Risk report regarding capital adequacy statement as at 31 December 2008

Nordjyske Bank

Risk report regarding capital adequacy statement

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Introduction

This risk report, which is available at www.nordjyskebank.dk, was prepared in accordance with the provisions of the Danish Executive Order on Capital Adequacy.

The report is published once a year in connection with the release of the bank's annual report for the previous year.

The report only mentions areas that are relevant for the bank's activities.

It is the bank's opinion that the published information and the frequency of publication are appropriate in the light of the bank's risk exposure.

The information in this risk report has not been audited.

Objectives and risk policy

As a result of its activities, the bank is exposed to a number of different risk types:
- credit risk
- market risk
- liquidity risk
- operational risk

The credit risk is defined as the risk of customers' payment obligations to the bank being estimated as unrecoverable due to certain customers' inability or unwillingness to pay in accordance with the agreed timeframe.

Market risk is defined as the risk of the market value of the bank's assets and equity and liabilities being affected by changes in market conditions.

Liquidity risk is defined as the risk of the bank's cash resources being insufficient to honour the bank's payment obligations

The operational risk is defined as the risk of financial losses occurring directly or indirectly as a result of errors in internal processes and systems, human errors or as a result of external events.

It is the bank's general policy only to assume risks that comply with the bank's business principles and which the bank has the necessary competences to manage.

Credit risks
Nordjyske Bank assumes credit risks in accordance with an established credit policy with the following goals:
- to create a balanced relationship between the risks assumed and the return achieved by the bank
- to ensure that the bank's losses are at an acceptable level compared with similar Danish financial institutions
- to ensure that the bank's losses do not exceed its profit.

The bank's credit risk is distributed among a large number of minor commitments. The total of large commitments, i.e. commitments that amount to more than 10% of the bank's capital base after deductions, amounts to DKK 41.1% of the bank's capital base after deductions. The total of large commitments before deductions in the capital base for investments in securities relating to the bank's pension pool – securities where the risk is borne by the pension savers – amounts to 25.3 % of the capital base.

The total gearing of loans is, and has always been, moderate. At the end of 2008 it was thus 5.4 times the equity.

In connection with the granting of credit, the bank endeavours to obtain the maximum amount of security for its commitments. The most important types of security in connection with credit to private customers are real property, securities and vehicles. The most important types of security in connection with credit to business customers are real property, securities, operating equipment, inventory, debtors and guarantees.

The total credit risk is managed in accordance with policies and frameworks that are laid down by the bank's management. The responsibility for monitoring, general risk taking and reporting to the bank's management is centrally anchored in the bank's credit office.

Market risks
It is the fundamental policy of the bank that market risks should be maintained at a low level. For each type of market risk, the bank's management has laid down a specific risk framework that cannot be exceeded.

Most of the bank's loans and deposits as well as balances with other credit institutions have been entered into at a floating rate. By the end of 2008, the interest risk, defined as the loss the bank would incur in connection with an increase in the effective rate of interest of one percentage point, on the fixed rate exposures amounted to 0.7% of the bank's core capital after deductions.

The bank's main currency is Danish kroner but the bank has also entered into transactions in foreign currencies. Important foreign currency positions are hedged by offsetting transactions on an ongoing basis. The bank is therefore only to a limited extent exposed to fluctuations in exchange rates. At the end of 2008 the bank's currency risk (indicator 2) amounted to DKK 0.2 million.

The bank is the co-owner of a number of sector companies (BankInvest Holding A/S, Sparinvest Holding A/S, DLR Kredit A/S, PRAS A/S, PBS Holding A/S, Multidata Holding A/S and Bankdata). These ownership interests can be compared with the wholly owned subsidiaries of large banks, and the investments are therefore not regarded as part of the bank's share risk. In addition, the bank has a small portfolio of listed shares. At the end of 2008, the bank's holding of listed shares amounted to approximately DKK 52 million or 5% of the bank's equity.

