# Risk and Capital Management 2014

## Nykredit Realkredit Group


Nykredit

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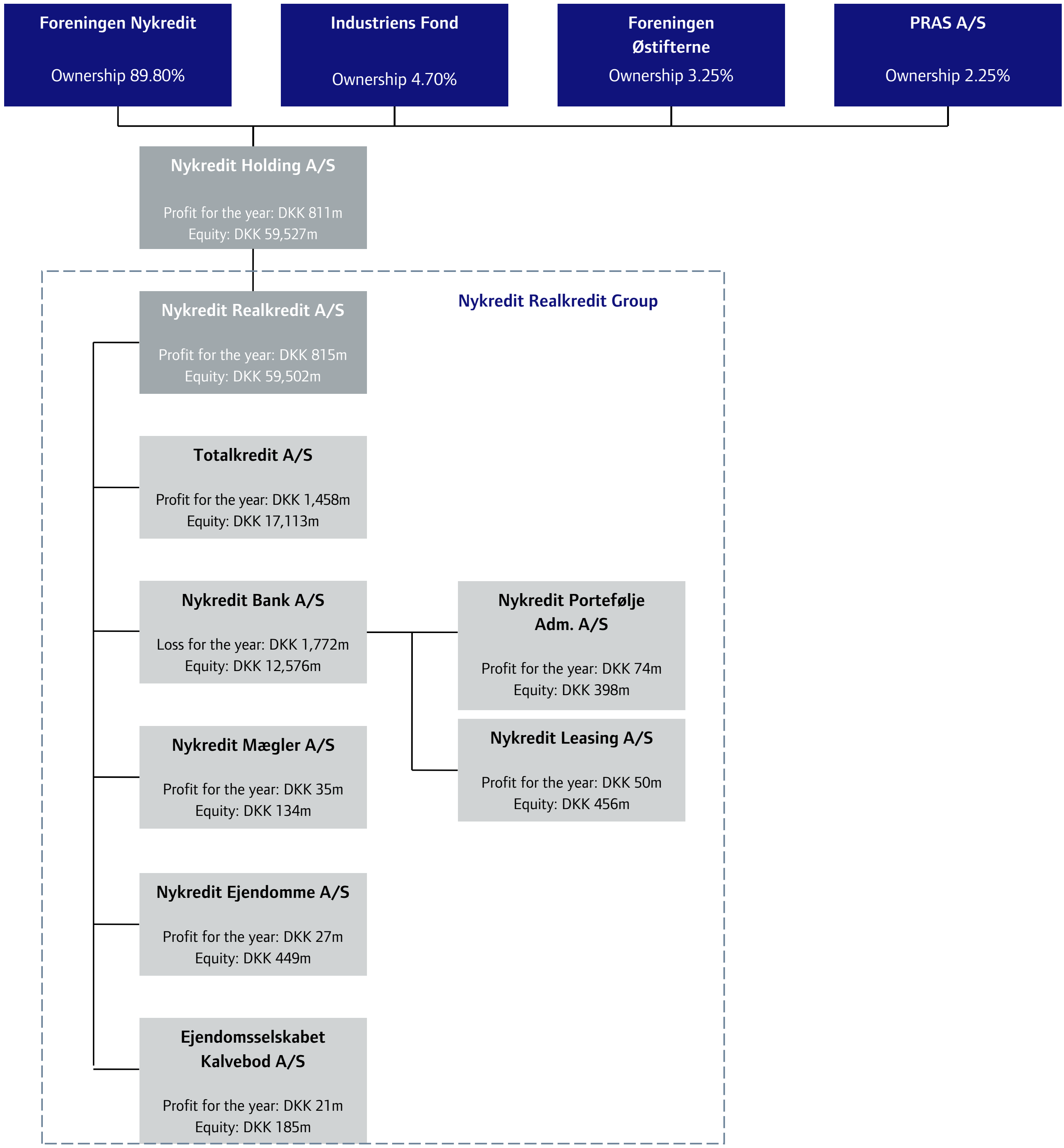
# GROUP CHART


Foreningen Nykredit
Ownership 89.80%
Industriens Fond
Ownership 4.70%
Foreningen Østifterne
Ownership 3.25%
PRAS A/S
Ownership 2.25%
Nykredit Holding A/S
Profit for the year: DKK 811m
Equity: DKK 59,527m
Nykredit Realkredit Group
Nykredit Realkredit A/S
Profit for the year: DKK 815m
Equity: DKK 59,502m
Totalkredit A/S
Profit for the year: DKK 1,458m
Equity: DKK 17,113m
Nykredit Bank A/S
Loss for the year: DKK 1,772m
Equity: DKK 12,576m
Nykredit Portefølje Adm. A/S
Profit for the year: DKK 74m
Equity: DKK 398m
Nykredit Leasing A/S
Profit for the year: DKK 50m
Equity: DKK 456m
Nykredit Mægler A/S
Profit for the year: DKK 35m
Equity: DKK 134m
Nykredit Ejendomme A/S
Profit for the year: DKK 27m
Equity: DKK 449m
Ejendomsselskabet Kalvebod A/S
Profit for the year: DKK 21m
Equity: DKK 185m

# 2014 IN BRIEF

**Overview**
Economic growth accelerated during 2014 and so did growth in private consumption. Unemployment dropped to around 5% over the first months of 2014 and largely remained at that level throughout the year.

At national level, both house and flat prices increased in 2014. At just over 5%, the rise was somewhat higher for flats than the almost 1.5% rise for house prices. Due to the development in housing prices, the LTV level of the Group's private residential lending fell slightly to 74.8% at end-2014. The requirement for supplementary collateral reduced on the back of the price rises in the housing market and amounted to DKK 40.3bn at end-2014 against DKK 44.3bn a year earlier.

**Loan portfolio in good shape**
Based on directly observable key figures, Nykredit's loan portfolio is generally stable.

This is evidenced by, for instance, a continuing decline in arrears ratios for large parts of the Group's mortgage loans. The 75-day arrears ratio for total group mortgage lending dropped from 0.47% at end-2013 to 0.42% at end-2014.

Total incurred loan losses on the Group's customers in 2014 were DKK 1,717m, equal to a loss ratio of 0.14%. The ratio is almost unchanged from 2013, indicating that the increase in Nykredit's loan losses in the wake of the financial crisis has stabilised.

Total impairment provisions for the Group's mortgage lending rose by DKK 1,128m, amounting to DKK 5,506m, or 0.50% of lending, at end-2014. The rise reflects an increase of DKK 779m in impairment provisions for housing cooperatives in particular, and DKK 372m for agricultural lending.

The portfolio of properties acquired at forced sales by public auction counted 238 at end-2014, a decrease relative to the portfolio of 322 at end-2013. During 2014, 459 properties were sold, of which 339 private residential properties. This is far below the portfolio of some 1,500 properties during the housing market crisis in the early 1990s, and the upward trend that set in after the financial crisis and lasted until 2012 has furthermore been broken.

**Higher credit risk on Nykredit's swap portfolio**
Nykredit has made sizeable provisions of approximately DKK 4.1bn for housing cooperatives, corresponding to just over half the negative market value related to their financial instruments. The sizeable provisions should be seen in the context that the counterparty value of swaps in the lowest rating category is always value adjusted to nil. The vast majority of customers in this rating category make their payments as scheduled and on time, but are placed in this rating category based on a long-term assessment of the housing cooperative's equity according to conservative valuation principles. Considering that Nykredit has sustained total losses of DKK 300m on terminated swaps, estimates in this area are very conservative. The most likely scenario is still that a considerable part of the provisions will be reversed over time.

**Nykredit's capital targets towards 2019**
Nykredit's target is equity equal to 15% of the risk exposure amount, to which should be added the statutory deductions from equity of approximately DKK 5bn. An equity level of 15% is significantly higher than the formal statutory requirement, but from a market perspective it is deemed necessary/appropriate for a major bond issuer such as Nykredit.

Nykredit's target is a total capital ratio of 18-20% of the risk exposure amount. Also this level is markedly above the formal requirement, but deemed to be the necessary/appropriate level.

Nykredit is now entitled to issue non-voting shares for capitalisation purposes.

**Winning the Double**
Nykredit launched a new strategy in 2014. The new strategy is a natural extension of our Nykredit 2015 plan launched at end-2013. This was an operational plan of short-term initiatives: strengthening our customer focus, growing earnings, streamlining the Group and further developing the Totalkredit partnership.

The Nykredit 2015 plan has been incorporated into the Group's new strategy, Winning the Double, which sets the long-term direction for the Group. We call the strategy Winning the Double, because that is precisely what Nykredit must do – win on two fronts:

- We will win homeowners over as satisfied and loyal full-service customers of Nykredit, and
- We will win our partner banks over in a strong and loyal Totalkredit partnership.

Our new strategy and organisational structure are the platform from which we will strengthen our market position and realise the Group's potential. We want Danish homeowners to experience Nykredit as a trustworthy and competent partner in all stages of life. Our customers' situations differ significantly not least with respect to stage of life, income and wealth, but their homes are the natural pivot of our relationship with them. We will take a number of specific initiatives in 2015 to strengthen our services and market position in personal banking. The most important initiatives are the launch of a new customer programme and stepping up digital communication with customers.

Over the years, the Totalkredit partnership has grown into a great success for Danish local and regional banks as well as for Nykredit. The partnership will be intensified and further developed in coming years. Nykredit will share its expertise and capacity with its partners so that together we may establish joint solutions leading to joint synergies. A number of specific initiatives to strengthen the partnership have already been realised, including the introduction of a secured homeowner loan and a new variable-rate loan, F-kort, and re-introduction of one-tier mortgage lending. Also, the user experience of the joint mortgage system, Xportalen, has improved.

**FSA inspections**
The Danish Financial Supervisory Authority (FSA) performs regular inspections of Danish banks and mortgage lenders.

In 2014 the FSA conducted inspections of Nykredit. The published inspection reports are available at nykredit.dk.

The observations of the FSA have been incorporated in Nykredit's internal capital adequacy requirement.

# GOVERNANCE AND MANAGEMENT OF RISK

**NYKREDIT'S CHARACTERISTICS**

The Group's activities consist mainly of match-funded mortgage lending secured by mortgages over real estate. Danish legislation provides limits to the mortgaging of properties, and losses on mortgage loans are therefore limited. Mortgage lending and the matching funding are regulated by the balance principle, which provides narrow limits to the related liquidity and market risks.

The Group's activities also include bank deposits and lending, trading in securities and financial instruments, debt capital, asset management, pension products and insurance mediation. The business activities combined with the investment portfolio involve credit, market, operational and liquidity risks.

Nykredit strives to meet best international practice for risk management including disclosure of risk areas. Nykredit's advanced models for quantifying risks are central elements of the Group's risk and capital management.

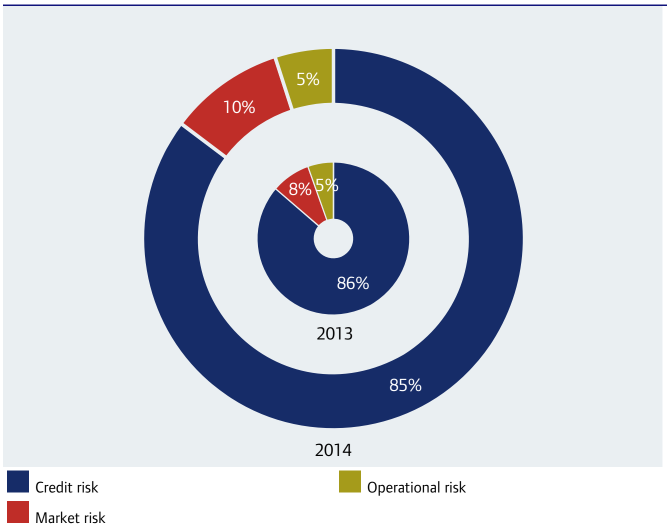
**RISK APPETITE**

The capital and risk policy of the Nykredit Group reflects the Group's overall tolerance for taking risks. The overall risk appetite is determined on the basis of Nykredit's strategy, regulatory and credit rating agency capital requirements and the capital targets set out by the Board of Directors. Nykredit manages its capital requirements by preparing a capital budget annually. The budget should be seen in the context of the overall capital and strategy plan towards 2019. Capital is optimised, allocated and prioritised with due consideration for business returns and strategic decisions.

**TYPES OF RISK**

Risk management is the responsibility of the Board of Directors and the Executive Board and is a key element of Nykredit's day-to-day operations. Through risk management, Nykredit seeks to ensure financially sustainable solutions in the short and long term. Nykredit values balanced risk management and a strong capital structure.

**Nykredit Realkredit Group**
**Capital requirement by type of risk**




Note: The capital charge for liquidity risk is not quantified.

Nykredit distinguishes between four main types of risk. Each type of risk has its own special features, and risk management is structured accordingly.

Credit risk reflects the risk of loss following the non-performance of parties with whom Nykredit has contracted. An element of credit risk is counterparty risk, which is the risk of loss that Nykredit may sustain if a counterparty defaults on its obligations under financial instruments.

Market risk reflects the risk of loss as a result of movements in financial markets (interest rate, foreign exchange, equity price, volatility risks, etc).

Operational risk reflects the risk of loss as a result of inadequate or failed internal processes, people and systems or external events.

Liquidity risk reflects the risk of loss as a result of insufficient liquidity to cover current payment obligations.

Credit, market and operational risks are mitigated by the holding of adequate capital, while liquidity risk is mitigated by the holding of a sufficient stock of liquid assets.

The determination of the risk exposure amount (REA) is to ensure that credit institutions hold adequate capital to withstand potential losses. This is described in more detail in the following sections. New liquidity measures are to ensure that credit institutions hold sufficient stocks of liquid assets to fulfil future payment obligations. This is described in more detail under "Liquidity and funding".

**ORGANISATION, DELEGATION OF RESPONSIBILITIES AND CORPORATE GOVERNANCE**

The Board of Directors of Nykredit Realkredit A/S is responsible for defining limits to and monitoring group risks as well as approving overall instructions and policies. The Board is responsible for the overall approach to capital and risk management, the capital requirement rules and the internal models. Risk exposures and business developments are reported to the Board of Directors on a current basis.

The Board of Directors of Nykredit Realkredit A/S counts 15 members, of which ten are elected by the General Meeting for a term of one year and five are elected by and among the staff for a term of four years.

The Board of Directors is the supreme management body of the Company, which makes decisions of a strategic and fundamental nature and lays down guidelines for the day-to-day management by the Group Executive Board.

Nykredit is committed to having a board of a suitable size, composition and diversity, which possesses the skills required to perform the management tasks and the responsibility resting at all times with the Board of Directors as the supreme management body of the Company.

The Board of Directors reviews its competency profile on an ongoing basis. It has been decided that the Board of Directors should have special skills and knowledge as regards:

**Organisation and delegation of responsibilities**

Board of Directors
- Overall governance and strategic management
- Lays down overall policies and guidelines

Audit Board
- Monitors matters relating to accounting, audit, internal controls and risk management

Remuneration Board
- Prepares and recommends the remuneration policy

Nomination Board
- Nominates candidates for the Committee of Representatives, Board of Directors and Executive Board
- Prepares resolutions on the competency profiles of the Board of Directors and Executive Board

Risk Board
- Advises the Board of Directors on the Nykredit Group's risk profile and risk management

Group Executive Board
- Overall day-to-day management
- Strategic planning and business development
- Operationalises policies and guidelines

Group committees
- Governance and management within selected fields of business

Credits
- Manages and formulates the credit policy
- Approves large exposures

Asset/Liabilities
- Overall asset/liability and liquidity management
- SDO cover pool management

Risk
- General capital and risk management
- General risk policy
- Approves risk models

Contingency
- Responsible for compliance with contingency plans and related IT security policy

Products
- Ensures development and maintenance of concepts and products

- Strategy
- Sector and real estate expertise
- Economics, finance and accounting
- Capital markets, securities and funding
- Politics, public administration and associations
- Legal and regulatory matters of importance to financial business
- Corporate governance
- Financial business management, including IT
- Management of large companies
- Market conditions, customer relations and sales
- Organisation/HR and processes
- Credit matters.

Further details on the competency profile of the Board of Directors, the special skills and experience of each board member and the composition, size and diversity of the Board of Directors are available at nykredit.com/organisationuk.

**Board committees**

The Board of Directors of Nykredit Realkredit A/S has appointed a Risk Board, an Audit Board, a Remuneration Board and a Nomination Board. Each of these board committees monitors selected areas and prepares cases for review by the entire Board of Directors, each within their field of responsibility.

*Risk Board*

The task of the Risk Board is to monitor Nykredit's overall risk profile and strategy. This includes assessing long-term capital requirements, capital policy, products, business model, remuneration structure and incentives as well as risk models and basis of methodology, etc. The Risk Board assists the Board of Directors in overseeing that the risk appetite laid down by the Board of Directors is implemented correctly in the organisation.

The Risk Board serves the companies of Nykredit that are required to appoint such a board. In addition to Nykredit Realkredit A/S, this concerns Totalkredit A/S and Nykredit Bank A/S.

The Risk Board held three meetings in 2014.

*Audit Board*

The principal tasks of the Audit Board are to monitor the financial reporting process, the effectiveness of Nykredit's internal control systems, internal audit and risk management as well as the statutory audit of the financial statements, and to monitor and verify the independence of the auditors.

The Audit Board serves the companies of Nykredit that are required to appoint such a board. In addition to Nykredit Realkredit A/S, this concerns Totalkredit A/S and Nykredit Bank A/S.

The Audit Board held four meetings in 2014

*Remuneration Board*

One of the principal tasks of the Remuneration Board is to make recommendations in respect of Nykredit's remuneration policy, including guidelines on incentive pay, for the approval of the Board of Directors. Moreover, the Remuneration Board makes proposals for remuneration of the Committee of Representatives, the Board of Directors and the Executive Board. It also reviews and considers draft resolutions concerning staff bonus budgets and ensures that the information in the Annual Report about remuneration of the Board of Directors and the Executive Board is correct, fair and satisfactory.

The Remuneration Board held three meetings in 2014.

*Nomination Board*
The Nomination Board is tasked with drawing up recommendations for the Board of Directors on the nomination of candidates for the Committee of Representatives, the Board of Directors and the Executive Board. The Nomination Board is further tasked with setting targets for the under-represented gender on the Board of Directors and laying down a diversity policy for the Board of Directors. In addition, the Nomination Board, which is accountable to the Board of Directors, is overall responsible for the competency profiles and continuous evaluation of the work and results of the Board of Directors and the Executive Board.

The Nomination Board held three meetings in 2014.

**Group committees**
Nykredit has appointed a number of group committees which are to perform specific tasks within selected fields. All the committees include at least one member of the Group Executive Board.

The *Credits Committee* is charged with overseeing the management of risks in Nykredit's credits area. The Committee chiefly considers cases and manages portfolios in the credits area.

The *Asset/Liability Committee* is charged with monitoring and coordinating the use of the limited resources in the form of capital and liquidity, monitoring profitability at the business level and laying down internal limits in relation to the Nykredit Group and the companies Nykredit Realkredit, Totalkredit and Nykredit Bank.

The *Risk Committee* is charged with overseeing the overall risk profile and capital requirements of the Nykredit Group in order to assist (i) the managements of Foreningen Nykredit (the Nykredit Association) and Nykredit Holding A/S in overseeing – and (ii) the managements of Nykredit Realkredit, Totalkredit and Nykredit Bank in ensuring – compliance with current legislation and practice in the risk area.

The *Contingency Committee* has the overall responsibility for compliance with IT security policy rules in relation to contingencies (major accidents and catastrophes) and the Group's contingency plans covering IT as well as business aspects.

The *Products Committee*'s overarching purpose is to ensure that the development and maintenance of concepts and products potentially involving material risks for the Group, counterparties and/or customers are undertaken in accordance with the Group's business model and the guidelines which the Group Executive Board has approved for development and approval of new concepts and products.

For further information on Nykredit's board committees and group committees, please see Nykredit's Annual Report available at nykredit.com.

**Corporate governance**
The Board of Directors of Nykredit Realkredit A/S has decided that Nykredit should act as a listed company for external purposes, operating on sound business terms.

In consequence, Nykredit complies with the revised Recommendations on Corporate Governance of the Danish Committee on Corporate Governance subject to the adjustments that follow from Nykredit's special ownership and management structure. The recommendations form part of the rules of Nasdaq Copenhagen.

Further information on organisation and corporate governance is available at nykredit.com/corporategovernanceuk.

**Risk areas reviewed by the Board of Directors**

| | |
|---|---|
| **Annually** | |
| **Capital and risk policy** | Review of and decision on Nykredit's required own funds, internal capital adequacy requirement as well as the long-term capital requirement, capital policy and risk appetite |
| **Return** | Review of and decision on current return targets |
| **Risk models** | Review of ongoing model development and consequences thereof |
| **Stress tests** | Review of results of Nykredit's stress tests and scenario analyses |
| **Ongoing** | |
| **Risk reporting** | Quarterly/semi-annual reporting on key risk areas:<br>▪ Capital structure, required own funds and internal capital adequacy requirement<br>▪ Liquidity risk and SDO risk<br>Balance principle and investment rules<br>Liquidity position<br>▪ Credit risk<br>Development in credit risk and parameters, and ratings<br>Concentration risk<br>Exposures by size, industry, loan type and geography<br>Housing prices and LTV ratios<br>Provisions for guarantees, loan impairment arrears and incurred losses<br>Counterparty risk<br>▪ Market risk<br>Interest rate, foreign exchange and equity price risks (traditional measures and Value-at-Risk)<br>Credit risk of investment portfolios<br>Back tests and stress tests<br>▪ Operational risk<br>▪ Regulatory risk<br>Monthly reporting on key risk areas:<br>▪ Market risk<br>Interest rate, foreign exchange and equity price risks (traditional measures and Value-at-Risk)<br>Investment portfolio income and return relative to benchmark<br>▪ Liquidity risk<br>Liquidity and excess coverage for the period<br>Stress tests |
| **Exposure review** | Review and assessment of exposures above a certain limit. |

## REMUNERATION

**Risk-takers**

The Group has identified a total of 83 risk-takers:

- Members of the Board of Directors: 29
- Group managing directors: 5
- Subsidiary managing directors: 10
- Other risk-takers: 39.

The group of other risk-takers is designated by the Board of Directors primarily based on the size of the loss that the individual risk-taker may inflict on Nykredit in terms of credit or market risk.

As Nykredit is the largest provider of domestic loans in Denmark, the majority of the risk-takers have been designated because of their potential ability to inflict credit losses on Nykredit.

**Remuneration of risk-takers**

Pursuant to the Danish Financial Business Act, risk-takers are subject to special restrictions, chiefly in relation to variable remuneration. Some of these restrictions are deferral of payout over a several-year period, partial payout through bonds subject to selling restrictions instead of cash payment and the possibility that Nykredit may retain the deferred amount under special circumstances.

Members of the Board of Directors and group managing directors do not receive variable remuneration, nor bonus awards.

The 2014 bonus provisions in respect of subsidiary managing directors and other risk-takers amounted to DKK 14m compared with bonus of DKK 18m awarded for 2013. The 2014 bonus provisions corresponded to 19% of their fixed salaries.

**Bonus programmes**

Individual bonus programmes apply to Nykredit's senior executives and specialists in key areas.

Special individual bonus programmes apply to some of the staff of Nykredit Markets, Nykredit Asset Management and Group Treasury who have major earnings responsibility, in line with market standards for such positions. The remuneration of these staff members is based on their job performance. The 2014 bonus provisions in respect of these staff members (excl risk-takers) amounted to DKK46m compared with the awarded bonus of DKK 63m for 2013. The 2014 bonus provisions corresponded to 27% of the total salaries of these staff members.

In addition, a limited number of individual bonus programmes apply to staff with responsibility for corporate and institutional clients. The 2014 bonus provisions in respect of these staff members (excl risk-takers) amounted to DKK 6m compared with the awarded bonus of DKK 21m for 2013. The 2014 bonus provisions corresponded to 10% of the total salaries of these staff members. The decline from 2013 to 2014 is principally attributable to the discontinuation of bonus programmes in some of the units in 2014.

Management staff and certain senior staff members participate in an individual programme with a potential bonus of up to three months' salary. The 2014 bonus provisions in respect of these staff members (excl risk-takers) amounted to DKK 12m compared with the bonus of DKK 11m awarded for 2013. The 2014 bonus provisions corresponded to 5% of the total salaries of these staff members.

The bonus programmes do not apply to other management or staff members, but they may receive an individual performance award. For 2014, provisions of DKK 10m were made for performance awards, which was in line with the performance awards for 2013. The performance award provisions for 2014 corresponded to 0.5% of their total salaries.

Details on bonuses for risk-takers, remuneration policy and practices are available at nykredit.com/aboutnykredit.

## INTERNAL CONTROL AND RISK MANAGEMENT SYSTEMS

Nykredit's internal controls and risk management are designed to efficiently manage rather than eliminate the risk of errors and omissions.

Nykredit regularly expands and improves its monitoring and control of risk. Risk exposure is reported on a continuous basis in all material areas such as credit risk, market risk, liquidity risk, operational risk and IT risk.

**Risk management**

The risk management process is based on internal control and risk management systems, which together ensure that all relevant financial transactions are correctly reflected in the form of risk calculations and reports.

Capital & Risk handles Nykredit's overall risk management and reporting as well as the calculation of capital and capital adequacy and is responsible for ensuring that Nykredit's risk reporting and calculations of capital and capital adequacy comply with policies laid down and current legislation.

A number of working committees have been appointed to ensure compliance with current legislation. They review and comment on new and amended capital requirement rules and policies for the purpose of adapting financial reporting and capital requirement calculations.

Capital & Risk prepares internal quarterly reports, including for the Board of Directors, and is responsible for the Nykredit's external risk reporting.

**Control environment**

Business procedures are laid down and controls are implemented for all material risk areas, including areas of significance to the determination of REA.

**Controls**

The purpose of the Group's controls is to ensure that policies and guidelines laid down by the Executive Board are observed and to ensure timely prevention, detection and correction of any errors, deviations or omissions.

The controls comprise manual and physical controls as well as general IT controls and automatic application controls in the IT systems applied.

The Executive Board has reassigned its daily control duties, and overall control is based on three functional levels:

- *Business units* – the management of each unit is responsible for identifying, assessing and handling the risks arising in connection with the performance of the unit's duties and for implementing satisfactory permanent internal controls for the handling of business operations.
- *Risk functions* – comprise a number of cross-functional areas, such as Group Credits, Group Finance, decentralised finance functions, Capital & Risk including the Chief Risk Officer, Compliance and IT Security. These areas are in charge of providing policies and procedures on behalf of Management. Further, they are responsible for testing whether policies and procedures are observed and whether internal controls performed by the business units are satisfactory.
- *Audit* – comprises internal and external audit. On the basis of an audit plan approved by the Board of Directors, Internal Audit is responsible for carrying out an independent audit of internal controls in Nykredit and performing the statutory audit of the Annual Report together with the external auditors. The internal and external auditors endorse the Annual Report and in this connection issue a long-form audit report to the Board of Directors on any matters of which the Board of Directors should be informed.

The three functional levels are to ensure:

- The value of Nykredit's assets, including efficient management of relevant risks
- Reliable internal and external reporting
- Compliance with legislation, other external rules and internal guidelines.

**Information and communication**

The Board of Directors has adopted an information and communications policy, which lays down the general requirements for external financial reporting in accordance with legislation and relevant rules and regulations. Nykredit is committed to a transparent and credible business conduct – in compliance with legislation and the Stock Exchange Code of Ethics.

Internal and external risk reports are submitted regularly to the Group's boards of directors and executive boards. Internal reporting includes analyses of material matters in, for instance, Nykredit's business areas and subsidiaries.

**Monitoring**

Nykredit's Audit Board and Risk Board regularly receive reports from the Executive Board and internal/external audit on compliance with the guidelines provided, business procedures and rules as well as reviews of model-related initiatives and changes.

## CHIEF RISK OFFICER AND RISK REPORTING

### Chief Risk Officer

The responsibilities of the Chief Risk Officer extend to all activities involving risk, including also risks relating to outsourced functions. This includes activities involving credit risk, market risk, liquidity risk and operational risk.

The Head of Nykredit's risk management function, Capital & Risk, has been appointed Chief Risk Officer. Nykredit's organisational structure, in which Capital & Risk has been segregated from all risk-taking entities of the Group, ensures independence between the Chief Risk Officer and the acting entities. The Group's central risk management function performs intercompany controls, monitors group risks and prepares risk reports for the boards of directors on all risk areas.

### Risk reporting

The internal models are the core of the day-to-day risk management of the Group. The models are checked on a continuous basis and validated at least once a year. The results are reported to the Risk Committee for approval once a year.

Internal Audit reviews the Group's internal models and their application annually. The review includes an assessment of the organisational structure, the estimation and validation of risk parameters and verification that the Group complies with the requirements of the Capital Requirements Regulation (CRR) and the Danish Financial Business Act.

Over the past few years, Nykredit has expanded and improved the current risk reporting. Risk is reported to the boards of directors, committees, executive boards, the relevant management levels and the business areas.

## CREDIT POLICY AND CREDIT APPROVAL AUTHORITY

The credit policy lays down Nykredit's risk profile as determined by the Board of Directors. It is based on Nykredit's strategy and the aim that customers should perceive Nykredit as a reliable and competent partner. The credit policy should be seen in conjunction with Nykredit's return requirements and the business objectives of growth and profitability. Business activities with customers should thus be based on balanced risk management and the desire for a strong capital structure.

Assessing a customer's creditworthiness is the core element of credit granting. The security provided may support the assessment of a customer's creditworthiness as a supplement. Security provided is determined using a conservative approach based on the market value less a margin.

The credit policy is supplemented by business procedures setting out the practical implementation of the credit policy and by credit approval instructions determining the credit approval authority delegated in Nykredit.

The Board of Directors is presented with the Group's largest credit applications for approval or briefing on a current basis. The Board of Directors is briefed semi-annually about any impairment losses in excess of DKK 30m and annually about any exposures to members of the Board of Directors, the Executive Board, etc.

Nykredit's local customer centres are authorised to decide on most credit applications in line with the Group's aim to process most credit applications locally. Credit applications exceeding the authority assigned to the centres are processed centrally by Group Credits. The applications received are decided by Group Credits unless they involve exposures of a size requiring the approval of the Credits Committee or the Board of Directors.

The Credits Committee grants or approves loans and/or facilities that, if granted, will bring Nykredit's total exposure to a customer over DKK 50m and, subsequently, when the exposure exceeds multiples of DKK 50m. The Board of Directors grants or approves loans and/or facilities that, if granted, will bring Nykredit's total exposure to a customer over DKK 200m and, subsequently, when the exposure exceeds multiples of DKK 100m. The credit limits are higher if the customer is a bank or mortgage lender.

### CREDIT APPROVAL AND MONITORING

Group Credits is responsible for managing and monitoring credit risk in accordance with the guidelines laid down by the Board of Directors and the Group Executive Board. The Credits Committee undertakes all reporting on individual credit exposures and is responsible for approving credit models and assessing credit risk at portfolio level.

When processing credit applications, the centres conduct an assessment of the individual customer. The assessment is based on a customer rating which reflects a conversion of a customer's probability of default computed by Nykredit's own credit models. The customer rating is supplemented with an assessment of the customer's financial position and any other relevant matters. In connection with mortgage loan applications, the statutory property valuations are also performed. All major customers have been assigned to a specific unit which is primarily responsible for serving the customer and for the credit quality of the exposure, including exposure reviews and the valuation of security.

Banking exposures exceeding DKK 2m and mortgage exposures exceeding DKK 20m are reviewed at least once a year. This forms part of the monitoring of credit exposures and is based on updated financial and customer information.

