

Risk Management 2017

Danske Bank Group



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The objective of Risk Management 2017 is to inform shareholders and other stakeholders of Danske Bank Group's risk management, including policies, methodologies and practices.

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

2017 in brief

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1.

Danske Bank Group is a Nordic universal bank with strong regional roots and bridges to the rest of the world. We have a well-diversified business model serving personal, business and institutional customers. In addition to banking products and services, we offer life insurance and pension, mortgage credit, wealth management, real estate and leasing products and services.

Our risk strategy and risk objectives are essential in supporting our business model, and they play a central role in our proactive risk management approach. We want to be a solid, balanced and predictable bank that supports customers through the business cycle.

We ensure that our risk appetite is in line with our strategic goals, and this requires a robust approach to aggregating, monitoring and measuring risk and understanding the implications of financial stress on our business. We have a strong control environment in place based on a thorough understanding of risks, clear roles and responsibilities, and we use the right controls and mitigation activities where and whenever needed.

We strive to further embed risk awareness in our corporate culture in order to ensure that we serve our customers as they expect us to serve them. Our impact on the wider society is substantial and will therefore continue to be monitored and developed in order to meet all stakeholder's expectations.

We constantly monitor and take views of the environment in which we operate and adapt to the ever-changing landscape around us. Proactive identification of top and emerging risks is critical to our ability to anticipate where disruptions and vulnerabilities are likely to occur.

1.1 Main developments in 2017

In 2017, the operating environment in our home markets was characterised by positive macroeconomic developments, high customer activity and growing business despite the continuing variety of geopolitical risks.

In Denmark, the recovery in production, income and employment continued in 2017. The Danish economy is closely linked to overall European performance. Growth was fuelled by an increase in disposable income for households because wages grew faster than prices and was also supported by higher employment. Total credit grew slowly and non-mortgage bank lending declined. House prices increased more than inflation, thus supporting residential investment.

Swedish GDP growth continued at a comfortable 3% in 2017. But as the current 12% decline in the prices of Stockholm owner-occupied flats spread to other regions, we expect residential construction to slow down markedly in 2018, bringing GDP growth down to 1.7%. This assumes, however, that the labour market remains strong to bolster household income and that the export industry gains strength to set off the negative effects of falling house prices. Inflation is likely to slow down again because domestic wage pressures are too low relative to the inflation target.

In Norway, GDP growth picked up substantially as the headwinds from the oil recession abated. Unemployment dropped and capacity utilisation increased. Growth was driven by public demand and residential investments, and towards the end of the year, private demand and oil investments also picked up. After rising strongly for three consecutive years, house prices started to fall because of a combination of stronger supply and tighter credit regulation.

In Finland, GDP growth accelerated towards 3% in 2017. Growth became more diversified as exports recovered and companies became confident enough to invest. Employment improved slowly and consumer confidence was unusually high. House prices increased and construction activity went up in the main cities, but the housing market was calm at the national level. Credit growth was slow and loans to housing companies continued to outpace mortgages or corporate loans.

The low-interest-rate environment remains a factor that may inflate asset prices in the medium term in our core home markets.

Uncertainties about the implementation of Brexit combined with higher inflation have been damping growth in the United Kingdom, not least in Northern Ireland. In 2017, UK investments further declined because companies remained on the sidelines awaiting the economic implications of the separation process.

As in previous years, the persistently low level of oil prices slowed down the recovery of the offshore industry, and the sector was characterised by low investment activity. A further decline in oil prices will primarily have an adverse effect on our Norwegian portfolio.

The tension in East Asia increased during the year. A further escalation of the situation may have a negative impact on global economic sentiment, resulting in financial market stress.

The increasing number of devastating cyberattacks increases the risk of a cyberattack against Danske Bank Group. IT crime can have a significant impact on the Group - directly via operational losses and indirectly through a negative reputational effect.

While closely monitoring the risks mentioned above and constantly assessing the impact on the Group and the need for risk-mitigating actions, we also continued our efforts in 2017 to enhance and strengthen our risk management capabilities, which included the main initiatives described in the following sections.

Strengthened risk and compliance organisations

In 2017, we made several enhancements to our risk organisation. Group Risk Management consolidated its Portfolio Management, Credit Quality Assurance and Risk Governance functions and created a dedicated team, COO Risk Functions, with the aim of further strengthening the Group's risk appetite framework and building enhanced analytical and stress-testing capabilities. A credit data team was established to support these capabilities.

We also increased our cyberrisk capabilities by strengthening the organisation, disrupting the efforts of cybercriminals and protecting our customers. A new initiative, Keep it Safe, was launched to increase our customers' security awareness because the Group believes that raising customer awareness will ultimately reduce cybersecurity risks.

The Security Operations Centre (SOC) and the Security Incident Response Team (SIRT), both established in 2016, have demonstrated their worth in leveraging cybersecurity capabilities. The SOC and the SIRT work according to the best-practice playbooks under the National Institute of Standard and Technology (NIST) framework on security incidents, and their capabilities were highly accredited by a leading external assessor in 2017.

In August 2017, Carsten Rasch Egeriis joined the Group as new chief risk officer (CRO) and became a member of the Executive Board.

The compliance organisation was further strengthened in a number of areas. Fintech units at both Personal Banking and Business Banking Compliance were established to ensure agile and close compliance coverage of the Group's large-scale digital and technological initiatives and projects. A new unit, Compliance Incident Management, established in January 2018, will be responsible for handling the control and coordination of material incidents across the compliance discipline, and a new compliance unit, International Banking, was also set up.

The Group makes substantial efforts to comply with regulation and prevent criminals from using the Group for money laundering or other financial crime activities. In 2017, the Group focused on enhancing customer onboarding and ongoing due diligence processes, transaction monitoring and improving the training of employees.

Strengthened risk culture and discipline

Our enterprise risk management framework is the foundation for maintaining a strong risk culture and risk discipline across the Group. Throughout 2017, we enhanced the framework to ensure a common understanding of risks, risk ownership and a joint risk language within the Group. The framework provides a structured and holistic approach to risk management. We also enhanced our Group risk appetite framework for the purpose of strengthening our ability to aggregate and optimise our risk exposure and increasing our stress testing capabilities.

We continued to train our staff by offering courses at our Risk University and by organising other training activities.

Market risk initiatives

Throughout 2017, we strengthened our strategy to hedge risks in the financial markets by improving our xVA model.¹ The model enables the Group to actively and effectively limit the xVA-embedded market risk and thus P/L volatility.

¹ See chapter 12 Definitions for explanation.

It is our ambition to continue developing the xVA model so that it remains in line with best practice in the market.

We also developed a new framework for managing interest rate risk in the banking book (IRRBB), and this provides a solid platform for the future management of IRRBB.

Improved risk profile

Credit quality remained strong, and we saw net impairment reversals driven by positive macroeconomic conditions and higher collateral values. Our risk profile continued to improve, with capital and liquidity levels remaining strong. We further reduced our Non-core portfolios in Ireland and divested parts of our Baltic personal customer portfolio. Non-performing assets fell significantly, reflecting robust economic growth and an improvement in asset prices.

In August 2017, Moody's upgraded Danske Bank A/S's long-term senior debt rating from A2 to A1 and its long-term deposit rating from A1 to Aa3, thus acknowledging the continued strengthening of our asset quality, capitalisation and profitability. At the same time, Moody's reiterated its positive outlook on our senior debt ratings, citing an expected positive effect from future issuance of non-preferred senior debt.

Continued focus on portfolio developments and portfolio management

Our personal customer portfolio remained stable, with growth in Denmark, Norway and Sweden driven by strategic partnerships and selective underwriting standards.

For our commercial property portfolio, we focused on growth in Denmark and Sweden and on reducing non-performing loans through disciplined underwriting, improving LTV ratios and low interest rates.

The market conditions for our offshore shipping and oil-related portfolios remained difficult because of low oil prices and limited investments throughout the year. However, the increase in oil prices and a number of successful restructurings leave positive signs for the coming years. Relevant specialist teams monitored and proactively addressed the situation with our customers, and this resulted in a number of successful restructurings. Collective impairment charges against offshore shipping and oil-related customers at Corporates & Institutions amounted to DKK 1.1 billion at the end of 2017.

In our agriculture portfolio, high indebtedness and a very high proportion of variable-rate loans remained major risks in 2017, and we focused on reducing our customers' interest rate sensitivity. Market conditions and earnings for pig and milk farmers improved markedly in 2017, and we saw reversals as a consequence of this development. The main drivers behind the market developments were stronger demand from China and the rest of Asia, reduced supply and higher productivity. Pork prices have recently started to fall, but we are confident that the collective impairment charges made so far will be adequate to cover potential losses resulting from the fall in prices. Specialist teams for customer relationships and credit management manage the Group's agricultural exposure.

New funding initiatives

As part of the ambition to strengthen our position in the Swedish personal banking market, we applied for and obtained permission to issue covered bonds through Danske Hypotek AB, the Group's new mortgage subsidiary. The company successfully completed its first SEK benchmark covered bond programme in August 2017.

Enhanced digitalisation

In 2017, we onboarded many new customers digitally. This gave customers a better experience and increased the scalability of our business model. We maintained a fast pace of innovation, launching several new business initiatives within areas such as mortgage finance, investments and mobile solutions. Going forward, we will focus on automation and on optimising our credit decisions to support our business transformation strategy of building the future digital customer experience and to make instant and consistent credit decisions with a risk-reward approach.

The main developments in the individual risk areas in 2017 are summarised below.

1.2 Capital management

The main purposes of the Group's capital management are to support the Group's business strategy and to ensure a sufficient level of capital to withstand even severe macroeconomic downturns without breaching regulatory requirements. The Group also works to ensure a sufficient level of capital to maintain access to the funding markets under all market conditions. The Group's ambition is to have a capital level that is considered robust by rating agencies and investors.

At the end of 2017, the Group's capital position was strong, with a total capital ratio of 22.6% and a common equity tier 1 (CET1) capital ratio of 17.6% (2016: 21.8% and 16.3%, respectively). The Group's solvency need ratio was 10.5%, and its leverage ratio was 4.4% under the transitional rules.

The total risk exposure amount (REA) decreased by DKK 62 billion to DKK 753 billion at the end of 2017 (2016: DKK 815 billion). The decrease was primarily attributable to a reduction in market risk and counterparty credit risk, which were historically low because of both lower volatility and risk premiums in the financial markets. In addition, the implementation of the A-IRB approach for Finnish retail exposures and the sale of the Irish Non-core portfolio reduced the REA for credit risk.

At 31 December 2017, we had bought back 37.5 million shares for a total amount of DKK 9.2 billion (figures at the trade date) of our planned DKK 10.0 billion share buy-back programme.

1.3 Credit risk

The Group's Credit Risk Appetite and Credit Policy aim to ensure that risk-taking remains supportive of the Group's business strategy and that credit risk management activities are conducted throughout the organisation.

In 2017, the Group saw an improvement in overall credit quality, mainly because of increased exposure to highly rated customers and the continuation of low interest rates. In particular, we witnessed a satisfactory increase in the net customer inflow in Norway and Sweden, and this had a positive effect on our results. The size of our commercial property portfolio increased, mainly because of new high-quality transactions in Sweden. The persistently difficult market conditions in the offshore shipping industry continued to affect the portfolio's credit quality, while the "lower for longer" situation in the oil market led to increased impairment charges - especially against a few large customers with oil-related exposures.

Total net credit exposure from lending activities increased by DKK 154 billion during the period from 2016 (DKK 2,534 billion) to the end of 2017 (DKK 2,688 billion). Net non-performing exposure (NPL) decreased to DKK 17.3 billion at the end of 2017 (2016: DKK 21.9 billion). Total net impairment charges at our core business units amounted to DKK -873 million (2016: DKK -3 million). The active reduction of the Non-core portfolio amounted to DKK 13 billion, resulting in a portfolio of DKK 8.2 billion at the end of 2017 (2016: DKK 23.4 billion).

1.4 Counterparty credit risk

Counterparty credit risk arises from a combination of market risk and credit risk. Counterparty credit risk is managed in accordance with the Group's overall credit risk governance, while the derived credit risk exposure is modelled and measured by Group Market Risk.

The total exposure after netting was significantly lower in 2017 than at the end of 2016. On a mark-to-market basis after close-out netting and collateral management agreements, the Group's derivatives and securities financing transactions amounted to DKK 29.7 billion (2016: DKK 40.9 billion). The counterparty credit risk quality remained strong, with more than 90% of the exposure relating to counterparties with a classification comparable to investment grade. Just below 60% of the derivatives trading volume (the total notional amount) was cleared through central clearing counterparties, and 94% of non-cleared transactions were supported by collateral agreements.

1.5 Market risk

The Group's market risk management covers trading-related market risk and market risk in relation to fair value adjustments as well as non-trading-related market risk. The market risk framework is designed to systematically identify, assess, monitor and report market risk.

The activities that involve trading-related market risk derive mainly from the Group's initiatives to provide Corporates & Institutions (C&I) clients with risk management solutions. During 2017, day-to-day income from trading-related activities at C&I continued to show low fluctuations because of low market volatility and low risk levels.

The Group's fair value adjustments (xVA) are based on a fully market-implied xVA model framework that is in line with industry best practice. The framework provides a fairly unique level of granularity in the risk figures and enables the Group to actively and effectively limit the xVA-embedded market risk and P/L volatility. In order to reduce P/L volatility caused by xVA, the Group pursues a strategy to hedge the risk in financial markets in order to improve income stability and predictability under this framework. As a result, a relatively stable trading income with few drawdowns was observed in 2017. Non-trading-related market risk covers interest rate risk in the banking book (IRRBB). The IRRBB framework provides a

solid foundation for the future management of IRRBB and gives the Group a granular insight into its risk exposure. This allows the Group to price IRRBB correctly and to mitigate such risk effectively.

In 2017, the Group continued to keep the risk associated with its trading operations at a low level, only marginally increasing the average trading-related VaR from DKK 44 million in 2016 to DKK 46 million in 2017. Standalone interest rate risk was largely unchanged in 2017. Bond spread risk declined because of a reduction in bond holdings during the year. Foreign exchange risk was largely unchanged, while equity risk doubled. The number of days with losses in 2017 was marginally higher than in 2016, while the average daily P/L result was marginally lower in 2017 than in 2016.

1.6 Liquidity risk

The Group manages liquidity risk by holding a sufficient, diversified and highly liquid reserve of assets to meet its obligations and to support its strategies, business plans and rating ambitions, even in stressed situations. By ensuring sufficient time to respond in case of a prolonged crisis and reducing market reliance, management will be able to adjust to changed conditions in a controlled manner and ensure the sustainability of the Group's long-term business model.

The Group's liquidity position and liquidity profile were largely constant throughout the year. At the end of December 2017, the Group's liquidity coverage ratio stood at 171% (2016: 158%). As planned, the currency-specific LCR requirements imposed on Danish SIFs by the Danish Financial Supervisory Authority (the FSA) were tightened in 2017. The initial requirements were a minimum LCR of 60% for EUR and 60% for USD. In 2017, these requirements were raised to 100% for both EUR and USD. By the end of 2017, the EUR LCR was 224%, while the USD LCR was 156%.

In 2017, the Group issued DKK 30 billion worth of senior debt, DKK 32 billion worth of covered bonds and DKK 5 billion worth of additional tier 1 capital, bringing total long-term funding to DKK 67 billion. A total of DKK 65 billion worth of long-term debt was redeemed in 2017. The Group witnessed higher-than-expected deposit inflows throughout the year and remained dedicated to the strategy of securing more funding directly in its main lending currencies. Stress tests showed a sufficient liquidity buffer well beyond 12 months.

1.7 Operational risk

The Group's operational risk management approach serves to continually improve its ability to anticipate all material risks and to reduce, with a high degree of confidence, potential failures in processes. This improves the customer experience and reinforces the need for clear ownership and accountability for all risks across Group processes.

In 2017, the Group further enhanced its operational risk framework with more clarification on roles and responsibilities for the first and second lines of defence, simplifying the overall framework and broadening the approach. In 2018, the Group will maintain a strong risk discipline to continue the development of its operational risk framework.

Two risk types accounted for the majority of operational loss events in 2017: *external fraud* and *execution, delivery and process management*, for which the number of loss events were similar to 2016.

1.8 Insurance risk

The Group runs its life and health insurance and pension operations with the aim of providing best-in-class services to its clients, while at the same time maintaining a predictable risk profile. In the currently low-interest-rate environment, this calls for active management of all risk types.

Danica Pension performs both daily solvency monitoring and a monthly best-effort solvency calculation to reconcile balance sheet and profit and loss statements. This is in line with the regulations that apply to the Danish life insurance industry, which has operated under fully phased-in Solvency II rules since 1 January 2016. Towards the end of 2017, Danica Pension acquired SEB Pension, the Danish life insurance arm of SEB Group. The acquisition is subject to approval by the relevant Danish authorities and is expected to take effect during 2018. This will allow Danica Pension to harvest significant synergies and leverage SEB Pension's strong digital capabilities and attractive customer base.

Danica Pension's solvency ratio was 227% at the end of 2017, down from 246% at the end of 2016. The change mainly reflects a narrowing of the differences in valuation between accounts and Solvency II regarding the technical provisions for unit-linked business.

1.9 Key ratios and risk figures

Key ratios and risk figures for Danske Bank Group (At 31 December)	2017	2016	2015
Earnings			
Dividends per share [DKK]	10.0	9.0	8.0
Earnings per share [DKK] ¹	22.2	20.2	12.8
Share price (end of year) [DKK]	241.6	214.2	185.2
Book value per share [DKK] ¹	171.2	162,8	153.2
Return on average shareholders' equity [%] ¹	13.6	13.1	8.5
Return on goodwill impairment charges on average shareholders' equity [%] ¹	13.6	13.1	11.6
Return on average tangible equity [%] ¹	14.6	14.0	12.9
Net interest income as % of loans and deposits	0.9	0.9	0.9
Cost/income ratio [%]	47.2	47.2	59.8
Cost/income ratio before goodwill impairment charges [%]	47.2	47.2	49.4
Capital			
Common equity tier 1 capital ratio [%]	17.6	16.3	16.1
Tier 1 capital ratio [%]	20.1	19.1	18.5
Total capital ratio [%]	22.6	21.8	21.0
Leverage ratio, transitional [%]	4.4	4.6	4.7
Leverage ratio, fully phased-in [%]	4.4	4.3	4.2
Funding and Liquidity			
Liquidity coverage ratio [LCR] [%]	171	158	125
Asset encumbrance [DKK billions]	1,328	1,314	1,170
Asset encumbrance ratio [%] ³	43	42	44
S&P Global issuer rating & outlook	A / stable	A / stable	A / stable
Moody's issuer rating & outlook	A1 / positive	A2 / stable	A2 / stable
Fitch issuer rating & outlook	A / stable	A / stable	A / stable
Asset quality			
Risk exposure amount total [DKK billions]	753.4	815.3	833.6
Expected loss [DKK billions] ²	13.2	14.9	17.7
Impairment charges, loans, total, full year [DKK millions] ³	-873	-3	57
Impairment charges, loans, individual accumulated [DKK billions] ³	15.9	18.5	23.2
Loan loss ratio, full year [%] ⁴	0.0	0.0	0.0
Non-performing loans, gross exposure [DKK billions] ⁴	33.3	40.4	47.8
Non-performing loans, net exposure [DKK millions] ⁴	17.3	21.9	24.7
Non-performing loans as % of total gross exposure [%]	1.2	1.6	2.0
Non-performing loans coverage ratio [%] ⁵	86.1	82.7	82.8
Defaulted loans, gross [DKK billions] ⁴	16.0	21.4	26.6
Defaulted loans, net [DKK billions] ⁴	6.0	8.8	10.5
Forborne loans [DKK billions]	27.4	24.6	17.7
Other			
Core net credit exposure, lending activities [DKK billions]	2,688	2,534	2,323
Non-core net credit exposure, lending activities [DKK billions]	8.0	23.0	28.6
Exposure at default [DKK billions]	2,729	2,581	2,356
Total assets [DKK billions]	3,540	3,484	3,293
Assets under management [DKK billions]	1,530	1,420	1,369

¹ Ratios are calculated with additional tier 1 capital being classified as a liability. Average shareholders' equity is calculated as a quarterly average.

² Expected loss figure (downturn-adjusted amount according to regulatory requirements).

³ At the group level.

⁴ At the group level, core portfolios, excluding non-core.

⁵ Accumulated individual impairment charges as a percentage of gross impaired loans net of collateral (after haircut).

Risk strategy and governance

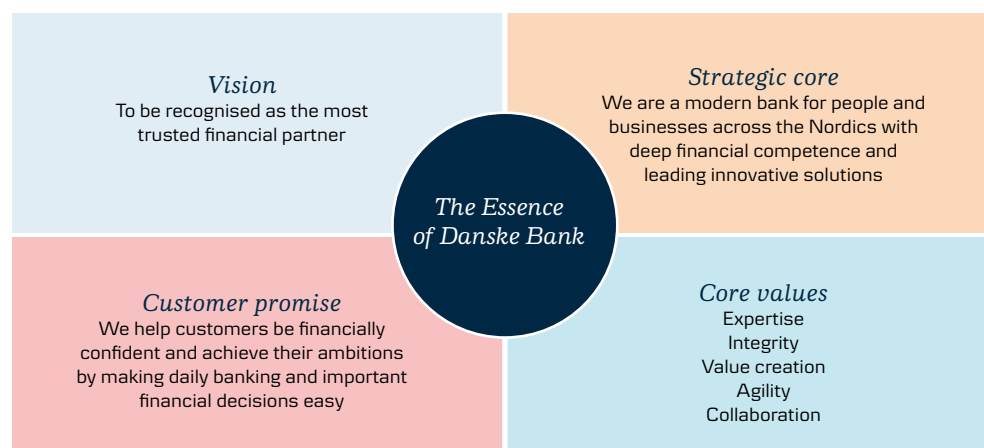
12	2.1	Risk strategy
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2.

2.1 Risk strategy

Danske Bank Group is a Nordic universal bank with strong regional roots and bridges to the rest of the world. The Group has a well-diversified business model and serves personal, business and institutional customers. In addition to banking products and services, we offer life insurance and pension, mortgage credit, wealth management, real estate and leasing products and services.

The Group's Essence is the foundation on which we build our business. It is based on four pillars:



Our risk strategy and risk objectives are essential in supporting our business model, and they play a central role in our proactive risk management approach. Our key risk objectives are as follows:

1. **Risk appetite** - accepting the appropriate risk types and risk amounts in pursuit of our strategic goals. This requires a strong approach to aggregating, monitoring and measuring risk and in turn understanding the implications of severe financial stress on our business.
2. **Strong control environment** - having a thorough understanding of our risks, clear roles and responsibilities and putting the right controls and mitigating activities in place where needed. At the same time, we must balance quality management and focus on customers with effective controls.
3. **Robust decision-making based on analytics** - providing a strong risk management platform for robust individual or modelled-based decisions backed by sound analytics.
4. **Forward-looking views** - having forward-looking views of our operating environment and adapting to the ever-changing landscape around us. Proactive identification of risks and opportunities is critical, and the ability to anticipate where disruption and vulnerabilities are likely to occur is paramount.
5. **People and culture** - having the right skills, mindset and capability. We need to foster strong, independently thinking risk managers who are also able to collaborate with the business.

Identifying an acceptable level of risk is key to fulfilling the Group's vision of being the most trusted financial partner. We want to be a solid, balanced and predictable bank that supports customers through the business cycle. To ensure that we operate within acceptable levels of risk, the Board of Directors has defined a number of risk policies and appetites that are detailed in directives set forth by the Executive Board. These form the foundation for the business and control procedures of the business units.

Our risk approach combines strategic ambitions and macroeconomic analysis with customer and industry insights through top-down and bottom-up approaches. The Board of Directors determines the risks that the Group may assume, the size of these risks, the limits on the main activities and the principles for calculating and measuring such risks. These are formulated in individual risk appetites for

- credit risk, including counterparty credit risk
- market risk
- operational risk
- liquidity risk

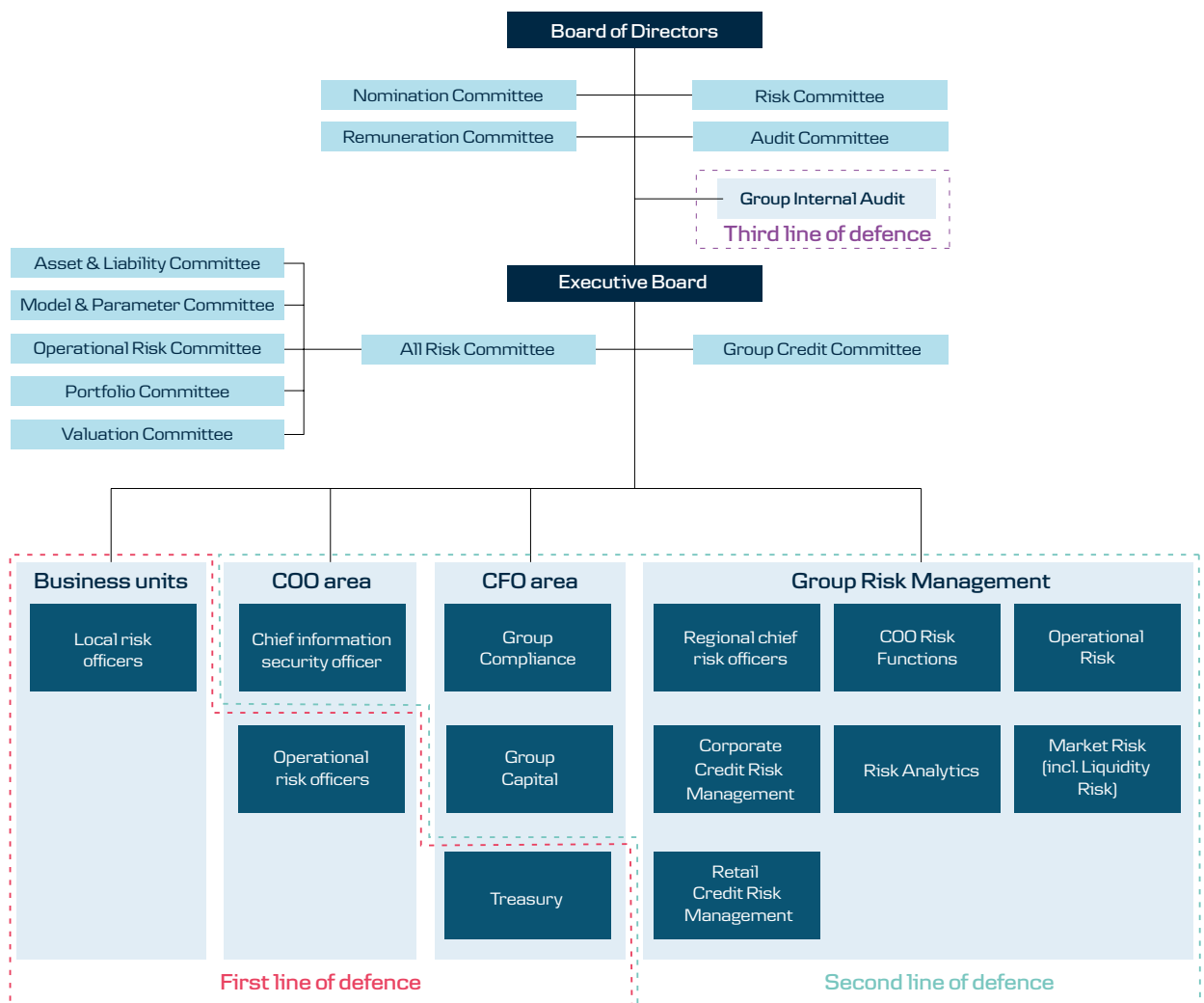
Relevant performance indicators are incorporated in regular risk reporting, and this enables the Group to monitor whether the individual risk profile remains within the risk appetite. The individual risk sections in this report include more information about the individual risk appetites and profiles.