If possible, the bank wishes to own the premises from which it operates. On the other hand, the bank only wishes to own real property for use in connection with its banking activities. Consequently, the bank's property portfolio mainly consists of owner-occupied properties. At the end of 2008, the bank's holding of investment properties amounted to approximately DKK 34 million or 3% of the bank's equity.

Liquidity risks
The bank's objective is to be able to finance its loan portfolio by the sum of:

- deposits from customers
  (excluding pool deposits and time deposits in excess of 15% of total deposits)
- subordinated debt
- equity
- senior loans from the international capital market

At the end of 2008, compared with the above objective, the bank had an excess capital adequacy of DKK 544 million – corresponding to 10% of the loan portfolio.

Attempts are made to ensure that in the event of a liquidity crisis, the bank will be able to honour its statutory liquidity requirements without drawing on the unconfirmed lines of other financial institutions. As at the end of 2008, the bank also complied with this objective.

In the event of a liquidity crisis, the bank has further options that can be activated upon request corresponding to more than DKK 900 million in the form of repo transactions relating to pool assets, temporary loan facilities with the Danish National Bank and mortgages on bank properties.

Operational risks
Losses and events that are deemed to relate to operational risks are reported on an ongoing basis to the bank's management. These reports are used for assessing whether business procedures, etc. should be adjusted or amended with a view to preventing or minimising the operational risks.

IT services, which constitute the main area of operational risks for the bank, have been outsourced to Bankdata, which is owned by the bank together with a number of other financial institutions. The bank's IT security is assessed on an ongoing basis and the necessary adjustments made to the bank's contingency plans.

Field of application

The risk report covers the activities of

Nordjyske Bank A/S
CVR No. 30 82 87 12

The bank owns the entire share capital of A/S Sæbygård Skov. The subsidiary's balance sheet and income statement are insignificant in relation to those of the bank. No consolidated financial statements have therefore been prepared. It is likewise not regarded as relevant to distinguish between consolidation for accounting purposes and consolidation in accordance with Part 12 of the Danish Financial Business Act.

Capital base, statement

As at 31 December 2008	DKK 1,000	DKK 1,000
Core capital		
Share capital/capital adequacy/contributed capital	80,400	
Reserves	619	
Retained earnings	945,257	
Total core capital		1,026,276
Primary deductions in core capital		
Proposed dividend	0	
Deferred capitalised tax assets	5,600	
Total, primary deductions in core capital		5,600
Core capital after primary deductions		1,020,676
Other deductions		
Half of the sum of equity investments, etc. > 10%	91,167	
Excess deductions	65,816	
Total, other deductions		156,983
Core capital after deductions		863,693
Supplementary capital		
Subordinated loan capital	4,102	
Revaluation reserve	21,249	
Included supplementary capital		25,351
Capital base before deductions		889,044
Deductions from capital base		
Half of the sum of equity investments, etc. > 10%	91,167	
Offsetting of excess deductions	65,816	
Deductions from capital base, net		25,351
Capital base after deductions		863,693

Risk report regarding capital adequacy statement
At the end of 2008, the bank's solvency ratio, the capital base after deductions, amounted to 14.3% of the weighted items of a total of DKK 6,059 million, based on equity alone.

The core capital ratio also amounts to 14.3%.

The bank is of the opinion that the ratio of weighted items to the bank's capital base before deduction of equity investment in other financial institutions better reflects the bank's solvency. The reason for this is that a large part of the deductions relate to investments in securities in connection with the bank's pension pools – securities for which the pension savers carry the risk. The bank's solvency ratio before these deductions amounts to approximately 17.3%.

Solvency requirements and adequate capital base

The board of directors and the executive board have determined the bank's individual solvency requirements in accordance with the provisions in the Danish Executive Order on Capital Adequacy. The solvency requirement has been determined according to a model in which capital is allocated to four risk areas (credit risk, market risk, real property risk and other risks).