In connection with the review of banking and mortgage exposures exceeding DKK 2m and DKK 20m, respectively, or in connection with a credit event, it will be assessed specifically whether the customers concerned are weak. For exposures below the amount triggering an exposure review, the correctness of the rating will be assessed in case of a credit event or if the rating falls to "weak customer".

All weak exposures are reviewed at least once a year. Banking exposures are reviewed quarterly. The review includes as a minimum assessment of whether the customer category is appropriate and thus whether the customer is still weak. Also, it is checked that the exposure strategy is adhered to. Weak customers are described in detail under "Credit risk".

**Risk areas reviewed by group committees**

| | |
|---|---|
| **Risk Committee** | |
| **Capital policy and requirement** | Assessment of Nykredit's required own funds and future capital requirements |
| **Models and methodology** | Review of analyses and model-related initiatives and changes, including:<br>▪ New models and risk assessment methods<br>▪ Sensitivity analyses and stress tests<br>▪ Validation and back tests |
| **Risk reporting** | Review and analysis of:<br>▪ Credit risk, including LTVs<br>▪ Market risk<br>▪ Liquidity risk<br>▪ Operational risk<br>▪ Other risks<br>▪ New products<br>▪ Rating of bonds and companies |
| **Legislative measures** | Assessment of amendments to financial legislation from the Danish FSA and the EU. |
| | |
| **Asset/Liability Committee** | |
| **Liquidity** | Liquidity position and leverage of the Group and group entities<br>Current funding levels (SDOs/ROs, money market and senior capital)<br>Current funding activity (covered bonds and other funding)<br>Stress tests of free liquidity |
| **Capital structure and balance sheet** | Capital structure of group entities<br>Monitoring of employment of capital of the Group's business entities<br>Current funding capacity |
| **SDOs (Danish covered bonds)** | Assessment of development in prices of mortgaged properties<br>Required supplementary collateral and issuance of junior covered bonds |
| **Legislative measures** | Assessment of amendments to financial legislation from the Danish FSA and the EU |
| | |
| **Credits Committee** | |
| **Credit policy** | Maintenance and development of credit policies |
| **Approval of selected exposures** | Approval based on assessment of:<br>▪ Customer (finances, payment record, rating, etc)<br>▪ Exposure<br>▪ Security |
| **Board approval** | Recommendation to the Board of Directors concerning approval of special exposures beyond the authority of the Credits Committee |
| **Credit institutions** | Review of credit lines granted to credit institutions |
| **Loan impairment** | Approval and assessment of loan impairment provisions |

# CAPITAL AND CAPITAL ADEQUACY

## OWN FUNDS

Nykredit's own funds stood at DKK 65.6bn at end-2014 against DKK 65.3bn at end-2013.

Nykredit's Tier 1 capital consists mainly of equity. As shown in the table, Tier 1 capital after deductions amounted to DKK 61.7bn, of which Additional Tier 1 (AT1) capital accounted for DKK 6.2bn.

In 2014 Nykredit redeemed AT1 capital of EUR 500m. In order to meet the new capital requirements and Nykredit's capital targets at a comfortable margin, Nykredit issued EUR 600m of Tier 2 capital.

In accordance with the capital requirements, Tier 1 capital and own funds must be adjusted for the difference between the IRB losses and impairment and value adjustment for accounting purposes of exposures subject to internal ratings-based (IRB) approaches.

In line with FSA guidelines, IRB losses are determined based on the Basel parameter Loss Given Default (LGD) for the period 1991-1993, cf "IRB losses". IRB losses are a concept applied for regulatory purposes and do not correspond to Nykredit's own loss expectations. The main change relative to the previous rules is that all deductions from Tier 2 capital must be deducted from CET1 capital in future.

From 2015 the requirement for CET1 capital and Tier 1 capital increases from 4% to 4.5% and from 5.5% to 6.0%, respectively.

From 2015 and 2016 additional buffers will be phased in, increasing the requirements for both equity and total own funds. One of those buffers is a 2% SIFI buffer to be phased in gradually from 2015 to 2019. Nykredit's capital policy is described in detail under "Nykredit's capital targets towards 2019".

**Nykredit Realkredit Group**
**Own funds**

| DKK million | 2013 | 01.01 2014 | 2014 |
|---|---|---|---|
| **Common Equity Tier 1 (CET1) capital** | | | |
| **CET1 before deductions** | **58,511** | **58,511** | **59,502** |
| **CET1 primary deductions** | | | |
| Proposed dividend | - | - | - |
| Prudent valuation | - | - | (551) |
| Intangible assets, including goodwill, and deferred capitalised tax assets | (3,054) | (3,054) | (3,040) |
| Deferred tax assets | - | - | (23) |
| Current loss for the year | - | - | - |
| Exposures exempt from limits applicable to large exposures | - | - | - |
| Assets in defined-benefit pension fund | - | - | (214) |
| Equity investments > 10% | (399) | - | - |
| Sum of equity investments > 10% | - | - | - |
| Deduction for difference between IRB losses and impairments | (90) | (180) | (115) |
| Deduction for expected losses on equity investments | (25) | (50) | - |
| Other deductions | (277) | 0 | - |
| **Total CET1 deductions** | **(3,845)** | **(3,283)** | **(3,944)** |
| **Total CET1 capital** | **54,666** | **55,228** | **55,559** |
| **Additional Tier 1 (AT1) capital** | | | |
| **AT1 capital** | **10,678** | **8,542** | **6,746** |
| **AT1 deductions** | **-** | **-** | **(588)** |
| **Total AT1 capital** | **10,678** | **8,542** | **6,158** |
| **Total Tier 1 capital** | **65,344** | **63,770** | **61,717** |
| **Tier 2 capital** | | | |
| Subordinated debt | - | - | 4,463 |
| Revaluation reserves | 205 | 205 | - |
| Reserves in series | 32 | 32 | - |
| Charge for difference between IRB losses and impairments | - | - | - |
| **Tier 2 capital before deductions** | **237** | **237** | **4,463** |
| **Tier 2 deductions** | | | |
| Equity investments > 10% | (399) | (98) | - |
| Sum of equity investments > 10% | - | - | - |
| Deduction for difference between IRB losses and impairments | (90) | - | (573) |
| Deduction for expected losses on equity investments | (25) | - | - |
| Other deductions | 277 | - | - |
| **Total Tier 2 deductions** | **(237)** | **(98)** | **(573)** |
| **Total Tier 2 capital** | **0** | **139** | **3,890** |
| **Own funds** | **65,344** | **63,909** | **65,606** |

**Nykredit Realkredit Group**
**Loan capital 2014**

| DKK million | Interest rate | Call option | Maturity | Capital included |
|---|---|---|---|---|
| **Nykredit Realkredit A/S** | | | | |
| Additional Tier 1 capital | 9.0% until 1 April 2015, then floating | 1 April 2015 | Perpetual | 6,699 |
| Subordinated debt (Tier 2, CoCo) | 4.0% | 3 June 2021 | 3 June 2036 | 4,463 |
| **Total** | | | | **11,162** |
| | | | | |
| **Nykredit Bank A/S** | | | | |
| Additional Tier 1 capital | 3M Cibor + 1.7% until 1 May 2016, then floating | 1 May 2016 | Perpetual | 100 |
| **Total** | | | | **100** |

## DETERMINATION METHODS

### Credit risk

Nykredit has been authorised by the Danish FSA to use the advanced IRB approach to determine the risk exposure amount (REA) for credit risk in relation to:

- Retail and commercial exposures of Nykredit Realkredit A/S
- Retail exposures of Totalkredit A/S and Nykredit Bank A/S.

The foundation IRB approach is applied to determine REA for credit risk in relation to:

- Commercial exposures of Nykredit Bank A/S.

Nykredit has developed models in order that the part of the portfolio that is subject to the foundation IRB approach can be determined by means of the advanced IRB approach. Nykredit Bank has submitted an application to the Danish FSA.

The standardised approach is applied to determine REA for credit risk in relation to:

- Sovereign and credit institution exposures
- A few minor portfolios.

### Market risk

For the determination of REA for market risk, Nykredit Realkredit A/S has obtained FSA approval to apply a Value-at-Risk (VaR) model to estimate the general risk related to equities, debt instruments and foreign exchange. Only assets in the trading book are included. Empirical correlations across risk groups are applied.

Nykredit Bank A/S has obtained FSA approval to apply a VaR model to estimate the general risk related to debt instruments and foreign exchange.

For market risk in Totalkredit A/S and the parts of the portfolio for which REA is not determined using VaR, the standardised approach is applied.

Operational risk

All group companies apply the basic indicator approach to determine REA for operational risk.

### Transitional rules

REA is subject to a transitional rule and must constitute at least 80% of REA determined under Basel I.

## CONSOLIDATION METHODS

REA is determined according to the rules of the Danish Financial Business Act and the Capital Requirements Regulation (CRR). The determination comprises Nykredit Realkredit A/S (the Parent Company) and the enterprises in which Nykredit Realkredit A/S exercises direct or indirect control of the enterprises' financial and operational management. Nykredit Realkredit A/S and its subsidiaries are referred to collectively as Nykredit in this report.

The consolidated risk exposures include:

- Nykredit Realkredit A/S
- Totalkredit A/S
- The Nykredit Bank Group

Together with other enterprises, Nykredit controls an enterprise which is not included in the consolidated financial statements. This enterprise, JN Data, is recognised according to the equity method.

**Nykredit Realkredit Group**
**Share of total exposure covered by different approaches to credit risk determination**

| 2014 | Advanced IRB approach % | Foundation IRB approach % | Standardised approach % | Total % | Total exposures DKK million |
|---|---|---|---|---|---|
| Retail exposures | 99.9 | - | 0.1 | 100.0 | 754,673 |
| *Of which* | | | | | |
| *- mortgages over real estate* | *99.9* | - | *0.1* | *100.0* | *734,890* |
| *- revolving exposures, etc* | *100.0* | - | - | *100.0* | *0* |
| *- other retail exposures* | *100.0* | - | - | *100.0* | *19,783* |
| Commercial exposures | 74.6 | 23.1 | 2.3 | 100.0 | 522,533 |
| Credit institution exposures[1] | - | - | 100.0 | 100.0 | 74,375 |
| Sovereign exposures | - | - | 100.0 | 100.0 | 47,134 |
| Equity exposures [2] | 95.4 | - | 4.6 | 100.0 | 3,828 |
| Assets with no counterparty | 100.0 | - | - | 100.0 | 4,263 |
| Credit value adjustments (CVA) | - | - | 100.0 | 100.0 | 3,388 |
| Default fund contribution | - | - | 100.0 | 100.0 | 312 |
| **Total 2014** | **81.6** | **8.6** | **9.8** | **100.0** | **1,410,507** |
| Total 2013 | **82.9** | **10.1** | **7.0** | **100.0** | **1,383,593** |

[1] Credit institution exposures include guarantees issued by banks of a total of DKK 8.7bn.
[2] REA for equity exposures in the banking book has been determined using the simple risk weight approach. Of the total exposure of DKK 3.8bn, DKK 2.5bn is unlisted equities and has been assigned a risk weight of 370%.

### DIFFERENCES COMPARED WITH FINANCIAL STATEMENTS

Unexercised loan offers, credit and loan commitments, and potential future credit exposures in financial instruments are included in exposures used for the determination of REA. The same applies to guarantees.

REA for securities are calculated at ISIN level.

### RISK EXPOSURE AMOUNT

At end-2014 Nykredit's REA totalled DKK 359bn. With own funds at DKK 65.6bn, this corresponds to a total capital ratio of 18.2% against DKK 18.9bn at end-2013. Common Equity Tier 1 (CET1) capital amounted to DKK 55.6bn, which was about DKK 600m higher than at end-2013.

Nykredit's REA subject to the transitional rule came to DKK 630bn at end-2014. The current transitional rule has been extended and so far applies until end-2017.

Required own funds stood at DKK 40.4bn at end-2014, equal to an internal capital adequacy requirement of 11.3%. The determination of the internal capital adequacy requirement is described further under "Capital management".

### OWN FUNDS AND RISK EXPOSURE AMOUNTS OF GROUP COMPANIES

All companies of the Nykredit Group have total capital ratios at comfortable levels above the statutory 8%.

At end-2014 Nykredit Realkredit A/S's REA amounted to DKK 380bn and own funds stood at DKK 65.6bn. Totalkredit A/S had DKK 93.4bn of REA and DKK 19.5bn of own funds. The Nykredit Bank Group had DKK 94.1bn of REA and DKK 12.4bn of own funds.

**Nykredit Realkredit Group**
**Risk exposure amount and capital adequacy**

| DKK million | 2013 | 01.01.2014 | 2014 |
|---|---|---|---|
| **Credit risk** | | | |
| Standardised approach | 15,173 | 15,173 | 20,115 |
| IRB approach | 283,402 | 283,388 | 283,501 |
| Securitisations, IRB approach | 14 | 14 | - |
| New capital rules | - | 2,357 | - |
| Default fund contribution | - | - | 312 |
| Credit value adjustment (CVA) | - | - | 1,394 |
| **Total credit risk** | **298,574** | **300,931** | **305,322** |
| **Market risk** | | | |
| Internal models | 19,472 | 19,472 | 26,272 |
| Standardised approach | 9,099 | 9,099 | 9,061 |
| **Total market risk** | **28,571** | **28,571** | **35,333** |
| **Operational risk** | | | |
| Basic indicator approach | 18,818 | 18,818 | 17,933 |
| **Total operational risk** | **18,818** | **18,818** | **17,933** |
| **Total REA** | **345,963** | **348,320** | **358,589** |
| | | | |
| Own funds | 65,344 | 63,909 | 65,606 |
| Total capital ratio, % | 18.9 | 18.3 | 18.2 |
| CET1 capital ratio, % | 15.8 | 15.9 | 15.4 |
| Internal capital adequacy requirement, % | 10.4 | 10.4 | 11.3 |
| CET1 capital ratio, fully loaded[1], % | - | - | 13.8 |
| | | | |
| **Basel II transitional rule** | | | |
| **REA subject to transitional rule[2]** | **632,272** | **632,272** | **629,817** |

Note: "01.01.2014" shows REA according to the new rules applicable from 2014.
[1] Fully loaded with respect to future rules and expected REA levels following implementation of new credit models.
[2] REA subject to the transitional rule has been determined in accordance with the transitional legislative provisions. REA in 2014 must constitute at least 80% of REA determined under Basel I.

**Nykredit Realkredit Group**
**Own funds and risk exposure amounts of group companies**

| 2014<br>DKK million | Nykredit Realkredit A/S | Totalkredit A/S | Nykredit Bank Group | Nykredit Realkredit Group |
|---|---|---|---|---|
| Credit risk | 348,765 | 87,427 | 76,730 | 305,322 |
| Market risk | 21,767 | 2,912 | 12,417 | 35,333 |
| Operational risk | 9,705 | 3,049 | 4,904 | 17,933 |
| **Total REA not subject to transitional rule** | **380,237** | **93,388** | **94,051** | **358,589** |
| **Total REA subject to transitional rule[2]** | **411,342** | **223,951** | **71,969** | **629,817** |
| | | | | |
| **Own funds** | **65,630** | **19,540** | **12,365** | **65,606** |

[1] Including intercompany exposures, for which reason the credit risk is greater for the company than for the Group.
[2] REA subject to the transitional rule have been determined in accordance with the transitional legislative provisions. REA must constitute at least 80% of REA determined under Basel I.

# CAPITAL MANAGEMENT

**NYKREDIT'S CAPITAL AND RISK POLICY**

In October 2014, the Board of Directors laid down a capital and risk policy which contains an explicit formulation of the Group's capital policy and risk appetite.

The overall risk appetite is determined on the basis of Nykredit's strategy, regulatory and credit rating agency capital requirements and the capital targets set out by the Board of Directors. The risk appetite reflects Nykredit's overall tolerance for taking risks. In some areas, it is directly measurable through credit policies, targets, limits or restrictions, while in other areas our risk appetite is expressed through overall objectives.

Nykredit's overall risk appetite is formulated in the box below.

Nykredit's capital targets are determined on the basis of the estimated market standard for a business with Nykredit's characteristics. Nykredit's capital policy is described under "Capital targets 2015-2019" below.

**Nykredit's overall risk appetite**

**The objective is to be able to maintain active lending to the Group's full-service customers, also in a challenging economic climate.**

This is to be achieved as follows:

| | |
|---|---|
| **Capital:** | by having equity after deductions at 15% of REA and own funds at 18-20% of REA (target for 2019). |
| **Credit:** | by having a credit policy that regulates the level of large exposures as well as the composition of the loan portfolio across mortgage/bank lending, lending to personal customers and special lending segments. Credit risk is measured, for example, through the loss risk during a mild macroeconomic stress and during stress conditions with high unemployment and relatively high interest rates. |
| **Market risk:** | by having a market risk policy according to which the market risk in ordinary stress tests does not result in a net loss at group level measured four quarters ahead – and which specifies limits to all significant market risks. |
| **Liquidity:** | by having a liquidity policy that sets out targets for relevant stress scenarios, including both market and credit institution-specific stress factors. The liquidity policy must provide a very high probability that Nykredit maintains a strong position in the stress scenarios outlined. |
| **Leverage:** | by limiting financial leverage so that Tier 1 capital after deductions relative to lending does not exceed the regulatory maximum limit applicable at any time, currently expected to be 3%. |
| **Operational risk:** | by having operational risks which are low relative to other risks and which are assessed on the basis of the probability of a given event and the loss resulting from such event. |

**REQUIRED OWN FUNDS**

Pursuant to the Danish Financial Business Act, it is the responsibility of the Board of Directors and the Executive Board to ensure that Nykredit has the required own funds. The required own funds are the minimum capital required, in Management's judgement, to cover all significant risks.

The determination takes into account the business objectives and capital policy targets by allocating capital for all relevant risks, including any model uncertainties.

The determination of the internal capital adequacy requirement of both the Group and the group companies involves a comparison of Nykredit's own assessment of the required own funds and the results obtained using the 8+ method of the Danish FSA.

Required own funds consist of two components: Pillar I and Pillar II.

*Pillar I*

Pillar I capital covers credit, market and operational risks. The Pillar I requirement is identical to the statutory capital requirement.

*Pillar II*

Pillar II comprises capital to cover other risks as well as an increased capital requirement during an economic downturn. The capital requirement during a slight economic downturn is determined by means of stress tests, cf "Stress tests and capital projections".

Nykredit applies the following methods to determine required own funds:

- Credit risk is determined using Nykredit's internal IRB models, which are also applied to determine the statutory capital requirement.
- Market risk is determined using Nykredit's internal VaR model, including stressed VaR. The calculation is the same as for the statutory capital requirement.
- No deductions are made from required own funds for any diversification effects between risk types, business areas or countries.
- Stress tests are applied to determine the capital requirement for increasing impairment losses and the capital requirement in a slightly weaker economic climate.
- Operating losses in stress tests increase the capital requirement, while operating profits are not included.

These calculation methods support the aim of maintaining a stable capital level even if the economic climate deteriorates.

*Slightly weaker economic climate*

In its Pillar II assessment, Nykredit assumes that a slightly weaker economic climate will set in, which is compared with the forecasts of economic trends from various recognised sources.

In a slightly weaker economic climate, the need for capital will grow concurrently with falling property prices and increasing arrears. The calculations also factor in any operating losses due to higher impairment losses etc.

*Other factors*
The determination of other factors includes assessments of reputation risk, control risk, strategic risk, external risk, concentration risk, interest rate risk on swaps and CVA etc as well as a general capital charge for uncertainties. About DKK 2.7bn has been provided for the effects of the new models to be implemented in 2015, including new IRB models applied for the Bank's commercial exposures.

The new IRB models are described in detail under "Credit risk models".

*Model and calculation uncertainties*
Nykredit applies various models to calculate the capital requirements under both Pillar I and Pillar II.

The capital requirement calculated depends on the choice of model, model design, level of detail, etc. Under Pillar II, a capital charge is included to reflect the uncertainty of the models used. Generally, the charge applied corresponds to 10% of the amounts calculated.

Nykredit has considered the other future requirements for assessing the internal capital adequacy requirement. They are covered by the existing determination method. The assessments do not give rise to further capital charges in the determination of required own funds or internal capital adequacy requirements for Nykredit or group companies.

## STRESS TESTS AND CAPITAL PROJECTIONS

Nykredit conducts a large number of model-based stress tests and capital projections to determine the required own funds in the current economic climate and in a severe recession scenario. The results are applied at both group and company level and are included in the annual assessment by the individual boards of directors of the internal capital adequacy requirement as well as in the future capital planning. In the determination of the capital requirements, the stress tests are not the only element, but are included in an overall assessment along with the company's capital policy, risk profile and capital structure.

The stress test calculations include the macroeconomic factors of greatest importance historically to Nykredit's customers.

The most important macroeconomic factors identified are:
- Interest rates
- Property prices
- GDP growth
- Equity prices
- Unemployment.

**Nykredit Realkredit Group**
**Required own funds**

| 2014<br>DKK million | Nykredit Realkredit A/S[1] | Totalkredit A/S | Nykredit Bank Group | Nykredit Realkredit Group |
|---|---|---|---|---|
| Credit risk (IRB approach) | 27,901 | 6,994 | 6,138 | 24,426 |
| Market risk (internal Value-at-Risk-model) | 1,741 | 233 | 993 | 2,827 |
| Operational risk (standardised approach) | 776 | 244 | 392 | 1,435 |
| **Total Pillar I** | **30,419** | **7,471** | **7,524** | **28,687** |
| | | | | |
| Model and calculation uncertainties | 3,440 | 896 | 1,004 | 3,674 |
| Slightly weaker economic climate (stress tests, etc) | 1,646 | 1,311 | 524 | 3,510 |
| Other factors [2] | 2,335 | 175 | 1,987 | 4,538 |
| **Total Pillar II** | **7,421** | **2,381** | **3,515** | **11,722** |
| **Total required own funds** | **37,839** | **9,853** | **11,039** | **40,409** |

[1] The credit risk of Nykredit Realkredit A/S includes the capital charge for intercompany exposures, including investments in subsidiaries and joint funding with Totalkredit A/S. Intercompany exposures are eliminated in the determination for the Nykredit Realkredit Group, for which reason the credit risk is higher for Nykredit Realkredit A/S than for the Nykredit Realkredit Group.
[2] Other factors include assessment of control risk, strategic risk, external risk, concentration risk, liquidity risk, etc.

**Nykredit Realkredit Group**
**Internal capital adequacy requirement**

| 2014<br>% of REA | Nykredit Realkredit A/S | Totalkredit A/S | Nykredit Bank Group | Nykredit Realkredit Group |
|---|---|---|---|---|
| Credit risk (internal credit risk model) | 7.3 | 7.5 | 6.5 | 6.8 |
| Market risk (internal Value-at-Risk model) | 0.5 | 0.5 | 1.1 | 0.8 |
| Operational risk (standardised approach) | 0.2 | 0.3 | 0.4 | 0.4 |
| **Total Pillar I** | **8.0** | **8.0** | **8.0** | **8.0** |
| | | | | |
| Model and calculation uncertainties | 0.9 | 1.0 | 1.1 | 1.0 |
| Slightly weaker economic climate (stress tests, etc) | 0.4 | 1.4 | 0.6 | 1.0 |
| Other factors[1] | 0.7 | 0.2 | 2.0 | 1.3 |
| **Total Pillar II** | **2.0** | **2.6** | **3.7** | **3.3** |
| **Total internal capital adequacy requirement** | **10.0** | **10.6** | **11.7** | **11.3** |

[1] Other factors include assessment of control risk, strategic risk, external risk, concentration risk, liquidity risk, etc.

Nykredit generally operates with three scenarios for the macroeconomic development: a base case scenario, a slightly weaker economic climate and a severe recession. Both in a slightly weaker economic climate and during a severe recession, the capital requirement for credit risk builds on correlations between the macroeconomic factors, customer default rates (PD) and the size of the loss in case of customer default (LGD). These correlations are an essential element of the capital projection model.

**Scenario: Base case**
This scenario is a projection of the Danish economy based on Nykredit's assessment of the current economic climate.

**Scenario: Slightly weaker economic climate in 2015-2017**
This scenario is designed to illustrate a slightly weaker economic climate relative to the base case scenario. The capital charge reflects how much Nykredit's capital requirement would increase if this scenario should occur.

The capital charge for a slightly weaker economic climate came to DKK 3.5bn at 31 December 2014.

**Scenario: Severe recession**
A central element of Nykredit's capital policy is to have sufficient own funds, also in the long term. The assessments are also factored into the current assessment of equity targets going forward.
Nykredit continually calculates the impact of severe recession combined with a relatively high interest rate level. When determining the size of the countercyclical buffer, it is assumed that the current lending volume is maintained regardless of the economic downturn.

Nykredit's severe recession scenario reflects an extreme, but not unlikely, situation.

In case of a severe recession, REA will increase by approximately DKK 100bn.

**Other stress tests**
As part of the Group's capital policy, in addition to calculating its own scenarios, Nykredit also assesses the stress scenarios prepared by the Danish FSA. The scenarios of the FSA and Nykredit are generally similar, but differ in terms of model setup. The results are compared regularly.

The FSA stress scenarios, which cover mortgage banks as well, have not given rise to adjustments of Nykredit's own capital targets.

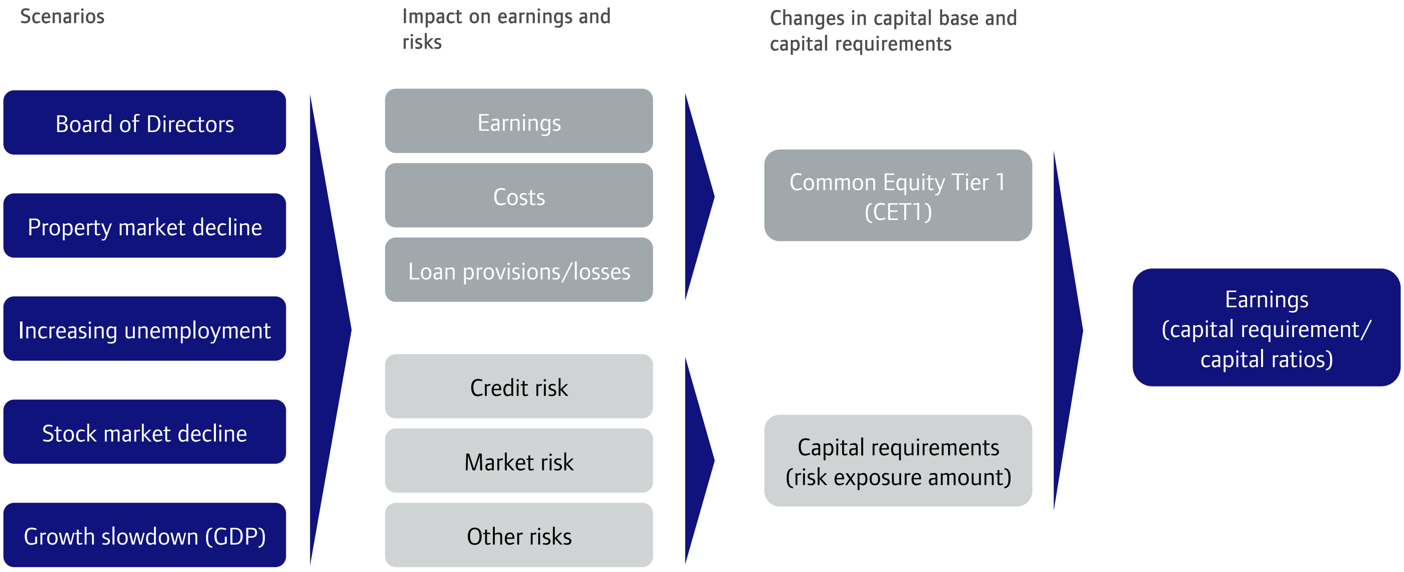
Nykredit also participates in the stress test exercises of the European Banking Authority (EBA), most recently in 2014. Nykredit also regularly participates in European studies of capital issues and releases of lending and risk data. The results have confirmed Nykredit's strong capital position.

**Stress scenarios for determination of capital requirement**

| % | 2015 | 2016 | 2017 |
|---|---|---|---|
| **Base case scenario** | | | |
| GDP growth | 1.7 | 1.6 | 1.7 |
| Interest rates[1] | 0.9 | 1.0 | 1.0 |
| Property prices, growth | 1.3 | 2.4 | 2.5 |
| Unemployment | 3.7 | 3.6 | 3.6 |
| Danish equity index, growth | 2.0 | 2.0 | 2.0 |
| | | | |
| **Slightly weaker economic climate (scenario applied under Pillar II)** | | | |
| GDP growth | (0.5) | 0.0 | 0.4 |
| Interest rates[1] | 2.3 | 2.8 | 3.7 |
| Property prices, growth | (3.0) | (3.0) | 0.0 |
| Unemployment | 5.2 | 6.0 | 6.2 |
| Danish equity index, growth | (5.0) | (5.0) | 0.0 |
| | | | |
| **Severe recession (scenario applied under capital targets)** | | | |
| GDP growth | (3.0) | (2.0) | 0.0 |
| Interest rates[1] | 5.5 | 6.5 | 7.0 |
| Property prices, growth | (12.0) | (10.0) | (5.0) |
| Unemployment | 6.5 | 9.0 | 10.0 |
| Danish equity index, growth | (10.0) | (10.0) | (5.0) |

[1] Average of 3-month money market rates and 10-year government bond yields.

**Structure of stress tests and capital projections**



### INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

On the basis of an internal capital adequacy assessment process (ICAAP), the boards of directors of the individual group companies determine the required own funds and internal capital adequacy requirement (ICAAP result) of their respective companies during a slightly weaker economic climate at least once a year. In addition, the Board of Directors of the Nykredit Realkredit Group determines the countercyclical buffer, which is an element of Nykredit's capital planning.

The boards of directors will reassess the ICAAP results if any major unexpected events occur.

The determination of the internal capital adequacy requirements by the individual boards of directors is based on a number of stress tests as well as an assessment of the company's business model, risk profile and capital structure.

Furthermore, the Risk Committee monitors the development in the internal capital adequacy requirements of the individual companies closely and is briefed at least quarterly. The Asset/Liability Committee monitors and coordinates the capital, funding and liquidity of the Group and the individual group companies.

### CAPITAL TARGETS 2015-2019

The overall capital policy and risk appetite are determined annually by the Board of Directors, including the Group's capital targets.

The capital targets are based on the current business volume with REA at approximately DKK 360bn and the change of DKK 35bn following from, inter alia, the statutory implementation of the advanced IRB approach for lending in Nykredit Bank. Today, the Bank uses the foundation IRB approach. The implementation has awaited the compilation of sufficient historical loss data for the Bank to build the required statistical models.

#### Nykredit's capital targets towards 2019

- Nykredit's target is equity to the tune of 15% of REA, to which should be added the statutory deductions from equity of approximately DKK 5bn. An equity level of 15% is significantly higher than the formal statutory requirement, but from a market perspective it is deemed necessary/appropriate for a major bond issuer such as Nykredit.
- Nykredit's target is a total capital ratio of 18-20% of REA. Also this level is markedly above the formal requirement, but from a market perspective it is deemed the necessary/appropriate level for a major bond issuer such as Nykredit.
- Nykredit aims to build a buffer in the order of DKK 10bn to achieve extra capital coverage during recessionary periods and to secure our growth potential. Such a buffer will help sustain a stable and active lending policy in relation to our customers.
- Nykredit is now entitled to issue non-voting shares for capitalisation purposes.

The capital requirement varies according to economic trends. All other things being equal, the requirement will rise in periods of high unemployment and high interest rates. This will be offset by two factors: Firstly, that Nykredit continually manages the employment of capital of the individual business entities and secondly, that the financial market demand for equity measured as a percentage of REA is expected to decrease to 13-14% in such a scenario.