We constantly strive to enhance our risk management capabilities for the purpose of executing on our risk objectives. It is our ambition to maintain a strong risk culture and a high level of execution management, which are essential drivers for embedding the risk strategy within the organisation.

2.2 Risk governance

The Group's risk management practices are organised according to the three-line-of-defence governance model. This model segregates responsibilities and duties between (1) units that enter into business transactions with customers or otherwise expose the Group to risk, (2) units that are in charge of risk oversight and control, and (3) the internal audit function.

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



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

The second line of defence is represented by group-wide functions that monitor whether the business units and the operations and service functions adhere to the general policies and mandates. Group Risk Management, units in the CFO area, regional chief risk officers and the chief information security officer share the responsibility for these group-wide functions.

The third line of defence is represented by Group Internal Audit. The primary role of Group Internal Audit is to help the Board of Directors and the Executive Board protect the assets, reputation and sustainability of the Group. Group Internal Audit assists the Group in achieving its objectives by applying a systematic and disciplined approach so as to provide independent assurance of the effectiveness of the Group's risk management, control and governance processes. The scope of Group Internal Audit is unrestricted and includes the activities of the first and second lines of defence.

2.2.1 Business units

Each of the four business units - Personal Banking, Wealth Management, Business Banking and Corporates & Institutions - is headed by a member of the Executive Board. Northern Ireland is a fifth business unit serving personal and business customers, and it is a separate legal entity with its own executive board and a separate board of directors.

The mandate of the business units to originate credit applications, take deposits and undertake investments for the Group is regulated by risk policies, instructions and limits. The Group strives to cultivate a corporate culture that supports and enforces the organisation's objective of assuming risk in accordance with the defined guidelines.

The heads of the business units and the heads of the operations and service functions are responsible for all business-related risks, and their responsibilities extend across national borders. Lending authorities are cascaded down from the Board of Directors, through the Executive Board to Group Risk Management, to lending officers at the business units. Credit applications exceeding the delegated lending authorities are submitted to the Group Credit Committee and to the Board of Directors. While the business units are responsible for risk assessments, the credit oversight functions, led by the heads of credit at Group Risk Management, oversee that credit applications are within the defined credit policy and credit risk appetite.

Procedures for new product approvals are based on a directive provided by the Executive Board to the heads of the business units. Materiality criteria determine whether the approval of new products is presented to the Group's chief risk officer. In cases of a reputational or material financial nature, both the Executive Board and the Board of Directors are involved in the approval processes.

The business units perform the fundamental tasks required for sound risk management and controls. These tasks include updating customer information used in risk management systems and models as well as maintaining and following up on customer relationships. Each business unit is responsible for preparing documentation and recording business transactions properly.

The business units ensure that all risk exposures do not exceed the specific risk limits and comply with the Group's relevant guidelines.

2.2.2 Group Risk Management

Group Risk Management serves as the Group's second line of defence. It is responsible for recommending and monitoring the Group's risk appetite and policies and for following up on and reporting on risk issues across all risk types, organisational units and geographical regions.

The department is headed by the Group's chief risk officer (CRO), who is a member of the Executive Board. In cooperation with the Group CEO, the Group CRO reports to the Board of Directors. The CRO has the authority to veto any decision in relation to credit applications and new products. The following terms apply to the CRO position:

1. The CRO cannot be removed from office without the preceding approval of the Board of Directors.
2. The CRO is the only Executive Board member who is a permanent member of the Risk Committee.
3. The CRO is responsible for the risk reports submitted to the Board of Directors, the Board of Directors' Risk Committee, the Executive Board and the All Risk Committee.

Group Risk Management oversees the risk management frameworks and practices across the organisation and serves as the secretariat of the Group Credit Committee, the All Risk Committee and the following four subcommittees: the Model & Parameter Committee, the Operational Risk Committee, the Portfolio Committee and the Group Liquidity Committee. Senior risk managers are also members of the Asset & Liability Committee and the Valuation Committee.

At Group Risk Management, various sub-departments are responsible for monitoring and managing the Group's main risk types.

The heads of Retail Credit Risk Management and Corporate Credit Risk Management report directly to the CRO and are responsible for managing retail and corporate credit risks, respectively. They delegate credit risk mandates and oversee day-to-day credit risk management in the first line of defence in their respective areas. This also includes reviewing the approval and follow-up processes for the lending books of the business units.

Risk Analytics develops and maintains credit rating methodologies and models. The team ensures that the methodologies and models are fit for day-to-day credit processing at the business units and that statutory requirements are met. Because of the Group's extensive use of models, model risks are closely monitored and managed. An independent and separate unit is responsible for validating credit and market risk parameters.

COO Risk Functions is responsible for the development of the Group's risk appetite framework, stress testing engine and portfolio management. The department facilitates the quarterly processes of calculating and consolidating impairment charges against credit exposures and monitors and reports on the Group's consolidated credit portfolio, with sector- and country-specific views and risk appetites. The department's credit quality assurance team ensures that policies and procedures are properly implemented by the first line of defence. Finally, the department maintains the Group's recovery plan and is responsible for risk governance.

Operational Risk is responsible for the independent oversight and reporting of operational risk management and the establishment of the group-wide operational risk management framework. The department reviews and challenges operational risk in respect of the group-wide approach to operational risk management.

Market Risk monitors and reports on the Group's market risk.

Liquidity Risk Management is responsible for independently reviewing and challenging the methodologies and metrics applied in day-to-day liquidity management.

In cooperation with country managers, the country chief risk officers are responsible for ensuring compliance with local rules and regulations. Local risk committees are established where relevant.

2.2.3 CFO area

The CFO area is headed by the Group's chief financial officer (CFO), who is a member of the Executive Board. The department oversees the Group's financial reporting, budgeting and strategic business analysis, including the tools used by the business units for performance follow-up. The department is also in charge of the Group's investor relations, relations with international rating agencies, legal, regulatory and corporate matters, capital management, compliance and treasury.

Group Compliance is an independent function that is responsible for identifying, assessing, monitoring and reporting on whether the Group complies with applicable laws, regulations and internal requirements. The head of Group Compliance reports to the CFO.

Group Capital is responsible for the overall management of the Group's capital position, and tasks include calculating the total risk exposure amount (REA), performing the Group's internal capital adequacy assessment process (ICAAP) and allocating capital to the business units. In addition, Group Capital is responsible for the Group's forward-looking views in terms of capital, including the implementation of new regulation, planned issues of capital instruments, the Group's payout policy and stress testing for ICAAP and regulatory purposes.

Group Treasury is responsible for executing the capital and funding plan, managing the Group's liquidity plan and monitoring its liquidity needs. Group Treasury also ensures that the Group's structural liquidity profile is within the defined limits and that the targets set by the Board of Directors and the All Risk Committee as well as regulatory and prudential requirements are met. Furthermore, Group Treasury is responsible for asset and liability management, private equity activities and long-term funding activities.

2.2.4 COO area

The COO area is headed by the Group's chief operating officer (COO), who is a member of the Executive Board. The department is responsible for the Group's operations and Group IT. Group IT is headed by the chief technology officer (CTO).

The chief information security officer (CISO) reports functionally to the CTO, with a secondary reporting line to the CRO. The CISO heads Group IT Security & Risk within Group IT. Group IT Security & Risk performs control monitoring and ensures compliance with the Security Policy as a second line of defence function.

2.2.5 Board of Directors and Executive Board

Danske Bank Group's rules of procedure for the Board of Directors and the Executive Board specify the responsibilities

of the two boards and the division of responsibilities between them. The two-tier management structure and the rules of procedure, which were developed in accordance with Danish law, regulations and relevant corporate governance recommendations, are central to the organisation of risk management and the delegation of authorities throughout the Group.

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

The Board of Directors ensures that the Group is organised properly. As part of this duty, the Board appoints the members of the Executive Board, the Group chief audit executive (CAE) 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, risk profile and strategy. In addition, the Board receives regular reporting on and monitors the main risks and reviews the largest credit exposures. The Board reviews risk appetites, risk policies, risk instructions and delegated risk mandates at least once a year.

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

The Board of Directors consists of six to ten members elected by the general meeting and a number of employee representatives as stipulated by Danish statutory rules. At the end of 2017, the Board consisted of twelve members, including four employee representatives.

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

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

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

The Executive Board consists of the chief executive officer, the heads of the four main business units and the heads of group functional areas related to risk, finance, and services and IT.

2.3 Risk committees

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

Committees established by the Board of Directors

<p>Risk Committee</p> <p>Convenes at least six times a year</p>	<p>The Risk Committee operates as a preparatory committee for the Board of Directors with respect to the Group's risk management and related matters.</p> <p>The committee advises the Board of Directors on the Group's risk profile, risk culture, risk appetite, risk strategy and risk management framework.</p> <p>The committee reviews and submits recommendations to the Board of Directors on the Group's risk appetite, risk policies, risk instructions, capital levels and allocation, leverage (ratio), liquidity, solvency need, recovery requirements, business continuity plans, impairment levels, new product approval processes, and the credit quality of the loan portfolio. Furthermore, the Risk Committee reviews the use of internal models, the adequacy of risk management resources and incentive programmes.</p>
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<p>Remuneration Committee</p> <p>Convenes at least twice a year</p>	<p>The Remuneration Committee operates as a preparatory committee for the Board of Directors with respect to general remuneration matters, with a focus on the remuneration of the members of the Board of Directors, the Executive Board, material risk takers, key employees and executives in charge of control and internal audit functions, as well as incentive programmes. The committee reviews and submits recommendations to the Board of Directors on remuneration policies and practices and on changes in remuneration levels, including variable remuneration. The committee monitors the incentive programmes to ensure that they promote ongoing, long-term shareholder value creation and that they comply with the Remuneration Policy.</p>
<p>Nomination Committee</p> <p>Convenes at least twice a year</p>	<p>The Nomination Committee operates as a preparatory committee for the Board of Directors with respect to the nomination and appointment of candidates to the Executive Board and the Board of Directors. The committee evaluates the work and performance of the Executive Board, the Board of Directors and the latter's individual members. The committee also submits policy proposals to the Board of Directors on succession planning, diversity and inclusion.</p>
<p>Audit Committee</p> <p>Convenes at least four times a year</p>	<p>The Audit Committee operates as a preparatory committee for the Board of Directors with respect to accounting and auditing, including related risk matters. The committee reviews and submits recommendations to the Board of Directors on financial reports and the assessment of related risks, key accounting principles and procedures, internal controls, reports from both internal and external auditors, whistleblowing, compliance and anti-money laundering activities.</p>

The Executive Board has established two risk committees: the All Risk Committee and the Group Credit Committee.

Committees established by the Executive Board

<p>All Risk Committee Consists of the members of the Executive Board</p>	<p>Group Credit Committee Consists of selected members of the Executive Board</p>
<p>Convenes once a month</p>	<p>Convenes twice a week</p>
<p>On behalf of the Executive Board, the committee</p> <ul style="list-style-type: none"> manages the balance sheet structure and developments defines the overall funding structure defines the general principles for measuring and managing risks monitors the effects of regulation ensures a robust and well-functioning risk management structure 	<p>On behalf of the Executive Board, the committee</p> <ul style="list-style-type: none"> approves or rejects credit applications that exceed the lending authorities delegated to the business units endorses credit applications for consideration by the Board of Directors

The Executive Board has overall responsibility for risk management as defined in the risk framework determined by the Board of Directors. The All Risk committee reviews the risk reports submitted to the Board of Directors and the Board's committees. The committee receives periodic group liquidity and solvency reports and monitors risk trends at both business unit and group levels.

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

Sub-committees of the All Risk Committee

<p>Asset & Liability Committee Convenes at least once a month</p>	<p>The committee oversees the alignment of balance sheet risks with the Group's liquidity risk appetite. It has a sub-committee, the Group Risk Liquidity Committee, which focuses on liquidity risk and funding plans.</p>
<p>Model & Parameter Committee Convenes at least four times a year</p>	<p>The committee oversees all material risks associated with risk models and model parameters that contribute to impairment charges, the REA, pricing and the Group's business decision models.</p>
<p>Operational Risk Committee Convenes at least six times a year</p>	<p>The committee oversees the implementation and maintenance of the operational risk framework within the Group.</p>
<p>Portfolio Committee Convenes at least six times a year</p>	<p>The committee oversees all material risks associated with the Group's business model that can be managed on a portfolio basis as well as activities across business units and geographical regions.</p>
<p>Valuation Committee Convenes at least four times a year</p>	<p>The committee oversees the valuation estimates and the valuation governance process.</p>

In general, the committees oversee risk developments within the Group and ensure that risk management and risk reporting are always compliant with statutory regulations and the Group's general principles for such practices.

2.4 Risk reporting and monitoring

The Group has allocated a considerable amount of resources to risk monitoring and to ensuring that approved risk limits are not exceeded. Processes have been established for reporting changes in risks to the relevant management bodies and risk committees.

The Group has an enterprise-wide approach to risk reporting, and this approach is supported by the monthly CRO Letter, which covers analyses across all risk types, business units and geographical regions.

Risk reporting

CRO Letter	This report provides a comprehensive overview of the Group's risk profile across all risk types, business units and geographical regions. It is updated monthly and presented to the All Risk Committee and to the Board of Directors.
Risk profile reports	These reports provide detailed portfolio and industry analyses focusing on exposure, risk factors, financial trends, performance and forward-looking developments.
Impairment report	This report provides a quarterly overview of detailed developments in collective and individual impairment charges.
Risk Management report	This report provides a detailed description of the Group's risk profile, capital management, risk management organisation and risk frameworks. It is presented along with the supplementary Pillar III disclosures, and together they fulfil the CRR/CRD IV requirements.

Solvency and liquidity reporting

ICAAP report	This report provides a review of the Group's capital adequacy. It presents the results from stress tests, including the effects of various scenarios on expected losses and the solvency need. A condensed format of the report is submitted quarterly, while an extensive version is provided annually.
ILAAP report	This report provides a description of the Group's liquidity situation and liquidity management, including its funding profile and plan. It assesses liquidity risk indicated in liquidity stress tests and similar analyses and also describes the minimum amount of liquidity reserves required by the Group. The report is submitted annually.

The Board of Directors receives risk reports, including ICAAP and ILAAP reports, on a regular basis. The Group's ICAAP report is submitted both quarterly and annually to the Board of Directors.

The Group regularly reviews and revises its risk and crisis management frameworks for the purpose of implementing new regulatory requirements, expanding its risk and crisis capabilities and improving efficiency. The Board of Directors reviews the revised frameworks.

2.4.1 Crisis management

The Group is a significant player in the Nordic financial markets and provides a number of critical functions upon which the financial systems in our core markets rely. The Group recognises the importance of having plans and procedures in place to ensure that it is viable in the long term and that the critical services are available.

The Group's operational crisis management is supported by business continuity plans. They describe measures to restore the Group's operational capabilities and to allow the Group to recover from material operational risk events.

In a situation of severe financial stress, the Group's contingency plans for capital and liquidity will ensure that the Group takes measures to restore the Group's capital, liquidity and funding position.

The Group has prepared a recovery plan in the event that conditions further deteriorate and threaten its liquidity or capital position and thus its long-term viability. The plan documents a framework that ensures that proper monitoring is in place to identify and understand a potential threat to the Group. It describes the governance processes and the selection of actions to be implemented to restore the Group's long-term viability.

The Group discusses the recovery plan with the Danish FSA and foreign supervisory authorities on an annual basis.

2.4.2 Management declaration

The Board of Directors reviews all risk frameworks, risk policies, risk instructions and risk appetites at least once a year.

Together with other risk reports, these reviews serve as the basis for the Board of Director's assessment of the Group's total and individual risks.

The management declaration on this assessment is included in section 11.1.

Capital management

21	3.1	Capital profile
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22	3.1.4	Capital allocation
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3.

3.1 Capital profile

The main purposes of the Group's capital management are to support the Group's business strategy and to ensure a sufficient level of capital to withstand even severe macroeconomic downturns without breaching regulatory requirements. The Group also works to ensure a sufficient level of capital to maintain access to the funding markets under all market conditions. The Group's ambition is to have a capital level that rating agencies and investors consider robust.

3.1.1 Capital targets

As part of its ongoing capital assessment, the Group reviewed its capital targets in 2016, and the targets were still applicable at the end of 2017. In light of regulatory uncertainty, the target for the common equity tier 1 (CET1) capital ratio is set at 14-15% in the short-to-medium term. This implies a management buffer of around 2-3% in relation to the fully phased-in CET1 capital requirement. The target for the total capital ratio is set at around 19%.

In December 2017, the Danish Systemic Risk Council recommended the activation of a countercyclical buffer requirement in Denmark of 0.5% from 31 March 2019. The introduction of a countercyclical buffer in Denmark will increase the Group's fully phased-in CET1 requirement by around 0.2%. The Group's capital targets are relatively robust to cyclical changes in capital buffer requirements. A possible countercyclical buffer requirement in Denmark will be managed within the Group's existing capital targets as has been the case with the implementation of countercyclical buffer requirements in other markets where the Group operates.

The Group has met its CET1 capital ratio target since the end of 2012, while the total capital ratio has been above the current target of 19% since Q3 2015. The Group's capital considerations are based on the rules governing the transition from current regulation, the phase-in of rules contained in the Capital Requirements Regulation/Capital Requirements Directive IV (CRR/CRD IV) and the SIFI requirements.

With respect to its capital targets, the Group has an ambition to pay out ordinary dividends of 40-60% of its net profit going forward following a revision from the previous pay out ratio of 40-50%. It is the intention to adjust the capital structure further through share buy-back programmes if excess capital relative to the capital targets is available after dividends have been paid out.

The Group revises its capital distribution at least once a year and will reassess its capital targets when the regulatory requirements are finalised.

3.1.2 Capital planning

The Group's capital planning takes into account both short-term and long-term horizons in order to give the Board of Directors a comprehensive view of current and future capital levels. The capital plan includes a forecast of the Group's expected capital performance based on budgets and takes pending regulation into account when future capital requirements are assessed. The Group also uses stress tests in its internal capital planning and compliance with regulatory capital requirements.

3.1.3 Input from stress test analysis

The Group uses macroeconomic stress tests in the Internal Capital Adequacy Assessment Process (ICAAP) for the purpose of projecting its solvency need and actual capital level in various unfavourable scenarios. Stress tests are an important means of analysing the risk profile since they give management a better understanding of how the Group's portfolios are affected by macroeconomic changes, including the effects of 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 solvency need. The Group evaluates the main scenarios and their relevance on an ongoing basis. The scenarios that are most relevant to the current economic situation and related risks are analysed at least once a year. New scenarios may be added when necessary. The scenarios are an essential part of the Group's capital planning in the ICAAP.

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. The scenarios are submitted to the Board of Directors for approval.

Regulatory stress tests

Because the Group has been approved to use internal ratings-based (IRB) models, it participates in the annual macroeconomic stress test conducted by the Danish Financial Supervisory Authority (the FSA). According to the latest stress test performed in the spring of 2017, the Group did not breach its 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. The purpose of the EBA stress test is to assess the health of the European banking sector in the stress scenario and the ability of the individual institutions to absorb losses. According to the latest stress test, which was conducted in the spring of 2016, the Group met the capital requirements with a solid margin and matched its Nordic peers.

The Group's most important stress test scenarios

Scenario	Description and use
Severe recession	<p>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.</p> <p>The Group uses the severe recession scenario in its capital planning to determine whether the capital level is satisfactory. If management concludes that the excess capital is too small in the scenario's worst year, it will consider changing the risk profile or raising capital.</p>
Extreme recession	<p>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.</p> <p>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 position.</p>
Regulatory scenarios	<p>Base cases and stress scenarios of the Danish Financial Supervisory Authority and the European Banking Authority.</p> <p>The Danish Financial Supervisory Authority uses the regulatory scenarios for the Supervisory Review and Evaluation Process (SREP).</p>
Other scenarios	<p>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.</p>

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 quarterly and annual reports at danskebank.com/ir.

3.1.4 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 in order to reflect as closely as possible the effects of new regulation and the risk entailed in its business activities. In 2016, the Group changed the principles for allocating capital across the business units so that they are fully aligned with the regulatory requirements and the CET1 capital ratio target. This means that the capital consumption of the Group's individual business units is closely aligned with the Group's total capital consumption.

3.2 Total capital

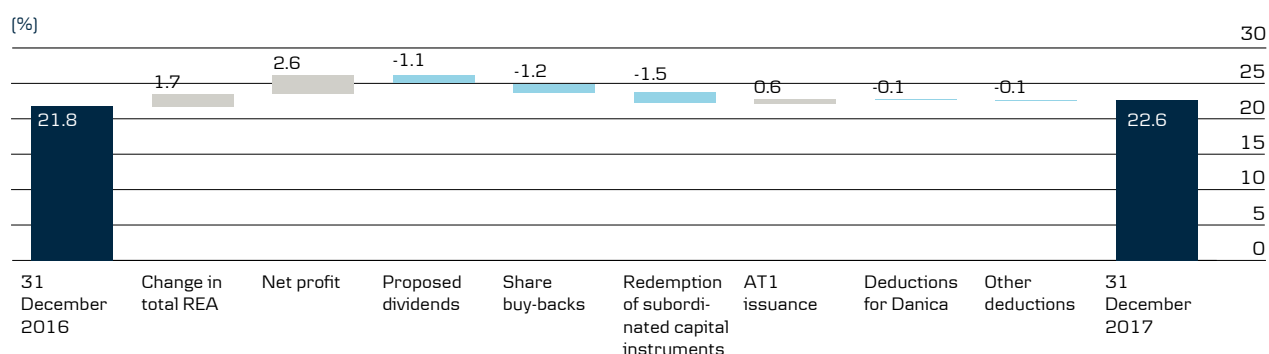
At 31 December 2017, the Group's CET1 capital amounted to DKK 132.7 billion, or 17.6% of the total risk exposure amount (REA), and its tier 1 capital amounted to DKK 151.1 billion, or 20.1% of the total REA. The Group's total capital amounted to DKK 170.3 billion, and its total capital ratio was 22.6%.

The high-level components of total capital are shown in the table below (a more detailed breakdown appears in the Group's Annual Report 2017). The figures reflect the capital subject to the transitional rules according to the CRR at 31 December 2017.

Danske Bank Group's total capital and ratios		
At 31 December (DKK millions)	2017	2016
Total equity	168,256	166,615
Adjustment to total equity	236	270
Total equity calculated according to the rules of the Danish FSA	168,492	166,886
Additional tier 1 (AT1) capital instruments included in total equity	-14,158	-14,133
Adjustments for accrued interest and tax effect on AT1 capital	-132	-132
Common equity tier 1 (CET1) capital instruments	154,202	152,621
Deductions from CET1 capital	-21,457	-19,927
- Portion from goodwill	-7,100	-6,707
- Portion from statutory deductions for insurance subsidiaries	-1,349	-626
CET1 capital	132,744	132,694
AT1 capital	18,574	23,623
Deductions from AT1 capital	-169	-209
Tier1 capital	151,150	156,108
Tier 2 capital instruments	19,343	22,141
Deductions from tier 2 capital	-169	-209
Total capital	170,324	178,041
Total risk exposure amount	753,409	815,249
Common equity tier 1 capital ratio (%)	17.6	16.3
Tier 1 capital ratio (%)	20.1	19.1
Total capital ratio (%)	22.6	21.8

The following chart shows the change in the Group's total capital ratio from 31 December 2016 to 31 December 2017. The decrease in the Group's total REA caused an increase in the total capital ratio of 1.7 percentage points. The other main drivers were the Group's net profit, its capital distribution and the redemption of subordinated capital instruments as part of the Group's ongoing work to optimise its capital structure. Finally, the Group issued USD 750 million worth of additional tier 1 capital in March 2017, and this increased the total capital ratio by 0.6 of a percentage point.