The first part of the model contains a number of stress tests. In these stress tests, the individual items are 'stressed' by seven variables:

1 Credit risks
1.1 increased losses on customers
2 Market risks
2.2 interest rate increases
2.3 drop in share prices
2.4 increased rates of exchange
2.5 increased losses on counterparties for derivatives
2.6 drop in property prices
3 Other risks
3.7 a general decline in the bank's revenue
3.8 known extraordinary increases in the bank's costs

The bank's management has defined which risks Nordjyske Bank should be able to handle and therefore which variables should be stress-tested. In principle, stress tests are an attempt at exposing the bank to a number of negative events – in order to see how the bank's figures react in the given scenario.

The result of the stress tests are part of the model used to calculate the solvency requirement, as the bank as a minimum must have sufficient capital to cover any deficit that might arise if the scenario in question becomes a reality. The combined effect of the stress test on the solvency requirement is calculated by comparing the total impact on the result with the weighted items. This comparison provides a measure for the amount of capital required by the bank to survive the scenario in question.

In addition to the risk areas covered by the stress tests, the bank's management regards a large number of risk areas as relevant for the assessment of the solvency requirement:

1 Credit risks
    1.1 major commitments
    1.2 weak commitments
    1.3 geographical concentration
    1.4 sector concentration
    1.5security concentration
2 Market risks
3 Operational risks
4 Other risks
    4.1 strategic risks
    4.2 risks to reputation
    4.3 size of institution
    4.4 capital procurement
    4.5 liquidity risks
    4.6 miscellaneous

The determination of the influence of these areas on the solvency requirement is calculated either directly in the form of supplementary calculations or by management estimating the influence of these risk areas on the calculation of the solvency requirement.

In the opinion of the bank, the risk factors included in the model cover all the risk areas that the bank's management by law must take into account in the determination of the solvency requirement as well as the risks the management considers relevant for the assessment of the solvency requirement.

In addition, the board of directors and the executive board must assess whether the capital base is sufficient to support future activities. In Nordjyske Bank, this assessment is part of the standard determination of the solvency requirement. Consequently, the management assesses at least twice a year how growth expectations affect the calculation of the solvency requirement. As far as the model is concerned, this means that the management must estimate the future growth percentage, the average solvency weight of the growth and the profit margin after tax. The estimated effect of the expected growth on the solvency requirement will directly impact on the solvency requirement in the model in the form of a supplement.

Statement of risk-weighted items with credit risk
The bank uses the standard credit risk method to calculate the risk-weighted items.

As at 31 December 2008 (in DKK 1,000)	Risk-weighted exposure	Capital adequacy requirement (8% of the exposure)
Public entities	12,146	972
Institutions	28,186	2,255
Private enterprises, etc.	2,030,865	162,469
Retail customers	2,175,273	174,022
Exposures secured by mortgage on real property	498,045	39,844
Exposures with overdue or overdrawn amounts	349,261	27,941
Exposures in other items, including assets without counterparties.	157,197	12,576
Total, weighted items with credit risk	5,250,973	420,079

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Statement of risk-weighted items with market risk

As at 31 December 2008 (in DKK 1,000)	Risk-weighted exposure	Capital adequacy requirement (8% of the exposure)
Debt instruments	129,242	10,339
Shares	10,560	845
Exchange rate risks	43,496	3,480
Total, weighted items with market risk	183,298	14,664

Statement of risk-weighted items with operational risk
The bank uses the basic indicator method to calculate the solvency requirement for the operational risk.

As at 31 December 2008 (in DKK 1,000)	Risk-weighted exposure	Capital adequacy requirement (8% of the exposure)
Weighted items with operational risk, total	639,504	51,160

Counterparty risks

The bank uses the market value method for counterparty risk to calculate the size of the exposure for derivative financial instruments that are covered by the definition in the Danish Executive Order on Capital Adequacy.