#### Nykredit's equity requirement towards 2019

- In a normal economic climate and during an economic boom: equity of DKK 65bn excluding the growth and regulatory capital buffer (15% of DKK 400bn plus statutory deductions of DKK 5bn).
- Including the growth and regulatory capital buffer: equity of DKK 70bn-80bn.

**Nykredit Realkredit Group**
**Capital targets in 2019 at current business volumes**

### SUPERVISORY DIAMOND FOR MORTGAGE BANKS AND REFINANCING OF LOANS WITH 1-YEAR INTEREST RESET

In December 2014, the Danish FSA introduced a Supervisory Diamond for mortgage banks. In parallel to the Supervisory Diamond, bank loans resembling mortgage loans will be subject to special supervision.

The Supervisory Diamond has five indicators of which the benchmark for lending with short-term funding and the benchmark for interest-only (IO) loans are main areas in which Nykredit's loan mix must change in the coming years. Nykredit already complies with all the other requirements of the Supervisory Diamond.

Nykredit's/Totalkredit's most recent readjustment of administration margin rates and refinancing costs should be seen as important elements of incentivising our customers to choose the loan types that enable Nykredit to meet the requirements of the Supervisory Diamond.

Repayment loans and loans with longer-dated funding have become more attractive, and the prices of the otherwise very popular IO ARMs with 1-year interest rate reset are no longer attractive to our customers, partly due to the increased refinancing costs. Furthermore, a significant share of personal customers start making principal payments on their loans when the IO period ends. In addition, Nykredit will continue its efforts to deconcentrate loan refinancings over the year.

**Supervisory Diamond for mortgage lenders**

| Benchmark | Definition | Commencement | Nykredit |
|---|---|---|---|
| Lending growth | Annual lending growth may not exceed 15% in each of the segments personal customers, commercial residential property, agriculture and other commercial. | 2018 | In recent years, Nykredit's lending growth has been below the benchmark. |
| Borrower's interest rate risk | The proportion of lending where the LTV ratio exceeds 75% of the LTV limit and where the loan rate is fixed for up to 2 years only may not exceed 25% of the total loan portfolio. | 2018 | Nykredit already meets the benchmark. |
| Interest-only (IO) loans to personal customers | The proportion of IO loans for all-year and holiday housing with an LTV band above 75% of the statutory LTV limit may not exceed 10% of total loans and advances. | 2020 | Nykredit focuses on reducing the proportion of IO loans with high LTV ratios. The realignment process towards 2020 is thus well under way, and the limit value of maximum 10% is expected to be met before 2020. |
| Limitation of short-term funding | The proportion of loans to be refinanced must be below 12.5% per quarter and 25% per year. | 2020 | Taking the substantial refinancing activity into account, Nykredit is expected to meet the benchmark before 2020. |
| Large exposures | The sum of the 20 largest exposures must not exceed equity. | 2018 | Nykredit already meets the benchmark. |

# CREDIT RISK

Credit risk denotes the risk of loss following the non-performance of payment obligations by counterparties. This applies to counterparties in the form of the Group's borrowers and counterparties under financial contracts.

Total credit exposures of the Nykredit Realkredit Group came to DKK 1,411bn at end-2014 against DKK 1,384bn at end-2013. In terms of credit exposures, commercial lending accounted for 37% but in terms of risk exposure amount (REA), the proportion was 52%.

In the period end-2013 to end-2014, total REA grew by 2.3% from DKK 299bn to DKK 305bn. The rise was caused mainly by the higher credit exposure. In addition, REA was affected by an increase in the risk weight applied to credit institution exposures from 20% to 50% and by the fact that equity investments must now be risk weighted rather than be deducted from own funds. Further, the Danish FSA has ordered the IRB banks to apply higher risk weights to qualifying revolving retail exposures (QRRE). This also increases REA. Conversely, the lower LTVs of Totalkredit customers had a downward impact on REA.

Part of the Group's mortgage lending is backed by guarantees. The vast majority of guarantees received in connection with mortgage lending were issued by banks and are recognised as credit institution exposures. At end-2014, guarantees received in connection with mortgage lending amounted to DKK 9bn.

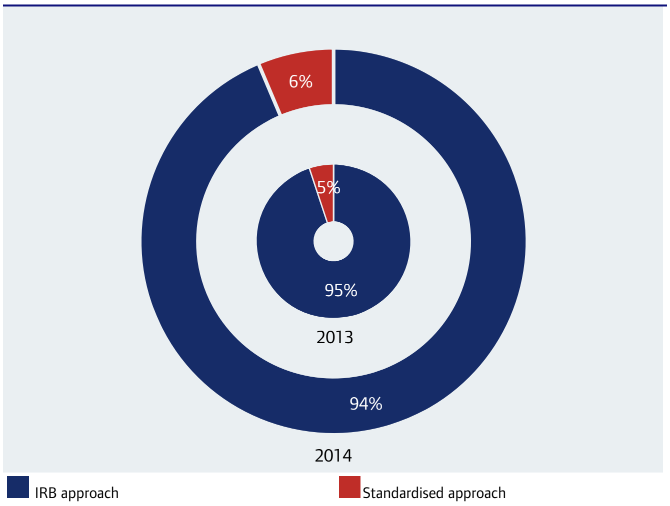
Similarly, guarantees issued by the government are recognised as sovereign exposures under mortgage lending. They amounted to DKK 32bn at end-2014.

**Elements of credit risk determination**

| | |
|---|---|
| PD | Probability of Default is the probability of a customer defaulting on an obligation to the Nykredit Group. |
| LGD | Loss Given Default is the loss rate of an exposure in case of a customer's default. |
| EAD | Exposure At Default is the total estimated exposure to a customer in DKK at the time of default, including any drawn part of a credit commitment. |
| Default | An exposure is in default where it is deemed improbable that the customer will repay all debt in full, or where a significant amount has been in arrears for 90 days. For mortgage products, Nykredit considers 75 days past due to be a clear sign that a customer is unable to repay its debt in full, while for bank products the third reminder will constitute such a sign. Exposures for which individual impairment provisions have been made or a direct loss has been incurred are also considered in default. |

The PD is customer-specific, while the other parameters are product-specific. One PD is therefore assigned to each customer, while each customer exposure has a separate LGD and EAD.

**Nykredit Realkredit Group**
**Determination of REA for credit risk**



**Nykredit Realkredit Group**
**Credit exposures and REA**

| 2014<br>DKK million/% | Mortgage lending | Bank lending | Guarantees issued | Other | Total exposures | *Of which undrawn commitments* | Exposure-weighted average risk weight, % | REA |
|---|---|---|---|---|---|---|---|---|
| Retail exposures | 717,693 | 13,648 | 11,585 | 11,747 | 754,673 | *8,372* | 15.3 | 115,794 |
| *Of which* | | | | | | | | |
| *- mortgages over real estate[1]* | *717,693* | *10,980* | *899[2]* | *5,318* | *734,890* | *4,888* | *14.5* | *106,413* |
| *- revolving exposures, etc* | - | - | - | - | - | - | - | - |
| *- other retail exposures* | - | *2,668* | *10,686[3]* | *6,429* | *19,783* | *3,483* | *47.4* | *9,382* |
| Commercial exposures | 386,660 | 38,545 | 8,671 | 88,657 | 522,533 | *17,168* | 30.2 | 157,848 |
| Credit institution exposures | 9,315 | - | 878 | 64,183 | 74,375 | *187* | 17.9 | 13,325 |
| Sovereign exposures | 32,067 | - | 1 | 15,067 | 47,134 | *3* | - | 0 |
| Equity exposures | - | - | - | 3,828 | 3,828 | - | 324.0 | 12,385 |
| Assets with no counterparty | - | - | - | 4,263 | 4,263 | - | 100.0 | 4,263 |
| Credit value adjustments (CVA) | - | - | - | 3,388 | 3,388 | - | 41.2 | 1,394 |
| Default fund contribution | - | - | - | 312 | 312 | - | 100.0 | 312 |
| **I alt 2014** | **1,145,735** | **52,194** | **21,135** | **191,444** | **1,410,507** | ***25,730*** | **21.6** | **305,322** |
| Total 2013 | 1,141,287 | 55,624 | 11,958 | 173,724 | 1,383,593 | *27,394* | 21.6 | 298,575 |

[1] Bank loans secured by real estate primarily relate to equity release credits (Friværdikonto).
[2] The guarantees include interim loans and buyer's certificates.
[3] The guarantees exclusively comprise mortgage registration guarantees.

**Nykredit Realkredit Group**
**Credit exposures by maturity**

| 2014<br>DKK million | Up to 1 year | Over 1 year and up to 5 years | Over 5 years | Total exposures |
|---|---|---|---|---|
| Retail exposures | 37,966 | 6,812 | 709,895 | 754,673 |
| *Of which* | | | | |
| *- mortgages over real estate[1]* | *18,182* | *6,812* | *709,895* | *734,890* |
| *- revolving exposures, etc* | - | - | - | - |
| *- other retail exposures* | *19,783* | - | - | *19,783* |
| Commercial exposures | 55,585 | 36,835 | 430,113 | 522,533 |
| Credit institution exposures | 64,183 | 878 | 9,315 | 74,375 |
| Sovereign exposures | 15,067 | 1 | 32,067 | 47,134 |
| Equity exposures | 3,650 | - | 177 | 3,828 |
| Assets with no counterparty | 4,263 | - | - | 4,263 |
| Credit value adjustments (CVA) | - | 3,388 | - | 3,388 |
| Default fund contribution | - | - | 312 | 312 |
| **Total 2014** | **180,713** | **47,914** | **1,181,880** | **1,410,507** |
| Total 2013 | 134,887 | 43,556 | 1,205,150 | 1,383,593 |

[1] Bank loans secured by mortgages over real estate primarily relate to equity release credits (Friværdikonto).

**Nykredit Realkredit Group**
**Credit exposures by counterparty**

| 2014<br>DKK million | Personal | Trade | Finance and insurance | Industry | Agriculture | Rental | Other | Total exposures |
|---|---|---|---|---|---|---|---|---|
| Retail exposures | 692,606 | 8,294 | 2,036 | 2,611 | 16,280 | 15,751 | 17,095 | 754,673 |
| Of which | | | | | | | | |
| *- mortgages over real estate* | *674,558* | *7,728* | *1,883* | *2,456* | *15,980* | *15,189* | *17,095* | *734,890* |
| *- other retail exposures* | *18,047* | *566* | *153* | *155* | *300* | *562* | *0* | *19,783* |
| Commercial exposures | 5,613 | 56,708 | 58,673 | 42,834 | 81,695 | 240,484 | 36,517 | 522,533 |
| Of which | | | | | | | | |
| *- SMEs* | *1,726* | *32,375* | *22,050* | *12,179* | *79,757* | *202,521* | *26,696* | *377,303* |
| Credit institution exposures | - | - | | | | | 74,375 | 74,375 |
| Sovereign exposures | - | - | | | | | 47,134 | 47,134 |
| Equity exposures | - | - | | | | | 3,828 | 3,828 |
| Securitisations | - | - | | | | | 4,263 | 4,263 |
| Assets with no counterparty | - | - | | | | | 3,388 | 3,388 |
| Default fund contribution | - | - | - | - | - | - | 312 | 312 |
| **Total 2014** | **698,219** | **65,002** | **60,709** | **45,454** | **97,975** | **256,235** | **186,912** | **1,410,507** |
| Total 2013 | 687,310 | 63,992 | 91,064 | 43,872 | 98,020 | 242,178 | 157,157 | 1,383,593 |

## FINANCIAL HEALTH OF CUSTOMERS

2014 saw a favourable development in the Danish labour market and mortgage rates. Average annual gross unemployment was about 5.1% in 2014 against 5.8% in 2013.

As a result, customers' ability to pay improved, and several observable indicators such as arrears, loans in default, acquired properties and incurred losses show that this had a positive overall effect on the Group's portfolio. This is reflected in a continuing decline in arrears ratios for large parts of the Group's mortgage lending. The 75-day arrears ratio for total group mortgage lending dropped from 0.47% to 0.42%. In respect of private residential mortgage lending, the arrears ratio was 0.28%, unchanged from 2013. With the exception of lending to the agricultural segment, the arrears ratios for the Group's mortgage lending to commercial customers declined. The arrears ratio for commercial lending dropped from 0.80% in 2013 to 0.65% in 2014.

The level of incurred losses increased relative to 2013, but the distribution between mortgage and banking activities remained unchanged.

However, despite the stable development in the credit risk relating to most of the Group's portfolios, certain minor portfolios involve a credit risk for the Group exceeding the risk following from average exposures. Nykredit has therefore made collective assessments of some of its commercial customers with an elevated credit risk. These customers are found mainly in the housing cooperative and agricultural segments.

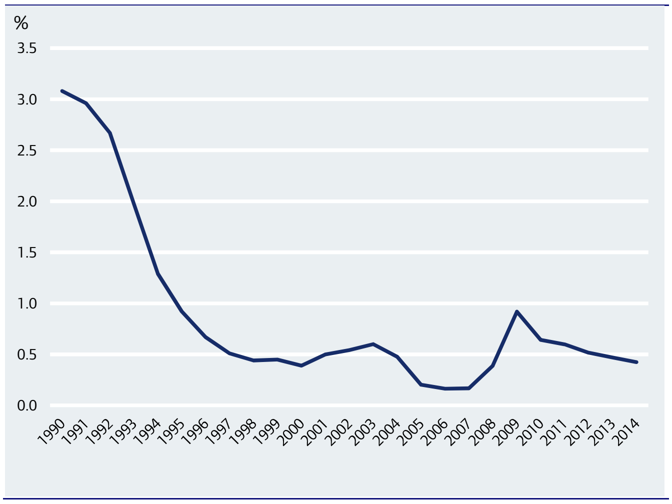
The risk pertaining to housing cooperatives mainly relates to cooperatives (i) established in the period 2005-2009, (ii) using financial instruments as part of their financing and (iii) having high LTV levels. The risk relating to this portfolio, including its sensitivity to changes in interest rates and to the legal set-up of housing cooperatives, is described in detail under "Counterparty risk".

In the agricultural segment, the expectation of declining earnings among milk and pig producers in particular has prompted Nykredit to stress test its agricultural portfolio. Arrears ratios were stress tested, and so were land and property prices on account of the expected earnings drop in the agricultural sector and the risk that many farmers may be forced to leave the industry. The stress tests gave rise to additional provisions for bank and mortgage loan impairment in the region of DKK 300m, bringing total impairment provisions for agricultural lending to DKK 1.0bn. Additional value adjustment of interest rate swaps amounted to about DKK 50m, bringing total provisions for swaps to DKK 400m. This should be seen in relation to total agricultural lending of just over DKK 100bn and interest rate swaps with negative market values totalling DKK 1.4bn.

Also, a more general assessment has been made of the portfolios with an elevated credit risk. This assessment included the retail area, ie homeowners in South and West Sealand and borrowers with expiring interest-only periods. The assessments led to a cautious approach to the exposures assessed. The result was an increased use of individual rating downgrades for certain customers as well as larger provisions for potential future losses following management judgement.

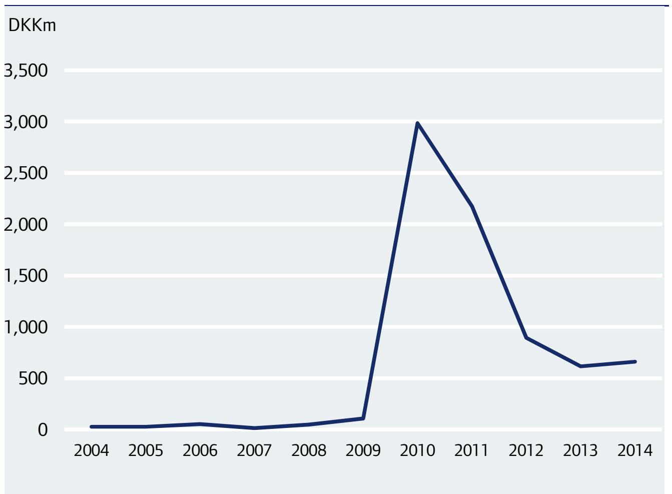
The financial statements of corporate clients reflect the relatively favourable macroeconomic conditions under which they operate. As a result, Nykredit's arrears and losses on this customer segment have

**Nykredit Realkredit Group – mortgage lending**
**Arrears ratio – 75 days past due**




**Nykredit Realkredit Group – mortgage lending**
**Incurred losses**


**Nykredit Realkredit Group – bank lending**
**Incurred losses**



improved quite considerably. By contrast, the economic conditions remain a challenge to small enterprises, especially those manufacturing for the domestic market.

As a result of the generally favourable macroeconomic trends, 75% of Nykredit's customers are characterised by timely payments and solid financial strength. For Nykredit's personal customers, the percentage is 78%, and for commercial, excluding agricultural, customers 76%. For agricultural customers, the percentage is 50%. Nykredit denotes these customers as "ordinary customers".

Of the remaining 25% of Nykredit's customers, 17 percentage points are considered "ordinary customers with some signs of weakness". These customers also make timely payments, but their financial strength is lower than that of "ordinary customers". Personal and commercial, excluding agricultural, customers make up 14% and 17%, respectively, of this group, and agricultural customers account for 37%.

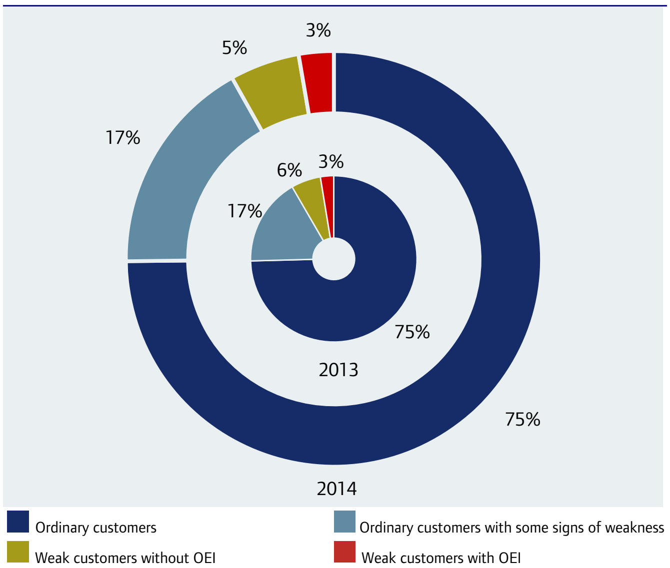
The remaining share of Nykredit's customers are considered "weak customers with or without objective evidence of impairment (OEI)". 3% of Nykredit's customers show OEI. Weak customers are described in detail below.

**Customers with signs of financial weakness**

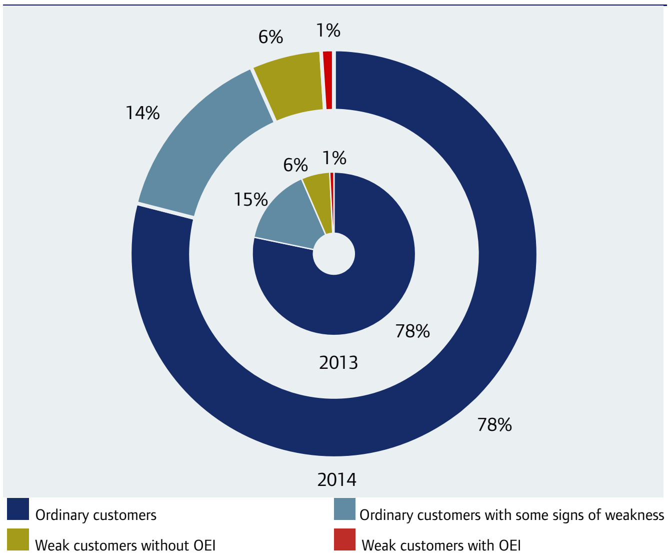
Nykredit considers customers with PDs between 3% and 100% as weak customers.

8% of Nykredit's customers were categorised as weak at end-2014, a small decline from end-2013 when the share was 9%. However, in the same period, the Danish FSA tightened the criteria for categorising a customer as weak, and Nykredit intensified its process of reviewing customers with incipient signs of weakness, and the generally declining arrears ratios are therefore not reflected in the share of weak customers. As a result of the Danish FSA's stricter criteria, the use of manual assessments of customer ratings has increased with a particular focus on agricultural, housing cooperative and personal customers.

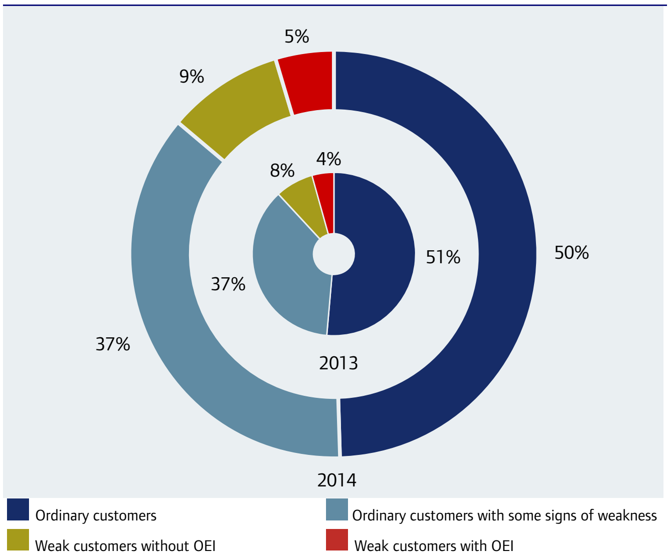
**Nykredit Realkredit Group**
**Breakdown of customers**



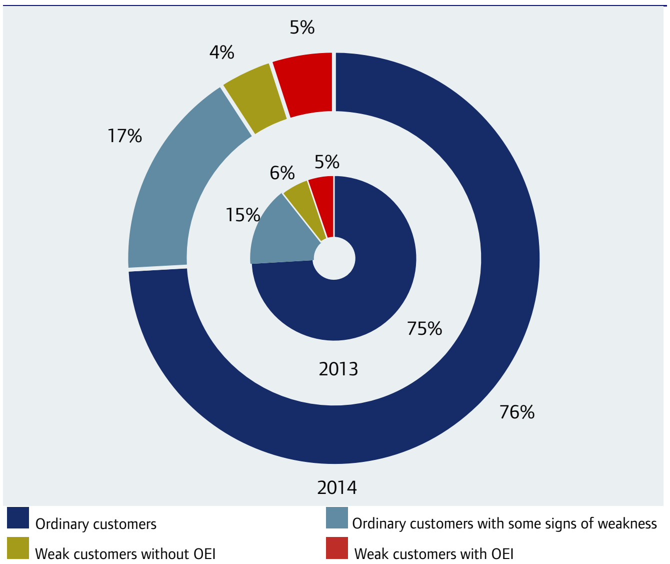

**Nykredit Realkredit Group – personal customers**




**Nykredit Realkredit Group – agricultural customers**




**Nykredit Realkredit Group – commercial customers excl agriculture**



**Arrears**
The arrears ratio for 2014 declined compared with 2013. At the September due date, the Group's 75-day mortgage loan arrears made up 0.42% of total mortgage payments due compared with 0.47% at the same time in 2013.

Arrears peaked in 2009; since then the arrears ratios for Nykredit Realkredit's private residential lending and Totalkredit's lending have more than halved. For 2014, the 75-day arrears ratio was 0.49% for Nykredit Realkredit's private residential lending and 0.23% for Totalkredit's lending.

In the commercial area, arrears ratios declined for Corporate & Institutional Banking clients in particular, but the arrears ratio for SMEs, although still relatively high, dropped as well. However, in the commercial segment, the agricultural sector stands out by having an increase in the 75-day arrears ratio. The ratio rose from about 0.77% in September 2013 to 0.94% at the same time in 2014.

**Loan impairment**
Regular individual reviews and risk assessments are conducted of all mortgage and bank exposures of a certain size with a view to uncovering any OEI and an expected adverse effect on future cash flows from an exposure. If necessary, impairment provisions are subsequently made for individual exposures.

Where OEI is identified for private residential mortgage lending, individual impairment provisions are calculated using a statistical model. Bank exposures are reviewed manually to identify any need for individual provisioning in case of OEI.

Exposures with OEI not subject to individual provisioning are subject to collective assessment. Collective impairment provisions are made for groups of loans involving uniform credit risk. For bank exposures, all customers are included in the calculation of collective impairment provisions.

Collective impairment provisions are calculated using a rating model that uses adjusted key parameters from the advanced credit models. Mortgage loans subject to collective provisioning include loans with PDs between 3% and 100% as well as loans in default for which no individual provisions have been made. All bank loans not provided for individually are included in the calculation of collective impairment provisions.

Impairment losses on loans and advances (earnings impact) declined by DKK 398m to DKK 2,336m at end-2014. The lower impairment losses reflect declining impairment losses at both Nykredit Bank, Nykredit Realkredit and Totalkredit. The decline in impairment losses on mortgage loans and advances was mainly caused by a drop in impairment losses on private residential property. In 2014 impairment losses mainly related to housing cooperatives and agricultural customers.

Total impairment provisions for mortgage lending rose by a net amount of DKK 1,128m compared with the beginning of the year, amounting to DKK 5,506m, or 0.50% of lending, at end-2014. The rise reflects an increase of DKK 779m in impairment provisions for private residential rental lending, including lending to housing cooperatives, and DKK 384m for agricultural lending.

Impairment provisions for bank loans and advances (including receivables from credit institutions and guarantees) came to DKK 3,711m at end-2014, equivalent to 7.3% of lending excluding reverse repurchase transactions.

Impairment losses on group lending are described in detail in the Annual Report of the Nykredit Realkredit Group available at nykredit.com/reports.

**Exposures in default**
For Nykredit as a whole, 2.2% of the exposures were in default. For Nykredit Realkredit and Totalkredit, 2.0% of total mortgage exposures were in default. The proportion of exposures provided for relative to exposures in default is considerably lower for Nykredit Realkredit and Totalkredit than for Nykredit Bank, as their mortgage exposures are fully secured.

For Nykredit Bank, loans in default accounted for 3.4% of the Bank's total exposures at end-2014. A breakdown shows that about 50% of exposures in default were subject to individual impairment provisioning. Of these, about 48% derived from the real estate and construction sectors. About 35% was broadly distributed across other business sectors and about 16% stemmed from the personal segment.

**Loan losses**
Total incurred loan losses on the Group's customers in 2014 were DKK 1,717m, equal to a loss ratio of 0.14%. The ratio is almost unchanged from 2013, indicating that the increase in Nykredit's loan losses in the wake of the financial crisis has stabilised. Nykredit's mortgage loan losses amounted to DKK 1,057m, while Nykredit Bank's loan losses came to DKK 660m.

About 60% of mortgage loan losses were on private residential lending, while 40% was on commercial lending.

Losses on the Group's mortgage lending increased relative to 2013. The rise is mainly attributable to higher losses in the commercial segment. Losses on Totalkredit loans have also increased, but losses on Nykredit Realkredit's private residential lending declined. In the private residential segment, South and West Sealand as well as Lolland-Falster still account for the majority of incurred losses. The higher losses in the commercial segment mainly reflected higher losses in the residential rental segment, but losses on lending for office and industrial properties also increased.

Considering the size of group lending, the level of losses is relatively low. This is due to the combination of low interest rates and relatively low unemployment, which supports the ability to pay, especially of personal customers.

Totalkredit's business concept is distribution of mortgage loans through its partner banks – Danish local and regional banks. The partner banks are responsible for customer services and hedging the loan portfolio risk. Risk is hedged by agreement with the partner banks. Under the agreement, realised losses corresponding to the cash part of a loan exceeding 60% of the mortgageable value of the property at the time of granting are offset against future commission payments from Totalkredit to the partner banks.

As a consequence of the set-off agreement, Totalkredit A/S is responsible for the full capital charge as well as any impairment losses on the loans. Through the set-off agreements with the partner banks, Totalkredit offset losses in the amount of DKK 270m in 2014.

The overall picture of Nykredit's bank loan losses is quite positive. At end-2014 the loss ratio was 1.3% (excluding reverse repurchase transactions). 87% of the Bank's losses related to commercial lending. In recent quarters, losses incurred on the Bank's commercial lending have been limited. Losses on the Bank's personal customers are low. The Bank's loan losses are generally characterised by being relatively volatile compared with mortgage loan losses.

## ACQUIRED PROPERTIES

During 2014 the Group acquired 375 properties at forced sales by public auction and sold 459. The property portfolio counted 238 properties at end-2014. By comparison, the Group had a portfolio in the region of 1,500 properties in the early 1990s.

**Nykredit Realkredit Group**
**Properties acquired/sold**

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Addition of properties | 375 | 356 | 551 | 529 | 448 |
| *Of which private residential* | *257* | *311* | *373* | *342* | *333* |
| | | | | | |
| Disposal of properties | 459 | 477 | 542 | 455 | 338 |
| *Of which private residential* | *339* | *352* | *378* | *283* | *261* |
| | | | | | |
| Property portfolio, year-end | 238 | 322 | 356 | 347 | 273 |
| *Of which private residential* | *126* | *196* | *237* | *242* | *183* |

**Nykredit Realkredit Group**
**Total individual and collective impairment provisions for loans and advances**

| 2014<br>DKK million | Provisions, individual impairment and other | Collective impairment provisions | Total impairment provisions | Total impairment provisions 2013 |
|---|---|---|---|---|
| Impairment provisions, beginning of year | 6,247 | 2,237 | 8,484 | 7,094 |
| Additions acquired | - | - | - | - |
| Impairment provisions for the year | 2,680 | 480 | 3,159 | 3,578 |
| Impairment provisions reversed | (1,018) | (115) | (1,132) | (990) |
| Value adjustment of acquired properties | (160) | - | (160) | (150) |
| Impairment provisions written off | (1,134) | - | (1,134) | (1,048) |
| **Impairment provisions, year-end** | **6,615** | **2,602** | **9,217** | **8,484** |
| | | | | |
| **Loans and advances before provisions** | **20,619** | **116,681** | **137,300** | **139,666** |
| Provisions | 6,615 | 2,602 | 9,217 | 8,353 |
| **Loans and advances after provisions** | **14,004** | **114,079** | **128,083** | **131,313** |

**Nykredit Realkredit Group**
**Total individual and collective impairment provisions for loans and advances**

| 2014<br>DKK million | Provisions, individual impairment and other | Collective impairment provisions | Total impairment provisions | Total claims in default |
|---|---|---|---|---|
| Retail exposures | 1,707 | 1,225 | 2,931 | 8,692 |
| *Of which* | | | | |
| *- mortgages over real estate* | *1,411* | *1,193* | *2,604* | *8,193* |
| *- revolving exposures, etc* | | | | |
| *- other retail exposures* | *296* | *31* | *327* | *498* |
| Commercial exposures | 4,866 | 1,377 | 6,125 | 22,645 |
| Credit institution exposures | 44 | 0 | 44 | 44 |
| Sovereign exposures | | | | |
| **Total** | **6,615** | **2,602** | **9,217** | **31,380** |

**Nykredit Realkredit Group**
**Loans, advances, guarantees and counterparty exposure as well as impairment losses on loans and advances**

| DKK million | Exposure[1] | | Exposure in default | | Total provisions for loan impairment and guarantees | | Impairment losses on loans and advances, earnings impact | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| **Mortgage lending** | | | | | | | | |
| Nykredit Realkredit | 629,469 | 646,897 | 21,386 | 20,372 | 4,270 | 3,204 | 1,712 | 1,826 |
| Totalkredit | 580,666 | 568,719 | 3,260 | 2,662 | 1,236 | 1,174 | 409 | 578 |
| **Total mortgage lending** | **1,210,135** | **1,215,616** | **24,646** | **23,034** | **5,506** | **4,378** | **2,121** | **2,404** |
| | | | | | | | | |
| **Bank lending** | **200,372** | **167,977** | **6,735** | **8,942** | **3,711** | **4,106** | **230** | **330** |
| *Of which* | | | | | | | | |
| *- Repo lending* | *62,918* | *73,901* | | | | | | |
| *- Guarantees* | *21,135* | *6,311* | | | *107* | *103* | *4* | *21* |
| **Total** | **1,410,507** | **1,383,593** | **31,380** | **31,976** | **9,217** | **8,484** | **2,336** | **2,734** |

[1] Exposure in the form of loans, advances and guarantees as well as counterparty exposure.