Change in total capital ratio, Danske Bank Group, 2017



3.2.1 Common equity tier 1 capital

Starting with total equity under IFRSs, the Group makes a number of adjustments in order to determine its CET1 capital. In accordance with IFRSs and the Danish FSA's accounting rules, total equity is subject to the following adjustments:

- Revaluation of domicile property is recognised at the estimated fair value. Revaluation to a value above the cost of acquisition is recognised as CET1 capital.
- The CRR-compliant additional tier 1 capital instruments issued in March 2014, February 2015 and November 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 instruments and instead categorised as additional tier 1 capital. The additional tier 1 capital instruments issued in March 2017 are not recognised as equity under accounting rules.

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

- Proposed dividends
- Carrying amounts of intangible assets, including goodwill
- Deferred tax assets
- Defined benefit pension fund assets
- Statutory deduction for insurance subsidiaries (see also section 3.2.4)
- Prudential filters
- Adjustment to eligible capital instruments (e.g. the deduction of the remaining share buy-back programme not yet reflected in equity)

At the end of 2017, the Group's CET1 capital amounted to DKK 132.7 billion, which was largely unchanged from 2016. The Group's net profit for 2017 increased its CET1 capital by DKK 20.9 billion in 2017, but this was partly offset by a deduction for proposed dividends of DKK 9.4 billion. The other main driver offsetting net profit was the Group's share buy-back programme of DKK 10 billion.

The phase-in of the CRR increases the level of deductions from CET1 capital until 2018. The remaining increase comes mainly from the transfer of statutory deductions for insurance subsidiaries from tier 1 and tier 2 capital to CET1 capital. The Group estimates that the CET1 capital ratio will decline by around 0.1 of a percentage point from the level at 31 December 2017 (17.6%) when it is calculated on the basis of the CRR with fully loaded capital deductions (fully phased-in rules by 2018).

3.2.2 Additional tier 1 capital and tier 2 capital

At the end of 2017, the Group's additional tier 1 capital amounted to DKK 18.4 billion, or 2.4 percentage points of the total capital ratio. In 2017, the Group redeemed additional tier 1 capital instruments not eligible under the CRR in the amount of DKK 11.7 billion.¹ To partly offset this redemption, the Group issued CRR-compliant additional tier 1 capital in the amount of DKK 4.6 billion.² At 31 December 2017, all of the Group's additional tier 1 capital instruments were fully CRR-compliant.

At 31 December 2017, the Group's tier 2 capital amounted to DKK 19.2 billion, or 2.5 percentage points of the total capital ratio. In 2017, the Group redeemed tier 2 capital in the amount of DKK 0.6 billion, while calling additional tier 1 capital instruments not eligible under the CRR reduced tier 2 capital even further. No issues were made in 2017.

The phase-in of the CRR will affect the way in which outstanding tier 2 capital instruments will be incorporated in the Group's total capital. Outstanding old tier 2 capital instruments not eligible under the CRR will be phased out over a period that started in 2014. At the end of 2017, around DKK 2.2 billion of the Group's tier 2 capital was subject to phase-out requirements. Since September 2013, the Group's issues of additional tier 1 and tier 2 capital instruments have been fully CRR-compliant.

For a description of the conditions of the Group's outstanding issues of individual additional tier 1 and tier 2 capital instruments, see note 21 in Annual Report 2017.

3.2.3 Consolidation methods

The consolidation of the Group's financial statements is based on IFRSs, whereas the prudential consolidation in the statement of capital is based on the rules of the Danish FSA and the CRR. The main difference is that, under IFRSs, Danica Pension is consolidated 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's solvency calculations are treated according to the deduction method described in section 3.2.4.

In rare circumstances, companies taken over by the Group because they are in default are consolidated in the financial statements and are sold as soon as they become marketable. They are not included in the calculation of the Group's total capital, but 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 investment in credit institutions.

¹ Only around DKK 9.8 billion was included as additional tier 1 capital at the end of 2016 because of grandfathering limits listed in the CRR. The remaining amount of DKK 1.8 billion was included as tier 2 capital.

² Capital instruments issued in USD - the amount of DKK 4.6 billion was the value at the end of 2017.

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

Subsidiaries and other holdings of Danske Bank A/S	Consolidation of solvency calculations		Consolidation in IFRS accounts	
	Full	Capital deductions	Full	One line
Credit institutions	√		√	
Significant investments in credit institutions		√		√
Insurance operations (consolidated) ¹		√	√	
Foreclosed companies (risk-weighted)			√	

¹ Insurance operations are consolidated according to the capital deduction method.

3.2.4 Statutory deductions for insurance companies and significant investments

As a financial conglomerate, the Group has obtained approval to use the Danish FSA's deduction method for investments in insurance subsidiaries in line with the conglomerate method 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. From 2018, the deductions for insurance subsidiaries will be fully deducted from CET1 capital in accordance with the transitional rules of the CRR. At the end of December 2017, the total capital deduction for Danica was DKK 1.7 billion.

Total capital deductions for insurance subsidiaries

At 31 December (DKK millions)	2017	2016
Capital requirement at Danica Pension	10,481	9,605
Less the difference between		
- Danica Pension's capital base	23,770	23,663
- Danske Bank's capital holdings	15,513	15,523
Danica Pension's holding of Danske Bank shares etc.	538	422
Total deductions for insurance subsidiaries	1,686	1,043
- Deductions from common equity tier 1 capital	1,349	626

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 100% weight. Danske Bank's capital holding in Danica Pension at the end of 2017 reflects the deduction of a proposed dividend from Danica Pension.

According to the CRR, capital holdings in other credit and financial institutions that represent more than 10% of the share capital of such institutions are considered 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 December 2017, the Group's sum of significant investments in financial sector entities was below the threshold, and the deduction was thus not applicable.

3.3 Total capital requirement

The total capital requirement is determined as the solvency need plus the combined phased-in buffer requirement. The solvency need 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 2017, the Group's solvency need was 10.5%, and the combined buffer requirement was 3.6%. When fully phased-in, the buffer requirement will be 6.1%, bringing the fully phased-in CET1 capital requirement to 12.0% and the fully phased-in total capital requirement to 16.6%. Assuming fully phased-in rules, the Group would have excess CET1 capital of 5.5 % of the total REA at the end of 2017.

Capital ratios and requirements		
(percentage of total risk exposure amount)	31 December 2017	Fully phased-in¹
Capital ratios		
CET1 capital ratio	17.6	17.5
Total capital ratio	22.6	22.3
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)	1.4	1.4
Combined buffer requirement	3.6	6.1
- Portion from countercyclical capital buffer	0.5	0.6
- Portion from capital conservation buffer	1.3	2.5
- Portion from SIFI buffer	1.8	3.0
CET1 capital requirement	9.5	12.0
Minimum capital requirement (Pillar I)	8.0	8.0
Capital add-on (Pillar II)	2.5	2.5
Combined buffer requirement	3.6	6.1
Total capital requirement	14.1	16.6
Excess capital		
CET1 capital	8.1	5.5
Total capital	8.5	5.6

¹ Based on fully phased-in CRR and CRD IV rules and requirements.

² The total capital requirement consists of the solvency need and the combined buffer requirement. The fully phased-in countercyclical capital buffer is based on the buffer rates announced at the end of 2017.

3.3.1 Minimum capital requirement

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

Credit risk amounted to 80.7% 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 Danske Bank Limited (Northern Ireland) and Danske Bank International (Luxembourg) and to retail exposures at Danske Bank Ireland. For these exposures, the Group currently uses the standardised approach.

At Danske 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 received approval to calculate the REA at Danske Bank Plc according to the F-IRB approach for the institutions asset class and according to 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 4.5% of the total REA. The Group uses an internal VaR model for both market risk on items in the trading book and for foreign exchange risk on items outside the trading book.

Operational risk amounted to 10.1% of the total REA. The Group uses the standardised approach for the calculation of operational risk.

Risk exposure amounts and risk weights

At 31 December (DKK millions)	2017		2016	
	REA	Weights ¹ [%]	REA	Weights [%]
Credit risk				
A-IRB approach:				
Institutions	7,912	27	10,784	29
Corporates	289,020	33	312,362	37
Exposures secured by real property	127,540	16	102,950	15
Other retail	29,341	24	21,227	21
Securitisations	573	18	2,421	51
Other assets	8,249	77	11,032	83
A-IRB approach, total	462,635	26	460,776	27
F-IRB approach, total	27,027	48	26,808	48
Standardised approach, total	118,248	14	150,320	18
Credit risk, total	607,910		637,904	
Counterparty credit risk	30,642		41,602	
Central counterparty (CCP) default risk	898		1,016	
Credit value adjustment (CVA) risk charge	4,216		6,099	
Counterparty credit risk (incl. CCP and CVA)	35,757		48,717	
Market risk, total	33,692		52,562	
Operational risk, total	76,050		76,065	
Total risk exposure amount	753,409		815,249	

¹ The average risk weights are determined as the sum of the REA relative to the sum of EAD for each exposure class.

From 2016 to 2017, the total REA declined by DKK 62 billion to DKK 753 billion. The main causes of the decrease in 2017 were lower market risk and counterparty credit risk and the implementation of approved IRB models.

The REA for credit risk fell by DKK 30 billion. The approval and implementation of the A-IRB and F-IRB approaches in respect of Finnish retail customers and institutions, respectively, led to a decrease in the REA of DKK 14 billion. In 2017, the Group also sold its Non-core retail activities in Ireland, which led to a reduction in the REA of DKK 6 billion.

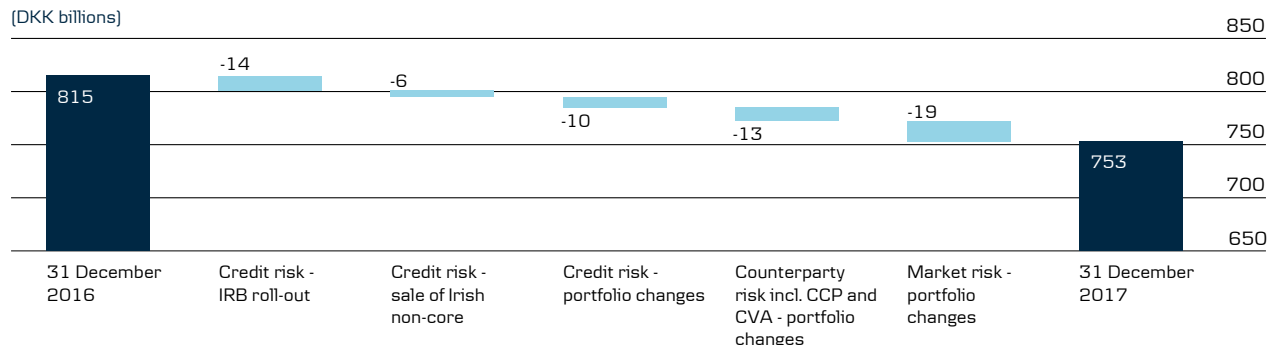
The REA for counterparty credit risk, including CCP default risk and the CVA risk charge, decreased by DKK 13 billion as a result of market movements and portfolio changes. The exposure at default (EAD) for counterparty credit risk decreased mainly because of interest rate increases and a weakening of the US dollar.

The REA for market risk fell by a total of DKK 19 billion and was historically low at the end of 2017. The decrease was attributable primarily to portfolio changes and market conditions, including both lower volatility and risk premiums in general.

The REA for operational risk was largely unchanged from 2016 at DKK 76 billion.

Change in total risk exposure amount, in 2017

(DKK billions)



3.3.2 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. According to Danish law, the solvency need ratio is the solvency need divided by the total REA determined under Pillar I.

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

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

Risk identification across activities

Activities	Danske Bank Group's risk categories						
	Credit risk	Market risk	Operational risk	Pension risk	Insurance risk ¹	Business risk	Liquidity risk
Banking activities	√	√	√			√	√
Market activities	√	√	√			√	√
Asset management			√			√	
Insurance (Danica Pension)					√		
Group-wide activities			√	√		√	√

¹Insurance risk includes a number of risk types such as market risk, operational risk and business risk.

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

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 evaluating 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 authorities on the institution's risks and capital needs. The outcome of the latest SREP for the Group was that the supervisory colleges, led by the Danish FSA, considered the Group adequately capitalised.

At the end of 2017, the Group used the Basel I transitional rules stated in the CRR as a "backstop" measure to determine the adequacy of its total capital. However, at the end of 2017, the Group's solvency need, including the phased-in regulatory buffer requirements, exceeded the capital requirement according to the transitional rules by DKK 9.6 billion. At 1 January 2018, the transitional rules are no longer applicable according to the CRR.

At the end of 2017, the Group's solvency need was DKK 79.4 billion, or 10.5% of the total REA. The solvency need declined by DKK 7.2 billion, mainly driven by the decrease in the total REA. The solvency need ratio declined by 0.1 of a percentage point from the level at the end of 2016.

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

3.3.3 Combined buffer requirement

CRD IV introduced a combined buffer that applies in addition to the solvency need, and it will be phased in from 2015 to 2019. The combined buffer consists of a countercyclical buffer, a capital conservation buffer and a SIFI buffer.

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 being phased in to reach a final level of 2.5% in 2019. The level at the end of 2017 was 1.25%. The countercyclical buffer requirement is calculated as a weighted average of the national buffers in effect in the jurisdictions in which a bank has credit exposures. The Group's countercyclical buffer rate of 0.5% at the end of 2017 was based primarily on the countercyclical buffer rates in Norway and Sweden (both set at 2.0%).

The Group was designated as a SIFI in Denmark in 2014. Consequently, the Group is subject to stricter capital requirements than non-SIFIs. The phase-in began in 2015, and the Group's SIFI buffer requirement was 1.8% at the end of 2017. The fully phased-in SIFI buffer requirement in 2019 will be 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.

According to the CRR, any dividends on CET1 and additional tier 1 capital instruments must be paid from distributable items, which are primarily retained earnings. At the end of 2017, Danske Banks A/S's distributable items amounted to DKK 117.5 billion.

Distributable items for Danske Bank A/S

At 31 December (DKK millions)	2017	2016
Retained earnings	108.6	106.5
Proposed dividends	9.4	8.9
Interest on AT1 capital instruments, not distributed	0.2	0.2
Foreign currency translation reserve	-0.7	-0.6
Distributable items	117.5	114.9

3.3.4 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 exposure). On the basis of the European Commission's legislative proposal for a revised CRR, a leverage ratio of 3% is expected to become a minimum requirement with the implementation of the revised CRR.

Even though the leverage ratio is not yet to be considered a regulatory binding capital requirement, it is still taken into consideration in the Group's capital management. 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 December 2017, the Group's leverage ratio was 4.4% under the transitional and fully phased-in rules.

Leverage ratio

At 31 December (DKK billion)	2017	2016
Total exposure for leverage ratio calculation	3,425.5	3,380.7
- Portion from derivatives	150.9	114.2
- Portion from securities-financing transactions	246.0	255.4
- Portion from exposure to central banks, institutions and cash in hand	358.4	252.0
Reported tier 1 capital (transitional rules)	151.1	156.1
Tier 1 capital (fully phased-in rules)	150.6	145.7
Leverage ratio (transitional rules) (%)	4.4	4.6
Leverage ratio (fully phased-in rules) (%)	4.4	4.3

Under the transitional rules, the leverage ratio decreased by 0.2 of a percentage point during 2017. The decline was caused by a lower level of tier 1 capital, primarily caused by the net redemption of additional tier 1 capital (see section 3.2.2), and an increase in the exposure amount, which was partly driven by an increase in exposures to central banks and credit institutions.

3.4 Future regulatory requirements

3.4.1 Transitional arrangements for IFRS 9 impact on regulatory capital

On 1 January 2018, the Group implemented IFRS 9, the new accounting standard for financial instruments. We expect the implementation of IFRS 9 to result in an increase in the allowance account of DKK 2.5 billion as a result of the introduction of the new expected credit loss impairment model. At 1 January 2018, the total reduction in shareholders equity, net of tax, from the implementation of IFRS 9 is expected to be DKK 2.0 billion. The effect includes other measurement changes due to the implementation of IFRS 9. Note 39 in Annual Report 2017 provides more information about the Group's implementation of IFRS 9.

In order to prevent the application of IFRS 9 from causing a sudden decrease in the capital ratios of financial institutions, institutions may apply a 5-year phase-in period in accordance with EU capital requirements regulation adopted in 2017. During the phase-in period, provisions due to the implementation of IFRS 9 are added back to CET1 capital according to specified percentages. Eligible provisions include those arising at the point of transition to IFRS 9 and provisions that are increased during the phase-in period. The add-back percentages start at 95% in 2018 and will fall to 25% in 2022, the final year of the transition period.

We will apply the phase-in arrangement for the IFRS 9 impact on regulatory capital. Consequently, at 1 January 2018, the implementation of IFRS 9 will reduce the CET 1 capital ratio by 0.1 of a percentage point (fully phased-in effect: 0.2 of a percentage point).

3.4.2 Minimum requirement for own funds and eligible liabilities (MREL)

As part of the Bank Recovery and Resolution Directive (BRRD), institutions in the EU are required to have 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.

There is no minimum European Union-wide level of MREL. The national resolution authorities are required to set an MREL based on the resolution plan for the individual institution. The Danish FSA is expected to set the MREL for the Group during 2018 with effect from 1 January 2019.

In 2017, the BRRD was amended to include an EU harmonised approach on bank creditor insolvency rankings. This means the introduction of a new creditor class for financial institutions. The creditor class covers "non-preferred senior debt", that is, typically senior funding programmes fulfilling some specific requirements. The new creditor class will rank immediately below ordinary unsecured claims. The purpose of introducing the new creditor class is to improve the possibility to bail in such non-preferred senior debt in case of the resolution of the individual institution. We expect the changes to be implemented in Danish law in the first half of 2018, but with retroactive effect from 1 January 2018.

3.4.3 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". According to the BCBS, the standards are revised in order 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 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 from 2022 to 2027.

We support the ambition of the BCBS to re-establish confidence in internal models. We think that this is best achieved by addressing key concerns directly in the internal models and maintaining the risk sensitivity of the capital adequacy framework.

It is too early to assess the effects of the changes since the political process to implement the recommendations in the EU has not yet been initiated, and the final outcome is subject to substantial uncertainty. On the basis of our strong earnings capacity and capitalisation, we are confident that we will be able to adapt smoothly to the future changes in EU regulatory requirements in relation to Basel IV.

Credit risk

32	4.1	Credit risk profile
33	4.1.1	Net credit exposure from lending activities
33	4.1.2	Credit quality
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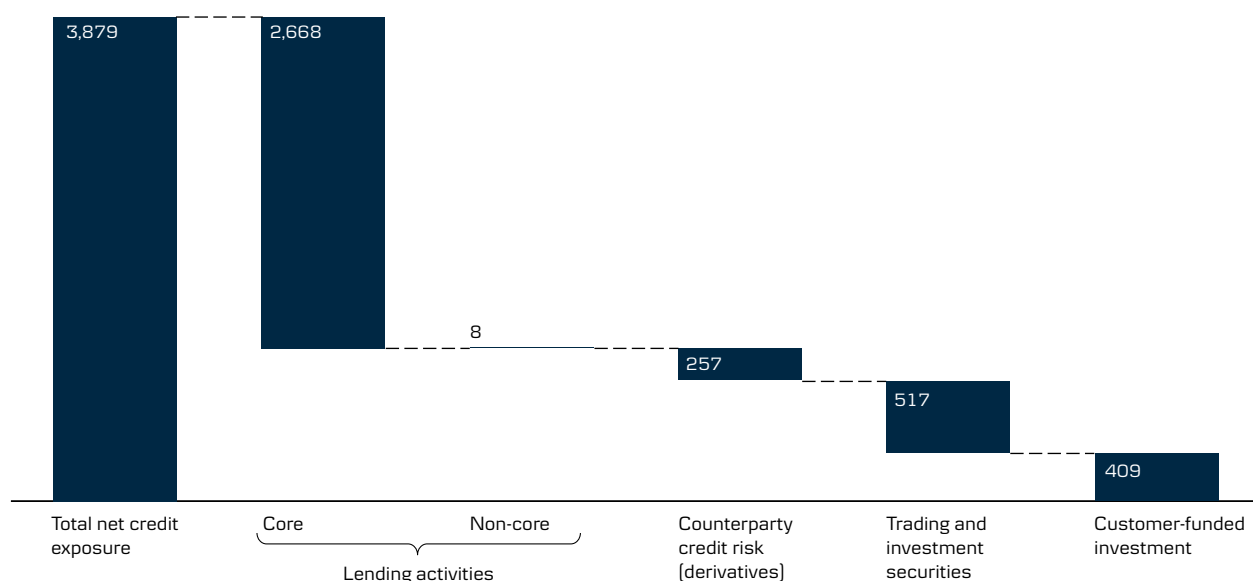
Credit risk is the risk of losses because debtors or counterparties fail to meet all or part of their payment obligations to the Group. The Group's credit risk appetite and credit policy aim to ensure that risk-taking remains supportive of the Group's business strategy and that credit risk management activities are conducted throughout the organisation.

4.1 Credit risk profile

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 2017, the Group's total net credit exposure for accounting purposes was DKK 3,879 billion (2016: DKK 3,796 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 is the focus of this section.

At the end of 2017, net credit exposure from core lending activities amounted to DKK 2,688 billion (2016: DKK 2,534 billion). Net credit exposure from Non-core lending activities decreased to DKK 8 billion (2016: DKK 23 billion) following the sale of a portfolio of Irish residential mortgage loans with a gross value of DKK 13 billion. Net credit exposure from lending activities includes amounts due from credit institutions and central banks, loans, guarantees, irrevocable loan commitments and repo loans.

At the end of 2017, the Group's counterparty credit risk amounted to DKK 257 billion (on a mark-to-market basis before closeout netting and collateral reduction). Counterparty credit risk is described in section 5.

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 Danske Bank Group's financial statements.

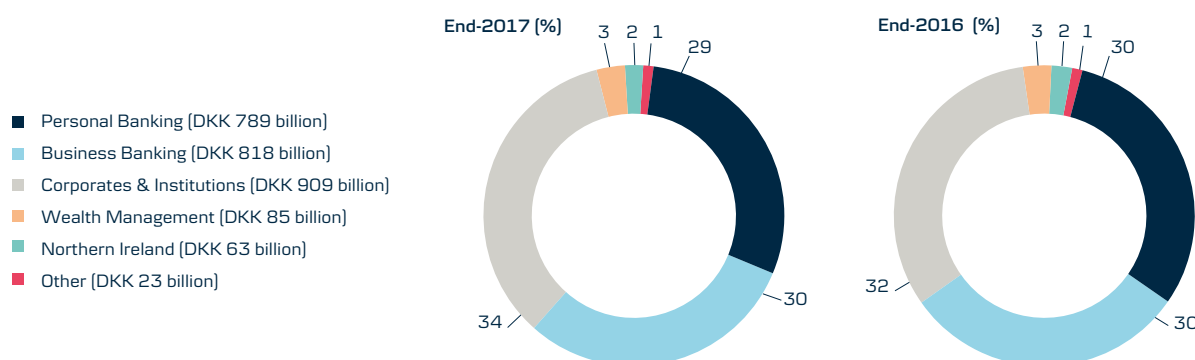
The Group's credit risk exposure from assets in customer-funded investment pools, unit-linked investment contracts and insurance contracts (customer-funded investments) is DKK 409 billion. The risk on assets under pooled schemes and unit-linked investment contracts is assumed solely by customers, while the risk on assets under insurance contracts is assumed primarily by customers. The credit risk on customer-funded investments and insurance contracts is explained in the notes on credit risk and insurance contracts to Danske Bank Group's financial statements.

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

4.1.1 Net credit exposure from lending activities

Overall, net credit exposure from lending activities increased by DKK 154 billion during the period from 2016 to the end of 2017. The main driver was increased deposits (Corporates & Institutions) with central banks. Lending at Personal Banking increased by DKK 18 billion, of which DKK 10 billion originated in Sweden and DKK 7 billion in Denmark. Lending at Business Banking increased by DKK 50 billion, with growth seen across most countries.

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



The corporate and sovereign portfolios at Business Banking and Corporates & Institutions are diversified across various industries with commercial property representing the largest exposure. Credit exposure to personal customers consisted mostly of home financing secured on real property.

Net credit exposure broken down by industry (lending activities)

	Net credit exposure (DKK billions)	
	End-2017	End-2016
Public institutions	414	330
Banks	53	70
Credit institutions	9	11
Insurance	38	47
Investment funds	25	41
Other financials	93	61
Agriculture	63	63
Commercial property	297	299
Construction & building products	45	39
Consumer discretionary	106	97
Consumer staples	58	55
Energy & utilities	51	50
Health care	35	37
Industrial services, supplies & machinery	96	103
IT & telecom	31	30
Materials	50	45
Non-profits & associations	170	152
Other commercials	86	58
Shipping	36	39
Transportation	24	22
Personal customers	911	888
Total	2,688	2,534

4.1.2 Credit quality

Net credit exposure broken down by rating category

Stable macroeconomic conditions, managerial efforts and enhanced underwriting continued to support the Group's credit risk profile in 2017. Overall credit quality remained stable, with 98% of total credit exposure having a rating classification from 1 to 8. This trend was unchanged from 2016. At Personal Banking, the exposure in rating categories 1-8 accounted for 98% of total exposure. At Business Banking and Corporates & Institutions, the exposure in rating

categories 1-8 accounted for 97% and 99% of credit exposure, respectively. The significant increase in rating category 1 was attributable to increased deposits with central banks.

At the end of 2017, the exposure-weighted PD was 0.64%, against 0.73% at the end of 2016.