The determination of the amount of exposure for counterparty risk using the market value method is as follows:

- Contracts are determined at market value to attain the actual replacement costs for all contracts with a positive value
- To determine a figure for the potential future credit exposure, the nominal value of the principal amounts of the contracts or the underlying values are multiplied by percentages fixed by the Danish Financial Supervisory Authority. Swaps based on the two variable rates of interest in the same currency are exempt, in so far as only the actual replacement costs must be calculated.
- The total of the actual replacement costs and the potential future credit exposure form the exposure value.

In connection with the bank's determination of sufficient capital base, the bank holds capital equivalent to 8% of the positive market value of the derivatives.

In its approval process and general monitoring of commitments, the bank takes into account the calculated exposure value to ensure it does not exceed the credit limit granted to the counterparty.

As at 31 December 2008, the value of the bank's total counterparty risk determined in accordance with the market value method amounted to a total of DKK 87,142,000.

Credit risks

When determining value adjustments and write downs of the bank's loans and receivables, the bank applies the provisions in Sections 51-54 of the Danish Financial Supervisory Authority's Executive Order on Financial Reports for Credit Institutions and Investment Companies.

Receivables from credit institutions and central banks are all individually assessed for an objective indication of impairment. For substantial loans, an individual assessment is also conducted as to whether objective indication of impairment is present. The indication of impairment is individually determined when an objective indication of impairment is present on the individual level. Individually assessed loans that have not been written down as well as other loans are subsequently assessed on a portfolio basis.

A portfolio-based assessment of the indication of impairment is carried out based upon objective indication of impairment for groups of loans that have uniform characteristics with regard to credit risk. The portfolio assessment is based on a rating of customers that is itself based upon financial ratios. A gross approach method is utilised in connection with the calculation of the requirement for group write downs. The method entails that the total group write downs are made up of the total of the individual customers' decline in rating classes without taking into account the fact that other customers improved their rating in the same period.

An individual loan or a group of loans are viewed as being impaired if and only if there is an objective indication of impairment as the result of one or more events that occurred upon the initial recognition of the loan, and if this (these) event(s)have an influence on the expected future payment flows, which can be reliably estimated. The agreed effective interest rate on the individual loan is used as the discount rate. For portfolios of loans, the weighted average of the agreed effective interest rate for the individual loan in the portfolio is used.

Impairment is determined as the difference between the amortised cost and the present value of the expected future payments, including the realisable value of any security. The future payments are prepared on the basis of the most probable outcome.

An assessment of the need for write downs of loan portfolios with uniform credit risk characteristics is based on the rating of the customers according to financial ratios. A gross approach method is utilised in connection with the calculation of the requirement for group write downs. The method entails that the total group write downs are made up of the total of the individual customers' decline in rating classes without taking into account the fact that other customers improved their rating in the same period.

In accordance with the Danish Executive Order on the Presentation of Financial Statements and the Executive Order on Capital Adequacy, loans and receivables are classified as being in default if payment of a minimum of DKK 1,000 has been overdue for an uninterrupted period of 90 days.

As at 31 December 2008, the total value of the bank's exposure after write downs and before credit risk reduction amounted to DKK 9,491 million in total.

Statement of the average value of the exposure:

Average (in DKK 1,000)	**2008**

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Central governments or central banks	560,299
Public entities	37,180
Institutions	189,743
Private enterprises, etc.	1,931,001
Retail customers	2,966,122
Exposures secured by mortgage on real property	1,017,397
Exposures with overdue or overdrawn amounts	296,578
Exposures in other items, including assets without counterparties	151,152
Total exposures	7,149,472

Credit exposures by sector and credit category

As at 31 December 2008 (in DKK 1,000)	Central governments or central banks	Public entities	Institutions	Private enterprises, etc.	Retail customers	Exposures secured by mortgage on real property	Exposures with overdue or overdrawn amounts	Exposures in other items, including assets without counterparties	Total
Public authorities		4			8,337	925			9,266
Agriculture, hunting and forestry				789,921	391,641	142,464	45,126		1,369,152
Fishery				141,521	63,367	6,022	6,885		217,795
Manufacturing, raw material extraction, electricity, gas, water and heating plants				402,171	228,272	21,934	2,807		655,184