**Nykredit Realkredit Group**
**75-day arrears by property category and due date**

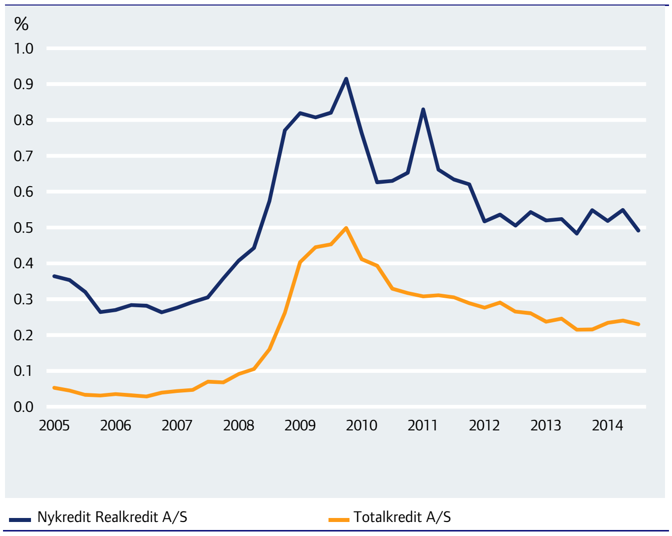
| DKK million | Loans and advances at fair value end-2014 | Loans and advances with individual provisioning | Total arrears | Arrears Q4/2014 | Arrears Q3/2014 | Arrears Q2/2014 | Arrears Q1/2014 | Arrears pre-2014 |
|---|---|---|---|---|---|---|---|---|
| Private residential property | 674,974 | 5,748 | 110 | 79 | 17 | 8 | 3 | 3 |
| Private residential rental | 87,575 | 1,753 | 28 | 17 | 5 | 2 | 2 | 2 |
| Industry and trades | 25,058 | 683 | 24 | 11 | 4 | 3 | 2 | 4 |
| Office and retail | 110,874 | 1,709 | 50 | 29 | 9 | 5 | 3 | 5 |
| Agriculture | 95,982 | 2,627 | 35 | 25 | 6 | 3 | 1 | 1 |
| Non-profit housing | 61,050 | 317 | 4 | 3 | 0 | 1 | 0 | 1 |
| Cooperative housing | 38,481 | 3,365 | 3 | 2 | 0 | 0 | 0 | 1 |
| Other | 219 | 219 | 3 | 2 | 0 | 0 | 0 | 0 |
| **Total** | **1,111,744** | **16,422** | **180** | **90** | **41** | **22** | **12** | **16** |

**Nykredit Bank Group**
**Total loans, advances and guarantees by sector**

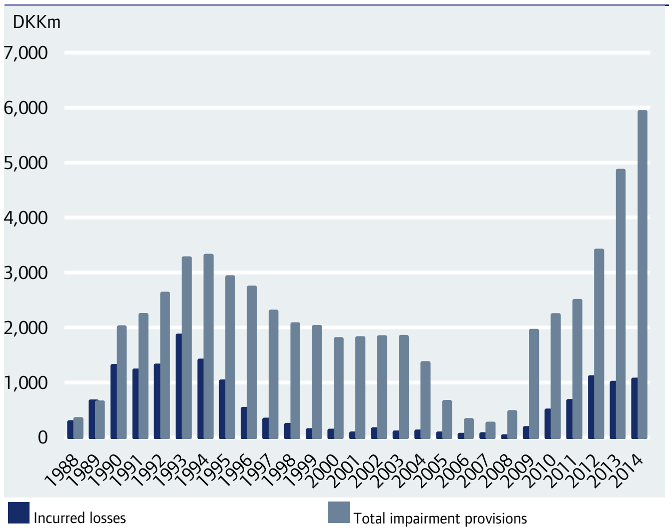
| DKK million | Loans, advances and guarantees | | Provisions for loan impairment and guarantees | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| **Public sector** | **596** | **493** | **0** | **8** |
| Agriculture, hunting, forestry and fishing | 3,230 | 2,026 | 138 | 177 |
| Manufacturing, mining and quarrying | 4,782 | 5,026 | 269 | 261 |
| Energy supply | 1,055 | 1,743 | 9 | 8 |
| Construction | 2,087 | 1,796 | 236 | 262 |
| Trade | 3,309 | 2,557 | 119 | 195 |
| Transport, accommodation and food service activities | 2,930 | 3,025 | 91 | 126 |
| Information and communication | 1,027 | 948 | 62 | 68 |
| Finance and insurance | 40.420[1] | 61,568 | 350 | 445 |
| Real estate | 13,071 | 10,676 | 1,540 | 1,465 |
| Other trade and industry | 9,643 | 7,811 | 305 | 422 |
| **Total commercial customers** | **81,554** | **97,176** | **3,119** | **3,429** |
| **Personal customers** | **24,465** | **17,789** | **592** | **641** |
| **Total** | **106,615** | **115,458** | **3,711** | **4,078** |

Note: The breakdown is based on public sector statistics and is therefore not directly comparable with Nykredit Bank's business areas.
[1] A significant part of lending for financial and insurance activities is based on lending with bonds serving as collateral (repo/reverse transactions).

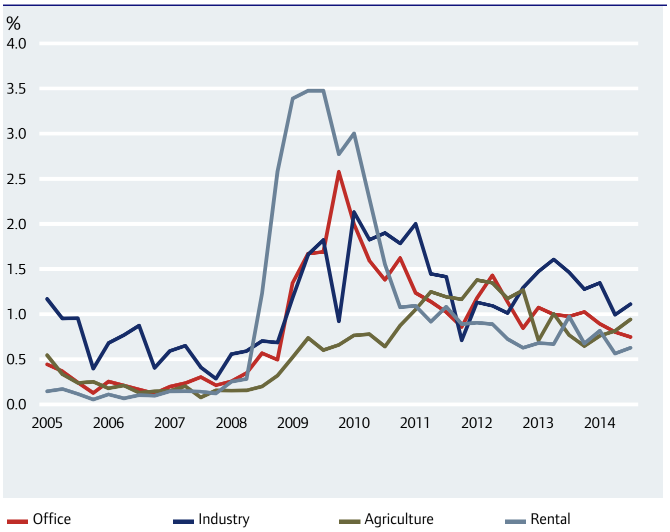
**Nykredit Realkredit Group – personal mortgage lending**
**Arrears ratio – 75 days past due**



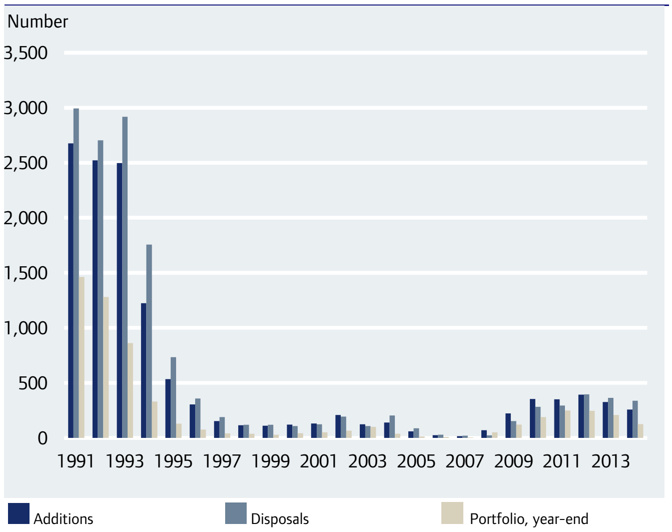

**Nykredit Realkredit Group – mortgage lending**
**Incurred losses and total impairment provisions**




**Nykredit Realkredit Group – commercial mortgage lending**
**Arrears ratio by sector – 75 days past due**




**Nykredit Realkredit Group – mortgage lending**
**Private residential properties acquired/sold**



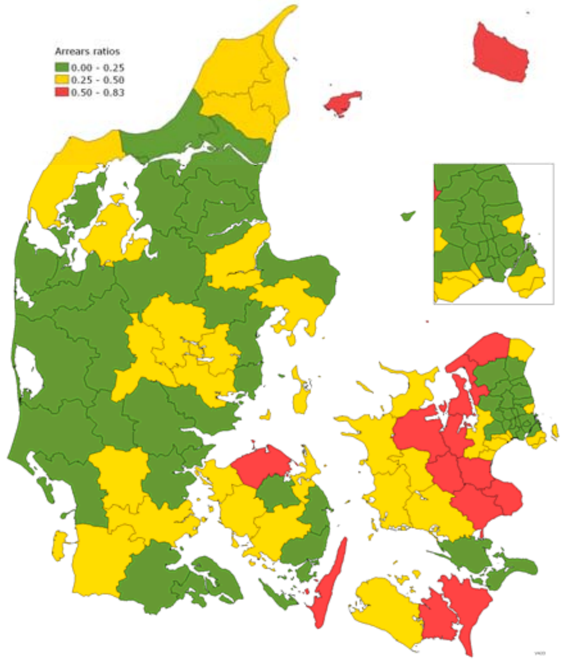
## CREDIT RISK AND REGIONAL OBSERVATIONS

The current growth upturn is mainly observed in the Copenhagen area. The same applies to the rise in employment and incomes. Following a crisis, it is natural for growth to return first in and about a country's cities. This time, however, there is a risk that the growth upturn in the Copenhagen area will not spread as fast to the rest of Denmark as after previous crises.

This phenomenon is related to recent years' structural rural-urban migration. As the urbanisation trend is part of a global megatrend, we expect it to continue over the next years.

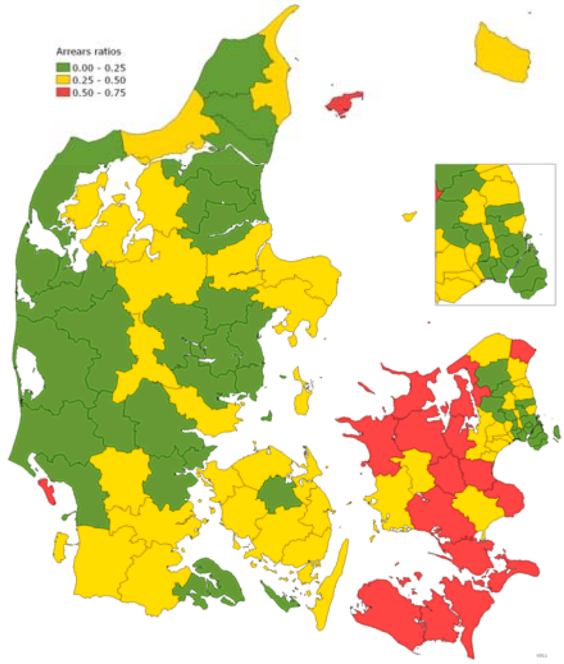
Nykredit's private residential lending was very stable throughout 2014 and remained concentrated around the large cities and parts of Jutland. A breakdown of arrears by region shows that South and West Sealand were still challenged, while arrears were significantly lower in Copenhagen and Jutland. Nykredit's losses on private residential lending were also concentrated in South and West Sealand and the North Jutland area around the Limfjord. Nykredit's losses on residential lending tend to be lower in and around the large cities and higher outside these areas. The regional angle on the Danish housing market is illustrated in more detail on the following pages.

**Nykredit Realkredit Group – private residential property**
**Arrears ratios 2013**



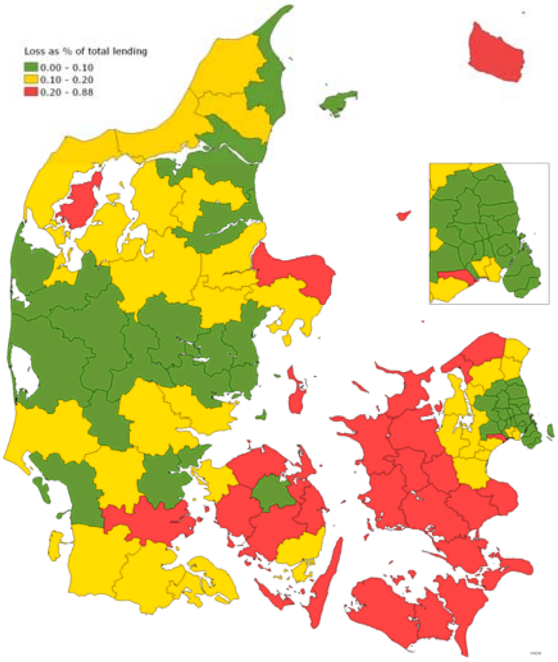

- The 75-day arrears ratio for private residential property was 0.26% at national level in 2013 (September due date).

**Nykredit Realkredit Group – private residential property**
**Arrears ratios 2014**



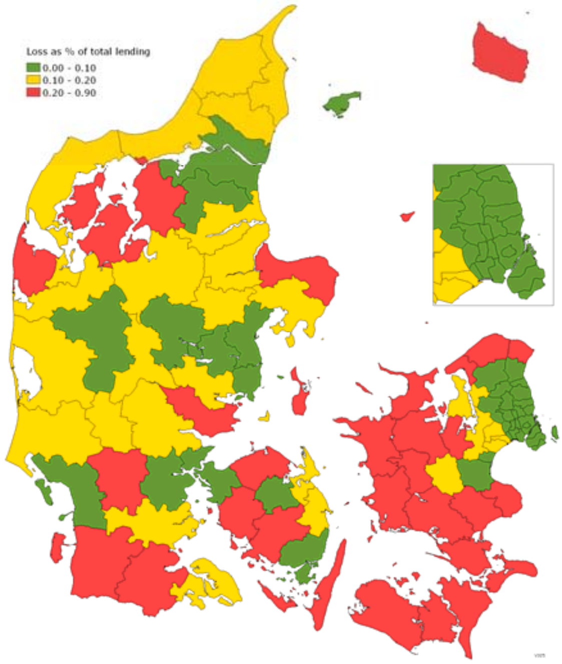

- The 75-day arrears ratio for private residential property was 0.28% at national level in 2014 (September due date).

**Nykredit Realkredit Group – private residential property**
**Losses relative to total lending 2013**



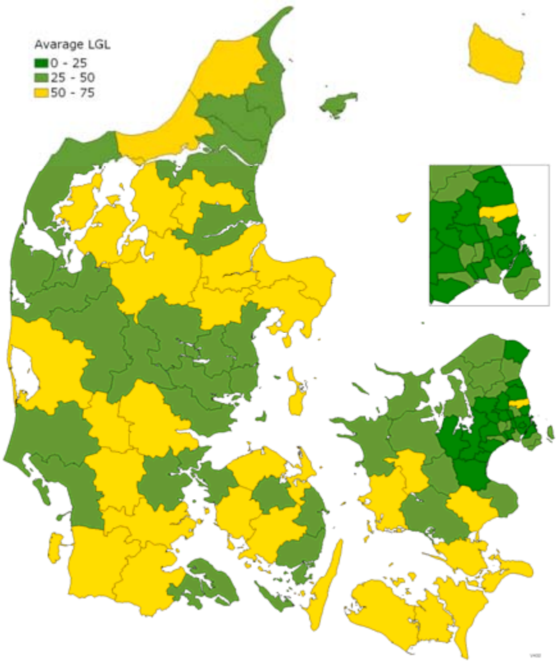

• At end-2013, the loss ratio (before set-off) for private residential property was 0.14% at national level.

**Nykredit Realkredit Group – private residential property**
**Losses relative to total lending 2014**



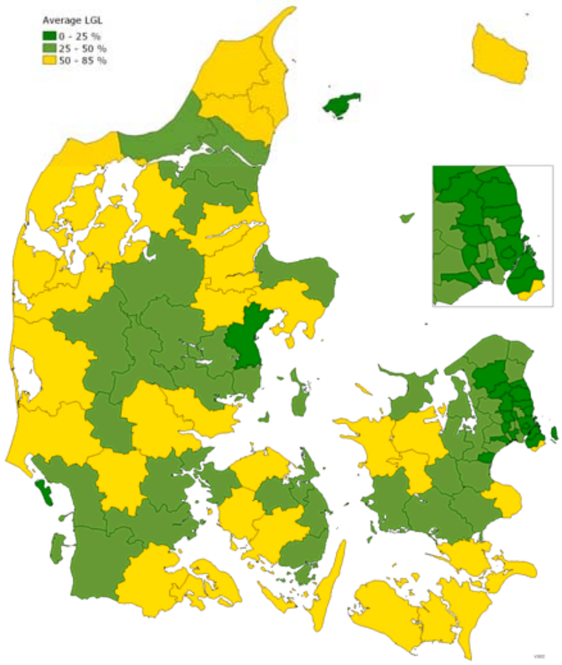

• At end-2014, the loss ratio (before set-off) for private residential property was 0.14% at national level (unchanged from 2013).

**Nykredit Realkredit Group – private residential property**
**Loss ratios by LGL 2013**




• In 2013, LGL for private residential property was 48.1% at national level.

**Nykredit Realkredit Group – private residential property**
**Loss ratios by LGL 2014**




• In 2014, LGL for private residential property was 46.5% at national level.

## MORTGAGE LENDING

Group mortgage lending at fair value was DKK 1,138bn at end-2014, which is largely unchanged on end-2013.

The portfolio is highly diversified in terms of loan type, geography, loan term and size of debt outstanding. A majority of the mortgage loans (60%) were granted to homeowners. Nykredit's lending to industry and trades and to office and retail amounted to 12%, while lending to agricultural customers accounted for 9%. Nykredit's lending to residential rental customers (non-profit housing and private rental) and housing cooperatives amounted to 14% and 3%, respectively.

The Group's portfolio of fixed-rate loans grew by almost DKK 19bn during 2014. The rise derived from fixed-rate loans with as well as without interest-only (IO) periods. The portfolio of IO loans increased by DKK 5bn, while fixed-rate repayment loans rose by DKK 14bn.

54% of all mortgage loans come with an optional IO period. 58% of mortgage loans for private residential property come with an optional IO period. The IO periods of loans totalling about DKK 23bn will expire in 2015.

Geographically, around 40% of the loan portfolio is in Jutland, 24% in the Copenhagen area and the remainder on Funen and the rest of Sealand.

### Concentration risk

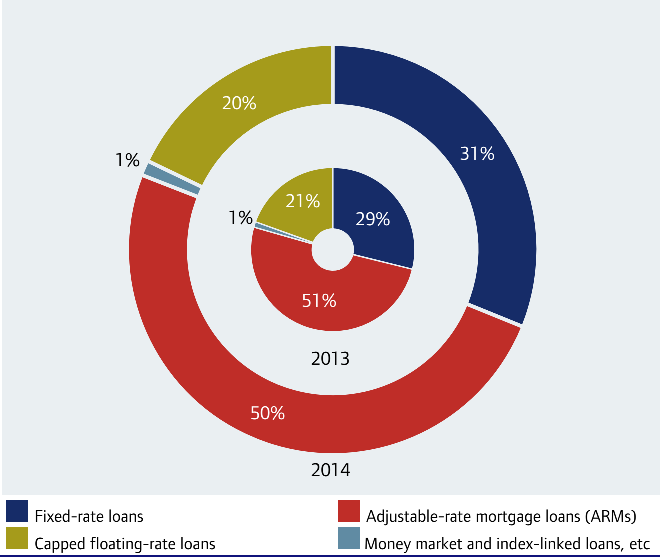
Based on indicators from the Danish FSA, the Group's mortgage lending is not deemed to have any specific geographic concentrations. Nor is there any sector concentration in relation to commercial lending, in Nykredit's opinion.

Nykredit's international credit exposures represent about 5% of the total portfolio. Nykredit has no lending for activities outside Europe.

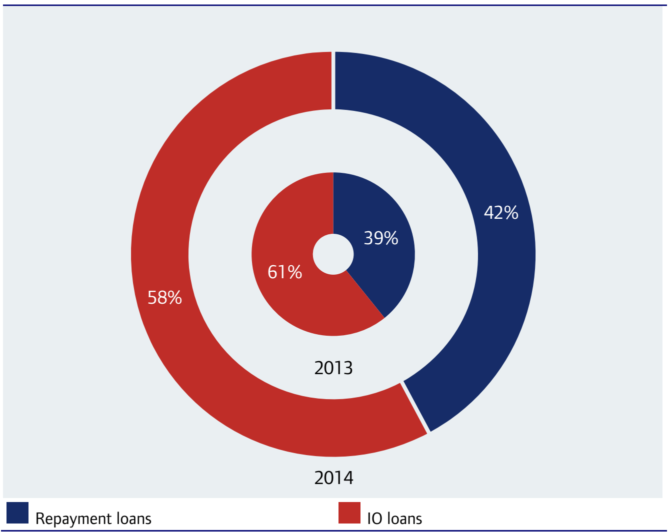
**Nykredit Realkredit Group**
**International lending at fair value**

| DKK million | 2014 | 2013 |
|---|---|---|
| Poland | 965 | 1,095 |
| Sweden | 21,468 | 21,577 |
| Germany | 15,987 | 15,183 |
| United Kingdom | 4,112 | 5,276 |
| France | 4,545 | 4,479 |
| Spain | 5,112 | 4,695 |
| Other | 6,545 | 6,277 |
| **Total international lending** | **58,734** | **58,583** |
| **Total lending** | **1,111,744** | **1,137,843** |

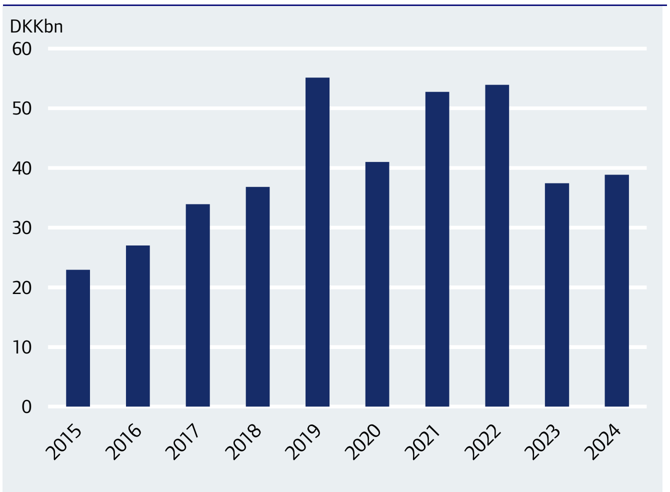
**Nykredit Realkredit Group**
**Private residential lending by loan type**




**Nykredit Realkredit Group**
**Private residential lending with/without IO periods**




**Nykredit Realkredit Group**
**Private residential lending with expiry of IO periods**



**Nykredit Realkredit Group**
**Mortgage lending**

| Fair value at end-2014<br>DKK million | Private residential property | Non-profit housing | Co-operative housing | Private residential rental | Office and retail | Agriculture | Industry and trades | Other | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Bond debt outstanding by property type** | | | | | | | | | |
| - Bond debt outstanding | 688,356 | 66,118 | 39,589 | 88,362 | 112,622 | 99,750 | 25,257 | 17,929 | 1,137,983 |
| - Number of loans | 719,296 | 17,459 | 5,831 | 26,868 | 22,932 | 39,785 | 3,444 | 2,920 | 838,535 |
| | | | | | | | | | |
| Bond debt outstanding by loans involving: | | | | | | | | | |
| - Public guarantees | 1 | 50,923 | 2,808 | 19 | 12 | 292 | 0 | 127 | 54,182 |
| - Bank guarantees[1] | 18,766 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 18,766 |
| - Set-off agreement with partner banks | 532,800 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 536,800 |
| - No guarantee | 132,789 | 15,195 | 36,781 | 88,343 | 112,610 | 99,458 | 25,257 | 17,802 | 528,235 |
| **Total** | **688,356** | **66,118** | **39,589** | **88,362** | **112,622** | **99,750** | **25,257** | **17,929** | **1,137,983** |
| **Bond debt outstanding by loan type** | | | | | | | | | |
| Fixed-rate loans | | | | | | | | | |
| - repayment loans | 139,049 | 20,860 | 7,903 | 4,703 | 9,535 | 6,870 | 1,386 | 3,373 | 193,679 |
| - loans with IO period | 75,305 | 6 | 1,843 | 3,310 | 826 | 3,251 | 17 | 312 | 84,870 |
| Adjustable-rate mortgage loans (ARMs) | | | | | | | | | |
| - loans with IO period, 1-year funding | 41,445 | 482 | 437 | 6,881 | 10,117 | 10,853 | 2,353 | 1,407 | 73,976 |
| - other repayment loans | 59,105 | 20,709 | 1,227 | 5,572 | 9,281 | 6,109 | 3,542 | 960 | 106,505 |
| - loans with IO period, 1-year funding | 108,585 | 61 | 617 | 16,100 | 18,969 | 14,966 | 1,995 | 296 | 161,589 |
| - other loans with IO period | 133,646 | 94 | 6,942 | 17,491 | 13,632 | 10,381 | 3,432 | 273 | 185,891 |
| Money market-linked loans | | | | | | | | | |
| Loans with interest rate cap | | | | | | | | | |
| - repayment loans | 52,199 | 80 | 495 | 826 | 1,044 | 2,728 | 197 | 671 | 55,997 |
| - loans with IO period | 76,297 | 7 | 426 | 733 | 611 | 2,894 | 12 | 48 | 77,860 |
| Loans without interest rate cap | | | | | | | | | |
| - repayment loans | 691 | 263 | 1,053 | 5,822 | 18,723 | 8,439 | 7,066 | 5,984 | 48,118 |
| - loans with IO period | 7,438 | 162 | 16,312 | 20,582 | 27,483 | 26,850 | 5,270 | 4,343 | 108,348 |
| Index-linked loans | 4 | 23,395 | 2,333 | 165 | 20 | 253 | 1 | 208 | 27,248 |
| **Total** | **688,356** | **66,118** | **39,589** | **85,362** | **112,622** | **99,750** | **25,257** | **17,929** | **1,137,983** |
| **Bond debt outstanding by region** | | | | | | | | | |
| - Capital Region of Denmark | 160,777 | 23,413 | 21,038 | 23,295 | 28,689 | 2,523 | 1,603 | 6,169 | 267,506 |
| - Sealand Region | 94,504 | 7,652 | 3,700 | 4,593 | 11,085 | 15,141 | 2,662 | 1,783 | 141,120 |
| - North Denmark Region | 95,237 | 6,973 | 3,707 | 8,899 | 10,184 | 25,237 | 3,378 | 1,508 | 155,124 |
| - Central Denmark Region | 173,051 | 12,994 | 5,376 | 20,141 | 22,164 | 30,458 | 8,151 | 5,128 | 277,462 |
| - South Denmark Region | 151,860 | 15,086 | 5,582 | 12,459 | 18,817 | 26,253 | 4,764 | 3,340 | 238,162 |
| - Faroe Islands and Greenland | 2,209 | 0 | 185 | 153 | 184 | 0 | 0 | 1 | 2,732 |
| - International | 10,718 | 0 | 0 | 18,822 | 21,500 | 139 | 4,699 | 0 | 55,877 |
| **Total** | **688,356** | **66,118** | **39,589** | **88,362** | **112,622** | **99,750** | **25,257** | **17,929** | **1,137,983** |
| **Bond debt outstanding by debt outstanding** | | | | | | | | | |
| 0-2 | 526,278 | 5,866 | 1,626 | 16,413 | 13,014 | 21,233 | 1,772 | 1,114 | 587,315 |
| 2-5 | 146,802 | 7,279 | 5,701 | 14,062 | 14,113 | 30,625 | 2,314 | 1,922 | 222,818 |
| 5-20 | 14,264 | 25,612 | 18,500 | 20,565 | 24,909 | 40,887 | 4,825 | 5,991 | 155,552 |
| 20-50 | 1,012 | 17,895 | 8,108 | 10,475 | 13,692 | 5,633 | 2,563 | 3,918 | 63,297 |
| 50-100 | 0 | 6,119 | 2,066 | 6,110 | 10,881 | 1,077 | 1,239 | 1,486 | 28,980 |
| 100-… | 0 | 3,347 | 3,587 | 20,737 | 36,013 | 295 | 12,544 | 3,497 | 80,021 |
| **Total** | **688,356** | **66,118** | **39,589** | **88,362** | **112,622** | **99,750** | **25,257** | **17,929** | **1,137,983** |
| **Bond debt outstanding by remaining loan term** | | | | | | | | | |
| 0-10 | 25,959 | 4,358 | 531 | 14,662 | 29,309 | 2,386 | 3,753 | 964 | 81,922 |
| 10-15 | 23,996 | 6,259 | 903 | 11,303 | 30,217 | 3,606 | 11,466 | 1,944 | 89,693 |
| 15-20 | 87,360 | 11,281 | 4,299 | 10,036 | 29,469 | 12,096 | 4,308 | 4,678 | 163,527 |
| 20-25 | 263,875 | 8,148 | 18,418 | 24,703 | 13,809 | 50,373 | 4,925 | 4,674 | 388,925 |
| 25-30 | 287,166 | 24,316 | 14,553 | 27,627 | 9,819 | 31,289 | 804 | 5,668 | 401,242 |
| 30-35 | 0 | 11,460 | 884 | 30 | 0 | 0 | 0 | 0 | 12,374 |
| 35-… | 0 | 296 | 1 | 1 | 0 | 0 | 0 | 2 | 299 |
| **Total** | **688,356** | **66,118** | **39,589** | **88,362** | **112,622** | **99,750** | **25,257** | **17,929** | **1,137,983** |

Note: Including lending to Nykredit Ejendomme.

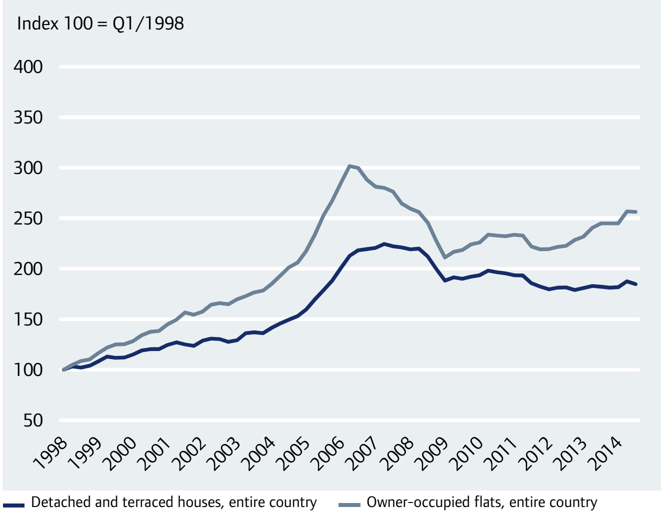
[1] Bank guarantees denote debt outstanding covered by loss guarantee.

**Housing prices**

The housing market continued the positive trend of 2013. The positive trend was particularly pronounced for prices of owner-occupied flats, which were up almost 5% at national level at end-Q3/2014 compared with a year earlier. For house prices, the rise was about 1.5%, while prices of holiday homes remained challenged, showing a decline of almost 2% in the same period.

Copenhagen leads the housing market recovery. House prices rose by almost 10% in Copenhagen over the first nine months of 2014 and somewhat more moderately by 2% in South and West Sealand. These two areas are the two extremes of regional house price development. Unlike many other places in Denmark, Copenhagen is recording relatively high economic growth, rising employment and a high net inflow of migrants, which underpins housing prices. Nykredit expects the regional imbalances to continue in 2015.

**Housing prices in Denmark**




Source: Association of Danish Mortgage Banks

**Housing costs – fixed-rate repayment mortgage loans**


Housing costs are defined as housing-related expenses (mortgage payments, insurance, user costs, etc) relative to disposable income.