Rating category breakdown

Rating category	PD scale (%)		Net credit exposure (DKK billions)		Net credit exposure (% accumulated)	
	Upper	Lower	End-2017	End-2016	End-2017	End-2016
1	0.00	0.01	324	251	12	10
2	0.01	0.03	269	253	22	20
3	0.03	0.06	437	414	38	36
4	0.06	0.14	587	544	60	58
5	0.14	0.31	489	461	78	76
6	0.31	0.63	298	302	89	88
7	0.63	1.90	170	179	96	95
8	1.90	7.98	57	64	98	97
9	7.98	25.70	11	14	98	98
10	25.70	99.99	31	35	99	99
11	100.00	100.00	16	16	100	100
Total			2,688	2,534	100	100

Impairment charges, non-performing loans and forborne exposures

In 2017, net impairment charges at our core business units amounted to DKK -873 million (2016: DKK -3 million).

NPL and impairment charges broken down by industry and personal customers

[DKK millions]	End-2017				End-2016			
	Gross NPL = a+b	Acc. individual impairment charges 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	6	1	6	2	1	-	-	-
Banks	127	128	-	-	149	149	-	-
Credit institutions	-	-	-	-	-	-	-	-
Insurance	14	8	6	-	16	8	8	-
Investment funds	248	162	86	36	320	205	115	33
Other financials	-	-	-	-	-	-	-	-
Agriculture	4,306	2,540	1,766	285	5,335	2,994	2,341	187
Commercial property	6,033	2,451	3,583	184	7,887	3,091	4,797	260
Construction & building products	852	542	310	150	1,513	1,010	503	127
Consumer discretionary	2,208	1,305	902	272	2,684	1,526	1,157	581
Consumer staples	342	163	179	-	345	161	184	22
Energy & utilities	1,354	408	946	-	484	180	304	-
Health care	85	51	35	10	103	64	40	4
Industrial services, supplies & machinery	1,915	1,089	827	64	2,173	1,238	934	96
IT and telecommunication services	146	88	58	33	209	146	63	25
Materials	846	522	324	76	1,011	768	243	-
Non-profits & associations	1,808	680	1,128	85	1,929	814	1,115	139
Other commercials	195	191	5	-	275	269	7	-
Shipping	2,037	681	1,356	68	3,504	719	2,785	52
Transportation	173	117	56	-	163	110	53	7
Personal customers	10,558	4,841	5,717	1,323	12,303	5,054	7,248	2,334
Total	33,255	15,965	17,290	2,587	40,406	18,505	21,900	3,868

Solid credit quality driven by increasing property prices in most geographical areas and improving macroeconomic conditions resulted in the continued reversal of loan impairment charges throughout 2017. Declining house prices in major cities in Norway and Sweden were observed in the second half of 2017, and we are monitoring the downside risk of this development. At Business Banking, the reversals related primarily to facilities in Denmark, where commercial property prices rose. Impairment reversals were booked against agricultural customers as a result of improved output prices and the performance of farmers. Pork prices have recently started to fall, but we are confident that the collective impairment charges made so far will be adequate to cover the potential losses resulting from the fall in prices. Impairment charges were made in Norway during the year against a few individual customers. Similarly, Corporates & Institutions continued to book impairment charges for exposures to the shipping and offshore industries, although at a lower level than in 2016.

Net non-performing exposure (NPL) decreased to DKK 17.3 billion at the end of 2017 (2016: DKK 21.9 billion). The decrease was attributable mainly to a few large customers and a positive trend in the personal customer segment.

Since 2014, the Group has identified an increasing number of exposures subject to forbearance measures. Benign economic conditions allow the Group to establish work-out processes for large customers, including forbearance measures. In 2017, concessions were introduced for a few large oil and gas customers. Forborne exposures generally saw an increase in credit quality and loans started to perform again. This was reflected in the increase in performing exposures of DKK 4 billion from 2016 levels.

Exposure subject to forbearance

(DKK millions)	End of 2017		End of 2016	
	Performing	Non-performing ¹	Performing	Non-performing ¹
Modification	2,170	1,462	433	1,713
Refinancing	6,084	11,255	1,730	12,079
Under probation	6,472	-	8,682	-
Total	14,727	12,718	10,844	13,793

¹These loans are part of the total non-performing loan amount.

At the end of 2017, the Group had recognised properties taken over in Denmark at a carrying amount of DKK 38 million (2015: DKK 79 million) and properties taken over in other countries at DKK 44 million (2016: DKK 62 million).

4.1.3 Credit risk mitigation

The main method used by the Group to mitigate credit risk is to obtain collateral for new transactions. The most important collateral types, measured by volume, are real property, custody accounts and securities (financial assets in the form of shares and bonds). Personal customers' real property accounted for 48% of the total collateral base (after haircuts) in 2017.

Collateral value by type (after haircuts)

At 31 December (DKK billions)	Total		Portion from:											
	2017	2016	Personal Banking		Business Banking		Corporates & Institutions		Wealth Management		Northern Ireland		Other	
			2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Real property	1,238	1,197	675	653	454	438	27	27	53	50	29	28	-	-
- Personal	757	733	674	653	15	15	-	-	52	49	16	15	-	-
- Commercial	433	416	1	-	396	380	25	25	1	1	10	10	-	-
- Agricultural	48	49	-	-	43	43	2	2	-	-	3	3	-	-
Bank accounts	2	1	-	-	1	-	-	-	-	-	-	-	-	-
Custody accounts & securities	231	230	-	-	5	6	216	211	8	10	-	-	2	3
Vehicles	21	19	2	2	18	16	1	-	-	-	-	-	-	-
Equipment	20	22	-	-	17	17	1	2	-	-	3	2	-	-
Vessels and aircraft	27	31	-	-	4	3	23	27	-	-	-	-	-	-
Guarantees	12	13	4	4	3	3	3	5	2	2	-	-	-	-
Amounts due	4	4	-	-	4	4	-	-	-	-	-	-	-	-
Other assets	36	38	-	-	30	30	4	7	-	-	2	1	-	-
Total collateral	1,591	1,556	682	660	535	518	275	280	63	62	34	32	2	3

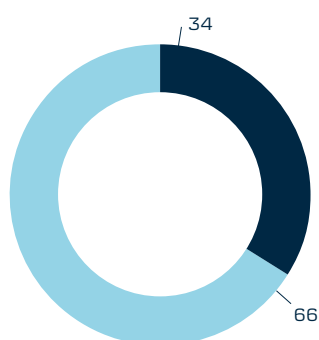
4.1.4 Trends in selected portfolios

This section describes 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.

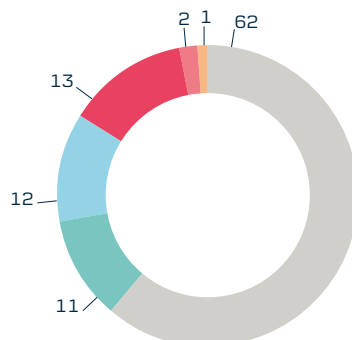
Measured by gross credit exposure, the personal customer portfolio is the Group's largest portfolio. At the end of 2017, gross credit exposure amounted to DKK 915 billion, with DKK 454 billion at Realkredit Danmark reflecting the Group's position as a leading Danish mortgage finance provider. The exposure to personal customers covers loans secured on customer assets, consumer loans and fully or partly secured credit facilities. Mortgage loans represent by far most of the exposure to personal customers (87%).

Personal customers

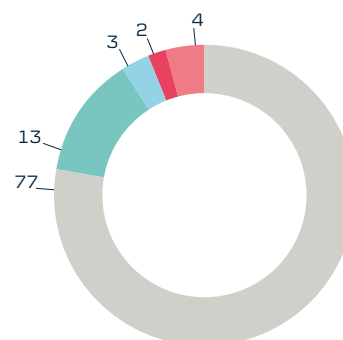
Gross credit exposure to personal customers as % of total lending portfolio



Gross credit exposure by country (%)



Individual allowance account by country (%)



■ Personal customers ■ The rest

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

Overall, the personal customer portfolio is stable, with underlying growth in Sweden and Norway (growth in local currency driven by strategic partnerships with large professional unions) and in Denmark. Taking a selective approach to growth enables the Group to grow in the Nordic markets without increasing the overall risk level.

The credit quality of the personal customer portfolio continued to benefit from low interest rates and favourable macro-economic conditions. The main risks in the personal customer portfolio relate to the following:

- Elevated asset prices in growth regions: house prices have been increasing in Denmark, Sweden and Norway for a long period, especially in the growth regions, driven by higher demand and low interest rates. However, initial signs of the housing market cooling down are starting to show in the growth regions.
- Interest rate increases: increases in historically low interest rates could put pressure on customer affordability. A stress test of the portfolio shows that customers with floating interest rates are exposed to changes in the current level but also that the overall portfolio is robust. We do not expect any major changes in interest rate levels in 2018.
- The Group considers the current level of impairment charges to be sufficient. The Group's Credit Risk Appetite includes a key performance indicator (KPI) for both high LTV ratios and short-term financed loans.

Developments in the personal customer portfolio

(DKK millions)	Key figures					Non-performing loans		
	Gross credit exposure ¹	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2016	893,472	5,054	1,143	-6	753,991	12,303	1.38	68
End-2017	915,489	4,841	837	2	779,527	10,558	1.15	79

¹ Gross credit exposure excludes accumulated collective impairment charges.

Commercial property

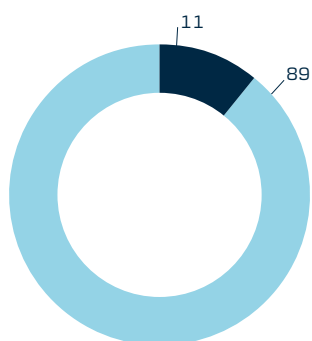
The commercial property portfolio consists primarily of secured property financing exposure to owners of property let to a third party. It also includes exposure in which the property owner and the property user are separate legal entities within the same group.

At the end of 2017, gross credit exposure amounted to DKK 299 billion. The individual allowance account for the portfolio, which amounted to DKK 2.5 billion, represented less than 1% of gross credit exposure.

In 2017, the commercial property portfolio remained stable, while non-performing loans continued to decline as a result of solid underwriting standards, improving LTV ratios and low interest rates.

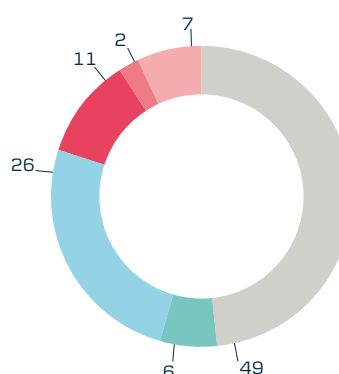
Commercial property

Gross credit exposure to commercial property as % of total lending portfolio



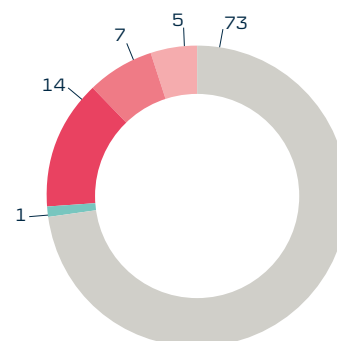
■ Commercial property ■ The rest

Gross credit exposure by country of residence (%)



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

Individual allowance account by country of residence (%)



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

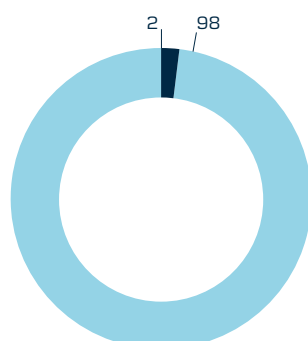
Developments in the commercial property portfolio

(DKK millions)	Key figures					Non-performing loans		
	Gross credit exposure ¹	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2016	301,776	3,091	1,164	-18	241,622	7,887	2.61	92
End-2017	299,398	2,451	345	-9	241,609	6,033	2.02	93

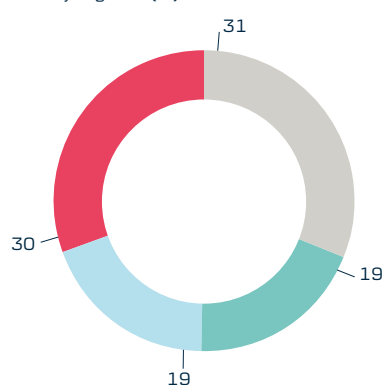
¹ Gross credit exposure excludes accumulated collective impairment charges.

Agriculture

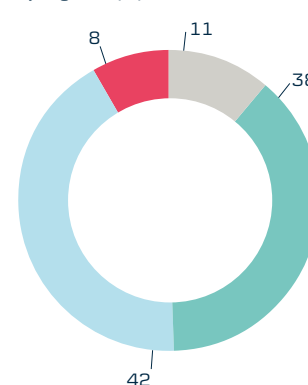
Gross credit exposure to agriculture as % of total lending portfolio



Gross credit exposure by segment (%)



Individual allowance account by segment (%)



■ Agriculture ■ The rest

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

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.

At the end of 2017, gross credit exposure amounted to DKK 65.1 billion, compared with DKK 65.7 billion at the end of 2016. Business Banking Denmark accounted for 79% of the portfolio's gross exposure and for 97% of accumulated individual impairment charges, while Realkredit Danmark accounted for 84% of gross exposure and for 10% of accumulated individual impairment charges. Credit quality remained weakest among pig producers and dairy farmers.

Market conditions and earnings for pig and milk farmers improved markedly in 2017. As a consequence, we started to see reversals of impairment charges during 2017. The main drivers behind the market developments were stronger demand from China and the rest of Asia, reduced supply and higher productivity.

Overall, high indebtedness and a very high proportion of variable-rate loans remained major risks in 2017, and we focused on reducing our customers' interest rate sensitivity. Pork prices have recently started to fall, but we are confident that the collective impairment charges made so far will be adequate to cover the potential losses resulting from the fall in prices. The Group's exposure to the agricultural segment is managed by specialist teams for customer relationships and credit management.

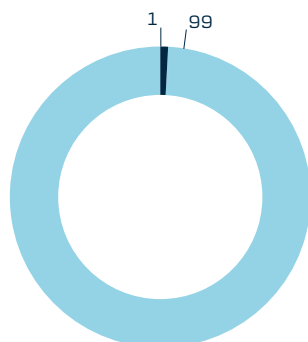
Developments in the agriculture portfolio

(DKK millions)	Key figures					Non-performing loans		
	Gross credit exposure ¹	Allowance account, individual	Write-offs	Impairment charges (bp)	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2016	65,686	2,994	403	95	51,433	5,335	8.1	94
End-2017	65,075	2,540	321	-42	51,199	4,306	6.6	90

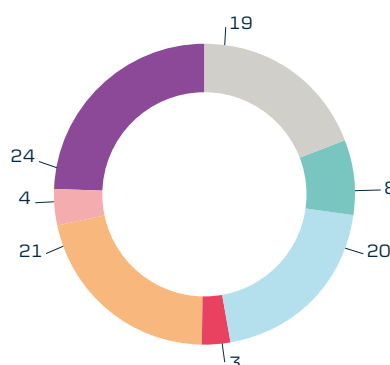
¹ Gross credit exposure excludes accumulated collective impairment charges.

Shipping

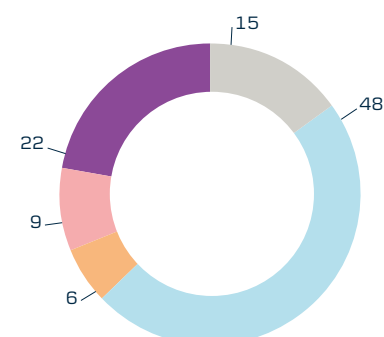
Gross credit exposure to shipping as % of total lending portfolio



Gross credit exposure by segment (%)



Individual allowance account by segment (%)



■ Shipping ■ The rest

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

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

Developments in the shipping portfolio

[DKK millions]	Key figures					Non-performing loans		
	Gross credit exposure ¹	Allowance account, individual	Write-offs	Impairment charges [bp]	Collateral (after haircut)	Gross exposure	Share of total segment exposure (%)	Coverage ratio (%)
End-2016	39,692	719	449	328	24,854	3,504	8.83	93
End-2017	36,674	681	305	91	22,940	2,037	5.55	91

¹ Gross credit exposure excludes accumulated collective impairment charges.

At the end of 2017, gross credit exposure amounted to DKK 36.7 billion, down from DKK 39.7 billion at the end of 2016. In recent years, the offshore shipping sector has been subject to an elevated risk. Impairment charges against non-offshore shipping customers have been low and are characterised by continued work-outs of old cases.

Collective impairment charges against offshore shipping and oil-related customers at Corporates & Institutions amounted to DKK 1.1 billion at the end of 2017. Market conditions are still difficult and continue to affect the portfolio's credit quality. Low oil prices had an adverse effect on the offshore segment in particular during 2017, and this led to downward pressures on prices and generally low investments. However, the increase in oil prices and a number of successful restructurings leave positive signs for the coming years.

In addition to the exposure to the offshore shipping segment, direct exposure to oil-related industries (mainly oil services and oil majors, which are included in the energy and utilities portfolio) amounted to DKK 13.7 billion at the end of 2017. The "lower for longer" situation in the oil market led to increased impairment charges - especially for a few large customers in the oil-related industries.

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

4.2 Governance and responsibilities

The Executive Board approves the Group's credit risk framework, which provides the overall structure that supports effective governance of the Group's credit risk. The Group's Credit Policy and Credit Risk Appetite and the credit risk framework set expectations for the conduct of the credit risk management activities and behaviour throughout the organisation.

This ensures the following:

- a consistent and effective execution of credit risk management activities across the Group
- a strong credit risk management culture
- a performance that is in line with strategic objectives
- compliance with legal and regulatory requirements in relation to credit risk

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

The Group uses dual underwriting as a general principle. Credit applications and renewals above a certain materiality threshold are considered under dual authority, which means that decisions made by business units are challenged or endorsed by Group Risk Management. The first line of defence is responsible for all credit exposures.

4.3 Credit risk appetite and concentration frameworks

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

Regular risk reporting enables the ongoing monitoring of the Group's credit risk profile in relation to the risk appetite.

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

As part of the overall risk appetite framework, the Group has implemented a set of frameworks to manage credit risk concentrations. The frameworks cover the following concentrations:

- Single-name concentrations
- Industry concentrations
- Geographical concentrations

Single-name concentrations

Single-name concentrations are managed according to two frameworks:

1. Large exposures framework: This framework is based on the regulatory definition of large exposures specified in article 395 of the CRR (Regulation (EU) No. 575/2013). At the end of 2017, the Group was well within the regulatory limits for large exposures. The Group has also defined stricter internal limits for managing single-name concentrations, including the following:
 - Absolute limit on single-name exposures
 - The sum of single-name exposures larger than 10% of the total adjusted capital may not exceed a portfolio limit of 95% of the total adjusted capital (at the end of 2017, 1 single-name exposure 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 2017, this segment represented 18% of the total adjusted capital)
2. Single-name concentration framework: The Group has also implemented a risk-sensitive internal framework that sets limits on exposure, expected loss (EL) and loss given default (LGD) in order to limit losses on single-name exposures.

The largest exposures are monitored daily under the large exposures framework. Large exposures are reported on a quarterly basis to the All Risk Committee, the Risk Committee and the Board of Directors. At the end of 2017, the Group was well within the regulatory limits for large exposures.

Single-name concentration is monitored monthly and reported on a quarterly basis to the All Risk Committee, the Risk Committee and the Board of Directors. The Group has reduced single-name exposures substantially in recent years.

Industry concentrations

The Group manages industry concentrations as part of its credit risk appetite framework by setting exposure limits on selected industries.

The Group accepts the risks on material concentrations in accordance with the industry-specific guidelines that outline the use of credit policies within the industry.

Geographical concentrations

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

4.4 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 2017, the Group reported DKK 2,729 billion of exposure at default (EAD), with 66.9% calculated according to the A-IRB approach, 2.1% according to the foundation IRB approach (F-IRB), 30.5% according to the standardised approach and 0.5% being rolled out.

In December 2016, the Group received approval to calculate the REA at Danske Bank Plc (Finland) according to the F-IRB approach for the institutions exposure class and according to the A-IRB approach for the retail exposure class. Implementation took place in the first quarter of 2017.

The following table shows an increase in the percentage of EAD covered by the A-IRB approach from 2016 to December 2017 and an equivalent decrease in the percentage of EAD covered by the standardised approach, mainly due to the approval mentioned above.

EAD broken down by credit risk measurement approach			
Measurement approach	2017	2016	2015
Advanced IRB (%)	66.9	66.1	69.4
Foundation IRB (%)	2.1	2.2	2.6
Standardised (%)	30.5	31.7	28.0
Rollout (%)	0.5	n/a	n/a

4.4.1 Organisation of IRB framework

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

- PD model development (for scoring and rating models, respectively)
- LGD and CF model development
- the maintenance of data availability and quality
- the rating of large customers
- credit REA calculations

These teams are embedded 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 4.4.4.

4.4.2 IRB exemptions and rollout

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

- Exposure to the sovereign exposure class
- Exposure to regional and local authorities (when the Group treats them as part of the institutions exposure class)
- Exposure to equities
- Exposure to purchased receivables
- Intragroup exposures
- Exposure through branches in Estonia, Latvia and Lithuania
- Exposure to the retail exposure class through branches in the Republic of Ireland
- Exposures at the legal entities Danske Bank Limited (Northern Ireland) and Danske Bank International (Luxembourg)
- Exposure to covered bonds
- Selected other minor portfolios

In addition to these exemptions, Danske Finance Plc (Finland) is currently switching to the IRB approach. The Group uses the standardised approach for both exempted portfolios and portfolios that are being switched to the IRB approach.

4.4.3 Models in the IRB framework

The Group classifies customers by means of probability of default (PD) models and uses loss given default (LGD) models to estimate the loss on facilities in case of default. The conversion factor (CF) models express a conservative estimate of the exposure at default (EAD).

The Group uses the PD models to assess the probability of default of customers in various segments. Corporate and financial customers¹ are classified by rating models, while small business customers and personal customers are classified by scoring models. Rating models rely in particular on financial data, but a rating officer may choose to include other information, including qualitative data, in the final rating. In contrast, scoring models use behavioural data as input to a much wider extent and are consequently updated at a higher frequency than rating models. Most data originate from internal sources, but in some cases data are acquired from external vendors, such as external credit scores to be used as model input. Although a few specific models have produced underestimated values, the general picture is that the PD model framework generates highly conservative estimates – a significant factor contributing to this result is the benign economic environment seen in recent years.

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

IRB PD models by exposure class

Exposure class	Classification process	Key model characteristics
Central governments & central banks	Permanent exemption from IRB	Permanent exemption from IRB
Institutions	1 rating model (hybrid)	Bank
Corporates excluding SMEs	1 scoring and 13 rating models (1 hybrid)	Covers 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	Retail SMEs Immovable property Other retail	7 scoring models 6 scoring models 8 scoring models
		Country-specific models Specific models for new customers Specific models for new customers
Equities	Permanent exemption from IRB	Permanent exemption from IRB

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 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.

For more information about the use of models, see sections 4.5.1 and 4.5.2.

4.4.4 IRB framework monitoring

Group Risk Management reviews and follows up on compliance with the minimum IRB requirements in CRR/CRD IV. This annual process includes reporting to the Executive Board, the Board of Directors and Internal Audit. The IRB framework is also subject to the group-wide Risk Identification Assessment (RIA) process.

The IRB governance structure and the modelling framework are evaluated regularly. The former was strengthened in 2017 through the establishment of the Group Model Risk Policy and the IRB Model Risk Instructions.

Reports are prepared in relation to the ongoing activities. In addition, the status and plans for the IRB framework are discussed and agreed with the Board of Directors. The main monitoring of the IRB framework is performed by a number of units as described below. These units work independently of the development teams.

¹ Customers with facilities exceeding DKK 2 million and customer groups with facilities of DKK 7 million.

Validation of credit risk models

The Group has an internal model validation system. This system 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 the team that develops the models. The validation is the main component for identifying model risk in the IRB framework.

The validation process plays an important role in 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.

Independence in respect of the validation function is ensured through direct reporting lines to the committee structure and the CRO. The validation unit owns the validation process and methodologies. The annual validations of the credit risk models are reviewed by the Model & Parameter Committee.

Audit of IRB models

As the Group's third line of defence, Group Internal Audit performs the independent audit of the IRB framework and reports directly to the Executive Board and the Board of Directors. The audit process consists of ongoing inspections and their scope is based on a risk and control-based approach set out by Group Internal Audit itself.

Committee structure

The committee structure - from local risk committees to the Executive Board's All Risk Committee and the Board of Directors' Risk Committee - reviews and challenges the IRB framework on an ongoing basis.

Changes to the IRB framework

The Group has introduced 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 and challenge is required from the units mentioned above (validation, audit and the committee structure). Internal approval lies with the unit appointed as the model owner.

Material changes to the IRB framework must be approved by the Danish FSA and/or the responsible supervisory authority. The Group must notify the FSA of less material changes. The Group follows the prescribed regulatory guidelines for this process.

4.5 Credit process

The credit process ensures that loans are granted within customers' financial capacity and that distressed and non-performing loans are identified at an early stage and managed proactively. Assessing a customer's financial capacity is an element of the credit approval process. The Group follows a policy of mitigating credit risk by means of guarantees and/or collateralisation. The credit control environment verifies that credit facilities granted are in compliance with credit policies and directives and in alignment with the Group's Credit Risk Appetite. Credit exposures are monitored so that credit plans can be made and/or forbearance measures be taken for distressed loans and impairment charges be calculated for non-performing loans.

4.5.1 Credit risk assessment

In the credit risk management process, the Group uses PIT estimates for PDs, LGDs and CFs. The PIT estimates are based on inputs that are sensitive to the current macroeconomic conditions and thus change over a business cycle, contrary to the parameters used for capital calculation (see section 4.4.3).

