risk Policy and Market Risk Instructions. The Group operates with a market risk appetite for the various areas.

The Group manages its liquidity on a daily basis by using risk indicators, risk triggers and a liquidity risk appetite as defined in the Group's Liquidity Policy and Liquidity Instructions. The policy documents define the limits and methods for calculating liquidity risk and set the overall principles and standards for the Group's liquidity management. At the end of December 2020, the Group's liquidity coverage ratio was 153.5% – well above the internal limit set at 110% by the Board of Directors. The Group's long-term debt was rated 'A'/'A'/'A3' (S&P Global/Fitch Rating/Moody's) at the end of December 2020.

Non-financial risk, which covers operational risk, financial crime risk, regulatoy compliance risk, technology risk, model risk, and financial control and strategic risk, is managed in accordance with the overarching Group Non-Financial Risk Policy and a number of supplementary policies and instructions. The Group monitors non-financial risk tolerance limits to ensure that the Group pursues its business strategy according to its risk tolerance.

BOARD OF DIRECTORS

Karsten Dybvad *Chairman*	Jan Thorsgaard Nielsen *Vice Chairman*	Carol Sergeant *Vice Chairman*
Martin Blessing	Lars-Erik Brenøe	Raija-Leena Hankonen
Bente Avnung Landsnes	Christian Sagild	Gerrit Zalm
Bente Bang	Kirsten Ebbe Brich	Thorbjørn Lundholm Dahl
	Charlotte Hoffmann	

Other Danske Bank Group publications, available at danskebank.com/investor-relations

Annual Report 2020

Corporate Governance
Report 2020

Sustainability Report 2020

Danske Bank A/S
Holmens Kanal 2-12
DK-1092 København K

Tel. +45 33 44 00 00
CVR No. 611262 28-København
danskebank.com