Flat prices continued their favourable development from 2013, and with a 12% rise at national level, prices accelerated further in 2014. Prices were up 16% in Copenhagen, which led to speculation about a local price bubble in central Copenhagen. In our opinion, the growing supply of owner-occupied flats following the price rises reduces the risk of a price bubble significantly, and the price rises should be seen against the backdrop of sharp price declines in the years 2009-2011.

**LTV development**

The Loan-To-Value (LTV) ratio expresses the debt outstanding relative to the estimated property value.

At end-2014, the LTV level of the Group's total loan portfolio was 69%, which is almost unchanged from end-2013 when it was 68%.

At 75% at end-2014, the LTV level of the Group's private residential lending was unchanged from end-2013.

The LTV level of total commercial lending was in the range 56-69% at end-2014, which was a small rise on end-2013. However, the LTV level of agricultural lending had declined slightly to 59% at end-2014 compared with 60% at the same time the year before.

At end-2014, 1.1% of the Group's private residential mortgage lending had LTV levels over 100%. The bulk of the Group's loans with LTV levels over 100% were granted to homeowners in South and West Sealand.

**Stress testing of homeowners' LTV levels**

To ensure that the credit and capital policies are sustainable in the long term, Nykredit is stress testing housing prices and interest rate levels. The results of these stress tests are submitted quarterly to an internal monitoring forum charged with overseeing property market developments.

Further information on the Group's mortgage loan portfolio is available under "Cover pool disclosure" at nykredit.com/ir.

**Nykredit Realkredit Group**
**Private residential mortgage debt outstanding relative to estimated property values and customer credit quality**

| Fair value 2014 | | | | LTV | | | |
|---|---|---|---|---|---|---|---|
| % | 0-40 | 40-60 | 60-80 | 80-90 | 90-100 | Over 100 | Total |
| Ordinary customers (rating categories 6-10) | 317,474 | 120,444 | 75,085 | 13,847 | 6,123 | 5,220 | 536,193 |
| Ordinary customers with some signs of weakness (rating categories 3-5) | 52,389 | 24,395 | 19,405 | 3,761 | 1,588 | 1,466 | 103,003 |
| Weak customers with and without OEI (rating categories 0-2) | 24,972 | 11,557 | 8,972 | 1,734 | 857 | 1,067 | 49,159 |
| **Total** | **392,835** | **156,397** | **103,462** | **19,342** | **8,568** | **7,753** | **688,356** |

Note: The debt outstanding is distributed continuously by LTV category. Loans with security covering for example between 0% and 60% of the mortgageable value are distributed with two thirds of the debt outstanding in the LTV category 0-40% and one third in the LTV category 40-60%.

**Nykredit Realkredit Group**
**Debt outstanding relative to estimated property values**

| Fair value 2014 | | | | LTV | | | | LTV |
|---|---|---|---|---|---|---|---|---|
| DKK million | 0-40 | 40-60 | 60-80 | 80-90 | 90-100 | >100 | Total | average, %[1] |
| Private residential property | 392,835 | 156,397 | 103,462 | 19,342 | 8,568 | 7,753 | 688,356 | 75 |
| Private residential rental | 77,032 | 28,397 | 15,075 | 2,293 | 1,132 | 1,261 | 125,190 | 69 |
| Industry and trades | 18,592 | 4,711 | 1,418 | 259 | 137 | 140 | 25,257 | 56 |
| Office and retail | 80,472 | 24,530 | 5,708 | 821 | 423 | 668 | 112,622 | 58 |
| Agriculture | 71,479 | 18,710 | 7,102 | 1,153 | 576 | 730 | 99,750 | 59 |
| Non-profit housing | - | - | - | - | - | - | - | - |
| Other | 13,404 | 3,055 | 1,250 | 77 | 46 | 97 | 17,929 | 55 |
| **Total 2014** | **653,815** | **235,800** | **134,014** | **23,945** | **10,883** | **10,648** | **1,137,983** | **69** |
| **Total 2013** | **656,393** | **234,719** | **132,155** | **25,063** | **11,416** | **10,536** | **1,137,843** | **68** |

Note: The figures are actual LTV ratios including any financed costs. Public authority guarantees reduce the credit risk relating to subsidised housing that forms part of lending to the non-profit housing segment. For this reason, LTVs of non-profit housing offer no relevant risk data.
In the table, debt outstanding is distributed continuously by LTV category. Loans with security covering for example between 0% and 60% of the mortgageable value are distributed with two thirds of the debt outstanding in the LTV category 0-40% and one third in the LTV category 40-60%.
[1] Determined as the top part of the debt outstanding relative to estimated property values.

**Nykredit Realkredit Group**
**Debt outstanding relative to estimated property values**

| | | | LTV | | | |
|---|---|---|---|---|---|---|
| % | 0-40 | 40-60 | 60-80 | 80-90 | 90-100 | >100 |
| Private residential property | 57 | 23 | 15 | 3 | 1 | 1 |
| Private residential rental | 62 | 23 | 12 | 2 | 1 | 1 |
| Industry and trades | 74 | 19 | 6 | 1 | 1 | 1 |
| Office and retail | 71 | 22 | 5 | 1 | 0 | 1 |
| Agriculture | 72 | 19 | 7 | 1 | 1 | 1 |
| Non-profit housing | - | - | - | - | - | |
| Other | 75 | 17 | 7 | 0 | 0 | 1 |
| **Total 2014[1]** | **61** | **22** | **12** | **2** | **1** | **1** |
| **Total 2013[1]** | **57** | **23** | **15** | **3** | **1** | **1** |

Note: In the table, debt outstanding is distributed continuously by LTV category. Loans with security covering for example between 0% and 60% of the mortgageable value are distributed with two thirds of the debt outstanding in the LTV category 0-40% and one third in the LTV category 40-60%. For example, the table shows that where private residential property is concerned, 56% of mortgage lending falls within 40% of the property values.
[1] Calculated on the basis of debt outstanding excluding non-profit housing for which reason the totals do not add up to 100%.

**Nykredit Realkredit Group**
**Change in debt outstanding relative to property values in 2014**

| Fair value 2014 | | | LTV | | | |
|---|---|---|---|---|---|---|
| Percentage points | 0-40 | 40-60 | 60-80 | 80-90 | 90-100 | >100 |
| Private residential property | 0 | 0 | 0 | 0 | 0 | 0 |
| Private residential rental | -1 | 0 | 0 | 0 | 0 | 0 |
| Industry and trades | 8 | -2 | -3 | -1 | -1 | 0 |
| Office and retail | -4 | 1 | 2 | 0 | 0 | 0 |
| Agriculture | 1 | -1 | 0 | 0 | 0 | 0 |
| Non-profit housing | - | - | - | - | - | |
| Other | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total change** | **0** | **0** | **0** | **0** | **0** | **0** |

Note: The debt outstanding is distributed continuously by LTV category. Loans with security covering for example between 0% and 60% of the mortgageable value are distributed with two thirds of the debt outstanding in the LTV category 0-40% and one third in the LTV category 40-60%.

## BANK LENDING

The credit exposures of the Nykredit Bank Group totalled DKK 191bn at end-2014, which was generally unchanged from end-2013. Of the total credit exposure, repo/reverse transactions amounted to 25%.

A characteristic of repo/reverse transactions is that the risk of the loan is hedged by bonds of extremely high credit quality. The credit risk of repo/reverse transactions is consequently marginal. The credit risk relating to the Bank's lending thus derives from its traditional banking activities. For the purpose of this section, the Bank's credit exposures are therefore exclusive of repo/reverse transactions.

### Traditional banking activities

The Nykredit Bank Group's total credit exposure to traditional banking activities amounted to DKK 73bn, a rise of DKK 7bn. The increase related solely to guarantees issued in connection with the refinancing activity at end-2014. Commercial exposures accounted for DKK 47bn and retail exposures for DKK 25bn, equal to 64% and 35%, respectively, of total bank exposures.

Compared with the banking sector in general, the Nykredit Bank Group has a limited exposure to the agricultural segment. At end-2014, only 3% of commercial exposures related to agricultural customers. For the banking sector as a whole, the proportion was 4%.

Guarantees issued amounted to DKK 21bn, or 11% of total exposures at end-2014, and undrawn commitments also amounted to DKK 21bn.

### Concentration risk

The Danish FSA has defined large exposures as exposures exceeding 10% of own funds. Based on own funds of DKK 12.4bn, the large exposure limit at end-2014 was DKK 1,240m. Nykredit Bank has two large non-financial counterparties.

Nykredit Bank's 20 largest exposures had risen to DKK 19.0bn at end-2014 from DKK 16.7bn at end-2013. The Bank's 20 largest exposures represented 10.0% of total exposures at end-2014, compared with 9% at end-2013. At end-2014 the Bank's 20 largest exposures made up 153% of equity. The corresponding share the year before was 117%.

**Nykredit Realkredit Group – banking activities**
**Credit exposures and REA**

| 2014<br>DKK million/% | Bank lending | Guarantees issued | Other | Total exposures | *Of which undrawn commitments* | Exposure-weighted average risk weight, % | REA |
|---|---|---|---|---|---|---|---|
| Retail exposures | 13,648 | 11,585 | 11,570 | 36,803 | *8,195* | 53.1 | 19,527 |
| *Of which* | | | | | | | |
| *- mortgages over real estate*[1] | *10,980* | *899* | *5,141* | *17,020* | *4,712* | *59.6* | *10,145* |
| *- revolving exposures, etc* | - | - | - | - | - | - | - |
| *- other retail exposures* | *2,668* | *10,686* | *6,429* | *19,783* | *3,483* | *47.4* | *9,382* |
| Commercial exposures | 38,545 | 8,671 | 85,338 | 132,554 | *13,044* | 38.0 | 50,370 |
| Credit institution exposures | - | 878 | 11,380 | 12,258 | *187* | 36.1 | 4,420 |
| Sovereign exposures | - | 1 | 5,131 | 5,131 | *3* | - | 0 |
| Equity exposures | - | - | 130 | 130 | - | 363.8 | 472 |
| Assets with no counterparty | - | - | 586 | 586 | - | 100.0 | 586 |
| Credit value adjustments (CVA) | - | - | 2,957 | 2,957 | - | 35.2 | 1,041 |
| Default fund contribution - | - | - | 312 | 312 | - | 100.0 | 312 |
| **Total 2014** | **52,194** | **21,135** | **117,404** | **190,732** | ***21,430*** | **40.2** | **76,729** |
| Total 2013 | 54,448 | 11,958 | 123,810 | 190,216 | *20,679* | 36.6 | 69,481 |

[1] Bank loans secured by mortgages over real estate primarily relate to equity release credits (Friværdikonto).

**Nykredit Realkredit Group – banking activities**
**Credit exposures by maturity**

| 2014<br>DKK million | Up to 1 year | Over 1 year and up to 5 years | Over 5 years | Total exposures |
|---|---|---|---|---|
| Retail exposures | - | - | 36,803 | 36,803 |
| *Of which* | | | | |
| *- mortgages over real estate* | - | - | *17,020* | *17,020* |
| *- revolving exposures, etc* | - | - | - | - |
| *- other retail exposures* | - | - | *19,783* | *19,783* |
| Commercial exposures | 53,450 | 17,228 | 61,877 | 132,554 |
| Credit institution exposures | 11,380 | 878 | | 12,258 |
| Sovereign exposures | 5,131 | - | - | 5,131 |
| Equity exposures | - | - | 130 | 130 |
| Assets with no counterparty | - | - | 586 | 586 |
| Credit value adjustments (CVA) | - | 2,957 | - | 2,957 |
| Default fund contribution | - | - | 312 | 312 |
| **Total 2014** | **69,961** | **21,063** | **99,708** | **190,732** |
| Total 2013 | 87,369 | 18,545 | 84,303 | 190,216 |

**Supervisory Diamond for banks**
In the wake of the financial crisis, the Danish FSA launched the Supervisory Diamond for banks in June 2010 applicable to all banks. The Supervisory Diamond is a strictly Danish initiative and does not stem from EU legislation.

The Supervisory Diamond model sets out the following limit values for five benchmarks that indicate when a bank is operating at an elevated risk:

- The sum of large exposures must be less than 125% of own funds.
- Lending growth must be less than 20% year-on-year. The limit value is determined exclusive of reverse repurchase lending and after impairments.
- Commercial property exposure must be less than 25% of total lending.
- The funding ratio must be less than 1.00. The ratio is calculated as loans and advances at amortised cost relative to working capital less bonds in issue with times-to-maturity of less than 1 year.
- The excess liquidity coverage must be greater than 50%. The excess liquidity coverage is the excess liquidity after fulfilment of the minimum statutory requirement.

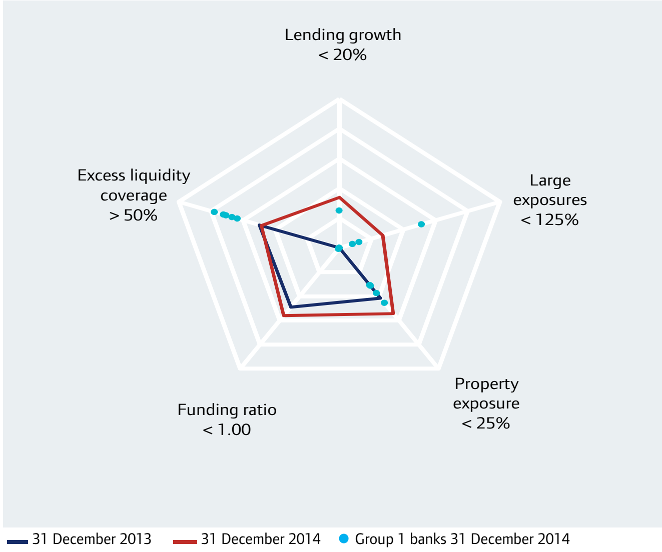
The Nykredit Bank Group has never breached the limit values of the Supervisory Diamond. The current limit values of the Supervisory Diamond model are shown in the table below, and as appears, Nykredit Bank is comfortably within the limits.

Lending exclusive of repo/reverse transactions shows 6.8% growth. The funding and liquidity ratios are also well above the limit values, as Nykredit Bank's internal requirements are considerably stricter than the limit values of the Supervisory Diamond.

**Nykredit Bank A/S**
**Supervisory Diamond**

| | 2014 | 2013 |
|---|---|---|
| Lending growth (limit value <20%) | 6.8 | -7.6 |
| Large exposures (limit value <125%) | 33.9 | 0.0 |
| Property exposure (limit value <25%) | 13.6 | 10.4 |
| Funding ratio (limit value <1.0%) | 56.0 | 0.5 |
| Excess liquidity coverage (limit value 50%) | 281.6 | 276.0 |

**Nykredit Bank Group**
**Supervisory Diamond**



## COUNTERPARTY RISK

Nykredit applies financial instruments, such as derivatives and repurchase agreements (repos), for serving customers and for managing liquidity and market risk. In addition, repos are applied in the day-to-day liquidity management.

Counterparty risk is a measure of the size of the loss which Nykredit may sustain in case of non-payment by a counterparty. For the purpose of calculating the capital requirement, counterparty risk exposures are calculated according to the market value method, ie as any positive market value of the transaction plus a potential future credit exposure.

Exposure at default (EAD) for counterparty risk amounted to DKK 131.2bn at end-2014, after netting DKK 27.6bn. Of this amount DKK 2.7bn were repos and DKK 24.9bn derivatives. REA totalled DKK 11.5bn.

Nykredit mitigates its counterparty risk through financial netting agreements as well as agreements on financial collateral. The contractual framework is based on market standards such as ISDA or GRMA agreements.

The use of derivative instruments is governed by the ordinary credit approval rules and credit policies, supplemented with a number of restrictions and policy rules. In addition to limits to amounts and terms, examples are requirements related to the type, size and creditworthiness of customers.

Nykredit uses central counterparties for professional derivatives clearing. Interest rate swaps, FRAs and repo transactions are cleared through direct membership of Nasdaq Copenhagen; moreover, interest rate swaps are cleared through indirect membership of the London Clearing House.

### Value adjustment of derivatives

The market value of a financial instrument changes according to the underlying market parameters, such as interest rates and exchange rates, which may lead to high market values in favour of both Nykredit and its counterparties.

Nykredit makes fair value adjustments of financial instruments in accordance with the International Financial Reporting Standards (IFRS).

A number of commercial customers with variable-rate mortgage loans have hedged their interest rate risk through swaps with Nykredit Bank.

Credit value adjustment (CVA) is made on an ongoing basis for derivatives entered into with customers based on the customer's current credit quality and individual value adjustments of customers with OEI.

The decline in interest rates in recent years has resulted in increasing market values of interest rate swaps and other instruments and has also increased the credit risk in respect of commercial customers that have not pledged collateral on an ongoing basis. As a consequence, a number of fair value adjustments have been made in recent years.

### Fixed-rate swaps

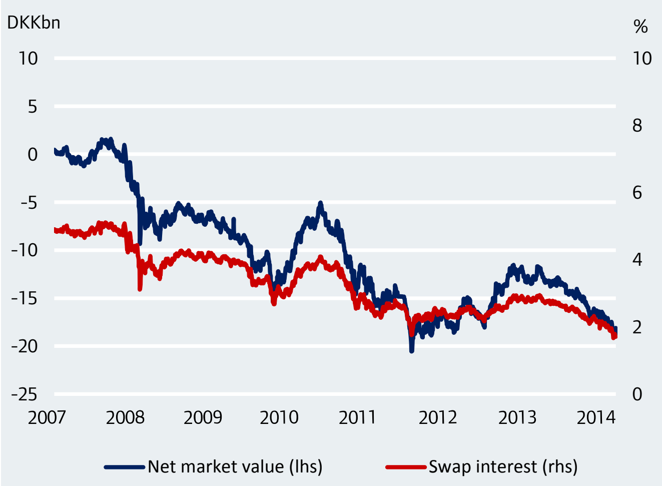
The main part of Nykredit's swap portfolio was established in the period 2005-2008 to allow customers to hedge the risk of rising interest rates on their underlying floating-rate mortgage loans. From the perspective of the customers, the interest rate declines in the ensuing years caused the market value of Nykredit's swap portfolio to become negative. At end-2014 the negative market value of interest rate derivatives related to customer exposures was about DKK 19.6bn. This value tracks the development in the long-term swap rate, which was 1.75% at year-end.

**Nykredit Realkredit Group**
**Market value, fixed-rate swaps and step-up interest rate instruments**

| DKKbn/% | Negative market value | Total impairment provisions | Total impairment provisions as % of market value |
|---|---|---|---|
| Housing cooperatives | 7.9 | 4.1 | 52 |
| Other | 11.7 | 1.4 | 12 |
| **Total** | **19.6** | **5.5** | **28** |

Note: The market value under Other shows no sign of segment concentration.

**Nykredit Realkredit Group**
**Net market value of derivatives contracts with commercial customers**




**Nykredit Realkredit Group**
**Counterparty risk**

| 2014 | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| DKK million | Derivatives | Repos | Total | Derivatives | Repos | Total |
| EAD before netting | 89,403 | 41,809 | 131,212 | 61,490 | 75,308 | 136,798 |
| Netting benefits | 61,436 | - | 61,436 | 39,932 | 3 | 39,934 |
| EAD after netting | 27,967 | 41,809 | 69,776 | 21,558 | 75,305 | 96,863 |
| Collateral received | 3,057 | 39,109 | 42,166 | 4,086 | 71,823 | 75,909 |
| **EAD after netting and collateral** | **24,910** | **2,700** | **27,610** | **17,473** | **3,482** | **20,955** |

The negative market value of swap contracts with housing cooperatives amounted to just under 40% of the total negative market value of interest rate derivatives related to customer exposures. Of this market value of about DKK 7.9bn, just over 50%, or about DKK 4.1bn, has been value adjusted.

Nykredit's counterparty risk exposure relating to swaps is value adjusted on a current basis. Nykredit uses three types of value adjustment. The first is applied to non-performing exposures (rating 0). For these exposures, swaps are fully value adjusted through profit or loss to reflect changes in market value. The second method is applied to other exposures and is divided into value adjustment of weak exposures with ratings 1 and 2 and exposures with ratings 3 to 10. The lower a customer's rating, the larger the proportion that is value adjusted. The third value adjustment method is based on management judgement. Under this method, the entire portfolio in a specific segment is reviewed and value adjusted based on the financial position of the customers, including any legal risks in the case of housing cooperatives.

At end-2014 individual value adjustments (methods 1 and 2) amounted to just under DKK 3.5bn (recognised as impairment provisions). Also at end-2014, value adjustments based on management judgement (method 3) amounted to almost DKK 2.0bn (recognised as impairment provisions). Accordingly, accumulated value adjustment of customer swaps for accounting purposes totalled just under DKK 5.5bn.

The negative value adjustment of the swap portfolio currently includes significant risk relating to housing cooperatives. Such risk arose from the currently pending swap-related legal proceedings involving housing cooperatives. Therefore, negative value adjustment sensitivity is not comparable with traditional interest rate risk, as value adjustment risk no longer depends only on the financial position of customers, but also on the legal set-up of housing cooperatives. The interest rate sensitivity related to the value adjustments amounts to DKK 1.4bn for each interest rate change of 1 percentage point (for all customers). As regards the remaining value adjustment, which is highly dependent on financial/legal risks, the interest rate sensitivity amounted to DKK 0.7bn for each interest rate change of 1 percentage point, other things being equal.

Considering that Nykredit's total losses on terminated swaps are DKK 300m, provisions in this area are very conservative. The most likely scenario is still that a considerable part of the provisions will be reversed over time.

## CREDIT RISK MODELS

Credit risk is determined using three key parameters:

- PD: Probability of Default – the probability of a customer defaulting on an obligation to Nykredit
- LGD: Loss Given Default – the loss rate of an exposure given a customer's default
- EAD: Exposure at Default – the estimated value of an exposure at the time of default, including any drawn part of a credit commitment.

The PD is customer-specific, while the other parameters are product-specific. One PD is therefore assigned to each customer, while each of the customer's products has a separate LGD and EAD. However, personal customers have two PDs, one assigned by Nykredit Bank and one assigned by Nykredit Realkredit/Totalkredit.

### Modelling principles

According to the CRR, PDs must be estimated on the basis of long-term averages of one-year default rates, while LGD estimates must reflect an economic downturn.

In the early 1990s, the Danish economy suffered a general crisis, and the financial sector saw a relatively large number of borrower defaults and increased losses. Nykredit stores data from that period and may thereby benefit from the experience gained during that recession when developing models.

PDs are calibrated by weighting current data against data dating back to the early 1990s at a 40:60 ratio. LGD ratios are calibrated so that the parameters reflect an economic downturn equal to the beginning of the 1990s. However, for Nykredit Bank's personal lending, some models use a gross unemployment rate of 10% to indicate an economic downturn, which is almost twice as high as the current level.

The modelling principles are of great importance when comparing PD and LGD estimates with current, observed values of default and loss rates. During an economic upturn, the PD and LGD estimates applied to calculate REA will be higher than the observed values. This is due to the fact that, contrary to the risk parameters, the observed values mirror only the current economic climate.

The principles applied to estimate the risk parameters ensure that the Group's REA remains more stable throughout an economic cycle than if the estimation were based exclusively on current data.

### Probability of Default (PD)

PD expresses the probability of a customer defaulting on an obligation to the Nykredit Group. Nykredit calculates a PD for each individual customer. This method is called direct estimation.

The PDs of personal customers and SMEs are determined using credit scoring models. The credit score denotes the creditworthiness of a customer, and the calculation includes data on the customer's financial position and payment behaviour as well as loan impairment.

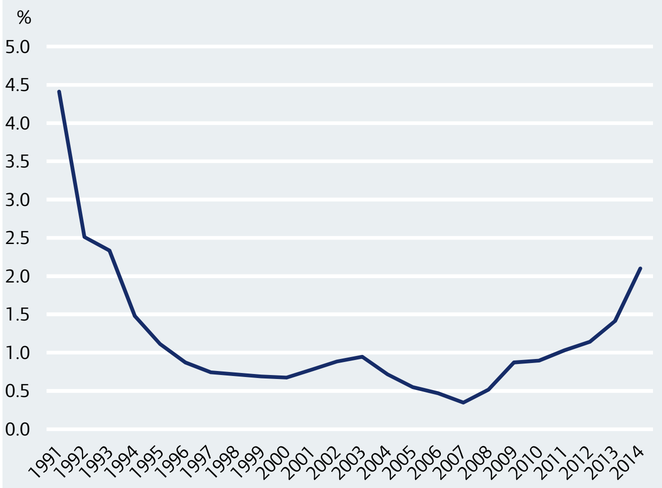
Statistical models have been developed for Corporate & Institutional Banking clients and production farming businesses based on conditional probabilities estimating PDs that factor in business-specific circumstances such as financial data, arrears and loan impairment as well as industry-specific conditions.

External credit ratings are used to a very limited extent for a few types of counterparty. External credit ratings are translated into PDs. PDs are updated as Nykredit receives new information about the customer or the customer's financial circumstances. Updates are made at least once every three months.

The accuracy of the estimated PDs can be assessed by comparing the estimates at the beginning of the year with the PDs observed for the year. Observed PD is the observed default rate of the Group's customers and thus reflects the current economic situation. To obtain an accurate comparison, it is therefore necessary to recalculate the estimated PDs at the beginning of the year into estimates which reflect only the current economic trends (point-in-time estimates).

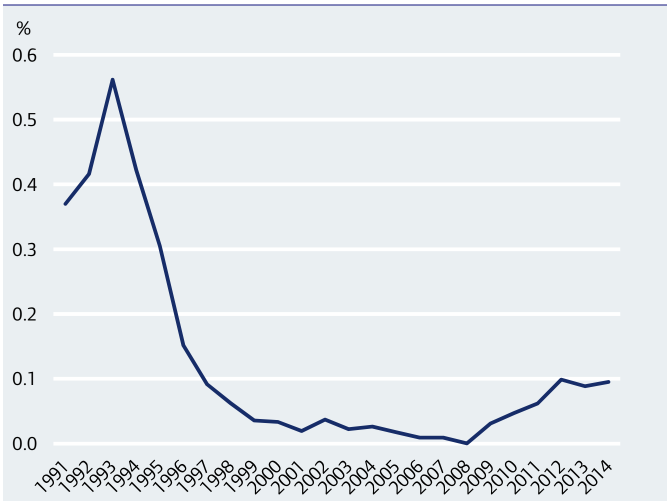
The PD estimates applied for calculating REA are estimated on the basis of data covering economic upturns as well as downturns. There-

**Nykredit Realkredit A/S**
**Data behind PD – observed default rates**




Note: Stated as number of customers

**Nykredit Realkredit Group – mortgage lending**
**Data behind LGD – loss ratios**




Note: Data for LGD level in relation to capital adequacy: 1991-1993.

fore, they are not directly comparable with the observed default rates or the point-in-time estimates.

**From PD to rating**

The PDs of individual customers are converted into ratings from 0 to 10, 10 being the highest rating. The individual rating categories have been defined based on fixed PD ranges. This means that, in periods of high business activity, a high rating will be assigned to relatively more customers, while the opposite will apply during an economic downturn.

**PD: Example of mortgage exposures**

The calculation of REA is based on "applied PD", which reflects current as well as historical data. Nykredit's REA determination assumes that 1.7% of Nykredit's customers would default on their loans.

To enable a comparison of the applied PD with the actual share of loans in default, "observed PD", the applied PD was recalculated into a so-called "point-in-time PD". The recalculation eliminates the historical element, and the point-in-time PD reflects only the economic trends prevailing at the beginning of the period.

The actual default rate, observed PD, was 1.3%. The levels of Nykredit's REA calculation were thus higher than the actual levels for the period.

Customer ratings are an important element of the credit policy and customer assessment. Ratings are also applied to increase the efficiency of credit approval procedures and to monitor exposures of low credit quality. If the calculated rating is deemed not to reflect the customer's real credit quality, the account manager may adjust the rating – possibly following a recommendation to Group Credits. This is referred to as an override.

**Nykredit Realkredit Group**
**Rating scale and marginal Probabilities of Default (PD)**

| 2014<br>Rating category | PD floor % | PD ceiling % | Average applied<br>PD % |
|---|---|---|---|
| 10 | > 0.00 | ≤ 0.15 | 0.10 |
| 9 | > 0.15 | ≤ 0.25 | 0.20 |
| 8 | > 0.25 | ≤ 0.40 | 0.33 |
| 7 | > 0.40 | ≤ 0.60 | 0.49 |
| 6 | > 0.60 | ≤ 0.90 | 0.73 |
| 5 | > 0.90 | ≤ 1.30 | 1.07 |
| 4 | > 1.30 | ≤ 2.00 | 1.60 |
| 3 | > 2.00 | ≤ 3.00 | 2.45 |
| 2 | > 3.00 | ≤ 7.00 | 4.53 |
| 1 | > 7.00 | ≤ 25.00 | 13.93 |
| 0 | > 25.00 | < 100.00 | 41.07 |
| Exposures in default | 100.00 | 100.00 | 100.00 |

Note: Average applied PD has been weighted by exposure.

**Nykredit Realkredit Group**
**Probability of Default (PD)**

| % | Point-in-time PD Beginning of 2014 | Observed PD End-2014 | Applied PD End-2014 | Point-in-time PD Beginning of 2013 | Observed PD End-2013 | Applied PD End-2013 |
|---|---|---|---|---|---|---|
| **Mortgage exposures** | | | | | | |
| Retail exposures | 1.3 | 0.8 | 1.4 | 1.4 | 0.8 | 1.3 |
| *Of which:* | | | | | | |
| *- mortgages over real estate* | *1.3* | *0.8* | *1.4* | *1.4* | *0.8* | *1.3* |
| *- revolving exposures, etc* | - | - | - | - | - | - |
| *- other retail exposures* | - | - | - | - | - | - |
| Commercial exposures | 2.3 | 1.9 | 2.7 | 2.3 | 2.2 | 2.3 |
| **Total mortgage exposures** | **1.6** | **1.2** | **1.8** | **1.7** | **1.3** | **1.7** |
| | | | | | | |
| **Bank exposures** | | | | | | |
| Retail exposures | 1.5 | 1.2 | 1.5 | 0.4 | 1.0 | 1.6 |
| *Of which:* | | | | | | |
| *- mortgages over real estate* | *1.5* | *1.4* | *1.5* | *0.3* | *1.0* | *1.7* |
| *- revolving exposures, etc* | - | - | - | *0.3* | *1.1* | *1.0* |
| *- other retail exposures* | *1.5* | *1.0* | *1.5* | *0.8* | *0.8* | *1.5* |
| Commercial exposures | 2.6 | 0.9 | 1.8 | 1.9 | 1.8 | 2.6 |
| **Total bank exposures** | **2.2** | **1.0** | **1.7** | **1.3** | **1.5** | **2.2** |
| | | | | | | |
| **Total exposures** | | | | | | |
| Retail exposures | 1.3 | 0.8 | 1.4 | 1.3 | 0.8 | 1.3 |
| *Of which:* | | | | | | |
| *- mortgages over real estate* | *1.3* | *0.8* | *1.4* | *1.3* | *0.8* | *1.3* |
| *- revolving exposures, etc* | - | - | - | *0.3* | *1.1* | *1.0* |
| *- other retail exposures* | *1.3* | *1.0* | *1.5* | *0.8* | *0.8* | *1.4* |
| Commercial exposures | 2.4 | 1.8 | 2.6 | 2.3 | 2.2 | 2.3 |
| **Total exposures, total** | **1.6** | **1.2** | **1.8** | **1.6** | **1.3** | **1.7** |

Note: Exposure-weighted and excl exposures in default. Includes exposures determined subject to the advanced as well as the foundation IRB approaches not using internal LGD estimates.