Rating and scoring

Group Risk Management is responsible for the overall rating process, including rating models. The rating process includes a control measure insofar as two employees are always involved in a rating decision: a rating officer recommending the rating and a senior rating officer with authority to approve the rating.

After approval, a rating applies until new customer information is received and the rating is reassessed. Customer ratings are reassessed periodically on the basis of new information that affects a customer's creditworthiness.

The Group assigns credit scores to customers that are not rated. The scoring models for personal customers and small and medium-sized enterprises are fully automated and are all statistically based models.

Credit scores are updated monthly in a process that is subject to automated controls and a manual review of the overall results.

Risk classification distribution

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

Scoring and rating are integral elements of the credit approval process and the overall credit risk management process.

The internal PD rating scale is comparable with the rating scales used by the international rating agencies.² The Group's internal ratings are based on PIT parameters, and the ratings reflect the probability of default within a year. Since Standard & Poor's and Moody's use TTC parameters, the rating scales are not 100% comparable.

4.5.2 Credit risk mitigation and collateral management

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

The market value of collateral is monitored and 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 the external inputs on which the valuation models are based. The Collateral System supports the process of reassessing the market value to ensure that the Group complies with regulatory requirements.

The market value of collateral is subject to a haircut. A haircut reflects the risk that the Group will not be able to obtain the estimated market value upon the sale of the individual asset in a distressed situation and thus includes forced sale reduction, price volatility during the sales period, realisation costs and maintenance costs. The haircut applied depends on the type of collateral type. For regulatory purposes, the Group also applies a downturn haircut.

4.5.3 Reporting and monitoring

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

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

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

The Group closely monitors changes in customers' financial conditions in order to determine whether the basis for granting credit facilities has changed.

The facilities should adhere to the Group's Credit Policy, including the Principles of Responsible Lending. These principles focus on the customer's understanding of the consequences of borrowing; the assessment of the customer's needs and ability to repay; and possible conflicts with the Group's environmental, social and governance guidelines.

The Delegated Lending Authorities System ensures the efficient administration and control of lending authorities. If a delegated lending authority is exceeded, a report or a request for verification will be sent to the relevant manager or local credit office.

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

4.5.4 Principles for impairment charges, non-performing loans and forbearance

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

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

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

Individual impairment charges

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

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

Collective impairment charges

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

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

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

Non-performing loans and forbearance

The Group defines non-performing loans (NPLs) as facilities for which individual impairment charges have been booked.³ For exposures to non-retail customers with NPLs, the entire amount of the customer's exposure is considered to be non-performing. For retail exposures, only impaired facilities are included in NPLs.

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

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.

IFRS 9

On 1 January 2018, the Group implemented IFRS 9, the new accounting standard for financial instruments. More information is provided in Annual Report 2017. As part of IFRS 9, the International Accounting Standards Board (IASB) introduced a new, expected credit loss impairment model that will require earlier recognition of expected credit losses. Specifically, the Group will be required to account for 12-month expected credit losses at the initial recognition of a financial instrument and to make earlier recognition of lifetime expected credit losses.

We have completed the process of making the required changes in our models, data, reporting and governance to ensure compliance with IFRS 9. On the basis of our work, the national regulator guidelines and the loan portfolio at 31 December 2017, our expectations for the effect of the implementation of IFRS 9 are unchanged. Thus we expect the implementation of IFRS 9 to result in an increase in the allowance account in the range of DKK 2-3 billion. The effect, net of tax, was recognised as a reduction in shareholders' equity at 1 January 2018.

We expect that the impact of IFRS 9 on capital ratios will be subject to a phase-in period through the ongoing revision of the EU capital requirements regulation. The transitional rules were finalised towards the end of 2017 and came into effect on 1 January 2018.

³ The Group's definition of non-performing loans differs from the EBA's definition by excluding fully covered exposures to customers in default and previously forborne exposures that are now performing and are under probation.

Counterparty credit risk

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5.

Counterparty credit risk is the risk of a financial loss on a derivative transaction because of the default of a counterparty. As such, counterparty credit risk arises as a combination of credit risk (a deterioration in the credit worthiness of a counterparty) and market risk (the potential value of a derivative contract). The financial loss is the replacement cost, that is, the cost of replacing an existing transaction by a new transaction with similar characteristics but at current market prices.

The potential future value of a derivative transaction is uncertain since the market value is related to the underlying market factors and thus fluctuates between positive and negative levels. The Group incurs a financial loss if a counterparty defaults and the market value of the derivative transaction is not covered after netting and the realisation of collateral.

Danske Bank Group takes on counterparty credit risk when it enters into derivatives transactions (interest rate, foreign exchange, equity, credit and commodity contracts) and securities-financing transactions (SFTs), which include repo agreements and securities lending.

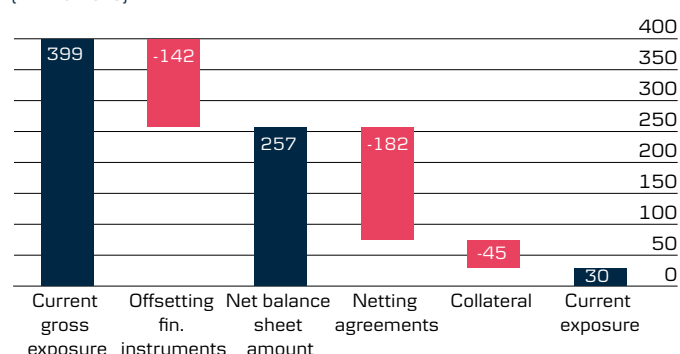
5.1 Counterparty credit risk profile

The Group measures counterparty credit risk in terms of current exposure. Current exposure is a simple measure of counterparty credit risk exposure that takes into account only current mark-to-market values and collateral. More advanced measures such as exposure at default (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 3 disclosures tables, which are accessible at danskebank.com/ir.

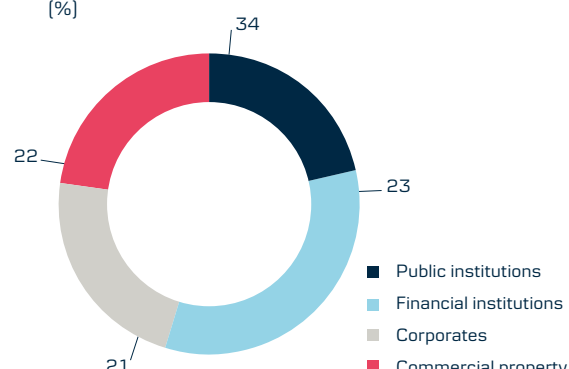
Exposures were significantly lower in 2017 than in 2016.

Counterparty credit risk, current exposure

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



Breakdown of current exposure by segment (%)



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 2017, the Group's current gross exposure to derivatives was DKK 399 billion (2016: DKK 521 billion). If the netting effect and collateral received are taken into account, the current exposure to derivatives was DKK 30 billion (2016: DKK 41 billion).

At the end of 2017, the Group was exposed mainly to public institutions, commercial property companies, financial institutions and corporates.

The Group mitigates counterparty credit risk through close-out netting agreements and collateral agreements. In 2017, the Group cleared 58% of the total notional amount of derivatives transactions through central clearing counterparties and used collateral agreements to support 94% of non-cleared transactions.

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

At 31 December (DKK millions)	2017			2016		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
Current gross exposure	407,151	399,452	7,699	528,847	520,722	8,125
Current exposure after netting	80,177	74,820	5,357	90,965	84,833	6,132
Current exposure after netting and collateral	34,979	29,788	5,191	46,845	40,946	5,899

Some 80% of the Group's collateral agreement holdings consisted of cash. The remainder consisted of mainly Danish and Swedish mortgage bonds and government bonds issued by Denmark, France, Germany, the Netherlands, Norway, Sweden and the United States.

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

Current exposure by rating category

At 31 December (DKK millions)	2017			2016		
	Total	Derivatives	SFTs	Total	Derivatives	SFTs
1	9,412	7,230	2,182	7,503	6,053	1,450
2	5,861	4,066	1,795	8,261	5,462	2,799
3	4,476	3,803	673	6,270	5,267	1,003
4	7,225	7,109	116	10,551	10,367	184
5	5,745	5,335	410	9,713	9,615	98
6	1,390	1,375	15	2,461	2,096	365
7	541	541	-	913	913	-
8	96	96	-	788	788	-
9	43	43	-	80	80	-
10	107	107	-	169	169	-
11	83	83	-	136	136	-
Total	34,979	29,788	5,191	46,845	40,946	5,899

At the end of 2017, the credit quality of the Group's counterparty credit risk remained strong with more than 90% of the exposure relating to counterparties with a classification comparable to investment grade.

5.2 Governance and organisation

As part of the overall credit risk governance described in section 4, the Group's Credit Directive on Counterparty Risk Mitigation approved by the All Risk Committee sets the requirements for counterparty credit risk management.

Group Risk Management is responsible for consolidated counterparty credit risk management, risk modelling and reporting, while local credit departments are in charge of day-to-day risk management. Group Market Risk management is responsible for developing counterparty risk exposure models, while an independent risk model validation team outside Group Market Risk validates the models.

5.3 Methodologies and models

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

The Group uses simulation-based models to calculate 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 simulation model (<10%), 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 transaction type, maturity, currency and collateral coverage and is determined using a conservative approach to ensure estimation adequacy.

The Danish Financial Supervisory Authority (the FSA) has approved the simulation model for calculating the regulatory capital requirement for counterparty credit risk.

5.4 Active risk management

In accordance with the Credit Directive on Counterparty Risk Mitigation, local credit departments are responsible for assigning specific credit lines for counterparty credit risk to the individual counterparties. Counterparty credit risk is managed by means of maximum tolerable PFE lines on a set of maturity buckets. Line checks are performed prior to trading.

Wrong-way risk is the risk that arises when credit exposure to a counterparty increases while the counterparty's credit-worthiness deteriorates. Specific wrong-way risk is a subtype of risk that arises because there is a legal connection between a counterparty and the issuer of the underlying instruments involved in a derivative or securities-financing transaction. The Group has set limitations on transactions entailing specific wrong-way risk. The limitations cover product range, counterparty rating and the rating of the underlying securities.

The Group manages its exposure to market risk on fair value adjustments (xVA), including CVA, under separate limits in the xVA framework as described in section 6, Market risk.

5.5 Monitoring and reporting

The Group carries out counterparty credit risk measurement and monitoring as well as intraday line utilisation monitoring on a daily basis. Consolidated counterparty credit risk exposure is accordingly reported to senior management.

The internal 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.

5.6 Data and systems

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

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

Market risk

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Market risk is the risk of losses or gains caused by changes in the market values of the Group's financial assets, liabilities and off-balance-sheet items resulting from changes in market prices or rates. Market risk affects the Group's financial statements through the valuation of 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 at Personal Banking, Wealth Management and Business Banking is 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.

6.1 Market risk profile

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

- Trading at Corporates & Institutions
- Fair value adjustments (xVA) at Corporates & Institutions
- Asset and liability management at Group Treasury

Market risk associated with activities at Personal Banking, Wealth Management and Business Banking or in Northern Ireland is either hedged by Corporates & Institutions or managed as part of Group Treasury's market risk positions.

Market risk at Danica Pension and for the Group's defined benefit pension plans is managed separately. For more detailed information, see section 9, Insurance risk, and section 10, Other risks.

6.1.1 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 C&I clients with risk management solutions (offering all of its products to Nordic customers and core Nordic products to customers outside the Nordic region). Trading market risk also arises from providing institutional clients with EUR products, mainly government bonds and simple derivatives. Advanced derivatives are traded predominantly with professional customers, while simple products are distributed to Business Banking and Personal Banking customers.

Within the trading portfolio, the main activities focus on interest rate risk management, both from a customer and a position-taking point of view. Interest rate risk management includes trading and risk-taking in a range of fixed income assets, money-market instruments and other assets with interest rate risk, including mortgage-related bonds. These transactions form an important part of the activities performed in the Group's domestic markets.

The Group's business activities involve a natural flow of various currencies, primarily currencies related to the Group's domestic markets in the Nordic region. They include all major currencies in support of our 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.

For trading and risk-taking in equity-related assets, the objective is to have a leading market position in the Nordic equity market. However, taking on equity market risk is limited relative to the market risk derived from interest rates.

The table below shows the Value-at-Risk (VaR) for the trading-related activities at Corporates & Institutions.

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

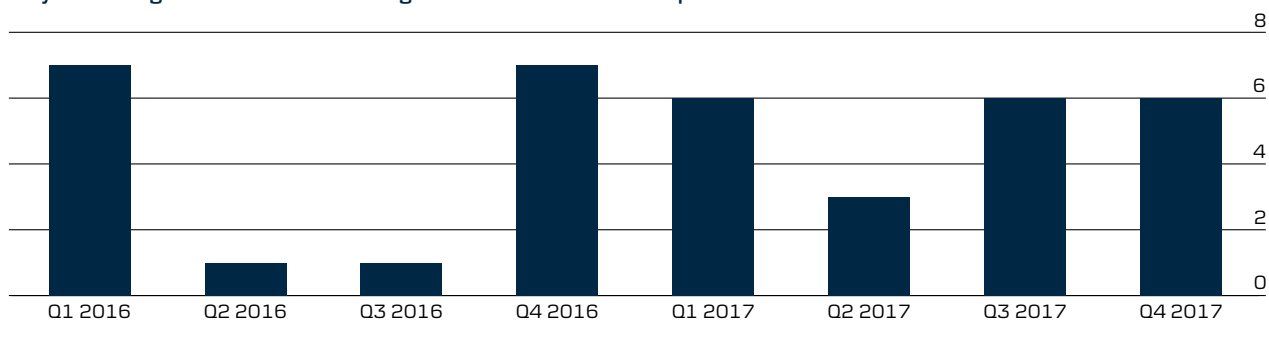
(DKK millions)	2017		2016	
	Average	31 December	Average	31 December
Bond spread risk	32	28	40	50
Interest rate risk	35	37	36	51
Foreign exchange risk	3	3	3	3
Equity risk	8	6	4	9
Diversification effects	-32	-37	-39	-46
Total VaR	46	37	44	67

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 2017, only marginally increasing its average trading-related market risk from DKK 44 million in 2016 to DKK 46 million in 2017. 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.

Stand-alone interest rate risk was largely unchanged in 2017. Bond spread risk declined because of a reduction in bond holdings over the year. Foreign exchange risk was largely unchanged, while equity risk doubled.

Days with negative income in trading-related activities at Corporates & Institutions



In line with the customer-oriented business model, day-to-day income from trading-related activities at Corporates & Institutions continued to show low fluctuations during 2017 as a result of low market volatility and low risk levels. The number of days with losses in 2017 was somewhat higher than in 2016, while the average daily P/L result was marginally lower in 2017 than in 2016.

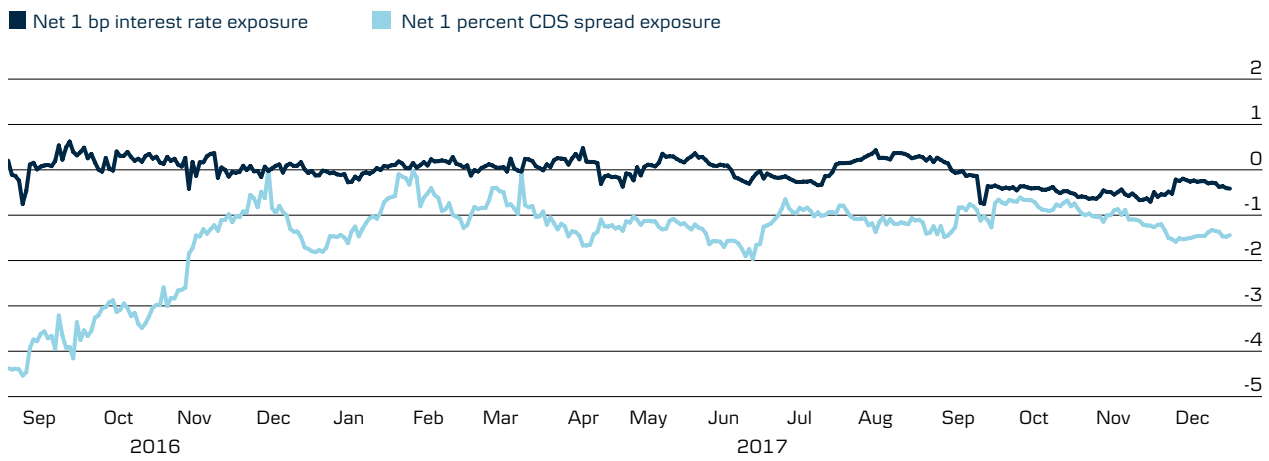
6.1.2 Market risk in relation to fair value adjustments

The Group's fair value adjustments (xVA)¹ cover funding value adjustments (FVA), credit value adjustments (CVA) and debt value adjustments (DVA). The Group applies a market-implied approach, which is in line with industry best practice. The Group's strategy is to continue developing the xVA model so that it remains in line with best practice in the market.

For the purposes of reducing P/L volatility caused by xVA, the Group pursues a strategy to hedge the risk in 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.

xVA-related market risk

(DKK millions)



The chart illustrates the sensitivity to CDS spread risk and interest rate risk. The net exposure to interest rate changes is rather low, while the net exposure to changes in CDS spreads is slightly higher.

¹ See chapter 12 Definitions for explanation.

6.1.3 Market risk in relation to asset and liability management

The Group's exposure to non-trading-related market risk originates from interest rate risk in the banking book (IRRBB), which derives mainly 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 portfolio of unlisted shares relating mainly to private equity funds and banking-related investments.

Interest rate risk in the banking book

The Group has progressively increased its resources to manage the interest rate risk associated with the Group's banking book activities. All of the components of this risk type have now been consolidated with the activities managed by Group Treasury.

IRRBB is driven by a number of factors: repricing mismatches between asset and liabilities, client behaviour, optionality within client products booked within the banking book, and interest rate floors 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 Asset & Liability Committee (ALCO) is responsible for monitoring and managing IRRBB.

Group Treasury provides the first line of defence for IRRBB. This involves the day-to-day management of the actual risk against the limit framework. Market Risk provides the second line of defence and maintains the risk management systems used for calculating the IRRBB measure. In addition, Market Risk maintains the limit framework and monitors adherence to the limits. Each month, the 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 ALCO reviews and monitors both Economic Value and Earnings at Risk metrics.

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 any 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 parallel shift in interest rates, a non-parallel shift in interest rates, contractual floors on customer products and liabilities issued by the Group, and customer behaviour. The latter is an important component and encompasses the ongoing assessment of non-maturing demand deposits (NMDs) and net free reserves. The duration assigned to NMDs is reviewed annually. The ALCO reviews and endorses the sensitivity of this duration (any increase or decrease) together with volume adjustments.

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

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

At last business day (DKK millions)	2017		2016	
	+100bp	-100bp	+100bp	-100bp
DKK	4,384	-5,381	4,742	-5,715
EUR	-862	2,823	-1,160	2,744
SEK	1	467	264	-140
GBP	45	-46	-29	122
NOK	409	-547	422	-555
USD	-43	42	2	-2
Other	-3	3	-	-
Total	3,932	-2,637	4,241	-3,546

The sensitivity of falling interest rates decreased from DKK 3,546 million in 2016 to DKK 2,637 million, while the sensitivity of rising interest rates decreased from DKK 4,241 million in 2016 to DKK 3,932 million in 2017.

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 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

In its risk management of shares outside the trading book, the Group makes a distinction between ordinary open positions (including positions in associated companies), exposure to private equity funds (including exposure in the form of commitments), and banking-related investments. Banking-related investments consist of equity holdings primarily in financial infrastructure businesses.

At the end of 2017, the total value of the portfolio was about DKK 2.1 billion, against DKK 2.6 billion at the end of 2016.

6.2 Governance and organisation

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

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

6.3 Methodologies and models

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

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

6.3.1 Value-at-Risk

The current internal market risk model was acknowledged by the Danish Financial Supervisory Authority in 2007 and has since then been used for the calculation of regulatory capital for Danske Bank Group and Danske Bank A/S. The model acknowledged in 2007 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 approved to include bond-specific risk and company-specific risk. At the same time the Group's incremental risk model was included in the framework.

VaR is a quantitative measure that shows, with a certain probability, the maximum potential loss that the Group will suffer at the calculation date within a specified horizon.

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 framework in place to mitigate these limitations.

Value-at-Risk model				
Value-at-Risk	Risk monitoring VaR limit	Capital requirement VaR	Capital requirement Stressed VaR	Backtesting
Percentile	95	99	99	99
Holding period	1 day	10 days	10 days	1 day
Historical data used	2 years	2 years	1 year	1 year
Period	Recent	Recent	1-year period of significant financial stress relevant to the 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 the front-office pricing 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 from 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 FX. A mixed approach is used for interest rates.

The stressed VaR is calculated using a holding period and historical data from a continued 12-month period of significant financial stress relevant to the the Group's portfolio. Scenarios are equally weighted. A structured approach is used for identifying the historical period representing a significant stress on the current portfolios since the historical period is identified by running the full VaR model over a comprehensive historical period to identify the 12-month period that produces the highest VaR for the current portfolio since 2008. On this basis, the most stressed periods are identified and analysed in more detail in order to validate the period to be used for the stressed VaR. The current stress period is August 2011 – August 2012.

Backtesting of the internal VaR model

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

Definition of actual and hypothetical profit and loss

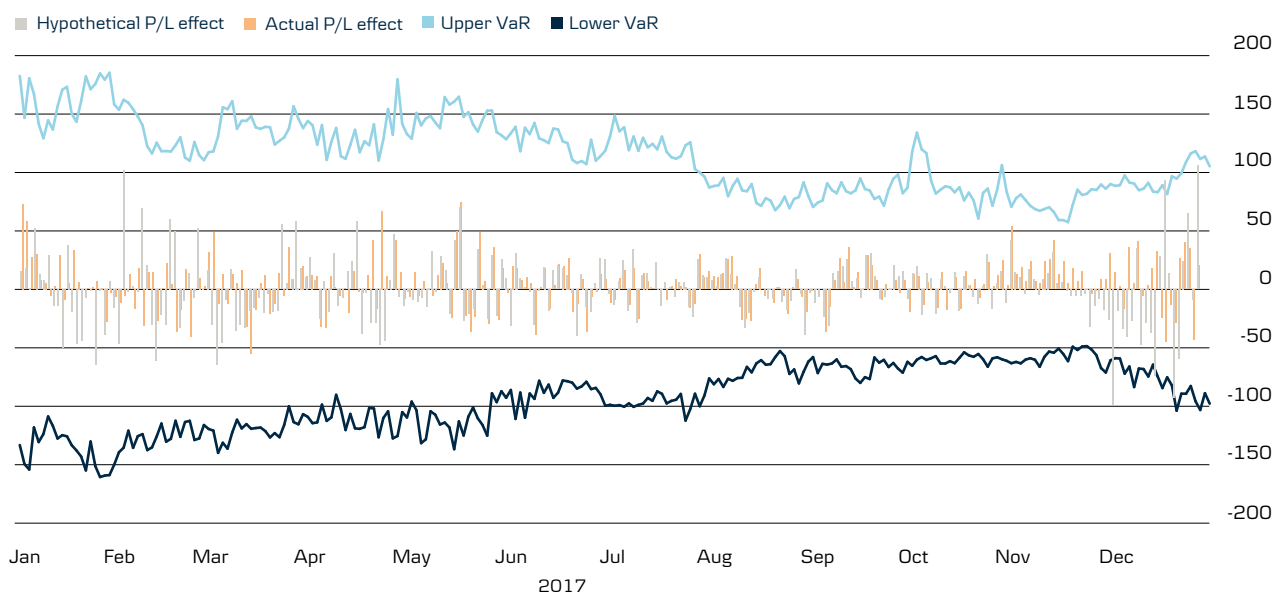
Actual P/L is defined as the loss or gain from actual changes in the market value of the trading book when daily closing values are compared with the subsequent business day's closing values (that is, intraday trades on the subsequent business day are included).

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 trading is included, although market prices change).

If the hypothetical or actual loss exceeds the predicted possible loss (VaR), an exception has occurred. Since the VaR figures used for backtesting are based on a confidence level of 99% (as in the calculation of regulatory capital), the expected number of exceptions per year is two to three. The backtesting results for 2017 are shown in the chart below.

Backtest results and P/L effect

(DKK millions)



The backtesting of the internal VaR model showed one exception in actual P/L and two exceptions in hypothetical P/L in 2017. The exception in actual P/L was a technical, regulatory exception that occurred on 6 September 2017 (the daily calculation of actual P/L was performed as a combined exercise for 6 and 7 September 2017). The two exceptions in hypothetical P/L occurred during December following large movements in short-term USD rates.

6.3.2 Incremental risk charge (IRC)

IRC is an additional capital charge to be added to the multiplier-adjusted VaR and stressed VaR capital charges. No diversification effects between capital charges are thus taken into account.

The IRC 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 the 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 annually on the basis of pairwise correlations of bond 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 re-calibrated quarterly.

6.3.3 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.

The Group regularly 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 threefold:

- The primary purpose is to assess the adequacy of the Group's financial resources for periods of severe stress and develop contingency plans for the Group if the need arises
- A secondary purpose is to promote risk identification and add further insight into the need for setting new limits
- A third purpose is to serve as 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.

6.3.4 Regulatory capital for market risk

The Group uses the internal VaR model to measure the regulatory capital for market risk in its trading book. 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 risk hedging that is not eligible under regulatory capital calculations for CVA risk.

The Group also uses the internal VaR model for calculating the stressed VaR capital charge. Incremental risks, such as default and rating migration risks on bond issuers and CDS names, are estimated in the incremental risk model.

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

6.3.5 Model validation

The Group conducts a variety of activities to maintain well-performing models in the market risk area. The activities can be divided into the validation of valuation and behavioural models used in day-to-day risk management and validation of internal models used for calculating regulatory capital.

