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Nykredit Capital Markets Day

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Agenda

- Danish Banking Sector update
  - Loan loss impairments
  - Capital and RWA
  - Funding
  - Market share of challenged banks

- Recent initiatives
  - New impairment rules
  - New Pillar 2 approach, 8 per cent add-on
  - Resolution
  - SIFI
  - Macro Prudential Council

Danish Banking Sector

Danish banking sector, 2012. Q2:

➢ Number of banks	106
➢ Total assets	4,349 DKK bn.
➢ Total assets/GDP	2.4

5 largest banks (solo), 2012. Q2 :

➢ Danske Bank	2,430 DKK bn.
➢ Nordea Bank Danmark	650
➢ Jyske Bank	256
➢ Nykredit Bank	253
➢ Sydbank	158
Total	3,748 DKK bn.
Share	86 Percent

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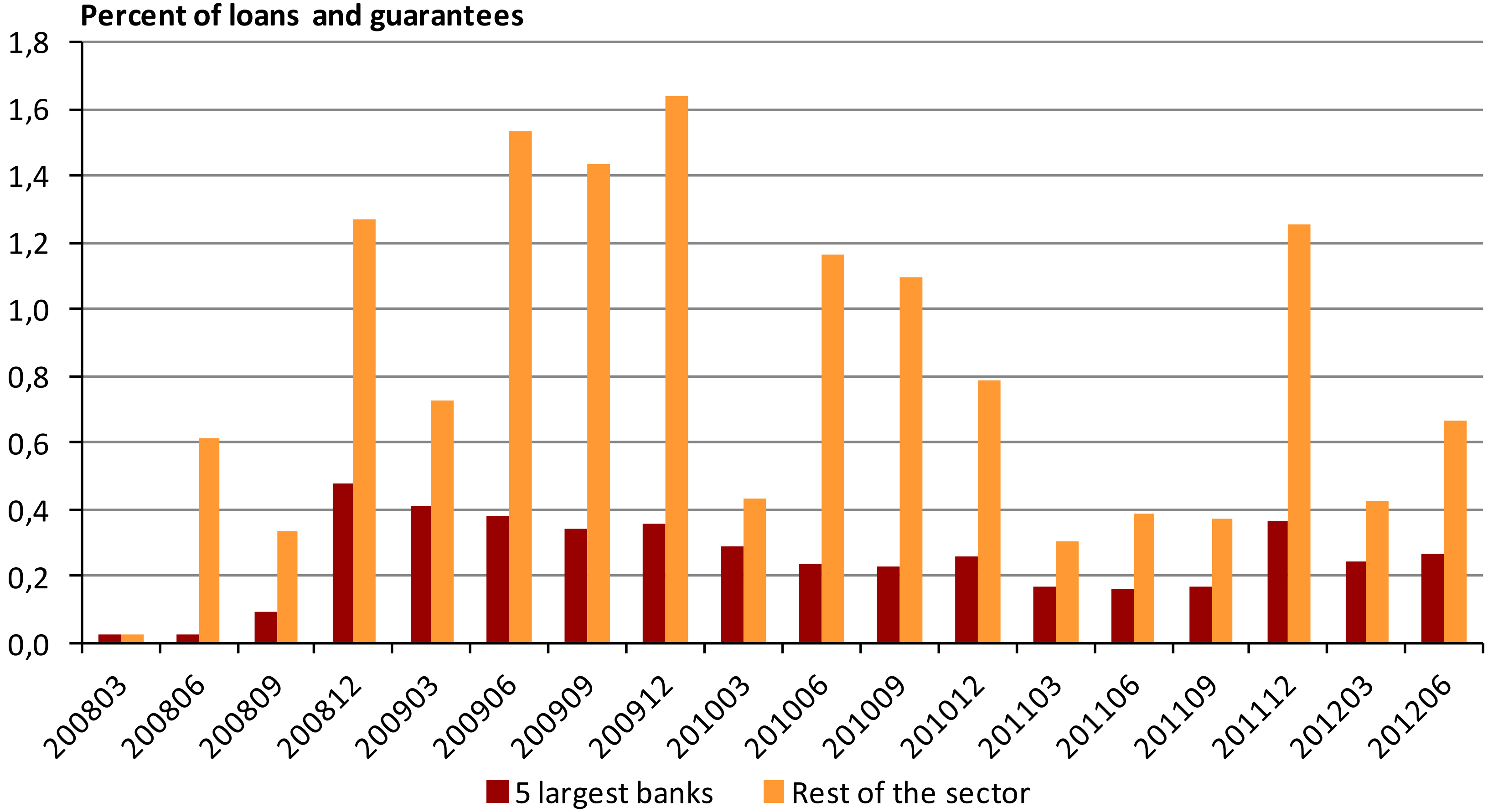
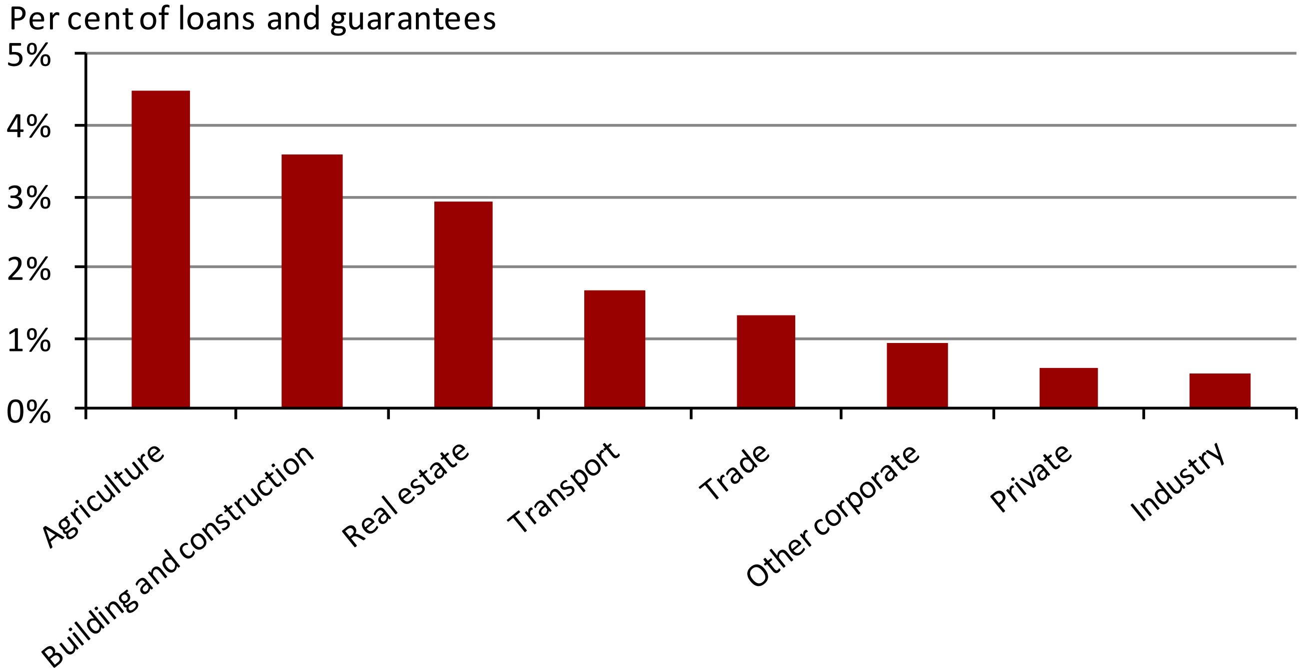
Loan Loss Impairments, Large Banks vs. Rest of the Sector