**Nykredit Realkredit Group – mortgage exposures**
**Retail exposures covered by IRB**

| 2014<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD[1]<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 40,621 | 3 | 4.4 | 1.2 | 479 |
| 9 | 74,901 | 6 | 6.3 | 2.7 | 2,034 |
| 8 | 168,650 | 43 | 8.8 | 5.4 | 9,090 |
| 7 | 155,980 | 12 | 12.0 | 9.7 | 15,115 |
| 6 | 117,529 | 15 | 13.6 | 14.5 | 17,082 |
| 5 | 53,549 | 37 | 13.6 | 18.3 | 9,859 |
| 4 | 37,553 | 9 | 13.9 | 24.6 | 9,240 |
| 3 | 18,373 | 30 | 13.4 | 29.8 | 5,473 |
| 2 | 18,471 | 13 | 11.3 | 37.1 | 6,845 |
| 1 | 18,260 | 6 | 12.5 | 65.2 | 11,903 |
| 0 | 4,985 | 1 | 15.0 | 82.2 | 4,096 |
| Exposures in default[2] | 7,727 | 1 | 16.5 | 60.6 | 4,684 |
| **Total** | **716,900** | **176** | **10.8** | **13.4** | **95,901** |

[1] Pursuant to Article 164 of the CRR, the exposure-weighted average LGD must be at least 10% for retail exposures secured by residential property and at least 15% for retail exposures secured by commercial property for the purpose of REA determination. Exposure-weighted average LGD has been determined after adjustment to ensure compliance with the floor requirements.
[2] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions.

**Nykredit Realkredit Group – mortgage exposures**
**Commercial exposures covered by IRB**

| 2014<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD[1]<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 11,875 | 160 | 17.2 | 19.2 | 2,276 |
| 9 | 39,374 | 379 | 15.4 | 21.7 | 8,556 |
| 8 | 88,472 | 1,166 | 13.6 | 22.3 | 19,720 |
| 7 | 86,657 | 509 | 13.7 | 24.7 | 21,434 |
| 6 | 55,693 | 973 | 12.9 | 25.0 | 13,927 |
| 5 | 28,598 | 211 | 12.5 | 27.5 | 7,852 |
| 4 | 19,797 | 154 | 15.4 | 36.8 | 7,278 |
| 3 | 24,564 | 431 | 11.7 | 29.3 | 7,186 |
| 2 | 1,132 | 9 | 16.3 | 45.7 | 518 |
| 1 | 6,369 | 24 | 15.7 | 72.1 | 4,786 |
| 0 | 10,717 | 37 | 15.9 | 60.2 | 6,453 |
| Exposures in default[1] | 16,490 | 70 | 21.3 | 44.1 | 7,270 |
| **Total** | **390,007** | **4,124** | **14.1** | **27.5** | **107,255** |

[1] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions.

**Nykredit Realkredit Group – bank exposures**
**Retail exposures covered by IRB**

| 2014<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD[1]<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 7,142 | 2,538 | 45.0 | 8.7 | 621 |
| 9 | 3,061 | 950 | 43.9 | 18.7 | 573 |
| 8 | 3,376 | 859 | 42.4 | 25.0 | 846 |
| 7 | 3,191 | 708 | 42.5 | 33.2 | 1,058 |
| 6 | 3,278 | 656 | 42.1 | 42.3 | 1,387 |
| 5 | 4,720 | 911 | 42.2 | 53.7 | 2,535 |
| 4 | 5,041 | 797 | 42.4 | 65.8 | 3,317 |
| 3 | 3,536 | 396 | 42.1 | 76.1 | 2,692 |
| 2 | 1,724 | 233 | 42.8 | 95.0 | 1,638 |
| 1 | 591 | 70 | 44.5 | 139.4 | 825 |
| 0 | 208 | 18 | 48.4 | 159.0 | 330 |
| Exposures in default[2] | 935 | 58 | 44.5 | 396.4 | 3,706 |
| **Total** | **36,803** | **8,195** | **43.1** | **53.1** | **19,527** |

[1] Pursuant to Article 164 of the CRR, the exposure-weighted average LGD must be at least 10% for retail exposures secured by residential property and at least 15% for retail exposures secured by commercial property for the purpose of REA determination. Exposure-weighted average LGD has been determined after adjustment to ensure compliance with the floor requirements.
[2] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions.

**Nykredit Realkredit Group – bank exposures**
**Commercial exposures covered by IRB**

| 2014<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 18,599 | 2,348 | 14.2 | 10.1 | 1,872 |
| 9 | 13,324 | 1,639 | 18.9 | 17.9 | 2,382 |
| 8 | 17,014 | 3,286 | 39.4 | 46.9 | 7,974 |
| 7 | 14,561 | 3,059 | 43.5 | 61.0 | 8,883 |
| 6 | 34,595 | 1,046 | 12.1 | 18.1 | 6,260 |
| 5 | 5,363 | 368 | 44.0 | 76.4 | 4,100 |
| 4 | 4,020 | 379 | 44.0 | 88.1 | 3,540 |
| 3 | 4,146 | 408 | 43.3 | 98.2 | 4,069 |
| 2 | 983 | 151 | 43.2 | 101.4 | 996 |
| 1 | 1,694 | 72 | 44.9 | 183.0 | 3,101 |
| 0 | 948 | 6 | 34.0 | 123.5 | 1,171 |
| Exposures in default[1] | 5,720 | 282 | 44.2 | 0.0 | - |
| **Total** | **120,967** | **13,044** | **26.7** | **36.7** | **44,347** |

Note: Includes exposures subject to the advanced as well as the foundation IRB approaches using internal PD estimates.
[1] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions. The low risk weight of the Nykredit Realkredit Group's exposures in default results from the fact that REA of the Nykredit Bank Group's commercial exposures in default is calculated using the foundation IRB approach, under which the risk weight is nil.

**Nykredit Realkredit Group – total exposures**
**Retail exposures covered by IRB**

| 2014 Rating category | Total exposures DKKm | Of which undrawn commitments DKKm | Exposure-weighted average LGD[1] % | Exposure-weighted average risk weight % | REA for credit risk DKKm |
|---|---|---|---|---|---|
| 10 | 47,763 | 2,541 | 10.5 | 2.3 | 1,100 |
| 9 | 77,962 | 956 | 7.8 | 3.3 | 2,607 |
| 8 | 172,026 | 901 | 9.4 | 5.8 | 9,936 |
| 7 | 159,171 | 720 | 12.6 | 10.2 | 16,173 |
| 6 | 120,708 | 671 | 14.4 | 15.3 | 18,468 |
| 5 | 58,569 | 948 | 15.9 | 21.2 | 12,394 |
| 4 | 42,594 | 806 | 17.3 | 29.5 | 12,558 |
| 3 | 21,909 | 426 | 18.0 | 37.3 | 8,165 |
| 2 | 20,194 | 247 | 14.0 | 42.0 | 8,483 |
| 1 | 18,851 | 76 | 13.5 | 67.5 | 12,726 |
| 0 | 5,193 | 19 | 16.4 | 85.2 | 4,426 |
| Exposures in default[2] | 8,662 | 59 | 19.6 | 96.9 | 8,390 |
| **Total** | **753,703** | **8,372** | **12.4** | **15.3** | **115,428** |

[1] Pursuant to Article 164 of the CRR, the exposure-weighted average LGD must be at least 10% for retail exposures secured by residential property and at least 15% for retail exposures secured by commercial property for the purpose of REA determination. Exposure-weighted average LGD has been determined after adjustment to ensure compliance with the floor requirements.
[2] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions.

**Nykredit Realkredit Group – total exposures**
**Commercial exposures covered by IRB**

| 2014 Rating category | Total exposures DKKm | Of which undrawn commitments DKKm | Exposure-weighted average LGD % | Exposure-weighted average risk weight % | REA for credit risk DKKm |
|---|---|---|---|---|---|
| 10 | 30,474 | 2,508 | 15.4 | 13.6 | 4,148 |
| 9 | 52,698 | 2,018 | 16.3 | 20.8 | 10,938 |
| 8 | 105,487 | 4,452 | 17.7 | 26.3 | 27,694 |
| 7 | 101,218 | 3,568 | 18.0 | 30.0 | 30,317 |
| 6 | 90,288 | 2,019 | 12.6 | 22.4 | 20,187 |
| 5 | 33,961 | 580 | 17.5 | 35.2 | 11,952 |
| 4 | 23,818 | 533 | 20.2 | 45.4 | 10,818 |
| 3 | 28,709 | 839 | 16.3 | 39.2 | 11,255 |
| 2 | 2,115 | 160 | 28.8 | 71.6 | 1,514 |
| 1 | 8,333 | 96 | 21.6 | 94.6 | 7,886 |
| 0 | 16,780 | 43 | 12.1 | 45.4 | 7,624 |
| Exposures in default[1] | 22,210 | 353 | 27.2 | 32.7 | 7,270 |
| **Total** | **516,089** | **17,168** | **16.9** | **29.4** | **151,602** |

Note: Includes exposures subject to the advanced as well as the foundation IRB approaches using internal PD estimates.
[1] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions. The low risk weight of the Nykredit Realkredit Group's exposures in default results from the fact that REA of the Nykredit Bank Group's commercial exposures in default is calculated using the foundation IRB approach, under which the risk weight is nil.

**Loss Given Default (LGD)**
For each customer exposure, Nykredit calculates an LGD, reflecting the percentage share of the exposure which is expected to be lost in case of customer default.

The LGD calculations factor in any security, including the type of security (such as mortgages over real estate), its quality, and its ranking in the order of priority.

**LGD: Example of mortgage exposures**

The determination of REA for mortgage lending is based on "applied LGD", which reflects the economic downturn in 1991-1993. Nykredit's REA determination assumes a loss of 14.12% of lending in case of default. For bank lending, applied LGD reflects the current macroeconomic levels, but with an elevated level of unemployment.

To enable a comparison of the applied LGD with the actual share of losses on loans in default, "observed LGD", the applied LGD was recalculated into a so-called "point-in-time LGD". The recalculation eliminates the historical element, and the point-in-time LGD reflects only the current economic trends.

The actual loss ratio, observed LGD, was 14.96%. The levels of REA calculation were thus higher than the actual levels for the period.

Nykredit determines losses as the part of the Group's claims at the time of realisation which is not subsequently covered by security provided, payments from customers, etc. Furthermore, costs incidental to debt collection are included.

The loss on a defaulting borrower cannot be determined until the case has been finally settled. This often takes several years. In cases involving security in the form of a mortgage over a property, for example, the loss cannot be determined until Nykredit has sold the acquired property. The determination of losses therefore includes estimates of the final losses in cases not yet settled.

LGDs vary with economic trends. In periods of high business activity, default will often not lead to any loss, as the value of the security will typically exceed the value of the loan. This applies in particular to loans secured by mortgages over real estate. Conversely, the Group would expect more and greater losses during an economic downturn.

The accuracy of the estimated LGDs can be assessed by comparing the estimates at the beginning of the year with the LGDs observed for the year. Observed LGDs are determined on the basis of actual losses for the year plus individual impairment provisions at year-end. Observed LGDs reflect the current economic climate. To obtain an accurate comparison, it is therefore necessary to recalculate the estimated LGDs at the beginning of the year into point-in-time estimates.

**Nykredit Realkredit Group**
**Loss Given Default (LGD)**

| % | Point-in-time LGD Beginning of 2014 | Observed LGD 2014 | Applied LGD 2014 | Point-in-time LGD Beginning of 2013 | Observed LGD End-2013 | Applied LGD End-2013 |
|---|---|---|---|---|---|---|
| **Mortgage exposures** | | | | | | |
| Retail exposures | 15.25 | 14.38 | 10.74 | 12.39 | 14.26 | 11.12 |
| *Of which* | | | | | | |
| *- mortgages over real estate* | *15.25* | *14.38* | *10.74* | *12.39* | *14.26* | *11.12* |
| *- revolving exposures, etc* | - | - | - | - | - | - |
| *- other retail exposures* | - | - | - | - | - | - |
| Commercial exposures | 8.00 | 11.61 | 13.80 | 9.28 | 10.88 | 13.66 |
| **Total mortgage exposures** | **10.47** | **13.08** | **11.80** | **11.34** | **12.63** | **11.97** |
| | | | | | | |
| **Bank exposures** | | | | | | |
| Retail exposures | 31.12 | 52.84 | 43.06 | 31.89 | 48.35 | 43.26 |
| *Of which* | | | | | | |
| *- mortgages over real estate* | *26.47* | *58.37* | *43.88* | *27.68* | *48.41* | *37.65* |
| *- revolving exposures, etc* | - | - | - | *38.15* | *42.12* | *57.20* |
| *- other retail exposures* | *37.38* | *39.25* | *47.54* | *37.21* | *54.91* | *44.81* |
| Commercial exposures[1] | 49.42 | 42.06 | 43.39 | 51.90 | 53.73 | 43.20 |
| **Total bank exposures** | **40.43** | **47.08** | **43.26** | **42.86** | **52.65** | **43.22** |
| | | | | | | |
| **Total exposures** | | | | | | |
| Retail exposures | 15.93 | 16.23 | 12.29 | 13.20 | 15.86 | 12.49 |
| *Of which* | | | | | | |
| *- mortgages over real estate* | *15.50* | *15.90* | *11.36* | *12.76* | *15.21* | *11.75* |
| *- revolving exposures, etc* | - | - | - | *38.15* | *42.12* | *57.20* |
| *- other retail exposures* | *37.38* | *39.25* | *47.54* | *37.21* | *54.91* | *44.81* |
| Commercial exposures | 12.63 | 13.48 | 17.33 | 15.75 | 18.29 | 16.87 |
| **Total exposures, total** | **12.49** | **14.96** | **14.12** | **13.20** | **17.12** | **14.03** |

Note: Pursuant to Article 164 of the CRR, the exposure-weighted average LGD must be at least 10% for retail exposures secured by residential property and at least 15% for retail exposures secured by commercial property for the purpose of REA determination. Applied LGDs for the Bank's commercial exposures are excl repos.
[1] LGD after credit risk hedging. Nykredit Bank's commercial lending is determined using the foundation IRB approach.

Applied LGD used to calculate REA corresponds to the loss ratio during a recession, as it reflects an economic downturn. Applied LGD is therefore not comparable with the observed loss ratios or point-in-time estimates, which both reflect the current economic climate.

Mortgage banking is characterised by low LGDs as the security provided by way of mortgages over real estate offers good protection against losses. The use of security is described in more detail under "Security".

**Exposure at Default (EAD)**
Nykredit estimates an EAD for all exposures relating to a customer, reflecting the total expected exposure to the customer at the time of default, including any drawn part of approved credit commitments. The latter is factored in using conversion factors (CF).

Conversion factors are estimated for banking products subject to flexible utilisation, such as revolving exposures, equity withdrawal credits, credit lines and loan offers. In respect of exposures in default subject to flexible utilisation, the credit maximum has often been reached or exceeded at the time of default. This applies to revolving exposures and similar credit facilities, which is why Nykredit applies a conversion factor above 1.

The table below shows observed and applied CFs for exposures to customers with undrawn credit. Observed CF is the average utilisation rate for exposures and other credit commitments at the time of default. Applied CF at year-end is the parameter for the utilisation rates applied to determine REA.

**New LGD and CF models at Nykredit Bank**
Nykredit's approval from 2007 to apply the advanced IRB approach does not include Nykredit Bank's commercial exposures, as Nykredit did not have sufficient loss data on commercial customers at the time to be able to develop internal LGD and CF models. Instead, Nykredit was authorised to apply the foundation IRB approach to Nykredit Bank's commercial exposures. Since then Nykredit has compiled and analysed loss data on Nykredit Bank's commercial customers.

In 2014 Nykredit applied to the Danish FSA for approval to apply the advanced IRB approach and internal LGD and CF estimates to Nykredit Bank's commercial exposures. The application also concerned new CF models to be applied to Nykredit Bank's personal customer exposures. The new models are expected to be approved and implemented in 2015.

It is expected that the new LGD and CF models will lead to a rise in Nykredit's REA of just over DKK 30bn. This capital impact derives from the new requirement that sufficient capital must be provided to cover loans in default and the fact that the Bank's actual LGD levels are higher than the standard value of 45% under the current approach.

**LTVs and property valuation model**
Nykredit continually monitors the Loan-To-Value (LTV) ratios of its customers, which express the debt outstanding relative to the value of the property. For that purpose, statistical models approved by the Danish FSA are applied. The models are applied to detached houses, owner-occupied flats and holiday homes that must satisfy specific requirements for mortgageable value, risk classification and time since the last valuation. The statistical valuations are performed centrally and supplemented with local valuations.

In the determination of LTVs, the proportion of lending covered by guarantees provided by public authorities is deducted. Public authority guarantees reduce the credit risk relating to subsidised housing, which forms part of lending to the non-profit housing segment. For this reason, LTVs of non-profit housing offer no relevant risk data.

Besides being a central element of the monitoring of the Group's mortgage loans, LTVs are an important factor in the credit models for determining a customer's credit quality. Other things being equal, customers with low LTVs have better ratings than customers with high LTVs. Also, LTVs are included in the calculations of customer LGDs.

**Nykredit Realkredit Group**
**Utilisation of commitments and credit lines at default, conversion factor (CF)**

| | Observed CF End-2014 | Applied CF End-2014 | Observed CF End-2013 | Applied CF End-2013 |
|---|---|---|---|---|
| **Bank exposures**[1] | | | | |
| Retail exposures | 0.39 | 1.10 | 0.50 | 1.11 |
| *Of which* | | | | |
| *- mortgages over real estate*[2] | *0.38* | *1.12* | *0.49* | *1.13* |
| *- revolving exposures, etc* | - | - | *0.50* | *1.07* |
| *- other retail exposures* | *0.39* | *1.07* | *0.45* | *1.09* |
| **Total bank exposures** | **0.39** | **1.10** | **0.50** | **1.11** |

Note: Exposure-weighted. Includes only exposures subject to the advanced IRB approach using internal CF estimates with undrawn credit.
[1] Covers only exposures of Nykredit Bank subject to the advanced IRB approach.
[2] Including exposures such as equity release and equity withdrawal credits.

**IRB losses**
The IRB loss is a concept applied for regulatory purposes which is calculated on the basis of loss ratios in a severe recession scenario. IRB losses express the expected losses on all exposures, including exposures in default.

The IRB losses of DKK 11.2bn are currently somewhat higher than the Group's total impairment provisions of DKK 9.2bn.

The level of incurred losses remained low in 2014. Total incurred losses amounted to DKK 1,767m in 2014 against DKK 1,611m in 2013. Losses incurred in 2014 were thus five times lower than current total impairment provisions.

**Validation and control of models**
Nykredit develops and improves its credit risk models on an ongoing basis. As the parameter estimates are used both in the determination of REA and for many internal business purposes, it is decisive that the models work as intended and provide consistent results.

The models are developed by Capital & Risk, a unit which is independent of Nykredit's credit approval and operations in general. To ensure a good forecasting ability and consistent estimates, all credit models are validated at the development stage and are then subject to regular validation – at least once a year. Model development and model validation are separate functions. The Parameters and Models board approves the results of the validation activities on a current basis, while the overall validation results are reported to the Risk Committee.

The ongoing validation includes:
- *Quarterly monitoring:* Monitoring of the models' customer ranking, comparison of the observed and the actual number of defaults, rating distributions and migration.
- *Annual back test:* Comparison of the expected and the actual number of defaults, as well as the loss ratios within and across rating categories. Analysis of changes in ratings over the year and parameters applied to determine REA.
- *Annual analysis of qualitative credit assessments*: As an integral part of the credit process, a qualitative assessment is made regularly of the ratings of the individual exposures. Overrides are made with respect to individual customers as required. Overrides and the qualitative assessments are reviewed annually.
- *Expert forums*: Nykredit's experienced credits and case officers and analysts compile and analyse any discrepancies between model estimates and internal assessments of business risks.

**Nykredit Realkredit Group**
**Impairment provisions, IRB losses and incurred losses**

| DKK million | Impairment provisions | IRB losses | Incurred losses |
|---|---|---|---|
| **Mortgage exposures** | | | |
| Retail exposures | 2,262 | 2,491 | 675 |
| *Of which* | | | |
| *- mortgages over real estate* | *2,262* | *2,491* | *675* |
| *- revolving exposures, etc* | - | - | - |
| *- other retail exposures* | - | - | - |
| Commercial exposures | 3,236 | 5,051 | 432 |
| **Total mortgage exposures** | **5,498** | **7,542** | **1,107** |
| | | | |
| **Bank exposures** | | | |
| Retail exposures | 669 | 655 | 84 |
| *Of which* | | | |
| *- mortgages over real estate* | *342* | *254* | 57 |
| *- revolving exposures, etc* | - | - | - |
| *- other retail exposures* | *327* | *401* | 27 |
| Commercial exposures | 2,996 | 3,032 | 576 |
| **Total bank exposures** | **3,665** | **3,687** | **660** |
| | | | |
| **Total exposures** | | | |
| Retail exposures | 2,931 | 3,146 | 759 |
| *Of which* | | | |
| *- mortgages over real estate* | *2,604* | *2,746* | *732* |
| *- revolving exposures, etc* | - | - | - |
| *- other retail exposures* | *327* | *401* | *27* |
| Commercial exposures | 6,232 | 8,083 | 1,008 |
| **Total exposures, total** | **9,163** | **11,229** | **1,767** |

Note: Includes exposures determined subject to the advanced and the foundation IRB approaches. Pursuant to Article 164 of the CRR, the exposure-weighted average LGD must be at least 10% for retail exposures secured by residential property and at least 15% for retail exposures secured by commercial property for the purpose of REA determination. Exposure-weighted average LGD has been determined after adjustment to ensure compliance with the floor requirements.
- Individual and collective loan impairment provisions and provisions for guarantees.
- Not including losses incurred on acquired properties, as they cannot be distributed over exposure categories.
- IRB losses are stated at end-2014 and express the model-based expected losses for the coming year. IRB losses have been determined using LGDs for 1991-1993 pursuant to legislation (CRR).
- The difference between IRB losses and impairment provisions is not directly comparable with the deduction from own funds due to adjustments for prudent valuation.

- *Validation of sub-elements*: At least every three years, the sub-elements of the individual models are assessed. It is assessed whether the model's input factors are still significant and representative and thereby contribute to correct customer ranking by the model.
- *Quality assurance and data input checks*: Data used for calculating the risk parameters are subject to a number of automatic controls. This applies to both internal data and data from external suppliers.
- *Case processing and data entry control:* Nykredit's controls consist of three elements – sampling, in-depth investigation and thematic surveys. Random sampling is performed every month across all customer centres. In-depth investigation of individual customer centres is performed according to a fixed rotation plan, while thematic surveys are carried out on an ad-hoc basis.

**Internal estimates**
For a number of years, Nykredit has applied credit models for risk management, capital management, customer assessments, collective impairment provisions and pricing. The credit models have become an integral part of business and are used in several areas:

- *Capital management:* Nykredit's risk and capital management is based on projections of the statutory minimum requirement for own funds, also in stressed scenarios.
- *Loan approval:* A uniform approach to credit assessment is taken, albeit with due regard for the characteristics of the individual business units. Credit assessment comprises the customer's creditworthiness, valuation of the security provided and the nature of the transaction concerned.

The credit assessment of customers and the approval of facilities are typically based on an overall assessment of the risk elements of the individual case and take into consideration the size of the total exposure to the customer concerned. Creditworthiness is determined on the basis of financial strength, stability in relation to external factors, managerial strength (businesses), etc.

When approving loans to personal customers, customer ratings are applied. The rating may be supplemented with policy rules based on key ratios on customers' personal finances and behaviour. Furthermore, the assessment includes the quality of the security provided.

This loan approval approach is used for retail exposures secured on real estate, revolving exposures, etc and other retail exposures.

The assessment of commercial customers includes an assessment of the customer's financial position, payment history and rating as well as the stability of value and transferability of the security provided etc. The lower the customer rating, the greater the importance of the security to the overall assessment.

Overrides allow case officers to adjust a rating, possibly following a recommendation to Group Credits, if the customer's current financial position or actual creditworthiness is not considered to be reflected in its financial statements etc.

The approval of financial products is based on a customer's creditworthiness, delimitation of the life of each product, contractual basis, an assessment of the quality of the security, etc.

## SECURITY

The decision to grant a loan is usually based on a customer's creditworthiness and a valuation of the security provided. The greater part of Nykredit's lending is secured by mortgages over real estate. Other types of security are guarantees, financial collateral and charges over equipment, machinery, plant, etc.

In the determination of REA and required own funds, only the effect of mortgages over real estate, guarantees received and financial collateral is included.

**Real estate**
Mortgages over real estate reduce the credit risk substantially. The mortgageable value of a property is determined at the time of loan granting and is subsequently monitored on a continuous basis. Valuations are based on the marketability, stability of value, alternative use, letting potential, etc of a property. Typically, no losses will be incurred on mortgage loans secured on properties with a high homeowner's equity at the time of loan granting. Nykredit has FSA approval to apply a statistical model in setting lending limits for private residential property. The model-based valuation is applied to detached and terraced houses as well as owner-occupied flats that meet specific requirements for the mortgageable value and risk classification. Such valuations are subject to approval by the valuer in the relevant geographical area and are monitored centrally.

Following the initial valuation, the market value of a property is monitored regularly. Nykredit uses a statistical model for the monitoring of detached and terraced houses, owner-occupied flats and holiday homes. The statistical valuations are performed centrally and supplemented with local valuations as required. The current valuation is also included in the LGD estimate.

**Nykredit Realkredit Group**
**Validation and control of models**

| % | Personal customers | | | Commercial customers | | |
|---|---|---|---|---|---|---|
| | Number of customers | Model expectations of defaults | Actual defaults | Number of customers | Model expectations of defaults | Actual defaults |
| Ordinary customers (rating categories 6-10) | 732,085 | 2,654 | 2,485 | 47,991 | 226 | 244 |
| Ordinary customers with some signs of weakness (rating categories 3-5) | 132,729 | 1,432 | 993 | 13,753 | 241 | 186 |
| Weak customers (rating categories 0-2) | 46,900 | 4,950 | 2,626 | 5,054 | 824 | 396 |
| **Total** | **911,714** | **9,036** | **6,104** | **66,798** | **1,291** | **826** |

The Property Prices board monitors market conditions and identifies areas and properties which should be checked separately. The board may also propose adjustments to the statistical models and policies etc. Its members are experienced staff with in-depth knowledge of the housing market and solid valuation skills. The Property Prices board reports to the Risk Committee.

**Guarantees**

Nykredit mainly receives guarantees from public authorities and banks. Guarantees issued by public authorities mitigate the credit risk mainly within mortgage lending to subsidised housing. Public authority guarantees are guarantees whereby the guarantor assumes primary liability. This means that Nykredit may enforce a guarantee as soon as a loan falls into arrears.

Bank guarantees include guarantees for registration of mortgages free from any adverse endorsements, guarantees for interim loans and loss guarantees.

Guarantees are widely applied in the day-to-day management of Nykredit's credit risk, particularly in customer relationships where a parent company contributes capital to group companies. The determination of Nykredit's REA and required own funds includes guarantees whereby limited liability companies, production farming businesses and large privately owned enterprises assume primary liability. Guarantees provided by small privately owned enterprises and private individuals are not included. On inclusion of a guarantee, the customer's rating is replaced by the guarantor's rating if the latter is better.

Under Nykredit's partnership agreement with the banks behind Totalkredit, mortgage loans to personal customers granted by the banks are covered by a set-off agreement for incurred losses. Under this agreement, any losses incurred up to a certain level are offset against the current commission paid by Nykredit.

**Financial collateral**

Financial collateral includes deposits in DKK or other currencies, positions in listed Danish government and covered bonds, other high-rated liquid Danish and foreign bonds, and listed and liquid equities.

Nykredit assigns an internal security value to the different types of financial collateral depending on the risk involved. The lower the market and credit risks, the higher the security value. The internal security values are used for the credit granting process and for internal management purposes.

For the purpose of calculating REA, Nykredit assigns to the different types of financial collateral a regulatory security value based on the rules of the CRR.

When establishing limits for financial products, Nykredit will also often require that a contractual basis be established providing group companies with a netting option. The contractual framework is based on market standards such as ISDA or GRMA agreements. In addition to a netting agreement, an agreement on financial collateral is typically concluded following an individual assessment. In the determination of the need for collateral from the individual counterparty or customer, all the financial contracts of a customer governed by the contractual basis are netted. Netting means that the potential obligations of each customer are determined as the sum of potential obligations under all the contracts of a customer less the sum of potential claims.

**Nykredit Realkredit Group**
**Types of security and credit exposures**

| 2014<br>DKK million | Real estate[1] | Guarantees received | Financial collateral | Total security value | Total exposure |
|---|---|---|---|---|---|
| Retail exposures | 692,210 | 9,315 | 78 | 701,603 | 754,673 |
| Of which | | | | | |
| *- mortgages over real estate* | *692,210* | *9,315* | *8* | *701,534* | *734,890* |
| *- revolving exposures, etc* | - | - | - | - | - |
| *- other retail exposures* | - | - | *70* | *70* | *19,783* |
| Commercial exposures | 371,564 | 32,067 | 49,174 | 452,805 | 522,533 |
| Credit institution exposures | - | - | - | - | 74,375 |
| Sovereign exposures | - | - | - | - | 47,134 |
| Equity exposures | - | - | - | - | 3,828 |
| Assets with no counterparty | - | - | - | - | 4,263 |
| Credit value adjustments (CVA) | - | - | - | - | 3,388 |
| Default fund contribution | - | - | - | - | 312 |
| **Total 2014** | **1,063,774** | **41,382** | **49,252** | **1,154,408** | **1,410,507** |
| Total 2013 | 1,082,674 | 38,559 | 73,873 | 1,195,105 | 1,383,593 |

Note: Exposures also include guarantees issued by banks (DKK 9bn), which have been recognised under credit institution exposures, and government guarantees (DKK 32bn), which have been recognised under sovereign exposures.

[1] The security value of real estate is measured at nominal value. The part of the exposure for which security has been provided is shown.

# MARKET RISK

Nykredit assumes various market risks through its business activities. Market risk reflects the risk of loss as a result of movements in financial markets (interest rate, foreign exchange, equity price, volatility risks, etc).

The share of risk exposures involving market risk relative to the total risk exposure amount (REA) is 10.1%.

## NYKREDIT'S INVESTMENT POLICY

Nykredit's market risk is determined for two purposes:

- Internal management of all positions involving market risk.
- Determination of REA for market risk, cf "Capital and capital adequacy".

For the internal management, a wide variety of different key figures are applied to determine market risk, including a Value-at-Risk model, and the Board of Directors lays down limits to Nykredit's market risk appetite.

The determination of REA for market risk takes place in accordance with various statutory methods, including a Value-at-Risk model. The model is combined with a number of other methods to determine one aggregate REA figure. The model has been approved by the Danish FSA for determination of a large part of Nykredit's general market risk.

### Nykredit's market risk policy

The Board of Directors has adopted a policy of having an appropriate appetite for market risk in order to prevent any major losses on market risk exposures that would keep Nykredit from generating a profit for the coming four quarters.

The most risky investments are placed in the Parent Company, while other investments involving market risk lie in the subsidiaries.

The primary investments are in Danish and European covered bonds. Other investments include high-rated bank bonds. The interest rate risk involved is reduced by offsetting selling of government bonds and the use of interest rate derivatives. This creates an exposure to spreads between covered bond/credit bond yields and swap rates. This exposure is not hedged, cf "Spread risk" below

By far the greater part of Nykredit's lending is mortgage lending. In practice, Nykredit incurs only negligible market and liquidity risks on these loans – regardless of the development in financial markets. This is because mortgage lending is governed by a statutory balance principle and match-funded, cf the description under "Liquidity and funding".

Nykredit's market risk relates mainly to the placing of equity and liquidity reserves. In addition, Nykredit Bank and Nykredit Realkredit incur market risk in connection with trading in bonds, swaps and other financial products with customers. The trading activities imply that the Bank quotes bid and ask prices for a large number of products, thereby temporarily entering into long and short positions for the Bank's own account.