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Construction and civil engineering works				135,033	207,330	53,792	44,278		440,433
Trade, restaurant and hotel business				302,737	323,978	81,133	45,091		752,939
Transport, post and telephone		70,166		19,937	88,776	4,750	4,130		187,759
Credit, finance and insurance	740,086		212,410	103,980	141	398		197,868	1,254,883
Property management and trade, business services				190,072	225,683	66,097	8,992		490,844

Other sectors				379,354	142,146	28,319	5,685			555,504
Total, business sectors	740,086	70,170	212,410	2,464,726	1,679,671	405,834	162,994	197,868		5,933,759
Private				121,416	2,361,774	960,989	112,720			3,556,899
Total	740,086	70,170	212,410	2,586,142	4,041,445	1,366,823	275,714	197,868		9,490,658

Credit exposures by time to maturity and credit category

As at 31 December 2008 (in DKK 1,000)	On demand	0 – 3 months	3 months – 1 year	1 – 5 years	Over 5 years	Total
Central governments or central banks	22,235	717,851				740,086
Public entities	34	70,136				70,170
Institutions	36,223	55,334	2,546	181	118,126	212,410
Private enterprises, etc.	609,046	488,715	1,035,178	259,198	194,005	2,586,142
Retail customers	883,448	233,061	830,868	745,286	1,348,782	4,041,445
Exposures secured by mortgage on real property	101,757	33,422	89,294	162,928	979,422	1,366,823
Exposures with overdue or overdrawn amounts	41,017	21,274	76,027	57,025	80,371	275,714
Exposures in other items, including assets without counterparties	197,868					197,868
Total	1,891,628	1,619,793	2,033,913	1,224,618	2,720,706	9,490,658

Claims in default or impaired, by exposure category

DKK 1,000	Exposure to claims in default	Exposure to impaired claims	Write downs/provisions at end of year	Expensed amounts relating to value adjustments and write downs
Public authorities				697
Agriculture, hunting and forestry	45,126	157,368	72,350	
Fishery	6,885		285	
Manufacturing, raw material extraction, electricity, gas, water and heating plants	2,807	124,477	14,836	40
Construction and civil engineering works	44,279	10,705	4,528	469
Trade, restaurant and hotel business	45,091	69,197	19,662	1,844
Transport, post and telephone	4,130	4,522	3,965	
Credit, finance and insurance		71,432	7,169	
Property management and trade, business services	8,992	13,706	10,087	424
Other sectors	5,685	4,789	17,303	
Total, business sectors	162,994	456,196	150,185	3,474
Private	112,720	54,502	21,612	10,495
Total	275,714	510,698	171,797	13,969

Movements in impaired claims as a result of value adjustments and write downs

As at 31 December 2008 (in DKK 1,000)	Loans	Guarantees
Individual write downs		
Write downs, beginning of the year	121,993	0
Write downs during the year	63,815	3,471
Reversal of write downs performed in previous financial years	23,026	
Final loss, previously written down individually	9,092	
Write downs, end of the year	153,690	3,471
Grouped write downs		
Write downs, beginning of the year	10,470	3,081
Write downs during the year	3,505	173
Reversal of write downs performed in previous financial years	868	1,725
Write downs, end of the year	13,107	1,529
Final loss (written down) not previously written down individually	4,964	
Received in respect of previously written down receivables	2,860	

Market risks

Statement of solvency risks on items representing position risks

As at 31 December 2008 (in DKK 1,000)	Weighted amount	Capital requirement (8% of the exposure)
Debt instruments	129,242	10,339
Shares, etc. (including group investment schemes)	10,560	845
Currency position	43,496	3,480

Operational risks

According to the Danish Executive Order on Capital Adequacy, sufficient capital must be set aside to cover operational risks. The capital requirement relating to the operational risks must cover: "The risk of losses as a result of inappropriate or insufficient internal procedures, human and system errors or external events, including legal risks."