Annual Impairments on Loans - by Industry and Sector, 2011



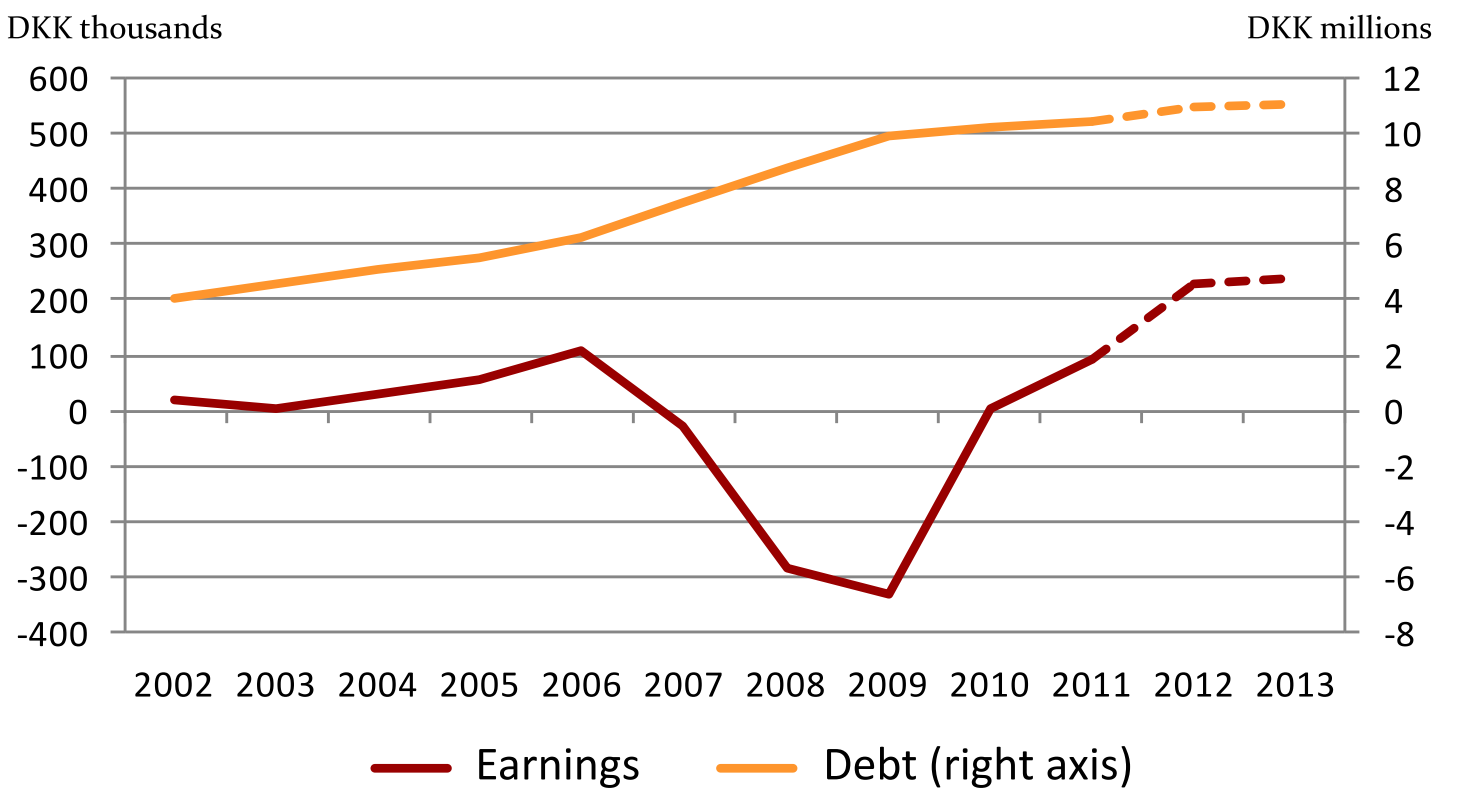
Accumulated impairment loss ratio:

- Agriculture: 9.8 %
- Building and construction: 10.3 %
- Real Estate: 7.3 %

Agriculture

- Agriculture amounts to 4.3 per cent of the Danish banking sector's total loan book.
- In 21 banks agriculture make up at least 15 per cent of the loan book. These 21 banks cover less than 3 per cent of the overall balance sheet of the sector.
- In 2012 Q1 the Danish FSA reviewed the agriculture exposures of the 5 largest banks.
  - Valuation and settlement prices
  - Asset quality and impairments
  - Credit policy