### Nykredit's guidelines for market risk

Nykredit's Board of Directors lays down market risk limits which are applied in the day-to-day management. Through the Asset/Liability Committee and within the limits provided by the Board of Directors, the Executive Board approves and delegates market risk limits to the group companies. The boards of directors of the individual companies then prescribe limits to their activities.

The limits provided by the boards of directors restrict the scope for assuming interest rate, equity price, foreign exchange, volatility, commodity and credit risks. The limits permit the use of financial instruments if the risk involved can be measured and managed. Financial instruments are included in the limit for the underlying asset.

The Products Committee coordinates the implementation of new products, thereby ensuring that the risks can be determined and managed correctly.

Compliance with risk limits is monitored daily and independently of

**Nykredit Realkredit Group**
**The Board of Directors' principal market risk limits at group level, end-2014**

| Key figure | Definition | Limit |
|---|---|---|
| Value-at-Risk | Maximum loss in one day at a 99% confidence level | DKK 300m |
| Interest rate risk | Loss on general rise in interest rates of 1 percentage point | DKK (800)m to 1,200m |
| Equities | Measured at book value | DKK (2,000)m to 6,000m |
| Foreign exchange risk, EUR | Measured at market value | DKK (4,000)m to 4,000m |
| Foreign exchange risk, main currency | Measured at market value | DKK (1,000)m to 1,000m |
| Foreign exchange risk, other currencies | Measured at market value | DKK (200)m to 200m |
| Spread risk, covered bonds | Loss on yield spread widening of 1 percentage point | DKK 0m to 5,000m |
| Spread risk, govt bonds | Loss on yield spread widening of 1 percentage point | DKK (1,500)m to 1,500m |
| Spread risk, credit bonds | Loss on yield spread widening of 1 percentage point | DKK (200)m to 700m |
| Credit bonds | Measured at book value | DKK (2,000)m to 7,500m |
| *- Up to A1/A+* | *Measured at book value* | *DKK (2,000)m to 5,000m* |
| *- Up to –Ba1/BB+ and not rated* | *Measured at book value* | *DKK (1,000)m to 2,000m* |
| Volatility risk | Measured as losses on a general rise in interest rate volatility of 1 percentage point | DKK (100)m to 100m |

the acting entities of the Group. Any breaches are reported to the Asset/Liability Committee, the Board of Directors of Nykredit Realkredit or other boards of directors depending on the nature of such non-compliance.

Determination, management and reporting of market risk require a range of different tools in the form of statistical models, key ratios and limits.

## MARKET RISK MEASURES

Market risk cannot be assessed adequately on the basis of a single risk measure. To obtain a full overview of the Group's market risk, Nykredit combines various measures that express sensitivity to the development in financial markets.

### Value-at-Risk

Value-at-Risk (VaR) is applied to calculate the maximum value decrease of a given portfolio over a given period and at a given probability.

VaR is calculated by describing all portfolios by means of approximately 500 risk factors across equity price, interest rate, foreign exchange, volatility and spread risks.

As opposed to the traditional risk measures, VaR thus captures the probability of a loss occurring.

*Advantages of VaR*

One of the advantages of using VaR is that the probability of a given outcome is included in the model. Nykredit's VaR figures thus show the maximum loss which the Group, at a 99% probability, may sustain in one day.

Another advantage of VaR is that the calculation factors in the covariation between the traditional risk measures. In other words, the VaR model factors in that Nykredit would normally not lose the maximum amount in all asset classes at the same time.

A further advantage of VaR is that all risks are comprised in a single number, which makes it manageable to communicate compared with a number of sensitivities on traditional risk measures.

The accuracy of the VaR model can be back tested using the recognised daily gain/loss.

*Disadvantages of VaR*

VaR is based on historical observations and even a brief period of minor market fluctuations may reduce VaR quite considerably. Also, covariation is often different in periods of financial turmoil than in calmer periods.

The calculation of VaR is based on the assumption that the financial markets are normally distributed. In reality, there are typically several extreme observations, which means that VaR may tend to reduce the risk.

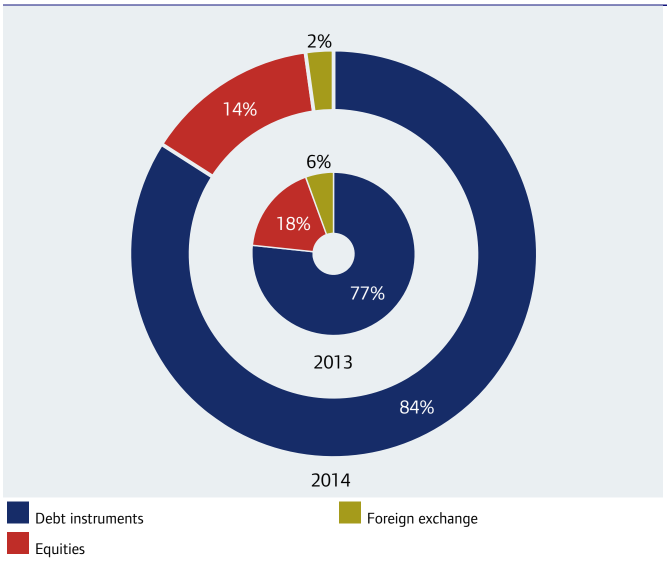
Nykredit's VaR model is a parametric model, which means that it assumes a linear correlation between changes in market data and changes in gain/loss. The VaR model is therefore less accurate in respect of instruments involving option risk.

*Internal management*

VaR is applied in the day-to-day internal management and in the determination of the required own funds.

VaR is calculated and reported on a daily basis, and the model is incorporated in Nykredit's securities systems. VaR limits exist at group, company and organisational entity levels.

**Nykredit Realkredit Group**
**Breakdown of market risk determined using VaR model**




Note: The capital charge for liquidity risk is not quantified.

**Nykredit Realkredit Group**
**REA for market risk**

| 2014<br>DKK million | Specific risk | General risk | Total REA | Total REA<br>2013 |
|---|---|---|---|---|
| **Internal models (VaR):** | | | | |
| Value-at-Risk (99%, 10 days) | - | 7,701 | 7,701 | 3,967 |
| Stressed Value-at-Risk (99%, 10 days) | - | 18,572 | 18,572 | 15,505 |
| **Standardised approach:** | | | | |
| Debt instruments | 5,606 | 1,367 | 6,973 | 7,839 |
| Equities | 1,451 | 188 | 1,639 | 573 |
| Foreign exchange risk | 0 | 0 | 0 | 0 |
| Collective investment schemes | 449 | 0 | 449 | 688 |
| **Total market risk** | **7,506** | **27,828** | **35,333** | **28,571** |

The confidence level of the VaR model is 99%, while the choice of time horizon depends on the specific purpose of the calculations. For the day-to-day internal management, a time horizon of one day is applied in the VaR model, while a time horizon of 10 days is applied for determinations of REA.

The Group's internal VaR totalled DKK 128m at end-2014 against DKK 70m at end-2013. This means that, according to the internal model, Nykredit would, at a 99% probability, lose a maximum of DKK 128m in one day in consequence of market fluctuations. The increase resulted from position-taking in especially interest rate volatility in Nykredit Realkredit A/S.

**Parameters used to determine Value-at-Risk**

Value-at-Risk is a statistical measure of the maximum loss on a portfolio at a given probability within a given time horizon. Risk is determined using a Value-at-Risk model that includes the risk relating to spreads between covered bond yields and swap rates, for selected government and credit bonds, as well as covered bonds in Nykredit Realkredit.

**The parameters used in the calculation of** Value-at-Risk are:

| | |
|---|---|
| Risk factors: | All portfolios are described by means of approximately 500 risk factors across equity price, interest rate, volatility and foreign exchange risks. |
| Volatilities and correlations: | Daily volatilities and correlations for the above-mentioned risk factors. In calculating the volatilities, last-dated observations have the highest weight. Volatilities and correlations are calculated on the basis of data for the last 250 banking days. |
| Time horizon: | Value-at-Risk is calculated at a time horizon of one day, but the figure may be scaled to other time horizons. The following time horizons are applied:<br>▪ REA for market risk: 10 days<br>▪ Day-to-day business management: 1 day |
| Confidence level: | Value-at-Risk is determined at a 99% confidence level. |

**Nykredit Realkredit Group**
**Internal Value-at-Risk (99%, 1 day)**

| DKK million | Average | Min | Max | Year-end |
|---|---|---|---|---|
| 2014 | 109 | 60 | 248 | 128 |
| 2013 | 78 | 55 | 122 | 70 |

**Nykredit Realkredit Group**
**Value-at-Risk**

| DKK million | Average | Min | Max | Year-end |
|---|---|---|---|---|
| 2014 | 47 | 25 | 80 | 56 |
| 2013 | 38 | 20 | 61 | 26 |

**Nykredit Realkredit Group**
**Stressed Value-at-Risk**

| DKK million | Average | Min | Max | Year-end |
|---|---|---|---|---|
| 2014 | 145 | 108 | 186 | 136 |
| 2013 | 136 | 108 | 188 | 110 |

Note: Contrary to VaR for REA, internal VaR includes strategic equities, unlisted equities and assets in the subsidiaries of Nykredit Realkredit A/S.
Capital requirements for VaR are determined as VaR (99%, 10 days) x statutory FSA spread, the latter depending on the number of back test breaches within the past year.
[2] Stressed VaR is calculated using volatilities and correlations from a period of significant stress.

*Capital adequacy determination*
Nykredit has the approval of the Danish FSA to apply VaR in determining REA for the market risk of Nykredit Realkredit A/S and Nykredit Bank A/S.

The VaR model for determining REA applies a statutory confidence level of 99% and a time horizon of 10 days. For the purpose of determining REA, Nykredit Realkredit A/S only calculates VaR in respect of the trading book, whereas Nykredit Bank A/S calculates VaR for the trading book as well as the banking book excluding equities – together a slightly smaller portfolio than the one used for the internal management.

The calculations are "mechanical" and based on historical data on financial market trends. During a financial crisis, however, the current conditions in financial markets may not always correspond to the historical conditions. The maximum expected loss calculated using a VaR model may therefore during the first stages of a crisis present an overly optimistic view of the risk of loss.

Legislation therefore requires Nykredit Realkredit A/S and Nykredit Bank A/S to calculate a stressed VaR in addition to the current VaR for determining the total VaR for REA.

Stressed VaR is calculated by means of the VaR model used to calculate REA. VaR must be calculated for the current portfolio, but using volatilities and correlations (market data) from a period of significant stress. This period is determined annually on the basis of the current portfolios of Nykredit Realkredit A/S and Nykredit Bank A/S, respectively.

Nykredit Realkredit A/S and Nykredit Bank A/S both apply periods between September 2008 and September 2009 for calculating stressed VaR. These periods are characterised by very substantial fluctuations in the model parameters and cover the period after the collapse of Lehman Brothers in September 2008.

Nykredit's total REA for VaR amounted to DKK 26.3bn at end-2014 against DKK 19.4bn at end-2013. Of this amount, stressed VaR amounted to DKK 18.6bn at end-2014 against DKK 15.5bn at end-2013. The increase resulted from position-taking in especially interest rate volatility in Nykredit Realkredit A/S

*Back tests and daily stress tests*
It is essential that the VaR models are reliable. The model results are therefore tested on a daily basis against realised returns on the portfolios through back tests. The daily earnings (gain/loss) are compared with the models' estimates of the maximum loss. Because of the statistical properties of the models, the actual losses are expected to exceed the maximum loss predicted by the VaR model two or three times a year.

If the actual losses exceed the model's estimates five or more times within one year, REA will be adjusted upwards. VaR back tests for Nykredit Realkredit A/S and Nykredit Bank A/S are shown in the figures.

In the back test of the model for calculation of REA for VaR in 2014 used by Nykredit Realkredit A/S there were 2 breaches , while there were no breaches in the corresponding model used by Nykredit Bank

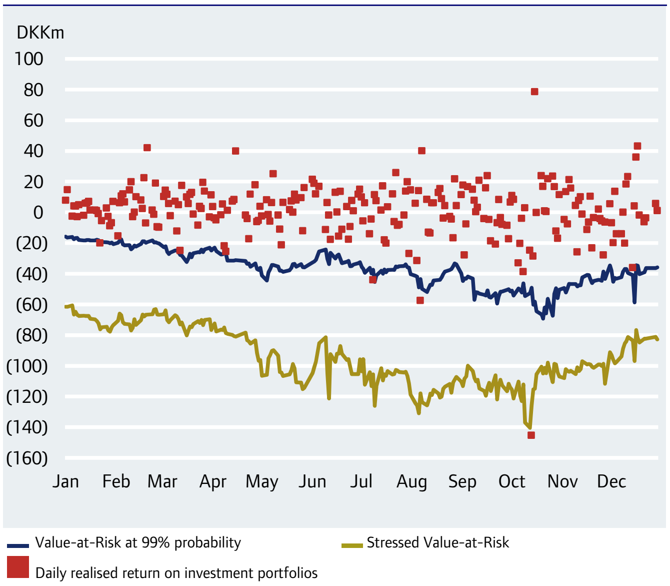
A/S. By comparison, both companies had the same numbers of breaches in 2013.

As a supplement to VaR, systematic stress tests are performed daily to measure the risk of loss during turbulent market conditions. The tests are based on simulated market movements and events. Stress testing is an attempt to assess the sensitivity of the portfolios to probable events.

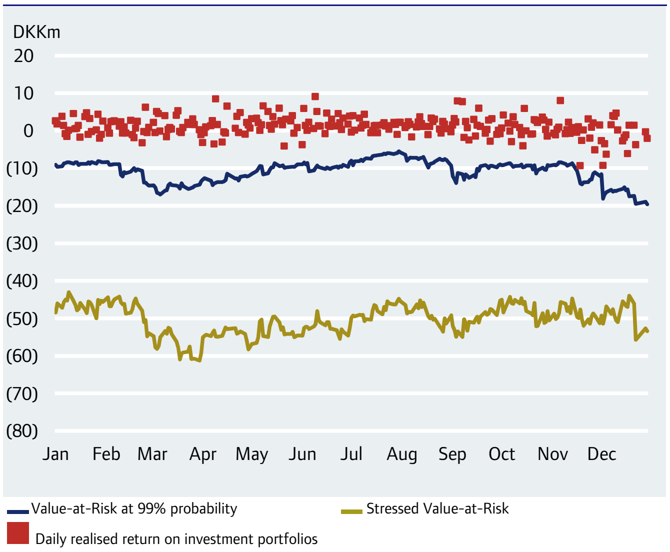
The main focus of the daily stress tests is the market risks to which the individual companies are exposed. The scenarios applied for the individual companies are therefore different and reflect their respective risk profiles. The tests are adjusted in line with business developments. In 2014 the stress tests did not give rise to a changed view of Nykredit's risk profile.

In calculating the required own funds, further stress tests are applied, cf "Capital management". The stress tests applied to determine the required own funds also contain elements relating to market risk, but they are less detailed than the daily stress tests of the VaR models.

**Nykredit Realkredit A/S**
**Backtest of VaR (99%, 1 day) 2014**




**Nykredit Bank A/S**
**Back test of VaR (99%, 1 day) 2014**




**Traditional risk measures**

The traditional risk measures, such as interest rate, equity price, volatility and foreign exchange risks, are so-called portfolio sensitivity tests. They are used to calculate the effect on the value of a portfolio in case of changing market conditions, such as increasing/decreasing interest rates, equity prices or volatility. Calculations are only made for one type of risk at a time.

The traditional risk measures do not indicate how likely a particular event is to occur, but rather how much it would affect the value of a portfolio.

*Interest rate risk*

Interest rate risk is the risk of loss as a result of interest rate changes, and the Group's interest rate risk is measured as the change in market value caused by a general interest rate increase of 1 percentage point in respect of bonds and financial instruments.

The Group's interest rate exposure was DKK 366m at end-2014.

The mortgage loan types Tilpasningslån, BoligXlån (ARMs) and RenteMax (floating-rate with an interest rate cap shorter than the loan term) are refinanced by means of new bond issues. Following refinancing, borrowers' loan rate mirrors the yield-to-maturity of the bonds sold.

*Spread risk*

Spread risk is the risk of spread widening between covered bond yields and swap rates. The spread risk of the Group's portfolio of covered bonds amounted to DKK 2.3bn at end-2014. This means that the Group would lose DKK 2.3bn on its investments in covered bonds if the spread between covered bond yields and swap rates widened by 1 percentage point.

*Equity price risk*

Equity price risk is the risk of loss as a result of changes in equity prices, and it is calculated as the loss in case of a general equity market decrease of 10%. The Group's equity price exposure amounted to DKK 344m at end-2014.

*Foreign exchange risk*

Foreign exchange risk is measured as the gain/loss in a given currency resulting from DKK strengthening by 10%. Foreign exchange risk is thus the risk of loss as a result of changes in exchange rates.

Foreign exchange risk is measured by foreign exchange positions excluding EUR and individual limits at currency level.

The Group hedges its foreign exchange risk except for some minor tactical foreign exchange positions held to achieve a gain. Therefore, the Group had only minor foreign exchange positions in currencies other than EUR in 2014.

*Volatility risk*

Volatility is a measure of the variation in the price of an asset, such as the movement in the price of a bond. The market value of options and financial instruments with embedded options such as callable covered bonds partly depends on the expected market volatility. Volatility risk is the risk of loss of market value as a result of changes in market expectations for future volatility.

Volatility risk is measured as the change in market value resulting from an increase in volatility of 1 percentage point, increased volatility implying a loss on Nykredit's part.

**TRADING BOOK AND BANKING BOOK**

Nykredit classifies the trading and banking books at portfolio level on the basis of the purpose of the portfolio concerned.

Portfolios with positions held for trading are placed in the trading book. Positions forming part of Nykredit's lending business and strategic positions are placed in the banking book. Furthermore, portfolios not unambiguously classifiable under the trading book are placed in the banking book.

**Nykredit Realkredit Group**
**Market risk**

| 2014<br>DKK million | Interest rate risk<br>(100bp change) | Spread risk<br>(100bp change) | Interest rate<br>volatility risk (Vega) | Equity price risk<br>(10% change) | Equity volatility risk<br>(Vega) |
|---|---|---|---|---|---|
| Money market instruments | (67) | - | - | - | - |
| Government bonds | 291 | (41) | - | - | - |
| Danish covered bonds | 1,562 | 2,652 | 11 | - | - |
| Swedish covered bonds | 247 | 258 | - | - | - |
| Other covered bonds | 223 | 363 | - | - | - |
| Senior secured debt | (466) | (538) | - | - | - |
| Bank issues | (173) | (305) | - | - | - |
| Other bonds, loans and advances | 89 | (73) | - | - | - |
| Equities | - | - | - | 25 | - |
| Derivative financial instruments | (1,341) | - | 0 | - | 1 |
| Securitisations | - | - | - | - | - |
| **Total** | **366** | **2,315** | **11** | **25** | **1** |

Note: Repo and reverse transactions are included in monety market instruments.

**Nykredit Realkredit Group**
**Market risk**

| DKK million | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | Average | Min | Max | Year-end | Average | Min | Max | Year-end |
| Interest rate exposure (1 pp change) | 106 | (223) | 460 | 366 | 375 | 106 | 549 | 450 |
| *– of which outside trading book* | *55* | *(69)* | *139* | *103* | *55* | *(59)* | *139* | *121* |
| *– of which on mortgage activities* | *33* | *(95)* | *139* | *84* | *53* | *(51)* | *185* | *65* |
| Spread risk (OAS) | 2,518 | 2,144 | 3,312 | 2,707 | 2,388 | 2,093 | 2,751 | 2,320 |
| Equity price exposure (10% change) | 369 | 215 | 471 | 344 | 294 | 222 | 383 | 287 |
| Foreign exchange exposure: | | | | | | | | |
| *– Foreign exchange positions, EUR* | *(156)* | *(1,068)* | *759* | *70* | *244* | *27* | *651* | *651* |
| *– Foreign exchange positions, other currencies* | *215* | *23* | *624* | *369* | *102* | *(26)* | *335* | *335* |
| Interest rate volatility risk (Vega) | 11 | (1) | 20 | 10 | 9 | 2 | 19 | 11 |

Note: Calculation of market risk covers both the trading book and the banking book. As some of the mortgage activities have been classified as belonging to the banking book, interest rate risk outside the trading book and interest rate risk on mortgage activities overlap.

**Nykredit Bank A/S and Nykredit Realkredit A/S**
**Losses in stress tests**

| 2014<br>DKK million | Min | Max | Average | Year-end |
|---|---|---|---|---|
| **Nykredit Bank** | **361** | **577** | **473** | **539** |
| Shock to short-term interest rates (scenario 1) | (80) | 145 | 23 | 64 |
| 20bp rise in DKK rates and 5% devaluation (scenario 2) | (7) | 104 | 46 | 68 |
| 20bp spread widening between govt and swap (scenario 3) | (13) | 44 | 12 | 32 |
| Credit crunch similar to Lehman collapse (scenario 4) | 298 | 487 | 393 | 375 |
| | | | | |
| **Nykredit Realkredit and Totalkredit**[1] | **2,039** | **5,044** | **3,140** | **2,324** |
| Interest rate rise of 65bp | (151) | 233 | 30 | 128 |
| Spread widening as during sovereign debt crisis | (70) | 96 | 17 | 61 |
| Equity, credit and volatility crisis similar to Lehman collapse | 1,826 | 5,071 | 3,093 | 2,082 |

[1] A scenario in which the impact on interest rates and equities is specified.

**Interest rate risk in the banking book**
Interest rate risk in the banking book is limited and derives mainly from the following sources:

- Prepaid funds and proceeds from borrowers with fixed-price agreements and borrowers prepaying their loans. Other funds relate to refinancing of the loan types Tilpasningslån, BoligXlån and RenteMax as well as accumulated interest and principal payments on certain types of ARMs.
- Subordinated capital hedged with interest rate swaps.

**Equity price risk in the banking book**
Equities in the banking book comprise Nykredit's strategic equities and private equity.

Strategic equities comprise equities in regional banks with which Nykredit has business relationships, equities in certain property companies and equities in VP Securities. They are classified as available for sale in accordance with IAS 39 and are therefore value-adjusted directly against equity.

Strategic equity exposures ranged between DKK 1.5bn and DKK 2.0bn in 2014, while private equity exposures ranged between DKK 0.4bn and DKK 0.5bn. The relatively large fluctuation in the exposure to strategic equities was due to Nykredit's sale of parts of its portfolio at the beginning of the year.

At end-2014, the portfolio of strategic equities stood at DKK 2.0bn, of which DKK 1.8bn in financial institutions and DKK 0.2bn in the property sector.

**Bonds in the trading book**
In line with Nykredit's investment strategy, the securities portfolio consists mainly of high-rated Danish as well as North and Central European covered bonds. The portfolio also includes high-rated bank bonds, whereas investments in CDOs, CLOs, US subprime, etc are minimal.

At end-2014, Nykredit had a government bond exposure of DKK 25.5bn. Nykredit had no exposures to Southern European capital markets.

Of Nykredit's total exposure in Danish and other covered bonds and credit bonds of an aggregate DKK 115.8bn, the exposure to securities rated Aa3/AA- or higher amounted to DKK 113.3bn.

**Nykredit Realkredit Group**
**REA for equities in the banking book**

| DKK million | Risk weight | 2014 | 2013 |
|---|---|---|---|
| Private equity | 190% | 0 | 0 |
| Listed equities | 290% | 1,002 | 165 |
| Other assets | 370% | 9,075 | 7,773 |
| Equity exposures subject to risk weighting | 250% | 2,130 | - |
| **Total** | | **12,208** | **7,938** |

Note: Nykredit's private equity portfolio is included with a risk weighting of 370%.

**Nykredit Realkredit Group**
**Bond portfolio by type and country**

| 2014<br>DKK billion | Government bonds | Covered bonds | Junior covered bonds | Credit bonds<br>(excl subordinated capital) | Subordinated capital | Total |
|---|---|---|---|---|---|---|
| EU | 1,692 | - | - | - | - | 1,692 |
| Denmark | 18,459 | 92,678 | 1,431 | 247 | 834 | 113,648 |
| Sweden | 4,827 | 12,169 | - | - | 56 | 17,052 |
| Norway | 43 | 5,509 | - | - | - | 5,553 |
| Finland | (87) | 697 | - | - | 0 | 610 |
| Germany | 768 | - | - | - | 225 | 994 |
| Netherlands | - | 703 | - | - | 210 | 914 |
| France | (218) | 807 | - | 1,025 | 212 | 1,826 |
| Belgium | - | - | - | - | - | - |
| United Kingdom | - | - | - | - | 213 | 213 |
| Switzerland | - | 487 | - | - | 142 | 629 |
| Italy | - | - | - | - | 7 | 7 |
| Other | - | - | - | 5 | 3 | 8 |
| **Total** | **25,483** | **113,050** | **1,431** | **1,277** | **1,903** | **143,144** |

Note: Calculation of market risk covers both the trading book and the banking book. As some of the mortgage activities have been classified as belonging to the banking book, interest rate risk outside the trading book and interest rate risk from mortgage activities overlap.

**Nykredit Realkredit Group**
**Bond portfolio by type and external rating category**

| 2014<br>DKK billion | Government bonds | Covered bonds | Junior covered bonds | Credit bonds[1]<br>(excl subordinated capital) | Subordinated capital | Total |
|---|---|---|---|---|---|---|
| Aaa/AAA | 24,162 | 111,850 | - | 0 | - | 136,013 |
| Aa1/AA+ - Aa3/AA- | 1,321 | 341 | - | 1,025 | - | 2,688 |
| A1/A+ - Baa3/BBB- | - | 632 | 1,426 | 76 | 1,091 | 3,225 |
| Ba1/BB+ or below | - | 223 | 5 | - | 386 | 613 |
| Not rated | - | 3 | - | 176 | 426 | 605 |
| **Total** | **25,483** | **113,050** | **1,431** | **1,277** | **1,903** | **143,144** |

Note: Calculation of market risk covers both the trading book and the banking book. As some of the mortgage activities have been classified as belonging to the banking book, interest rate risk outside the trading book and interest rate risk from mortgage activities overlap.
[1] In addition, Nykredit has hedged exposures through credit derivatives of a net amount of DKK 74m.

# LIQUIDITY AND FUNDING

Liquidity risk reflects the risk of loss as a result of insufficient liquidity to cover current payment obligations. Nykredit has structured its lending in a manner that ensures a high level of liquidity. The greater part of Nykredit's lending consists of mortgage loans funded by covered bonds (ROs and SDOs) according to the match-funding principle. Nykredit's mortgage borrowers make their payments on or before the date on which Nykredit pays bondholders. Accordingly, mortgage lending and the funding thereof produce positive liquidity. Add to this that lending by Nykredit Bank is funded by deposits.

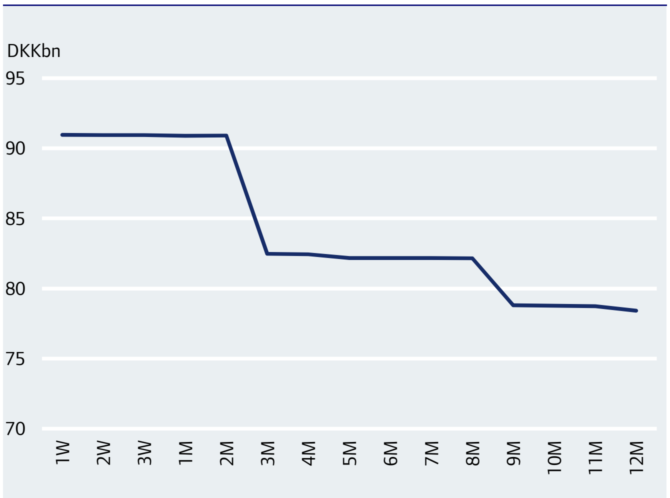
Nykredit's equity and capital market funding, excluding ROs/SDOs, are placed in liquid Danish and European government and covered bonds. These securities are eligible as collateral with the Danish or other European central banks and thus directly applicable for raising liquidity. To this should be added a small portfolio of money market deposits, equities, credit bonds and similar assets.

Nykredit's stock of liquid assets ensures that the Group has a sizeable buffer against liquidity movements from customer flows, loan arrears, current costs and maturing capital market funding.

Of the total stock of liquid assets in the Group's mortgage banks, available unencumbered assets amounted to DKK 91bn at end-2014 against DKK 98bn at end-2013.

In accordance with the Danish Executive Order on Management and Control of Banks etc., the Group's total liquidity risk is overseen and assessed by the Asset/Liability Committee. The Committee also monitors the liquidity of the group companies on an ongoing basis. Daily management of liquidity risk is undertaken by the individual companies.

**Mortgage lending**
**Liquidity stress testing (internal methods)**




Note: Liquidity raised by issuing junior covered bonds is included up to their maturity.

**LIQUIDITY AND FUNDING REQUIREMENTS**

Given a strong focus on ensuring that credit institutions have adequate capital and liquid assets to fulfil the claims of their creditors, the following regulatory requirements as well as requirements from credit rating agencies must be met.

- Minimum statutory requirements (s 153 of the Danish Financial Business Act)
- Supplementary collateral requirements (SDOs) in connection with falling property prices
- Overcollateralisation requirements from credit rating agencies.

In addition to the requirements already in force, Nykredit will be subject to the following future requirements:

- Liquidity Coverage Ratio (LCR)
- Net Stable Funding Ratio (NSFR)
- Broad liquid assets to short-term wholesale funding (BLAST)
- Stable funding ratio.

The LCR and NSFR were introduced as part of the CRR framework, while Standard & Poor's has introduced BLAST and stable funding ratio.

The new ratios from S&P largely match the requirements laid down in the CRR. Nykredit's BLAST and stable funding ratio at end-2014 were 0.41 and 77%, respectively. S&P has stated that they consider BLAST in the region of 1 and a stable funding ratio at around 100% as neutral levels.

The aim of the new measures is to ensure the resilience of credit institutions to liquidity risks in the short and long term. Credit institutions' activities are therefore regulated in respect of:

- the stock of liquid assets to cover short-term net cash outflows
- the maturity of the funding.

On 10 October 2014, the European Commission published the final regulation on LCR, which must be met as of October 2015. A requirement of 100% is expected for Danish SIFIs as at 1 October 2015. The LCR denotes the amount of high quality liquid assets (HQLAs) to be held by a credit institution to be able to cover net cash outflows over a stress period.

At end-2014, the Nykredit Realkredit Group's LCR was 254%. The aggregate LCR for Nykredit's mortgage banks was markedly above 1,000% due to a net cash inflow. The LCR of Nykredit Bank A/S was 107%. Depending on the final rules and any resulting change of procedures, the management of LCR across companies will be changed, and thus also the LCR levels.

The purpose of the other future requirements is to regulate the duration of the funding and encourage credit institutions to apply more medium- and long-term funding. The NSFR has not been finally adopted, however. At present, it is a reporting requirement, which is expected to be introduced as a hard requirement in 2018.

### Refinancing of ARMs with 1- to 2-year interest rate reset
In recent years, credit rating agencies and regulators in Denmark and the EU have pointed out that the large annual bond sales should be reduced so as to best secure the sale of bonds. Refinancing from ARMs with 1-year or 2-year interest rate reset (F1 and F2 loans) to other products will contribute to meeting the requirements of credit rating agencies and regulators, including the coming supervisory diamond.

Nykredit has launched initiatives to deconcentrate refinancing auctions, including a new price structure, cf below.

### Deconcentration of refinancing auctions
Nykredit now holds refinancing auctions four times a year. That way, auction volumes are deconcentrated, and the refinancing risk is reduced.

The July auctions used to be exclusively for the refinancing of Cibor loans, but as of 2014 adjustable-rate mortgages (ARM) will also be refinanced in July, like at the other auctions. This makes for further deconcentration of the refinancing auctions over the year.