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

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

An independent validation unit carries out the validation of internal models used for the regulatory capital calculations, including the validation of material changes to existing internal models and recurring validations of major model assumptions. The standards for these validations are set forth in the Group's Model Risk Policy, which is detailed and complemented by relevant Instructions.

In addition, 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 contains all significant risk factors.

6.3.6 Review of policies and procedures

The Group reviews and updates its market risk governance documents at least once a year or more frequently if changes in the operating environment and/or business strategy so demand. The purpose is to ensure that the documents are fit for purpose.

The review covers four areas. First, an organisational fit assessment is made to check that the documents are tailored in a manner that supports the Group's objectives and strategy in the trading and treasury areas in consideration of the desired risk profile. Second, regulatory compliance is assessed to ensure that the Group's risk management practices as a minimum live up to the regulatory requirements. Third, adherence is checked to make sure that the stipulated requirements are met. Finally, the effectiveness of policies and procedures is assessed to ensure that the outcome is as expected.

The Group pursues a structured approach in which relevant inputs are captured, assessed and discussed with key stakeholders and subsequently agreed, documented and communicated with relevant stakeholders. This contributes to the timely and effective maintenance and implementation of the documents.

6.4 Active market risk management

The Group actively manages the market risk in relation to 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.

6.4.1 Market risk appetite

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

The Group's exposure to the risk on fair value adjustments is managed under separate limits for changes in CDS spreads and interest rates supplemented by a zero appetite for exposure to foreign exchange rate changes.

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

6.4.2 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-related market risks):

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

Board limits are set by the Board of Directors in the Market Risk Instructions. This document defines overall limits for specific major risk factors. The overall limits are supplemented by a VaR limit for trading-related market risk. The All Risk Committee delegates the Board limits to the business areas and assigns additional limits for less significant risk factors. Detailed operational limits are set at business area 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 business units under the three distinct market risk frameworks.

6.4.3 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 the strategy. If the Group wants to expand its business into specific products or instruments, there may be a need for additional metrics and limits.

6.5 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 areas and trading sections must comply with limits at all times. If a limit is breached, the business 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 reports in which market risk figures are presented. The reports provide sufficient market risk information to create transparency about the Group's market risk.

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

6.6 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.

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

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

Liquidity risk

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

7.1 Liquidity risk profile

Liquidity risk is inherent in basic banking activities such as accepting deposits and providing loans and credits. The transformation of short-term deposits into long-term loans exposes banks to maturity mismatches that cannot be eliminated.

Liquidity risk is broken down into two key elements, and the Group addresses each element through a Liquidity Risk Appetite statement. The Group's liquidity risk appetite is conservative, and the Group must maintain both a strong liquidity position and a strong funding position.

Key element	Risk appetite
Distance to default	Management must have sufficient time to respond to events and developments in order to avoid financial or regulatory default.
Market reliance	The use of wholesale funding instruments reflects the Group's loan-to-deposit shortfall and its maturity transformation profile. If new funding is required too frequently, Danske Bank may be vulnerable to investor sentiments, market stress and market dysfunctionalities.

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 costly and 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, which issues mortgage bonds, is largely self-financing, and its liquidity is managed separately from the rest of the Group. Danica Pension's balance sheet includes long-term life insurance liabilities and assets. Most of Danica Pension's assets are readily marketable bonds and shares. Both companies are subject to statutory limits on their exposures to Danske Bank A/S. In the following sections, "Group" refers to the banking units only; that is, it does not include Realkredit Danmark and Danica Pension.

The Group monitors the two key elements through a set of risk indicators that make up the Group's liquidity risk profile. For an overview of these risk indicators, see 7.2.4, Monitoring and reporting.

7.1.1 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 case of a stressed liquidity situation. The indicators consist of the liquidity coverage ratio (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 scenario. As a Danish SIFI, the Group as well as Danske Bank A/S must maintain an LCR above 100%. The table below provides a breakdown of the Group's LCR at the end of 2017

Liquidity coverage ratio

31 December 2017 (DKK millions)	Danske Bank Group ¹			Danske Bank A/S
	Total	Portion from EUR ²	Portion from USD ²	Total
HQLA level 1	554	289	22	494
HQLA level 2	11	2	-	9
Limits due to cap	-	-	-	-
A. Liquid assets, total	565	291	22	503
Customer deposits ³	123	31	10	124
Market funding ⁴	132	27	40	140
Other cash outflows ⁵	129	305	196	132
Derivative currency adjustment	-	-5	123	-
B. Cash outflows, total	384	358	369	396
Lending to non-financial customers	6	1	-	4
Other cash inflows	48	227	354	66
C. Cash inflows, total	54	228	355	70
Liquidity coverage ratio [A/(B-C)], (%)	171	224	156	154

¹ Includes Realkredit Danmark.

² According to the Danish FSA's guidance on currency-specific LCR calculations.

³ Includes retail deposits, operational deposits, correspondent banking, prime brokerage accounts and non-operational deposits covered by deposit guarantees.

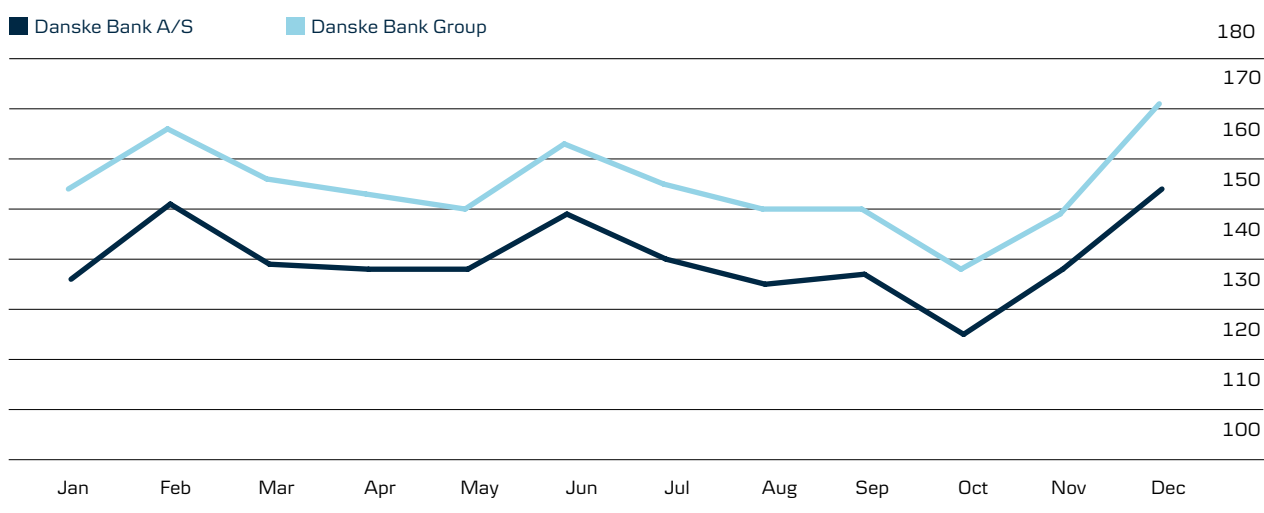
⁴ Includes non-operational deposits, unsecured debt issuances and secured funding.

⁵ Includes Realkredit Danmark's additional outflow requirement, which is equal to 2.5% of lending.

The following chart shows the monthly LCR figures for the Danske Bank Group and Danske Bank A/S through 2017. Both LCRs remained largely constant at high levels during 2017. The high levels reflect the current low-interest-rate environment in which liquidity is still being increased via central banks' quantitative easing programmes. The primary (central bank) liquidity added must be held by the banking sector and increases the LCR liquidity buffers of the banks concerned.

LCR figures for Danske Bank Group and Danske Bank A/S, 2017

(%)



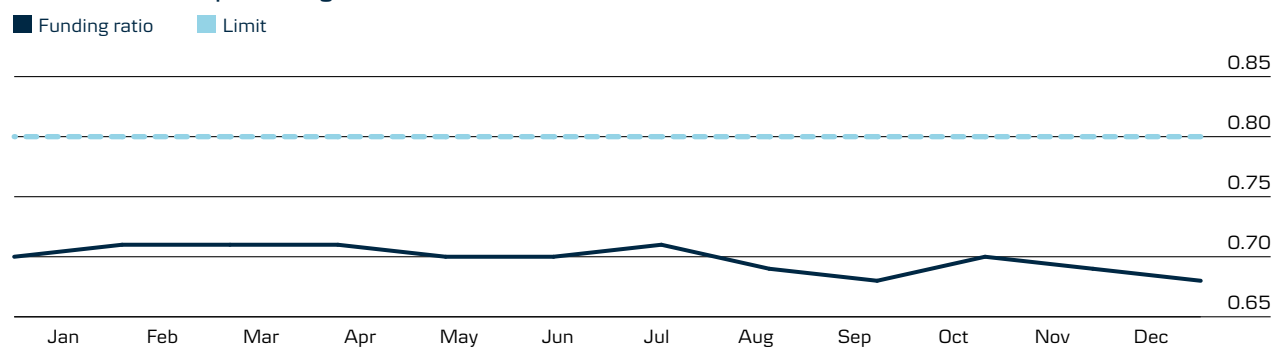
As planned, the currency-specific LCR requirements imposed on Danish SIFIs by the Danish Financial Supervisory Authority (the FSA) were tightened in 2017. The initial requirements were a minimum LCR of 60% for EUR and 60% for USD. In 2017, these requirements were raised to 100% for both EUR and USD.

Market reliance

The risk indicators used for managing market reliance enable the Group to have a prudent composition of its liabilities because they ensure that there is sufficient long-term funding for maturing long-term assets. This reduces any pressure on the Group in a situation involving a liquidity crisis. Until the introduction of the net stable funding ratio (NSFR), the funding ratio shown below is the key indicator for market reliance. The funding ratio limit is set at 0.8, and the historical

development reflects a conservative balance between loans and working capital. The Group oversees the maturity profile of its long-term funding to keep the portions of long-term funding maturing within a twelve-month horizon at an acceptable level.

Danske Bank Group's funding ratio, 2017



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 a newly established subsidiary, Danske Hypotek AB. Danske Bank is thus in a position to fund future growth in Sweden and Norway by means of covered bonds.

7.1.2 Ratings of Danske Bank A/S and Realkredit Danmark

On 16 August 2017, Moody's upgraded Danske Bank's Baseline Credit Assessment to 'a3' from 'baa1'. As a consequence, all other debt types were raised one notch.

Moody's rating upgrades on 16 August 2017

Rating	Before	After
Counterparty Risk Assessment	Aa3	Aa2
Long-term deposit	A1	Aa3
Senior debt	A2	A1
Subordinated debt	Baa3	Baa2
Additional tier 1 instruments	Ba1	Baa3

At the same time, the outlooks were revised to stable from positive, apart from the outlook for senior debt, which remains positive. The reason for the continued positive outlook is Moody's assessment of the impact of future issuance of non-preferred senior debt on its Loss Given Failure (LGF) model. Any senior debt rating change is unlikely before 2019.

S&P Global and Fitch Ratings maintained their long-term A-ratings with a stable outlook.

Ratings of Danske Bank A/S

	Fitch Ratings			Moody's Investor Service			S&P Global		
	Long-term	Short-term	Outlook	Long-term	Short-term	Outlook	Long-term	Short-term	Outlook
Debt type									
Standalone rating	VR ¹ a	VR ¹		BCA ² a3	BCA ²		SCP ³ a	SCP ³	
Issuer credit rating	A	F1	Stable	A1	P-1	Positive	A	A-1	Stable
AT1 instruments	BB+						BBB-		
T2 subordinated debt	BBB			Baa2			BBB+		
Senior debt	A	F1	Stable	A1	P-1	Positive	A	A-1	Stable
Deposits	A	F1	Stable	Aa3	P-1	Stable	A	A-1	Stable
Counterparty risk rating	A ⁴			Aa2 ⁴	P-1 ⁴		Not rated	Not rated	n/a

¹ Viability rating.

² Baseline Credit Assessment.

³ Standalone credit profile.

⁴ Derivative Counterparty Rating (DCR) for Fitch and Counterparty Risk Assessment (CRA) for Moody's.

Mortgage bonds and covered bonds (*RO* and *SDRO*) issued by Realkredit Danmark are rated AAA by S&P Global (stable outlook). In addition, bonds issued from capital centre S are rated AAA (stable outlook) by Fitch, while bonds issued from capital centre T are rated AA+ (stable outlook).

Covered bonds (*SDO*) issued by Danske Bank A/S are rated AAA by both S&P Global and Fitch Ratings, while covered bonds issued by Danske Mortgage Bank Plc are rated AAA by Moody's and covered bonds issued by Danske Hypotek AB are rated AAA by S&P Global.

The following table shows the Group's loss of liquidity under four scenarios involving downgrades of the Group's long- and short-term debt. It also shows how much the Group would have to prepay under the contracts or provide as supplementary collateral under the various scenarios. The number in brackets after each individual rating indicates how many notches the rating would drop from its current level.

Loss of liquidity if the Group's ratings are downgraded, end of 2017

Assumed rating	Short-term			Long-term			Supplementary collateral (DKK billions)
	Moody's	S&P	Fitch	Moody's	S&P	Fitch	
Present rating	P-1	A-1	F1	A1	A	A	
Scenario 1	P-1	A-1	F1	A2(▼1)	A-(▼1)	A-(▼1)	3.5
Scenario 2 (mild crisis)	P-2(▼1)	A-2(▼1)	F2(▼1)	A2(▼1)	A-(▼1)	A-(▼1)	4.3
Scenario 3	P2-(▼1)	A-2(▼1)	F2(▼1)	A3(▼2)	BBB+(▼2)	BBB+(▼2)	4.6
Scenario 4 (severe crisis)	P2-(▼1)	A-2(▼1)	F2(▼1)	Baa1(▼3)	BBB(▼3)	BBB(▼3)	5.6

7.1.3 Funding

In 2017, Danske Bank Group issued DKK 30 billion worth of senior debt, DKK 32 billion worth of covered bonds and DKK 5 billion worth of additional tier 1 capital, bringing total funding to DKK 67 billion. The Group redeemed a total of DKK 65 billion worth of long-term debt in 2017.

Realkredit Danmark's funding

Realkredit Danmark funds its mortgage lending activities by issuing covered bonds on the basis of the pass-through principle as stated in Danish mortgage banking regulations. Realkredit Danmark complies with the balance principle by applying a pass-through structure. This implies that

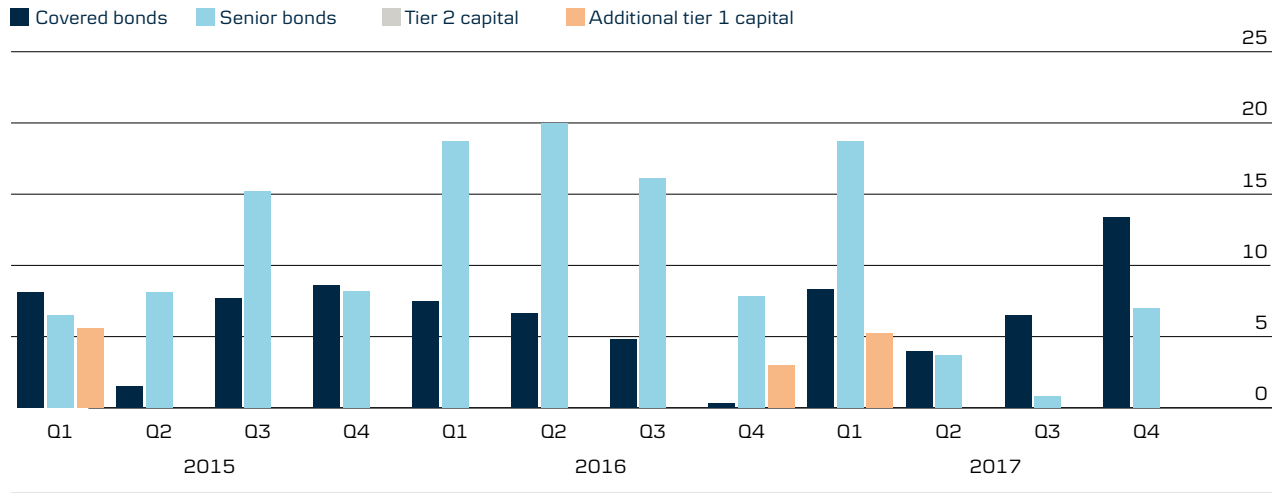
- all mortgages are funded by means of covered bonds with a matching cash flow
- all funding costs are absorbed by the borrowers
- amounts of interest, redemptions and margins from borrowers fall due in advance of interest payments and principal repayments to bondholders
- covered bonds are issued on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

The balance principle 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, the maturity of maturing covered bonds can be extended in case of a refinancing failure.

Consequently, Realkredit Danmark is exposed to limited funding and liquidity risks.

Debt issuance, by quarter

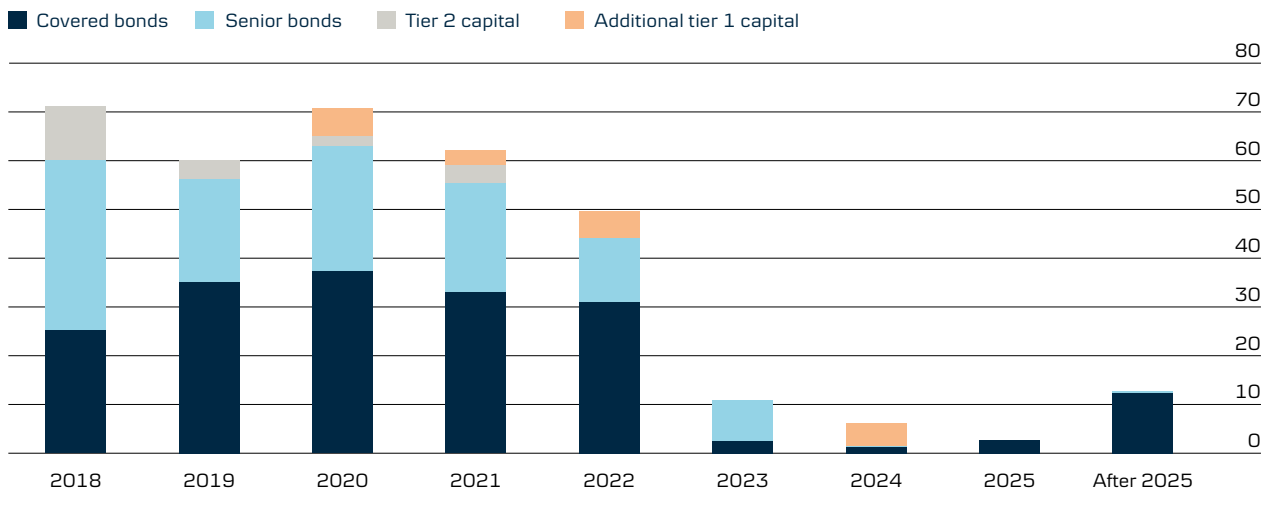
(DKK billions)



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 an acceptable level.

Danske Bank Group's redemption profile at 31 December 2017

(DKK billions)



Total wholesale funding consists of debt issues as well as deposits received from credit institutions and central banks. A detailed breakdown is shown below.

Breakdown of wholesale funding by contractual maturity

At 31 December (DKK billions)	0-1 month	1-3 months	3-12 months	1-5 years	> 5 years	Total 2017	Total 2016
Deposits from credit institutions and central banks	217	60	11	15	-	303	330
CDs and CP	4	43	51	-	-	98	73
Senior unsecured MTNs	1	13	23	91	9	136	142
Covered bonds	9	2	26	144	31	211	217
Subordinated liabilities	-	-	11	9	5	25	34
Total	230	117	122	260	44	773	797
Breakdown							
Secured instruments	90	41	7	15	-	153	177
Unsecured instruments	140	76	115	245	44	620	620

Note: In this table, wholesale funding is measured at nominal value, while it is measured at amortised cost in section 7.1. Covered bonds issued to enhance the Group's liquidity reserve are included. Repo transactions are not netted.

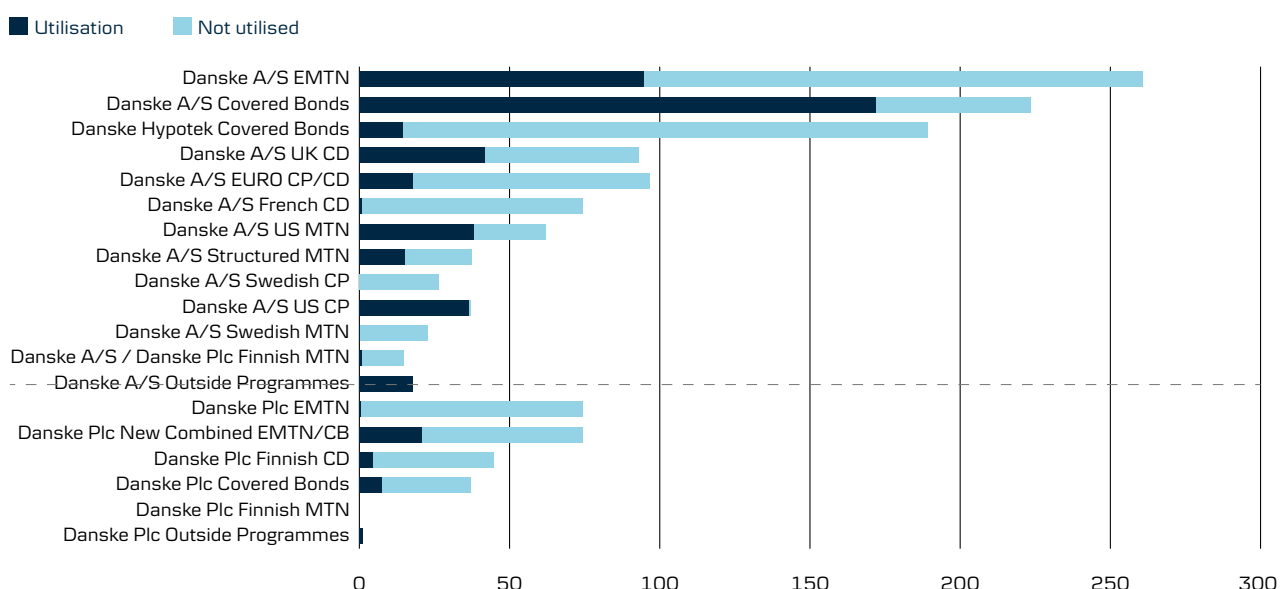
In 2017, the Group established a new Swedish covered-bond-issuing subsidiary, Danske Hypotek AB, similar to the subsidiaries operated by other banks in Sweden. The new entity issued its first covered bonds under Swedish law in 2017, and it will gear up its activities in 2018.

The initiatives in SEK and NOK will reduce the Group's dependency on cross-currency swaps.

The increase in local funding, in combination with our enhanced focus on asset and liability management, will ensure that the Group can stay within the risk appetite while executing its growth strategy for Norway and Sweden.

Utilisation of available long- and short-term programmes, end of 2017

(DKK billions)



7.1.4 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 value of the liquidity reserve in the LCR framework. The current low-interest-rate environment caused by the quantitative easing programmes launched by central banks around the world has also had an effect on the composition of the Group's liquidity reserve. The low interest rates mean that a greater proportion is held in cash rather than government bonds. This makes it easier for the Group to mobilise the liquidity reserve because a smaller portion needs to be monetised.

Group liquidity reserve – LCR definition			
At 31 December (DKK billions after haircut)		2017	2016
Total high-quality liquid assets		565	509
Level 1a assets	Central bank reserves	278	167
	Central government debt	66	62
	Other level 1a assets	40	27
Level 1b assets	Extremely high-quality covered bonds	171	234
Level 2a assets	High-quality covered bonds	9	15
	Other level 2a assets	1	3
Level 2b assets		1	-

A large number of the bonds held in the reserve are central-bank-eligible instruments, and they are vital for intraday liquidity needs, for overnight liquidity facilities and for defining liquidity in financial markets during stressed periods.

The internal stress tests use different parameters than the LCR to determine the liquidity value of bonds, so the value of the liquidity reserve differs depending on the risk indicator chosen.

7.1.5 Asset encumbrance

Regulators, rating agencies, investors and others regularly monitor asset encumbrance (the percentage of assets pledged or mortgaged as collateral) and the resulting structural subordination of senior unsecured creditors and depositors.

The Group's asset encumbrance has three main sources:

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

The Group's asset encumbrance reporting follows the method described in "Implementing Technical Standards", issued by the European Banking Authority. The following 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 2017 (DKK billions)	Danske Bank A/S	Danske Bank Group ¹
Assets on balance sheet		
Derivatives	52	52
Deposits (repos)	230	236
Covered bonds	160	1,024
- Portion from Realkredit Danmark	-	860
Other	13	16
Total encumbrance	455	1,328
Total assets	2,294	3,193
Collateral received		
Derivatives	21	19
Deposits (reverse repos)	249	230
Total encumbrance	270	248
Total assets	502	472
Asset encumbrance ratio (%)	26	43

¹ Includes Realkredit Danmark.

7.2 Liquidity risk framework

7.2.1 Governance and organisation

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

In 2016, the liquidity risk organisation was expanded with the establishment of the Asset & Liability Committee (ALCO). The purpose of the ALCO is to manage the Group's balance sheet and funding mix in accordance with the Liquidity Risk Appetite approved by the Board of Directors.

As a subcommittee of the All Risk Committee, the ALCO has a strategic focus on asset and liability management components, such as

- net interest income
- funds transfer pricing
- interest and currency risk on the balance sheet

The Group Liquidity Risk Committee (GLRC) is an ALCO subcommittee. The GLRC oversees the management of liquidity risk and funding at the group level. Both the ALCO and the GLRC consist of representatives from the Executive Board, Group Treasury, FICC and Group Risk Management.