Nordjyske Bank uses the basic indicator method, cf. Schedule 18 of the Executive Order on Capital Adequacy, to determine the capital requirement for operational risks. The capital requirement for the operational risks is consequently determined as 15% of the average "core income" for the last three years. The core income is the total of the net interest income and non-related net income.

However, the bank undertakes ongoing assessments of the capital requirement for operational risks. If the capital requirement is deemed to be higher than mentioned above, the bank will take it into account in the determination of the solvency requirement.

Exposure in shares, etc. that do not form part of the trading portfolio

Nordjyske Bank has made capital contributions to a number of sector companies together with other financial institutions. The objective of these sector companies is to support the business of financial services institutions in areas such as mortgage finance, payment services, IT, investment funds, etc. The bank has no plans to sell these capital contributions, as it views partaking in these sector companies as necessary for the bank's operation. The capital contributions are therefore not considered part of the trading portfolio.

In a number of the sector companies, the equity investments are redistributed in such a way that the ownership shares of the financial institutions reflect the individual financial institution's business volume with the sector company at all times. The redistribution is typically based on the sector company's equity value.

Equity investments in the sector companies are recognised at fair value. Determination of the fair value is based upon available information on current trading. Should current market information not be available, the fair value is determined on the basis of the companies' most recently submitted and approved annual reports. Other unlisted securities are recognised at acquisition cost or a possible lower fair value. Adjustments are booked on an ongoing basis in accordance with the rules governing the income statement.

In addition, the bank has minor holdings of unlisted shares that have been acquired as part of an effort to support business in the local area.

Holding of shares, etc.

As at 31 December 2008	Carrying amount
(in DKK 1,000)	
Shares in the trading portfolio	
– listed shares	52,123
Unlisted shares, etc. recognised at fair value, sector shares	108,374
Unlisted shares, etc. recognised at cost	1,154
Other shares	14,664
Total excluding the trading portfolio	124,192
Total shares, etc.	176,315

Interest rate risk excluding the trading portfolio

As at 31 December 2008, the bank's total interest rate risk amounted to DKK 5,801,000, which can be distributed as follows:

As at 31 December 2008

(in DKK 1,000)

Interest rate risk relating to trading portfolio positions:		
Securities	11,334	
Futures, forward exchange transactions and binding interest agreements	- 10	
Swaps	- 2,540	8,804
Interest rate risk relating to positions outside the trading portfolio:		
Items recognised in the balance sheet,		
i.e. loans and receivables as well as deposits and payables		- 3,002
Total interest rate risk		5,802
Of which		
– positions in DKK	6,134	
– positions in foreign currencies	-332	

Credit-reducing methods

Nordjyske Bank uses neither on-balance-sheet netting nor netting below the line.

In its policies and business procedures regarding security, the bank has given priority to receiving the following types of financial security:

- deposits
- securities and debt instruments
- unit trust certificates
- listed shares

Securities are increasingly used as financial security. This is partly due to investment options where the bank at the same time offers a finance package. To some extent, the bank also uses more traditional security in the form of an existing holding of securities.

In accordance with the bank's assessment policy for financial security, the value assessment is based on a conservative market value approach. Procedures have been established for the administration and value assessment of security and these procedures are an integral part of the bank's standard risk monitoring.

The credit-reducing technique used is the extended version of the standard method, which implies that the bank can reduce the effect of a commitment on the capital by registering charges against certain forms of financial security issued by a company or a country with a particularly good credit rating.

Statement of credit reduction with financial security and guarantees, etc.
The following table shows the total exposure covered by financial security, guarantees and credit derivatives:

As at 31 December 2008 (in DKK 1,000)	Financial security exposures	Exposures covered by guarantees and credit derivatives
Private enterprises	69,163	7,693
Retail customers	87,041	8,403
Exposures secured by mortgage on real property	10,268	0
Exposures with overdue or overdrawn amounts	3,243	0
Total exposures covered by financial security, guarantees and credit derivatives	169,715	16,096