### New product and new price structure
Nykredit and Totalkredit launched a new product in late August. The new product is a variable-rate loan, "F-kort", with interest rate reset every six months. F-kort is linked to the Cita rate, but is funded by bonds with longer maturities. This will contribute to meeting the requirements of credit rating agencies and regulators, including the coming supervisory diamond.

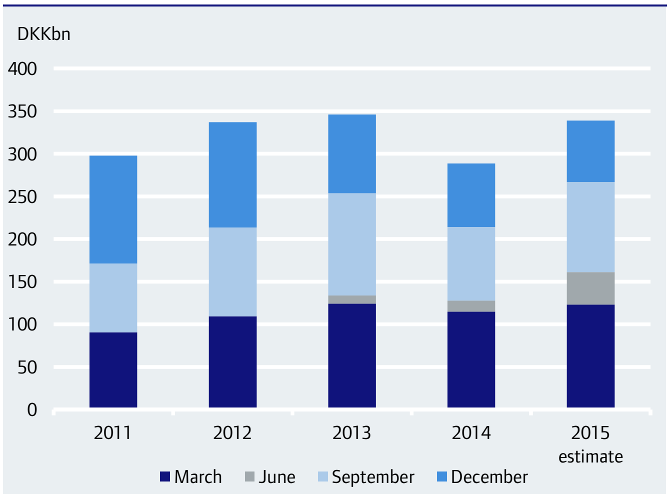
The prices of mortgage loans will change at 1 January 2015 to increase borrowers' incentives to choose repayment mortgages funded by bonds with longer maturities.

The new price structure introduces the largest price increases for loans involving the greatest uncertainty, for instance interest-only ARMs with 1-year interest rate reset, while no increases are introduced for the most secure loans such as fixed-rate repayment mortgages.

As a result of the new price structure, the refinancing auctions at the end of 2014 saw the refinancing of ARMs mainly with 1-year interest rate reset into loans with longer reset intervals and fixed-rate loans.

Such refinancing away from loans with frequent interest rate reset is expected to continue in 2015, which will contribute to continued improvement of the various liquidity and funding targets and making bond sales even more secure. The lower amount of ARMs with 1-year interest rate reset is likely to result in a noticeable decline in the total refinancing auction volumes in 2015 compared with 2014.

**Mortgage banking**
**Refinancing auctions of SDOs and ROs**




## REFINANCING RISK
Mortgage banks' adaptation to future regulatory requirements was facilitated by the adoption on 1 April 2014 of an act regulating refinancing risk. The background to the new act is the refinancing taking place in the form of auctions of new bonds, which involves the potential risk that a sufficient amount of new bonds cannot be sold, or that bond yields increase excessively.

The new act introduces rules for the issuance of bonds to refinance mortgage loans where the term of the loan is longer than the maturity of the underlying bonds. It also introduces mandatory maturity extension with the following triggers:

- Interest rate trigger: The yield-to-maturity rises by more than 5 percentage points at an auction of bonds with maturities up to 2 years.
- Auction trigger: An auction or a similar sale fails.

The act entered into force gradually. Short-term bonds used for refinancing of ARMs with 1-year interest rate reset became subject to the act as of 1 April 2014, while bonds used for refinancing of ARMs with 2-year interest rate reset and floating-rate loans with funding below 2 years will be subject to the act as of 1 January 2015. Existing bond issues will not be affected.

**Nykredit Realkredit Group**
**Implementation of new legislation**

| | Interest rate trigger | Auction trigger |
|---|---|---|
| 1 January 2015 | 1-2-year bonds<br>1-2-year floating-rate | All bonds refinancing loans (typically 1-10-year) |

**BANKING**

Nykredit Bank monitors its balance sheet and liquidity position on a daily basis as part of its liquidity risk management. The Bank's liquidity risk management is based on external requirements, both statutory and from rating agencies, as well as on internal factors such as the run-off profile and concentration risk of its assets and liabilities.

New liquidity rules and rating requirements require the Bank to hold a large liquidity buffer. Unencumbered securities in the trading book constitute a short-term liquidity buffer that may be applied in the case of unforeseen drains on the Bank's liquidity. These securities consist mainly of liquid Danish and European government and covered bonds eligible as collateral with the Danish central bank or other European central banks.

Stress testing is performed on a continuous basis using bank-specific, sector-specific and combination scenarios as prescribed by the Danish Executive Order on Management and Control of Banks etc.

According to a stress test of the Bank's liquidity based on scenarios involving no access to funding markets, the Bank has positive liquidity for at least 12 months.

Pursuant to the Danish Financial Business Act, a bank's liquidity must be at least 10% of total reduced debt and guarantee obligations. Nykredit Bank operates with an internal excess liquidity coverage of at least 50% relative to the statutory requirement.

At 31 December 2014, the excess coverage was 282% against 276% at end-2013, corresponding to a liquidity reserve of DKK 68.1bn compared with DKK 62.6bn at end-2013. In 2014 the liquidity reserve averaged DKK 47.3bn compared with DKK 44.4bn for 2013.

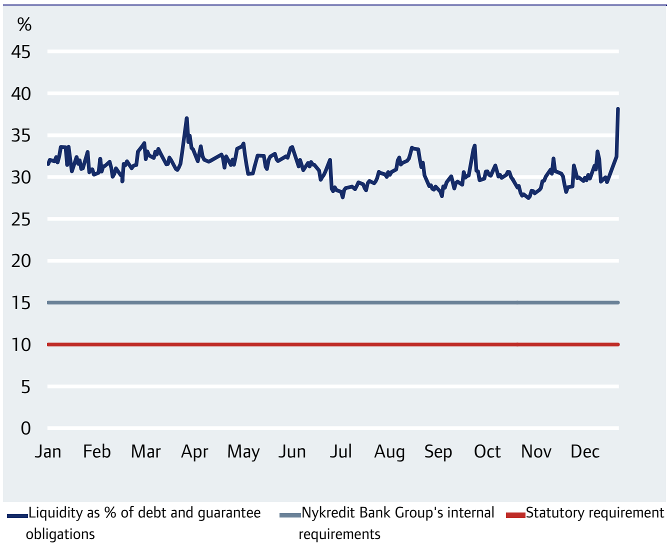
The aggregate amount issued under the ECP (Euro Commercial Paper) and EMTN (Euro Medium-Term Note) programmes was DKK 25.9bn at 31 December 2014 against DKK 29.3bn at end-2013.

Total run-off under Nykredit Bank's EMTN programme in 2015 will be DKK 6.7bn.

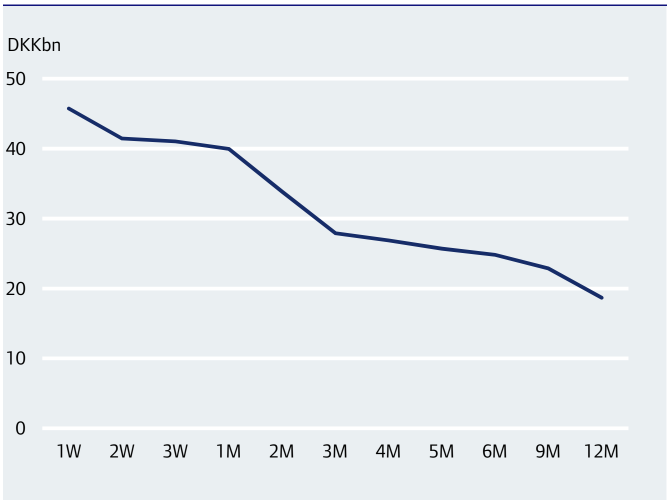
The total EMTN and ECP issuance requirement depends on the development in customer deposits and lending as well as the Bank's other business activities.

The Bank had a deposit surplus of DKK 16.4bn at 31 December 2014.

**Nykredit Bank Group**
**Liquidity relative to statutory requirements 2014**




**Nykredit Bank Group**
**Liquidity stress testing (internal methods) 2014**



## CREDIT RATINGS

Nykredit Realkredit A/S and Nykredit Bank A/S have a rating relationship with the international credit rating agencies Standard & Poor's and Fitch Ratings regarding the rating of the companies and their funding.

The bonds issued by Nykredit Realkredit A/S are primarily mortgage covered bonds (SDOs and ROs). Furthermore, Nykredit has issued bonds to fund supplementary collateral (senior secured and unsecured debt), subordinated debt (Tier 2, Coco) and Additional Tier 1 (AT1) capital.

### Standard & Poor's

Nykredit's SDOs and ROs issued through rated capital centres are all rated AAA by Standard & Poor's, which is the highest possible rating. The rating outlooks are stable.

Senior secured debt is rated A+ by Standard & Poor's.

Nykredit Realkredit A/S and Nykredit Bank A/S both have a long-term unsecured rating of A+ and a short-term unsecured rating of A-1.

The outlooks on the unsecured rating and the senior secured debt rating are negative. The negative outlooks are a consequence of Standard & Poor's changed view on the refinancing risk relating to adjustable-rate mortgages (ARMs) with short-term funding and the upcoming pan-European bank resolution rules, BRRD.

**Nykredit Realkredit Group**
**Supplementary collateral requirement (Capital Centres E and H)**

| DKK billion | 2014 |
|---|---|
| Present supplementary collateral requirement | 40.3 |
| Stress test of supplementary collateral requirement in 12 months | 50.8 |
| Assets provided as supplementary collateral | 68.1 |
| *- of which funded by senior secured debt*[1] | 24.0 |

[1] Exclusive of Nykredit Realkredit A/S's own portfolio of senior secured debt.

**Nykredit Realkredit Group**
**Senior secured and unsecured debt in issue**

| DKK million | Maturity date | Nominal outstanding amount |
|---|---|---|
| Senior secured debt 15 January (DKK) | 01.01.2015 | 1,430 |
| Senior secured debt 15 April (DKK) | 01.04.2015 | 1,115 |
| Senior secured debt 15 October (DKK) | 01.10.2015 | 3,275 |
| Senior secured debt 16 January (DKK) | 01.01.2016 | 118 |
| Senior secured debt 16 April (DKK) | 01.04.2016 | 4,800 |
| Senior secured debt 16 October (DKK) | 01.10.2016 | 2,000 |
| Senior unsecured debt (SEK) | 02.01.2017 | 570 |
| Senior secured debt 17 April (DKK) | 01.04.2017 | 1,000 |
| Senior secured debt 17 June (EUR) | 01.06.2017 | 5,583 |
| Senior secured debt 18 May (EUR) | 01.04.2017 | 3,722 |
| Senior secured debt 19 January (EUR) | 02.05.2018 | 3,722 |
| Senior unsecured debt (EUR) | 28.01.2019 | 3,722 |
| Private placements > 5 years | 10.09.2019 | 1,079 |
| **Total** | | **43,636** |

Note: Pursuant to the Danish Mortgage-Credit Loans and Mortgage-Credit Bonds etc. Act, senior secured debt may be applied to fund overcollateralisation in capital centres.

### Fitch Ratings

Nykredit Realkredit A/S and Nykredit Bank A/S both have a long-term unsecured rating of A (outlook stable) and a short-term unsecured rating of F1.

### Moody's Investors Service

Nykredit terminated its rating relationship with Moody's Investors Service in April 2012.

In this connection, Nykredit ceased supplying information for the purpose of Moody's rating process.

Moody's has opted to publish unsolicited ratings for some group companies.

**Nykredit Realkredit Group**
**Ratings**

| | Nominal DKKbn[1] | S&P | Fitch |
|---|---|---|---|
| **SDOs, ROs and senior secured debt** | | | |
| **Nykredit Realkredit A/S** | | | |
| - Capital Centre C (covered bonds, ROs) | 2 | AAA | |
| - Capital Centre D (covered bonds, ROs) | 194 | AAA | |
| - Capital Centre D (senior secured debt) | 4 | A+[2] | |
| - Capital Centre E (covered bonds, SDOs) | 334 | AAA | |
| - Capital Centre E (senior secured debt) | 6 | A+[2] | |
| - Capital Centre G (covered bonds, ROs) | 46 | AAA | |
| - Capital Centre H (covered bonds, SDOs) | 636 | AAA | |
| - Capital Centre H (senior secured debt) | 15 | A+[2] | |
| - Capital Centre I (covered bonds, ROs) | 13 | AAA | |
| - Nykredit Realkredit In General (covered bonds, ROs) | 2 | AAA | |
| **Totalkredit A/S** | | | |
| - Capital Centre C (covered bonds, ROs) | 38 | AAA | |
| **Other ratings** | | | |
| **Nykredit Realkredit A/S** | | | |
| - Short-term unsecured rating | | A-1 | F1 |
| - Long-term unsecured rating | | A+[2] | A |
| - Subordinated debt (Tier 2, CoCo) | | BBB | BBB |
| - AT1 capital | | BB+ | |
| **Nykredit Bank A/S** | | | |
| - Short-term deposit rating | | A-1 | F1 |
| - Long-term deposit rating | | A+[2] | A |
| **EMTN Programme** | | | |
| - Short-term senior debt | | A-1 | F1 |
| - Long-term senior debt | | A+[2] | A |
| **Euro Commercial Paper Programme and Certificate of Deposit Programme** | | | |
| - Short-term senior debt | | A-1 | F1 |

[1] Bonds in issue at nominal value at 31 December 2014
[2] Negative outlook

# OPERATIONAL RISK

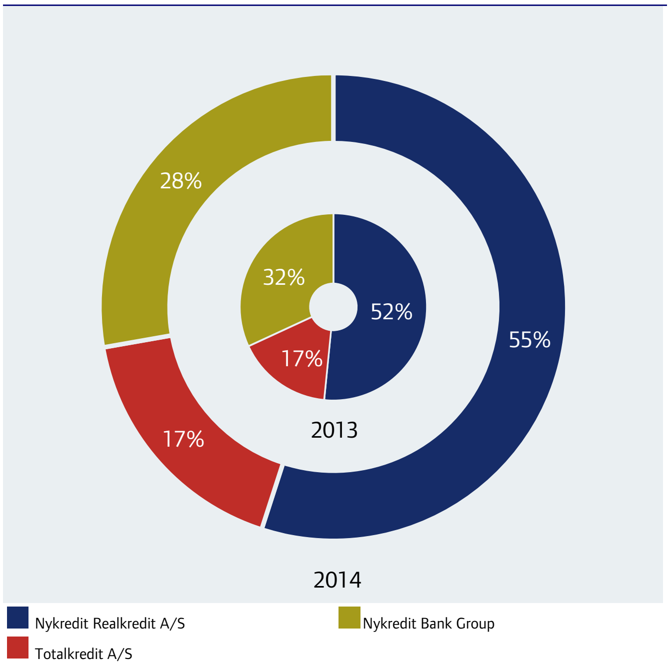
Operational risk reflects the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Nykredit is continuously working to create a risk culture where the awareness of operational risk is a natural part of everyday work. The Group strives always to limit operational risk taking into consideration the costs involved.

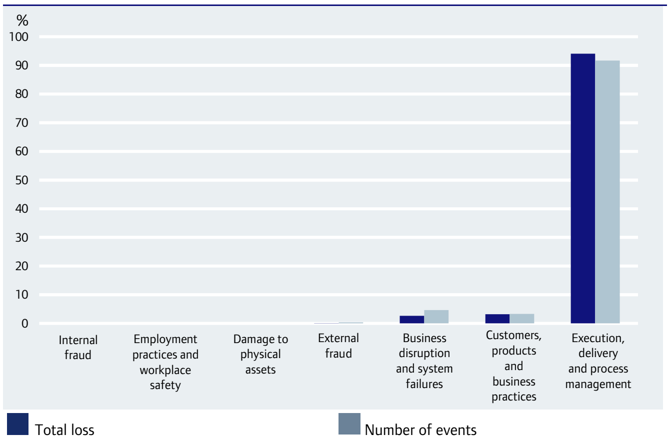
The operational risk relating to Nykredit's primary activities is inherently limited as mortgage lending activities are highly standardised.

The responsibility for the day-to-day management of operational risk is decentralised and lies with the individual business areas. Operational risk management activities are coordinated centrally to ensure consistency and optimisation across the Group.

**Nykredit Realkredit Group**
**Breakdown of operational risk**




**Nykredit Realkredit Group**
**Operational loss events in 2014**




Note: Operational loss events have been categorised according to the classification set out in Regulation (EU) No 575/2013 of the European Parliament and the Council of 26 June 2013 (CRR).

As part of operational risk management, operational loss events are systematically recorded, categorised and reported with a view to creating an overview of loss sources and gaining experience for sharing across the organisation. In respect of all operational events causing losses of over DKK 10,000, information is recorded about the type of product, process and risk the event concerned as well as on any insurance cover and time consumption relating to the event. In 2014 both the number of operational events and Nykredit's losses centred around the risk type "execution, delivery and process management", which includes human errors occurring in connection with manual daily routines.

In addition to the collection of data on operational loss events, Nykredit is continuously working on identifying significant operational risks. Operational risks are mapped on the basis of input supplied by each business area about its own significant risks to Nykredit's centralised operational risk function. Operational risk mapping provides a valuable overview of particularly risky processes and systems and therefore constitutes an excellent management tool.

Besides the more general approach to identifying operational risks, specific risk management procedures are applied in key areas such as IT supply and approval of new products and IT solutions. The comprehensive contingency plans are to ensure constant and secure operations in case of a shutdown of the IT supply or other emergencies.

The IT security area is monitored constantly, and Nykredit participates actively in a wide Danish and international network on IT security through the Danish Bankers Association. Furthermore, information is received regularly on potentially compromising customers from CSIS and from other banks.

Nykredit has laid down policies, business procedures and controls specifically relating to anti-money laundering, and customer transactions are monitored on a continuous basis.

Nykredit determines the capital requirement for operational risk using the basic indicator approach. This means that the capital requirement is calculated as 15% of average gross earnings of the past three years. To compute REA, the capital requirement is divided by 8%. REA for operational risk amounted to DKK 17.9bn throughout 2014.

**Nykredit Realkredit Group**
**Credit exposures and REA**

| 2013<br>DKK million | Mortgage lending | Bank lending | Guarantees issued | Other | Total exposures | *Of which undrawn commitments* | Exposure-weighted average risk weight, % | REA for credit risk |
|---|---|---|---|---|---|---|---|---|
| Retail exposures | 731,516 | 24,884 | 5,468 | - | 761,869 | *8,227* | 15.6 | 119,020 |
| *Of which* | | | | | | | | |
| *- mortgages over real estate*[1] | *731,516* | *16,584* | *722*[2] | - | *748,822* | *5,064* | *15.1* | *113,219* |
| *- revolving exposures, etc* | - | *6,241* | *0* | - | *6,241* | *2,829* | *23.3* | *1,454* |
| - other retail exposures | - | *2,060* | *4,746*[3] | - | *6,806* | *334* | *63.9* | *4,347* |
| Commercial exposures | 380,086 | 50,261 | 5,740 | 88,080 | 524,167 | 19,093 | 30.1 | 157,964 |
| Credit institution exposures | 7,979 | - | 751 | 42,320 | 51,050 | *50* | 17.6 | 9,007 |
| Sovereign exposures | 30,579 | - | - | 8,340 | 38,918 | *23* | 0.0 | 0 |
| Equity exposures | - | - | - | 3,054 | 3,054 | - | 263.1 | 8,036 |
| Securitisations | - | - | - | 1 | 1 | - | 1250.0 | 14 |
| Assets with no counterparty | - | - | - | 4,535 | 4,535 | - | 100.0 | 4,535 |
| **Total 2013** | **1,150,160** | **75,145** | **11,958** | **146,330** | **1,383,593** | **27,394** | **21.6** | **298,575** |
| Total 2012 | 1,148,960 | 76,549 | 12,404 | 126,436 | 1,364,349 | *27,132* | 21.5 | 293,073[4] |

[1] Bank loans secured by mortgages over real estate primarily relate to equity release credits (Friværdikonto).
[2] The guarantees include interim loans and buyer's certificates.
[3] The guarantees exclusively comprise mortgage registration guarantees.
[4] RWA for 2012 are exclusive of the loss guarantee provided by Nykredit Holding.

**Nykredit Realkredit Group**
**Credit exposures by maturity**

| 2013<br>DKK million | Up to 1 year | Over 1 year and up to 5 years | Over 5 years | Total exposures |
|---|---|---|---|---|
| Retail exposures | 363 | 6,885 | 754,621 | 761,869 |
| *Of which* | | | | |
| *- mortgages over real estate*[1] | *363* | *6,885* | *741,574* | *748,822* |
| *- revolving exposures, etc* | - | - | *6,241* | *6,241* |
| - other retail exposures | - | - | *6,806* | *6,806* |
| Commercial exposures | 76,373 | 35,921 | 411,873 | 524,167 |
| Credit institution exposures | 42,320 | 751 | 7,979 | 51,050 |
| Sovereign exposures | 8,340 | - | 30,579 | 38,918 |
| Equity exposures | 2,956 | - | 98 | 3,054 |
| Securitisations | - | - | 1 | 1 |
| Assets with no counterparty | 4,535 | - | - | 4,535 |
| **Total 2013** | **134,887** | **43,556** | **1,205,150** | **1,383,593** |
| Total 2012 | 109,764 | 65,306 | 1,189,279 | 1,364,349 |

[1] Bank loans secured by mortgages over real estate primarily relate to equity release credits (Friværdikonto).

**Nykredit Realkredit Group**
**Credit exposures by counterparty**

| 2013<br>DKK million | Personal customers | Trade | Finance and insurance | Industry | Agricultural property | Rental | Other | Total exposures |
|---|---|---|---|---|---|---|---|---|
| Retail exposures | 696,678 | 8,501 | 2,028 | 2,607 | 17,666 | 16,641 | 17,748 | 761,869 |
| Of which | | | | | | | | |
| *- mortgages over real estate* | *684,782* | *8,137* | *1,892* | *2,509* | *17,513* | *16,241* | *17,748* | *748,822* |
| *- revolving exposures, etc* | - | - | - | - | - | - | - | - |
| *- other retail exposures* | *11,896* | *364* | *136* | *98* | *153* | *400* | *0* | *13,047* |
| Commercial exposures | 2,528 | 55,104 | 85,275 | 41,245 | 80,350 | 225,473 | 34,192 | 524,167 |
| Credit institution exposures | - | - | 2,195 | - | - | - | 48,855 | 51,050 |
| Sovereign exposures | - | 387 | 1,566 | 18 | 5 | - | 36,942 | 38,918 |
| Equity exposures | - | - | - | - | - | - | 3,054 | 3,054 |
| Securitisations | - | - | - | - | - | - | 1 | 1 |
| Assets with no counterparty | - | - | - | - | - | - | 4,535 | 4,535 |
| **Total 2013** | **699,206** | **63,992** | **91,064** | **43,872** | **98,020** | **242,178** | **146,326** | **1,383,593** |
| Total 2012 | 685,725 | 64,544 | 72,352 | 40,328 | 100,651 | 247,180 | 153,570 | 1,364,349 |

**Nykredit Realkredit Group – total exposures**
**Retail exposures covered by IRB**

| 2013<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD[1]<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 40,517 | 2,282 | 4.0 | 1.8 | 740 |
| 9 | 76,394 | 942 | 8.0 | 3.3 | 2,504 |
| 8 | 172,298 | 877 | 9.7 | 5.9 | 10,124 |
| 7 | 163,150 | 694 | 12.7 | 10.2 | 16,589 |
| 6 | 126,972 | 644 | 14.5 | 15.4 | 19,593 |
| 5 | 62,870 | 969 | 15.6 | 20.9 | 13,167 |
| 4 | 43,708 | 842 | 17.2 | 29.5 | 12,900 |
| 3 | 21,199 | 452 | 17.1 | 37.0 | 7,837 |
| 2 | 21,809 | 377 | 14.6 | 44.2 | 9,638 |
| 1 | 19,494 | 88 | 13.1 | 66.2 | 12,905 |
| 0 | 4,942 | 16 | 16.2 | 90.0 | 4,446 |
| Exposures in default[2] | 7,397 | 45 | 18.5 | 110.1 | 8,142 |
| **Total** | **760,749** | **8,227** | **12.1** | **15.6** | **118,585** |

[1] Pursuant to section 70(5) of the Executive Order on Capital Adequacy, the exposure-weighted average LGD for retail exposures secured by mortgages on real property must be at least 10% in the determination of RWA. Exposure-weighted average LGD has been determined after adjustment to ensure compliance with the 10% requirement.
[2] The determination of REA for exposures in default is based on the difference between LGDs and individual impairment provisions.

**Nykredit Realkredit Group – total exposures**
**Commercial exposures covered by IRB**

| 2013<br>Rating category | Total exposures<br>DKKm | Of which undrawn commitments<br>DKKm | Exposure-weighted average LGD<br>% | Exposure-weighted average risk weight<br>% | REA for credit risk<br>DKKm |
|---|---|---|---|---|---|
| 10 | 19,431 | 3,468 | 22.5 | 22.1 | 4,289 |
| 9 | 62,984 | 1,560 | 13.3 | 17.9 | 11,274 |
| 8 | 119,850 | 5,643 | 14.8 | 22.2 | 26,552 |
| 7 | 92,957 | 4,253 | 16.9 | 30.3 | 28,193 |
| 6 | 69,859 | 923 | 14.9 | 29.7 | 20,731 |
| 5 | 40,521 | 435 | 11.9 | 26.3 | 10,650 |
| 4 | 22,756 | 557 | 18.4 | 45.0 | 10,235 |
| 3 | 41,632 | 1,497 | 11.5 | 30.7 | 12,790 |
| 2 | 4,470 | 216 | 23.6 | 67.9 | 3,037 |
| 1 | 11,046 | 107 | 21.6 | 100.5 | 11,106 |
| 0 | 9,136 | 75 | 20.3 | 80.1 | 7,320 |
| Exposures in default[1] | 23,892 | 360 | 27.1 | 25.8 | 6,154 |
| **Total** | **518,534** | **19,093** | **15.9** | **29.4** | **152,331** |

Note: Includes exposures subject to the advanced as well as the foundation IRB approaches using internal PD estimates.
[1] The determination of RWA for exposures in default is based on the difference between LGDs and individual impairment provisions. The low risk weight of the Nykredit Realkredit Group's exposures in default results from the fact that the risk weight of the Nykredit Bank Group's commercial exposures in default is calculated using the foundation IRB approach under which the risk weight is nil.

**Nykredit Realkredit Group**
**Types of security and credit exposures**

| 2013<br>DKK million | Real estate[1] | Guarantees received | Financial collateral | Total security value | Total exposure |
|---|---|---|---|---|---|
| Retail exposures | 710,144 | 7,979 | | 718,123 | 761,869 |
| Of which | | | | | |
| *- mortgages over real estate* | *710.144* | *7.979* | - | *718.123* | *748,822* |
| *- revolving exposures, etc* | | | | | *6,241* |
| *- other retail exposures* | | | | | *6,806* |
| Commercial exposures | 372,531 | 30,579 | 73,873 | 476,982 | 524,167 |
| Credit institution exposures | | | | | 51,050 |
| Sovereign exposures | | | | | 38,918 |
| Equity exposures | | | | | 3,054 |
| Securitisations | | | | | 1 |
| Assets with no counterparty | | | | | 4,535 |
| **Total 2013** | **1,082,674** | **38,559** | **73,873** | **1,195,105** | **1,383,593** |
| Total 2012 | 1,063,805 | 52,817 | 49,347 | 1,165,969 | 1,364,349 |

Note: Exposures also include guarantees issued by banks (DKK 8bn), which have been recognised under credit institution exposures, and government guarantees (DKK 30.6bn), which have been recognised under sovereign exposures.
[1] The security value of real estate is measured at nominal value. The part of the exposure for which security has been provided is shown.

# OVERVIEW OF CAPITAL INSTRUMENTS

### Nykredit Realkredit Group
### Overview of capital instruments

31-12-2014

| | | Nykredit Bank (Forstædernes Bank) | Nykredit Realkredit A/S | Nykredit Realkredit A/S |
|---|---|---|---|---|
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | DK00030017769 | XS0347918640 | XS1073143932 |
| 3 | Governing law(s) of the instrument | Danish law | Danish law | English/Danish law |
| | **Regulatory treatment** | | | |
| 4 | Transitional CRR rules | Additional Tier 1 | Additional Tier 1 | Tier 2 |
| 5 | Post-transitional CRR rules | Ineligible | Ineligible | Tier 2 |
| 6 | Eligible at solo/(sub-)consolidated/ solo&(sub-) consolidated | Solo and consolidated | Solo and consolidated | Solo and consolidated |
| 7 | Instrument type (types to be specified by each jurisdiction) | Hybrid kernekapital | Hybrid kernekapital | Supplerende kapital |
| 8 | Amount recognised in regulatory capital (end 2014) | DKK 100,000,000 | DKK 6,699,240,000 | DKK 4,466,160,000 |
| 9 | Nominal amount of instrument | DKK 100,000,000 | EUR 900,000,000 | EUR 600,000,000 |
| 9a | Issue price | 100 | 100 | 99,994 |
| 9b | Redemption price | 100 | 100 | 100 |
| 10 | Accounting classification | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost |
| 11 | Original date of issuance | 23-12-2005 | 04-11-2009 | 03-06-2014 |
| 12 | Perpetual or dated | Perpetual | Perpetual | Dated |
| 13 | Original maturity date | n/a | n/a | 03-06-2036 |
| 14 | Issuer call subject to prior supervisory approval | Yes | Yes | Yes |
| 15 | Optional call date, contingent call dates and redemption amount | 01-05-2016; par regulatory call | 01-04-2015; par/make whole regulatory/tax/accounting call | 03-06-2014; par regulatory/tax call |
| 16 | Subsequent call dates, if applicable | Quarterly | Annually | Annually |
| | **Coupons / dividends** | | | |
| 17 | Fixed or floating dividend/coupon | Float-to-float | Fixed-to-fixed | Fixed-to-fixed |
| 18 | Coupon rate and any related index | 3m CIBOR + 170bps | 9% | 4% |
| 19 | Existence of a dividend stopper | Yes | Yes | No |
| 20a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | Partially mandatory | Mandatory | Mandatory |
| 20b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | Partially mandatory | Partially mandatory | Mandatory |
| 21 | Existence of step up or other incentive to redeem | Yes | No | No |
| 22 | Noncumulative or cumulative | Cumulative | Noncumulative | n/a |
| 23 | Convertible or non-convertible | Non-convertible | Non-convertible | Non-convertible |
| 24 | If convertible, conversion trigger(s) | n/a | n/a | n/a |
| 25 | If convertible, fully or partially | n/a | n/a | n/a |
| 26 | If convertible, conversion rate | n/a | n/a | n/a |
| 27 | If convertible, mandatory or optional conversion | n/a | n/a | n/a |
| 28 | If convertible, specify instrument type convertible into | n/a | n/a | n/a |
| 29 | If convertible, specify issuer of instrument it converts into | n/a | n/a | n/a |
| 30 | Write-down features | Yes | Yes | Yes |
| 31 | If write-down, write-down trigger(s) | Contractual by shareholders if equity of the issuer is lost; statutory at PONV via bail-in | Contractual by shareholders if equity of the issuer is lost; statutory at PONV via bail-in | Contractual at CET1 of Issuer/Issuer Group/Nykredit Holding Group below 7%, statutory via bail-in |
| 32 | If write-down, full or partial | Partial | Partial | Full |
| 33 | If write-down, permanent or temporary | Permanent | Permanent | Permanent |
| 34 | If temporary write-down, description of write-up mechanism | n/a | n/a | n/a |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | Tier 2 | Tier 2 | At present Senior Unsecured. |
| 36 | Non-compliant transitioned features | Yes | Yes | No |
| 37 | If yes, specify non-compliant features | Dividend stopper, no going-concern conversion/write-down, partially mandatory coupons | Dividend stopper, no going-concern conversion/write-down, partially mandatory coupons | n/a |