The GLRC is empowered to challenge the way the Group manages its liquidity risk profile. Group Treasury is responsible for the Group's liquidity and funding. This includes executing the funding plan and managing the liquidity reserve. Short-term liquidity is managed by Danske Markets under the supervision of Group Treasury.

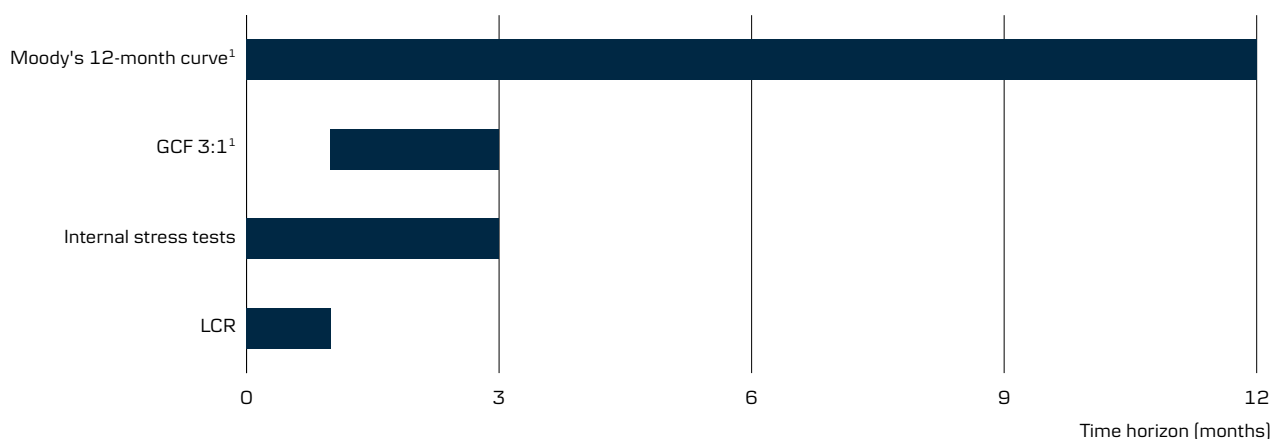
Liquidity management is centralised and conducted on a consolidated basis to ensure regulatory compliance at the group level and compliance with internal requirements. Regulatory compliance and the maintenance of adequate liquidity reserves at subsidiaries are managed locally.

7.2.2 Models and methodologies

Stress testing

Stress tests are a core element of the models and methodologies used by the Group to manage liquidity risk. Four of the seven risk indicators making up the risk profile are based on stressed liquidity scenarios.

Liquidity risk stress tests time horizons



¹ The requirement for bank's liquidity management as set out in 'Bank Financial Strength Ratings: Global Methodology' from Moody's Investors Service. The requirement states that the 12-month liquidity curve must generally be positive.

² Shows the maturity profile for market funding. In particular, it measures the remaining amount of market funding at any time, when maturing funding is not replaced. 3:1 refers to its value at 3 months relative to 1 month. This ratio is required by the FSA to be above 75%.

The Group conducts stress tests to measure its immediate liquidity risk in order to have sufficient time to respond to possible crises. The stress tests are conducted for various scenarios, including three standard scenarios: a scenario specific to the Group, a general market crisis and a combination of the two. A "stress-to-failure" test is also conducted.

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

7.2.3 Liquidity risk management

The Group is in the process of implementing a new asset and liability management system. Combined with other initiatives, this has already resulted in enhanced liquidity risk management. The improvements include the overall and currency-specific LCR calculations as well as the monitoring of intraday liquidity, described in more detail below.

Liquidity by currency

Regulation (EU) No. 575/2013 of the European Parliament and of the Council of the European Union of 26 June 2013 stipulates that the overall LCR must be above 100% for each legal entity covered. It is less explicit about the currency composition of the liquidity buffer, merely requiring that the denomination of the liquid assets in the buffer is "consistent" with the distribution by currency of net liquidity outflows.

For SIFIs in Denmark, the requirements are more specific in that currency-specific LCR requirements for EUR and USD were introduced in 2016 and tightened in 2017 (see section 7.1.1). In addition to complying with the quantitative requirements for USD and EUR, Danske Bank focuses on maintaining an overall currency distribution consistent with outflows, as required by Regulation (EU) No. 575/2013. In part, such considerations lay behind the Group's decision to issue more debt in local currencies such as NOK and SEK and to set up a mortgage subsidiary in Sweden. The increased focus on currency-specific liquidity is also incorporated in the Group's funding plan and ongoing balance sheet optimisation.

Intraday liquidity is monitored and reported by currency in accordance with the guidelines issued by the Basel Committee. Overall, these improvements have enhanced the Group's liquidity risk management capabilities and enabled it to reduce cross-currency liquidity risk.

Net stable funding ratio

With the successful implementation of the currency-specific LCR, the next milestone in liquidity risk management will be the final implementation of the net stable funding ratio (NSFR). While the LCR focuses on short-term liquidity risk, the NSFR addresses the balance between funding needs for assets and the stability of the funding sources. Adjustments to the balance sheet to comply with the NSFR requirement therefore require a longer implementation period. An internal NSFR steering committee is in charge of the implementation of the NSFR, including analysis and reporting of the expected effects on the balance sheet.

The Basel Committee on Banking Supervision (BCBS), which adopted the NSFR as a standard for internationally active

banks in 2014, has scheduled it for implementation by 1 January 2018. Implementation in the EU is under way. A package of proposals from the European Commission, including the NSFR, was published in November 2016. It is still under discussion in the Council and the European Parliament, and consequently, the NSFR is not yet legally binding on banks in the European Union.

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 at the business units. Business activity at the banking units is encouraged by assigning internal funding prices based on the matched-maturity principle. The FTP applies charges to loans and credits to deposits and other funding on the basis of the characteristics of the individual balance sheet items, e.g. product type, customer type, maturity, currency, amortisation profile, modelled behaviour and interest rate risk. Some charges and credits are based on behavioural assumptions, 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. FTP is fundamental in evaluating the profitability of the Group's balance sheet composition, and it has therefore been included in the profitability analysis at the customer level. It links liquidity risk assessment, product pricing and balance sheet valuation.

Mortgage loans provided through Realkredit Danmark are excluded from FTP because they are match-funded in accordance with Danish mortgage legislation and involve virtually no liquidity risk.

The Group's trading activities at Danske Markets are also subject to FTP. Trading activities require funding and increase demands on the liquidity buffer, for example because collateral is needed.

7.2.4 Monitoring and reporting

Monitoring and reporting are conducted separately according to the principle of three lines of defence. Group Treasury, as the first line of defence, reports the risk measures, whereas Group Risk Management, as the second line of defence, monitors compliance with the internal limits. Furthermore, Group Risk Management reviews and validates the models and assumptions used by the first line of defence for reporting risk measures.

Liquidity Risk Management monitors compliance with the risk limits set in the Liquidity Risk Appetite. The LCRs and operational liquidity are monitored and reported on a daily basis, while the other risk indicators are reported on a monthly basis to the GLRC and the All Risk Committee. Risk indicators are reported to the Board of Directors on a quarterly basis.

Distance to default			
Indicator	Requirement	Frequency	Monitoring unit
KRI 1	The most severe internal stress tests must be positive three months ahead	Monthly	Group Treasury
KRI 2	The Group LCR must be 105% or higher, and each legal entity must comply with local LCR 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 3	To ensure a suitable funding profile, at least 75% of the funding longer than one month must be funding over at least three months	Monthly	Group Treasury
SRI 4	Long-term funding maturing within 12 months may not exceed DKK 90 billion	Monthly	Group Risk Management
SRI 5	Twelve-month liquidity must be positive one year ahead	Monthly	Group Treasury

Liquidity Risk Management reports all limit breaches to the relevant parties and committees. Board limit breaches are reported to the Board of Directors and other relevant stakeholders (such as the GLRC, the All Risk Committee and the Executive Board). All Risk Committee limit breaches are reported to the Executive Board, the All Risk Committee and other relevant stakeholders, including the business units. Lower-level limit breaches are reported to the head of Liquidity 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.

Operational risk

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Operational risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events, including legal risks. Operational risk events are defined as operational risks which have occurred and may have caused a monetary loss (a loss event) or a reputational impact (a reputational event) or may have caused a loss that was rapidly recovered (a near-miss event). Losses are quantified as gross losses and net losses (gross loss less the amount recovered).

Operational risks arise from all the Group's activities. We take on additional operational risks each time we accept business from new customers, originate new transactions, introduce new products, open up new markets and hire new staff. New operational risk exposures can also arise from a variety of changes that we make to processes, people and systems and from changes in our external environment.

The Group's approach to operational risk management serves to continually improve its ability to anticipate all material risks and to reduce, with a high degree of confidence, failures in processes. This helps improve the customer experience and reinforces the need for clear ownership and accountability for all risks across Group processes.

While priority is given to risks in the order of their materiality, the Group must seek to improve its processes to improve cost efficiency and to maintain an optimal balance between risks related to customer experience and the costs of control.

8.1 Operational risk profile

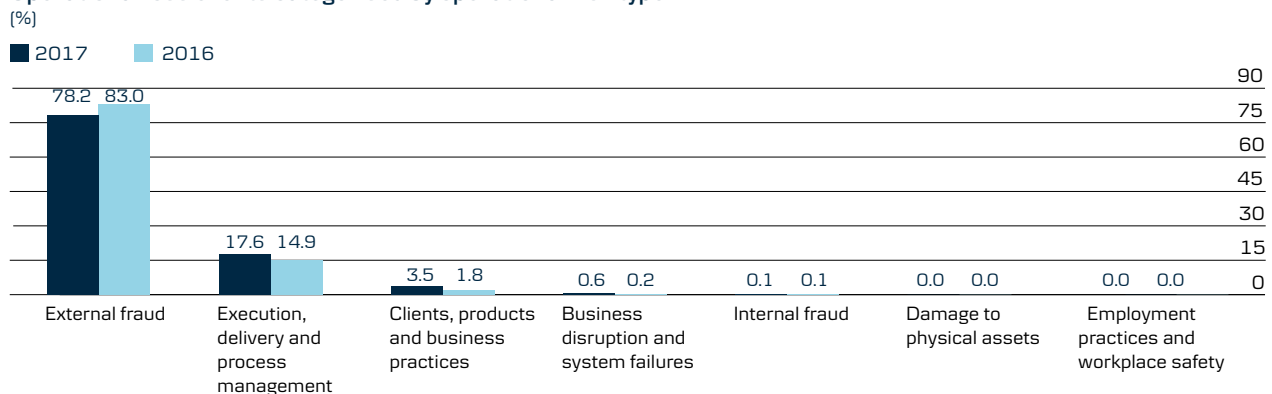
The Group's operational risk profile is its overall exposure to operational risk at a given point in time, covering all applicable operational risk types. The operational risk profile comprises two core components: the loss profile of operational risk events and the profile of operational risk exposures.

8.1.1 Operational risk events and losses

When events occur, actions are taken to ensure that each event is analysed for root causes, that appropriate remedial action is taken and that risk mitigation is implemented. The Group's operational loss profile is reviewed to ensure that loss trends are prioritised for mitigation action by the relevant areas in order to prevent a repetition of events. Significant losses are also reported to the Executive Board and the Board of Directors.

The following charts provide an overview of the Group's operational loss events and loss amounts in 2017 and 2016 broken down by operational risk type.

Operational loss events categorised by operational risk type



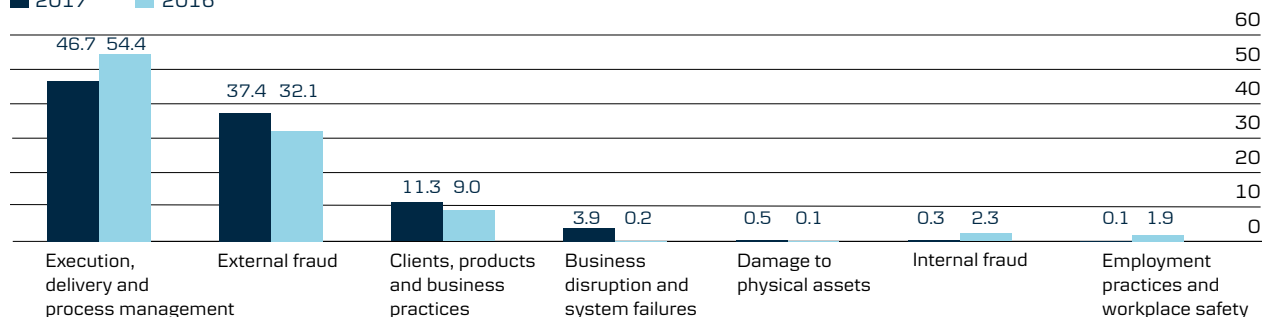
Measured by the number of loss events, two risk types accounted for the majority of loss events in 2017: External Fraud accounted for 78% and Execution, Delivery and Process Management for 18%. This was similar to 2016, when External Fraud accounted for 83% and Execution, Delivery and Process Management for 15%.

The decrease in the External Fraud loss events was the result of a number of initiatives implemented by the Group in 2017. The majority of External Fraud events were card frauds, payment frauds and falsified documents. These events are primarily high-frequency, low-value events with a low monetary impact.

Operational loss amounts categorised by operational risk type

[%]

■ 2017 ■ 2016



Note: The charts show the distribution broken down into Basel operational risk type categories, as reported for COREP reporting. Internal risk type categories are listed in section 8.5 Risk classification.

Measured by loss amount, External Fraud and Execution, Delivery and Process Management also accounted for the majority of loss amounts (37% and 47%, respectively). Loss amounts for Execution, Delivery and Process Management improved significantly in 2017 due to a decrease in the total number of events and fewer tail events (down from 55% in 2016 to 47% in 2017).

8.1.2 Operational risk exposures

The Group monitors its operational risk exposures for both inherent risk and residual risk. Operational risks are rated according to a standard set of risk assessment matrices measuring financial risk, regulatory risk, customer risk and reputational risk. These matrices are calibrated to measure the severity of impact and the likelihood of occurrence.

8.2 Operational risk framework

The Group's approach to operational risk management is in accordance with the Group's operational risk framework. It is consistent with the three-line-of-defence principle and enhances the Group's risk culture.

In 2017, the Group enhanced its operational risk framework by further defining the segregated roles and responsibilities for the first and second lines of defence, simplifying the overall framework and broadening the approach. The enhanced framework changes were approved by the Board of Directors. The Group Operational Risk function is the Group's second line of defence for operational risk. In particular, Group Operational Risk's role is to formulate the group-wide policy and to challenge and review top risks that threaten the operational risk appetite and to monitor the group-level operational risk profile against tolerance thresholds.

The Board of Directors approves the principles and standards for the approach to operational risk management in the Operational Risk Policy, which is embedded in the operational risk framework. The Executive Board has set up the Operational Risk Committee (ORCO), which is a sub-committee of the All Risk Committee, and it is responsible for overseeing the implementation and maintenance of the group-wide framework for managing operational risk.

The ORCO may make decisions within the authority of the All Risk Committee as set out in the All Risk Charter. As required and on behalf of the All Risk Committee, the ORCO reports and makes recommendations to the All Risk Committee, the Executive Board and the Board of Directors.

8.3 Operational risk management

The approach to operational risk management is a granular, forward-looking approach designed to identify possible breakdowns in the Group's activities and to take proactive steps to ensure that risks remain within defined levels. This includes all current activities and changes to activities, including changes to processes, new large complex Group projects and new products.

The Group identifies, assesses and manages operational risks on a continual basis. The first line of defence conducts a process of self-assessment to evaluate its activities on the basis of the following Group operational risk assessment standards:

Inherent risk: This measure of risk is defined as the realistic worst-case outcome of a potential failure in a process, system or activity. Each risk identified must be assigned an inherent risk rating. Inherent risk ratings reflect the measurement of the gross risk exposure, including the effect of key control failures. Inherent risks are categorised by risk type and rated to prioritise the risks, including top operational risks (top risks).

The first-line-of-defence risk owners prioritise and implement the processes of risk identification and assessment. For the purpose of risk assessment completion, the risk owners must engage the relevant control functions and Group Operational Risk to review and challenge the completeness and accuracy of the top risks identified.

If an inherent risk is rated as a top risk, the following Group standards apply:

- **Causes of inherent risk:** These are defined as the identified reasons why a failure may occur and indicate the level and type of mitigation that may be required.
- **Risk control assessment:** Risk controls are defined as key controls or process quality measures, including error-proofing or other action designed to mitigate the causes of inherent risk. Risk controls must be assessed for
 - the design set up to mitigate the cause(s)
 - the operational effectiveness of risk controls for risk mitigation purposes
- **Residual risk:** This measure of risk is defined as inherent risk less the effect of risk mitigation. Assessing the design and operational effectiveness of risk controls in mitigating the causes of inherent risk determines the level of residual risk. The results are used for developing residual risk ratings with justification of how inherent risks are mitigated and how much residual risk there is. Therefore, residual risk is the measure of the effectiveness of controlling inherent risk.
- **Risk treatment:** This is defined as the actions required to mitigate top risks so that they remain within the risk appetite. This may include decisions to take actions to reduce risk, restrict activities or accept taking risk in accordance with operational risk governance rules.

For all risk assessments, the Group must use the Group standard operational risk taxonomy for risk categorisation and standard operational risk assessment matrices for inherent and residual risk rating. The Group may also consider scenario analyses, where relevant, to identify, assess and manage exposure to low-frequency, high-severity risks for the purpose of performing stress tests to ensure that top risks remain within the risk appetite and can be used as input to assess the adequacy of operational risk capital.

8.4 Operational risk appetite

The Group aims to control operational risks within tolerances that are set to ensure that this does not cause material damage to the Group in its pursuit of its business strategy.

Top risks and events are monitored to check that they are within risk tolerances, and reports are submitted through the risk governance process to the Executive Board and the Board of Directors.

The Operational Risk Appetite has been aligned with the enterprise risk management framework approved by the All Risk Committee. It sets out the Group's risk appetite approach, which is approved by the Board of Directors.

8.5 Operational risk classification

Operational risks are identified and categorised by risk type. The Group uses operational risk types principally as a method to ensure comprehensive and consistent identification of operational risks wherever they may arise.

The following table lists the Group's operational risk types.

Operational risk types: categories and definition	
Operational risk type	Definition
Internal fraud	Risk that a person or persons, involving at least one internal party, act dishonestly or deceitfully for advantage or gain
External fraud	Risk that a person or persons, not involving any internal party, act dishonestly or deceitfully for advantage or gain

Employment practices and workplace safety	Risk arising from acts inconsistent with employment, health or safety laws or agreements
Clients, products and business practices	Risk of breach of financial services rules and regulations relating to client treatment, market behaviour, business practices and financial crime
Execution, delivery and process management	Risk of failure of operational processes
Damage to physical assets	Risk of damage to physical assets
Systems and data failure	Risk of deficiency or failure of systems or compromise of data integrity
Information technology security	Risk of breach of information technology security arising from the malicious act or unauthorised use of computer(s) or computer systems with an adverse effect on information or systems
Model risk	Risk of loss due to a significant discrepancy between the output of internal models and actual experience

8.6 Cybersecurity risk

Operational cybersecurity risks are categorised as information technology security risks that have consequences for the confidentiality, availability or integrity of information or information systems.

Cybersecurity management aims at handling and mitigating cybersecurity risks and establishing a robust cybersecurity platform that is a key component of the Group's IT strategy.

Group IT Security participates in and oversees the implementation of robust cybersecurity measures across the organisation. The unit is headed by the chief information security officer (CISO), who reports functionally to the CTO with a secondary reporting line to the CRO.

The efforts over the past three years to reach the objectives of the Group's cybersecurity strategy have proved its value on numerous occasions by combating cyberattacks and safeguarding against cyberthreats and cybercrime. The Group has significantly expanded its capabilities within the cybersecurity domain.

The Group addresses cybersecurity through five disciplines by leveraging the National Institute of Standard and Technology (NIST) cybersecurity framework:

- Identification: Have knowledge of assets and risks
- Protection: Secure assets and address risks diligently
- Detection: Monitor assets and enable visibility
- Response: Have the agility to react quickly to identify and mitigate security threats
- Recovery: Have resilience to recover efficiently and effectively from a cybersecurity breach

Automation and new digital offerings can increase customers' exposure to cybercrime. As banks have hardened their own defences, cybercriminals increasingly target customers that generally do not have the expertise or complete diligence of a bank with a large number of IT employees.

Given these trends, the Group is committed to educating and enabling customers to better protect themselves. In 2017, the Group increased its efforts in communication campaigns to inform customers of typical methods used by cybercriminals to trick customers. The Group also offers security kits to business customers in the UK and Norway to increase their level of protection and ensure that their devices are not compromised. This initiative was launched under the "Keep it Safe" label, and the Group will continue to expand it throughout 2018 in the belief that raising customer awareness will also reduce risk.

The Group also promotes cybersecurity awareness internally. In 2017, the Group focused on expanding and institutionalising the initiatives from 2016, holding security awareness courses throughout the Group and for specific employee groups, such as administrators, in order to ensure sufficient knowledge on administrator access. For example, secure programming courses for developers to reduce the risk of programming errors are launched as mandatory courses, and the Group also emphasises and measures the verification of skill sets (such as certifications).

The Security Operations Centre (SOC) and the Security Incident Response Team (SIRT) – the Group's two new units from 2016 with a dedicated focus on cybersecurity monitoring and operational management – have proved their

worth in reducing the response time in identifying and reducing the resolution of security incidents. The SOC and the SIRT work according to the best-practice playbooks under the NIST framework on security incidents, and their capabilities were highly accredited by a leading external assessor in 2017.

In 2017, Group IT also improved its layered defence by upgrading several of its security systems, including vulnerability management and access management systems. Furthermore, we led the establishment of the Nordic Financial CERT (NFCERT) to enhance the community's collaboration and capabilities to detect and respond to cyberattacks. We now automatically receive threat intelligence from the NFCERT platform and contribute to faster detection and prevention.

IT risk management

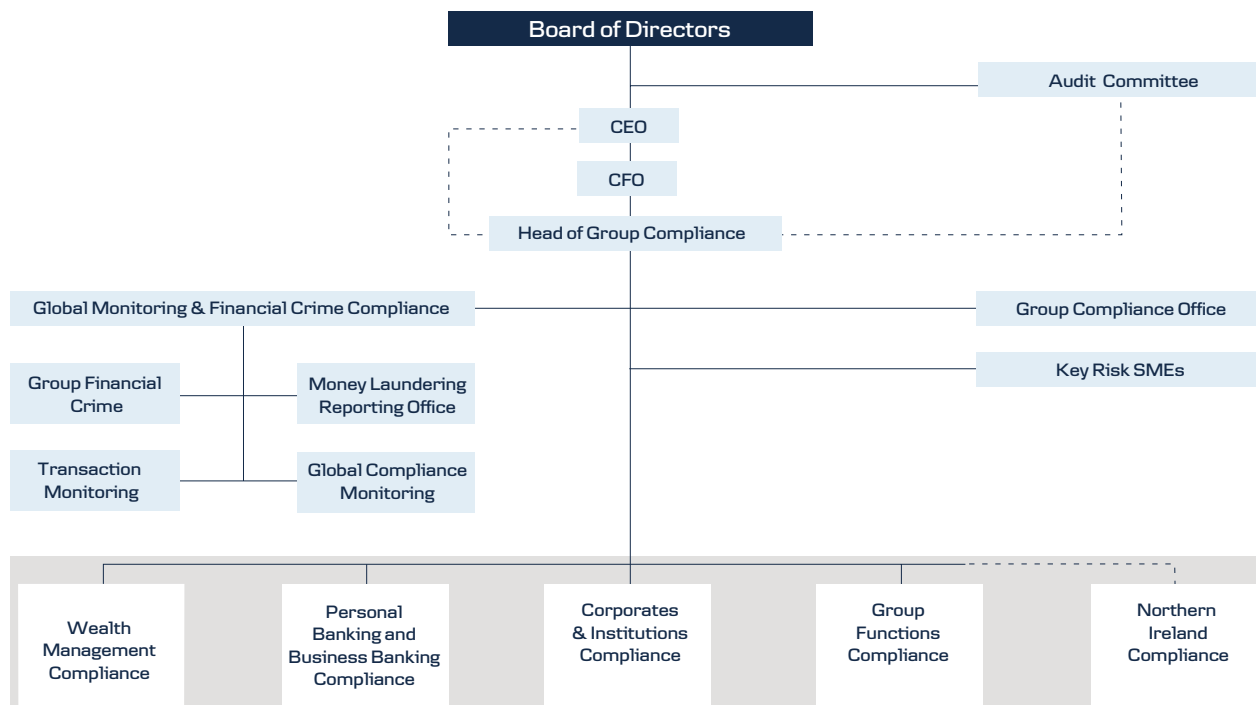
In addition to addressing cyberattacks and cyberthreats, Group IT, in 2017, further enhanced the mature risk framework that has been in place for many years. In particular, the Group is leveraging best practices for IT risk management through two newly deployed systems (IT GRC and ISMS)¹ based on the NIST framework for information security management (ISO 27001 for information security management and ISO 27005 for IT risk management).

8.7 Compliance risk

Compliance risk is defined as the risk of legal or regulatory sanctions, material financial loss or loss of reputation that the Group may suffer as a result of its failure to comply with laws, including the spirit of the law, regulations, generally accepted practices and standards, and financial industry codes of conduct applicable to the Group's activities.

Group Compliance is an independent function in the CFO area, and it is accountable for identifying, assessing, monitoring and reporting on whether the Group complies with applicable laws, regulations and internal standards. Furthermore, Group Compliance is accountable for providing advice to first-line-of-defence units in relation to the mitigation of compliance risks.

Danske Bank Group's second-line compliance organisation



Compliance is a shared responsibility for all Group employees, and it is an integral part of day-to-day business operations.

Group Compliance contributes to a strong compliance culture and a high degree of integrity within the Group and ensures that customers are treated fairly. Group Compliance thus supports the Group's vision of becoming the most trusted financial partner.

¹ IT GRC means IT Governance Risk and Compliance system. ISMS stands for Information Security Management System..

Group Compliance is led by the head of Group Compliance, who reports to the Group CFO with a dotted reporting line to the Group CEO and the chairman of the Audit Committee. The Group Compliance organisation reflects the Group's operational model and entails a segregation of roles and responsibilities into units of compliance officers for Wealth Management, Personal Banking, Business Banking and Corporates & Institutions. Additionally, Group Compliance has teams of compliance officers for Group Functions and Financial Crime and for the compliance framework, awareness and training. Compliance activities also form part of the day-to-day first-line business activities.

In 2017, the Group strengthened the compliance organisation by establishing a fintech unit for Personal Banking and Business Banking Compliance. The fintech unit ensures agile and close compliance coverage of the Group's large-scale digital and technological initiatives and projects. The Group also set up a new compliance unit, International Banking, to address challenges in international market areas. The unit is anchored in the Corporates & Institutions Compliance organisation.

Furthermore, a new unit, Compliance Incident Management, will be responsible for handling the control and coordination of material incidents across the compliance discipline from 1 January 2018.

The current organisation enables Group Compliance to foster the proper awareness and understanding of compliance among managers and employees across the Group and to meet the standards of the European banking industry.

Business units and operational units own the compliance risks associated with their processes. Group Compliance is accountable for the implementation of an effective compliance framework, and its key activities are as follows:

- identifying and assessing compliance risks
- providing advice on risk mitigation to compliance risk owners in the first line of defence
- monitoring the adequacy of risk mitigation and controls in the first line of defence and reporting on the compliance risk status for the Group

Group Compliance has a group-wide and risk-based approach to risk assessment, and this contributes to the enhanced management overview.

To ensure a high degree of expertise at Group Compliance and to meet the increasing requirements from regulators, the Group has run a compliance certification programme over the past few years in cooperation with the University of Manchester and under the auspices of the International Compliance Association.

The Group makes substantial efforts to comply with regulation and prevent criminals from using the Group for money laundering or other financial crime activities. In 2017, the Group focused on enhancing customer onboarding and ongoing due diligence processes, increasing transaction monitoring and improving the training of employees.

On the basis of suspicions that Danske Bank Estonia may have been used for money laundering, the Group launched several investigations into the non-resident portfolio at the Estonian branch from 2007 to 2015. The conclusion of a root cause analysis was that several deficiencies in the period from 2007 to 2015 led to the Estonian branch's not being sufficiently effective in preventing the potential use of the branch for money laundering. As a result, the Group chose to expand its investigation to cover all customers and transactions in the non-resident portfolio at the Estonian branch in that period. The purpose is to report any previously unreported suspicious activity to the authorities and to get a full understanding of historical activity in the portfolio. Moreover, it is essential for us to get a full insight into the matter and to use this to prevent something similar from happening in the future. The investigations are expected to be completed during the course of 2018.

Moreover, the Danish FSA conducted an on-site inspection in October 2017 with the scope of all financial crime areas (primarily the Danish activities and controls made by all three lines of defence). At the end of 2017, the Group still had not received any reaction from the Danish FSA.

In October 2017, Danske Bank A/S was placed under formal investigation by the French authorities in relation to suspicions of money laundering concerning transactions carried out by customers of Danske Bank Estonia in the period 2008-2011. In January 2018, the French court Tribunal de Grande Instance de Paris changed the status of Danske Bank in the investigation to that of an assisted witness. This means that Danske Bank is no longer placed under formal investigation, but still forms part of the investigation as an assisted witness.

In late December 2017, Danske Bank A/S was charged by the Danish Public Prosecutor for Serious Economic and International Crime (SØIK) with having violated the stipulations of Danish anti-money laundering legislation on the monitoring of transactions to and from correspondent banks. In this connection, Danske Bank accepted a fine of DKK 12.5

million. The charge and the fine were the result of the inspection made by the Danish FSA at Danske Bank in 2015.

The Markets in Financial Instruments Directive II (MiFID II) takes effect in January 2018 and introduces a number of requirements applicable to the entire financial sector in Europe. The aim is to create a single European market for financial instruments. The Group has established a group-wide project for this purpose, and it uses a risk-based approach and makes considerable efforts to ensure compliance with the requirements. This will strengthen the level of customer investment protection.

The EU regulation on the protection of individuals as regards the processing of personal data (the EU Data Protection Regulation) takes effect in May 2018. It will impose stricter requirements on the Group to document data flows and personal data processing activities. This will improve security for the Group's customers. A groupwide project to implement the EU regulation is ongoing, and it will include the establishment of a data protection officer role at Group Compliance.

Insurance risk

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81	9.2.2	Risk related to Danish with-profits products
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The Group's insurance risk is defined as all types of risk for the Danica Pension group, including market risk and life insurance risk. The Group runs its life insurance and pension operations with the aim of providing best-in-class services to our clients, while at the same time maintaining a predictable risk profile. In the current low-interest-rate environment, this calls for active management of all risk types.

9.1 Danica Pension's risks

Insurance risk consists of the risks originating from Danske Bank Group's ownership of Danica Pension. Operating under the Solvency II rules, Danica Pension provides pensions as well as life and health insurance products in Denmark, Norway and Sweden.

Two types of life insurance products in Denmark

With-profits policies

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

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

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

Unit-linked policies

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

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

In our main unit-linked product, *Danica Balance*, customers can choose to have their benefits guaranteed.

As part of its product offerings, Danica Pension provides guaranteed life annuities; insurance against death, disability and accident; and cover against adverse investment returns. This exposes Danica Pension to underwriting risks such as longevity and disability risk as well as to market risk. In addition, Danica Pension is exposed to operational and business risk like the rest of Danske Bank Group.

Underwriting risk is the risk of losses from the insurance business. At Danica Pension, these risks are almost exclusively life insurance risks, and they arise naturally out of the business model. Most underwriting risks materialise over long time horizons during which the gradual changes in biometric factors deviate from those assumed in contract pricing. 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 most prominent type of underwriting risk for Danica Pension. Most pension products come with life and disability insurance, which entails exposure to mortality and disability risk. Health and accident insurance contracts are typically shorter, so slowly materialising risks can be handled by means of repricing.

Market risk is the risk of losses because of changes in prices of traded assets, and it arises from various sources within the business. Shareholders' equity and funds ensuring insurance guarantees in which the shareholders bear all the risk are invested in relatively low-risk instruments that nevertheless are subject to some market risk. In with-profits policies, the customers bear the market risk, but in case of large losses where the customer buffers are depleted, the shareholders will have to step in with funds to ensure the benefits guaranteed to the customers. If the customers bear all the investment risk, losses may reduce assets under management and thus deplete future asset management fees in the long term.

Main risk factors affecting Danica Pension

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

9.2 Insurance risk profile

9.2.1 Developments

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.

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 major differences in the interest rate sensitivities for accounting and solvency purposes. The main difficulty lies in a slower build-up of assets under management and customer buffers since this may adversely affect income in the longer run.

Danica Pension's balance sheet broken down by business segment

At 31 December 2017 (DKK billions)	With-profits contracts				Unit-linked	Health and accident insurance	Other
	New customers	Low guarantee	Medium guarantee	High guarantee			
Profit margin	0.3	0.1	0.1	0.5	5.4	-	-
Collective bonus potential	1.7	0.8	0.9	2.2	-	-	0.5
Individual bonus potential	0.2	-	-	-	-	-	-
Other provisions	37.7	16.0	13.3	58.6	205.0	9.4	11.0
Provisions for insurance and investment contracts	39.9	16.9	14.3	61.3	210.4	9.4	11.6

In the past couple of years, Danica Pension has been working on implementing a new investment strategy to consistently generate returns for customers at the top end of the market. As part of its investment strategy, Danica Pension has increased its direct investment activities, including more alternative investments, and enhanced its focus on the future asset allocation. Also, Danica Pension has strengthened its investment team with several new investment experts.

Towards the end of 2017, Danica Pension acquired SEB Pension, the Danish life insurance arm of SEB Group. The acquisition is subject to approval by the relevant Danish authorities and is expected to take effect during 2018. This will allow Danica Pension to harvest significant synergies and leverage SEB Pension's strong digital capabilities and attractive customer base. In terms of product offerings and risk management, SEB Pension is very similar to Danica Pension's existing Danish operations, but enjoys strong bonus potentials in the with-profits portfolio. As such, the acquired business adds a stable and capital-efficient cash flow to Danica Pension.

How Danica Pension's results affect the Group's income statement

Danske Bank owns Danica Pension, and Danske Bank's financial results are 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.

The risk allowance is the annual return that Danica Pension may book from its with-profits business. The policyholders are grouped according to the technical interest rate, and for each group Danica Pension may book a percentage of assets under management. These percentages range from 0.6% to 0.9%. The risk allowance can be booked only as long as there is a collective bonus potential available.

9.2.2 Risk related to Danish with-profits products

The main source of risk at Danica Pension is the Danish with-profits pension product. This product offers policyholders an annuity of a guaranteed minimum amount in nominal terms, but lets customers participate in a fund whose returns may lead to higher benefits than those guaranteed. The present value of the guaranteed benefits depends on the level of interest rates used for discounting. If the fund's value falls below this level, the shareholders' equity will have to cover the shortfall. Managing this product thus involves a combination of managing the risks on behalf of the policyholders and managing the risk that the shareholders will have to cover losses.

Danica Pension uses interest rate hedging to maintain customer buffers and considers any duration mismatch between assets and liabilities to be an active investment decision. The interest rate used for discounting the technical provisions is the Solvency II discount curve. It is based primarily on the EUR swap rate and also takes into account the yields on Danish mortgage bonds and government bonds. It is not possible for Danica Pension to invest in instruments that

completely hedge the liabilities using this discount curve, and therefore some basis risk remains. The level of the long end of the discount curve, for which no reliable market data are available, is determined by the European Insurance and Occupational Pensions Authority (the EIOPA). From the beginning of 2018, this level will be gradually reduced until a revised methodology is phased in. Guaranteed cash flows at Danica Pension are not long enough for their values to be strongly affected by the long end of the discount curve, and the effects on customer buffers and Danica Pension's shareholders are thus rather limited.

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 well-rated counterparties.

The guaranteed life annuities included in the with-profits product give rise to longevity risk. Danica Pension generally does not hedge this risk since it is a natural element of the business model but rather focuses on prudent pricing of the risk. Danica Pension manages longevity risk by means of an internal model approved by the Danish Financial Supervisory Authority (the FSA) for use in solvency reporting. This model is based on the FSA's life expectancy benchmark and Danica Pension's own longevity observations. The FSA has decided to change the methodology for its life expectancy benchmark with the intention of making it more responsive to recent increases in improvement rates. When fully phased in, this change will reduce buffers in the with-profits business, but will not materially alter Danica Pension's risk profile.

9.2.3 Risk related to other products

Approximately 80% of unit-linked policies have no financial guarantees. For these policies, the policyholders bear all the investment risk. For the rest of the unit-linked policies, which consist mainly of Danica Balance policies, the policyholders have investment guarantees. The guarantees do not apply until the time of retirement, and they are paid for by an annual fee.

Danica Pension manages the risk on these guarantees by adjusting the allocation of equities and alternative investments for each individual policy. The adjustments ensure that sufficient funds are available to cover guarantees even after a substantial decline in equities and alternative investments.

Danica Pension's activities in Norway and Sweden account for 1.9% of its total provisions. In these markets, Danica Pension offers mainly unit-linked products without guarantees, and this gives rise to relatively little risk.

9.2.4 Sensitivities

Danica Pension continues to monitor its sensitivity to various shocks from market and underwriting risk, and a number of these shocks are listed below. Losses borne by the shareholders in these scenarios are generally limited since most of the losses are absorbed by buffers or borne by the policyholders themselves.

Sensitivity analysis for Danica Pension

At 31 December 2017 (DKK billions)	Effect on shareholders' equity
Interest rate increase of 0.7-1.0 pct. point	-0.2
Interest rate decrease of 0.7-1.0 pct. point	0.0
Decline in equity prices of 12%	-0.1
Decline in property prices of 8%	-0.3
Foreign exchange risk (VaR 99.0%)	0.0
Loss on counterparties of 8%	-0.1

9.3 Capital and solvency

The prudential supervision of Danica Pension is governed by the Solvency II framework, which provides for EU-harmonised solvency rules in the insurance sector. Solvency II imposes risk-based capital requirements and prescribes an economic valuation of assets and liabilities that may differ from statutory accounting. Danica Pension's capital includes a tier 2 subordinated loan issued in 2015.

Danica Pension's solvency ratio

At 31 December 2017 (DKK billions)

Shareholders' equity	17.1
Differences in valuation between accounts and Solvency II	4.5
Subordinated liabilities	3.8
Foreseeable dividends	-1.6
Eligible own funds for covering the solvency capital requirement	23.8
Solvency capital requirement	10.5
Solvency ratio (%)	227

Danica Pension's solvency ratio was 227% at the end of 2017, down from 246% at the end of 2016. The change mainly reflects slightly higher market risk in relation to with-profits products and unit-linked products with guarantees. Danica Pension performs both daily solvency monitoring and a monthly best-effort solvency calculation, and past calculations show that the solvency ratio was stable over the year.

9.4 Insurance risk framework

Danica Pension continues to strengthen its insurance risk framework and has steadily improved the enterprise-level coordination of various sources and types of risk. Solvency II prescribes a minimum framework for risk management, and Danica Pension has extended and supplemented this framework according to internal needs.

The insurance risk framework is governed by Danica Pension's Board of Directors. The Board of Directors decides on the general strategic goals and on the risk management framework at Danica Pension. It identifies the material risks to which Danica Pension is exposed and sets limits on measures of aggregate risk. 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 overseen by its All Risk Committee, which is responsible for monitoring the complete risk profile across risk types and undertakings. Reporting to the Board of Directors and the Executive Board, the All Risk Committee is chaired by Danica Pension's chief risk officer. Monitoring and reporting on individual risks are performed by specialised functions but coordinated by the All Risk Committee.

The All Risk Committee is supplemented by the Asset and Liability Management (ALM) Committee, which manages the risks arising from the differences in exposures between assets and liabilities and ensures that lines from the Board of Directors are not breached. The ALM Committee is chaired by Danica Pension's CFO, and it has representatives from three units [risk, actuarial and investments functions].

Other risks

85	10.1	Pension risk profile
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10.

Pension risk arises from 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 risk management strategy is for the plans to maintain a high concentration of fixed income assets that match liabilities to a high degree.

10.1 Pension risk profile

10.1.1 Pension plans

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

Overview of the Group's pension plans

At 31 December 2017	Northern Ireland	Ireland	Denmark	Sweden	
Pension plan for new employees	Defined contribution	Cash balance	Defined contribution	Defined contribution	
Status of defined benefit pension plan	Closed to new members in 2004	Closed to new members in 2008	Closed to new members	Closed to new members in 2013	
Gross liability (DKK millions)	10,017	3,869	1,193	1,721	
Assets at fair value (DKK millions)	11,290	4,204	1,341	1,963	
Net assets (net liabilities) (DKK millions)	1,273	336	148	242	
Number of members:					
	Active	822	51	109	789
	Deferred	1,671	1,247	-	1,467
	Pensioners	2,268	552	169	659
	Total	4,761	1,850	278	2,915

Note: In Norway, Finland and the Baltics, 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 22 million at 31 December 2017.

10.1.2 Control and management

The Group's defined benefit plans are funded by contributions from the Group and 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.

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

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

At the end of 2017, the Group's VaR was DKK 1,394 million (2016: DKK 1,594 million).

The Group's aggregate net pension obligation at the end of 2017 was DKK -1,977 million (that is, it had net pension assets of DKK 1,977 million), against DKK -1,349 million a year before.

Defined benefit pension plans

At 31 December (DKK millions)	2017	2016
Present value of unfunded pension obligations	149	156
Present value of fully or partly funded pension obligations	16,672	18,089
Fair value of plan assets	18,798	19,595
Net pension obligation	-1,977	-1,349

At 31 December 2017, the net present value of pension obligations was DKK 16,821 million (31 December 2016: DKK 18,245 million), and the fair value of plan assets was DKK 18,798 million (31 December 2016: DKK 19,595 million). The present value of obligations under defined benefit plans less the fair value of pension assets is recognised for each plan under Other assets and Other liabilities. Pension plan net assets amounted to DKK 2,126 million (2016: DKK 1,595 million), and pension plan net liabilities amounted to DKK 149 million (2016: DKK 246 million). The Group recognises service costs and interest on the net defined benefit assets and liabilities in the income statement, whereas actuarial gains or losses are recognised under Other comprehensive income.

10.1.3 Liability recognition

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

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); and 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 that is also used by the Danish Financial Supervisory Authority (the Danish FSA), among others. The calculations are subject to ongoing review in order to ensure that the values of the volatility and correlation parameters are set appropriately.

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

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, 2017	Effect, 2016
Equity prices	-20%	-526	-581
Interest rates	+1%/-1%	+665/-220	+847/-470
Life expectancy	+1 year	-354	-442

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

10.2 Business risk

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

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

The method used for calculating a possible Pillar II capital add-on for the Group's business risk involves two steps. First, the quarterly earnings before credit, market and operational losses over the past five years are used for estimating the likelihood of a loss based on current earnings, the historical volatility of the earnings, and expected losses from other risk types. The second step entails an additional strategic risk estimate of the effects of possible future events. For this

purpose, the Group has identified strategic scenarios that could cause the largest declines in earnings.

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

When the Group's earnings were stressed according to the absolute loss approach in 2017, the result was positive, and no capital was required for business risk.

Management declaration

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11.1 Management declaration

According to 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 must 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 compares with the risk tolerance set by the management body.

Board declaration

In accordance with the responsibilities of a company's board of directors as stipulated in the Danish Executive Order on Management and Control of Banks, Danske Bank's Board of Directors assesses the Group's individual and overall risks on an ongoing basis and at least once a year in the form of a comprehensive report from the Executive Board. 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 international banking services to home market customers. As such, we have a diversified business model spread across several industries, customer types and countries.

At the end of December 2017, the Group's solvency need ratio amounted to 10.5% of the total risk exposure amount (REA).

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

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

The Group manages its liquidity on a daily basis by means of the risk indicators and risk triggers defined in the Liquidity Instructions and the Liquidity Policy and Appetite. The latter document defines the overall principles and standards of the Group's liquidity management. The Group increased its liquidity reserve in 2017. At the end of December 2017, the liquidity coverage ratio was 171% - well above the regulatory requirement. The Group's long-term debt was rated A/A/A1 (S&P/Fitch/Moody's) at the end of December 2017.

Operational risk management involves a structured and uniform approach across the Group entailing risk identification, risk assessment, monitoring of risk indicators, risk mitigation and event follow-up. Events related to *external fraud* and to *execution, delivery and process management* accounted for the majority of losses in 2017.

The Group takes the elevated regulatory uncertainty into account and has set the target for its common equity tier 1 (CET1) capital ratio at 14-15% in the short-to-medium term and the target for its total capital ratio at around 19%. With substantial capital in excess of the regulatory requirements and above the internal targets, the Group considers itself well capitalised. At the end of December 2017, the Group's total capital ratio was 22.6%, and its CET1 capital ratio was 17.6%.

BOARD OF DIRECTORS

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Urban Bäckström
Vice Chairman

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Lars-Erik Brenøe

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Carol Sergeant

Hilde Tonne

Kirsten Ebbe Brich

Carsten Eilertsen

Charlotte Hoffmann

Martin Tivéus

Definitions

12.

Additional tier 1 (AT1) capital

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

Advanced internal ratings-based approach [A-IRB]

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

Allowance account

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

Asset encumbrance

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

Bond spread risk

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

Business risk

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

Business unit

The Group's banking operations are organised in five business units: Personal Banking, Business Banking, Corporates & Institutions, Wealth Management each of them spanning all of the Group's geographical markets – and then Northern Ireland.

Collateral

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

Collective impairment charges

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

Commodity risk

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

Company-specific equity risk

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

Conversion factor

A conversion factor expresses the percentage of an unutilised facility or credit line that will be converted into utilised exposure at the time of default.

Common equity tier 1 (CET1) capital

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

Common equity tier 1 capital ratio

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

Concentration risk

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

Counterparty credit risk

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

CRD IV

The fourth (4th) version of the European Union's Capital Requirements Directive (2013/36/EU), which is based on the Basel III standards as set by the Basel Committee on Banking Supervision (BCBS). In Denmark, the rules contained in the directive are incorporated in the Danish Financial Business Act and relevant executive orders. CRD IV was implemented in Denmark in March 2014.

CRR

The European Union's Capital Requirements Regulation (No. 575/2013), which is based on the Basel III standards as set by the Basel Committee on Banking Supervision (BCBS). The CRR entered into force on 1 January 2014.

Credit risk

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

Credit exposure

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

Credit value adjustment (CVA)

Credit reserves (liability) determined for counterparties and representing the expected loss on Danske Bank's portfolio of OTC derivatives because of the default of counterparties.

Credit exposure from lending activities

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

Debt value adjustment (DVA)

Expected gains on Danske Bank's own default (asset).

Default

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

Defined benefit pension plans

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

Defined contribution pension plans

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

Exposure at default (EAD)

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

Forbearance measures

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

Foreign exchange risk

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

Foundation internal-ratings based approach (F-IRB)

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

Funding cost/benefit adjustment (FCA/FBA)

The values of the funding cost/benefit resulting from borrowing/lending the negative/positive mark-to-market cash value of Danske Bank's OTC derivatives. The funding value adjustment (FVA) is the funding cost adjustment less the funding benefit adjustment. The funding value adjustment can be an asset or a liability.

Gross credit exposure

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

ICAAP

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

IFRSs

International Financial Reporting Standards.

Impairment

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

Incremental risk

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

Individual impairment charges

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

Insurance risk

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

Interest rate risk

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

Interest rate risk in the banking book (IRRBB)

Interest rate risks associated with both earnings and capital in respect of banking book positions and arising from adverse interest rate scenarios.

Leverage ratio

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

Liquidity coverage ratio (LCR)

The LCR is the amount of liquid assets relative to the projected net cash outflow in a 30-day stress scenario. The ratio must be at least 100%. LCR legislation sets out in detail the assets that may be considered liquid. It also specifies how the projection of cash inflows or outflows in the 30-day stress scenario is to be calculated for each item on the balance sheet.

Liquidity risk

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

Loss given default (LGD)

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

Market risk

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

Minimum requirement for own funds and eligible liabilities (MREL)

The MREL is the minimum requirement for own funds and eligible liabilities as determined in the European Union's Bank Recovery and Resolution Directive (BRRD) (2014/59/EU). The BRRD was implemented into Danish law and became effective on 1 June 2015 through Consolidation Act No. 333 of 31 March 2015 on Restructuring and Resolution of Certain Financial Undertakings (the Danish Recovery and Resolution Act) and by amendments to the Danish Financial Business Act.

Model risk

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

Net stable funding ratio (NSFR)

The NSFR is designed to ensure that banks maintain a stable funding profile, particularly when assets are illiquid. It uses a weighting system for assets and liabilities.

A liability is assigned a higher weight, the more stable it is. Equity and long-term debt, for example, are assigned high weights, and short-term money market funding is assigned a low weight. The total is called 'available stable funding'.

Assets are weighted according to their degree of liquidity, i.e. the degree to which they require stable funding. Cash is assigned a zero weight, while loans, for example, are assigned positive weights because they cannot be monetised quickly. The total is called 'required stable funding'.

The NSFR requirement states that available stable funding must exceed required stable funding.

Non-maturing demand deposits (NMD)

Non-interest, or low-interest, deposits that have variable interest terms. Even though the balances represented by this category have a short contractual maturity, the behavioural characteristics lead to a longer maturity being modelled when interest rate risks are assessed.

Non-performing loans (NPL)

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

NPL coverage ratio

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

Net credit exposure

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

Objective evidence of impairment (OEI) of loans

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

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

Operational risk

Operational risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events, including legal events. Operational risk events are defined as operational risks which have occurred and may have caused a monetary loss (a loss event) or a reputational impact (a reputational event) or may have caused a loss that was rapidly recovered (a near-miss event).

Pension risk

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

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

Potential future exposure (PFE)

The maximum expected future credit exposure on derivatives transactions evaluated at a certain confidence level. Danske Bank uses a 97.5 percentile for internal risk management.

Probability of default (PD)

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

Risk exposure amount (REA)

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

Risk policies

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

SIFI

Systemically important financial institution.

Solvency II

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

Solvency need

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

Solvency need ratio

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

Standardised approach

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

Tier 1 capital (T1)

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

Tier 1 capital ratio

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

Tier 2 capital (T2)

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

Total capital

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

Value-at-Risk (VaR)

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

Write-off

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

Wrong-way risk (WWR)

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

xVA

A generic term referring to a set of value adjustments, such as CVA, DVA and FVA.

xVA model

Fair value adjustment model. The model is used for the pricing and risk management of xVA.

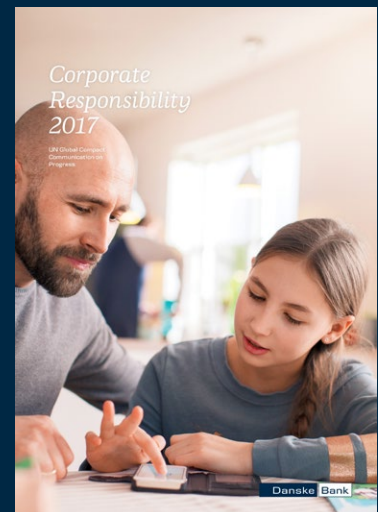
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