Earnings and Debt in Agricultural Sector



Source: Statistics Denmark, Knowledge Centre for Agriculture

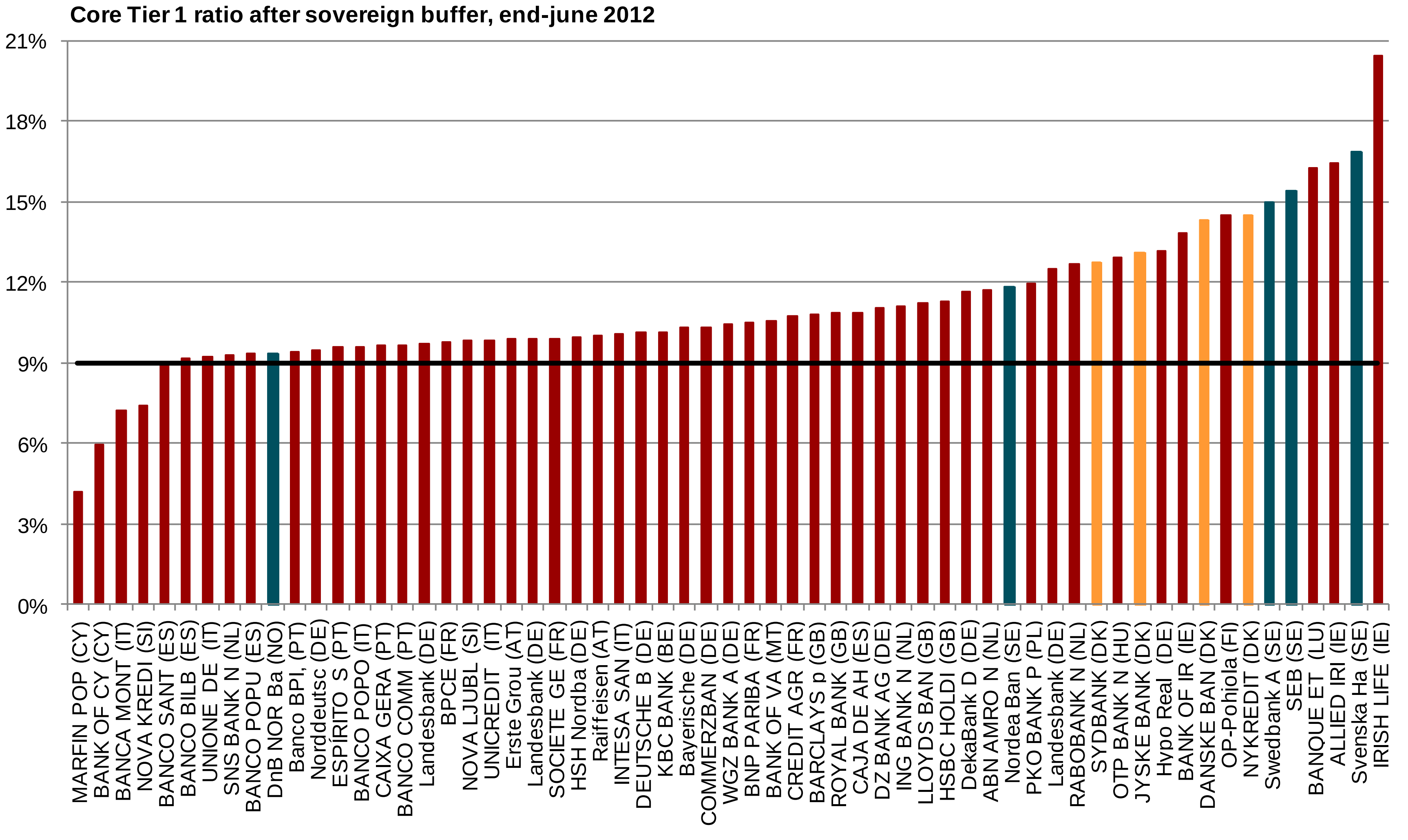
Final Results of the EU-wide Capital Exercise

- Final Danish results of the EU-wide capital exercise shows the following results for the four Danish participating banks by end-June 2012:

  - Danske Bank 14.3
  - Jyske Bank 13.1
  - Nykredit 14.5
  - Sydbank 12.8

- Data disclosed together with the final report confirms that the Danish banks are not exposed to vulnerable sovereign debt issuers to any significant extent, neither directly via sovereign bonds nor indirectly in the form of credit protection on sovereign exposures (e.g. CDS contracts).

CT1 Ratios for Danish Banks relative to other EU Banks



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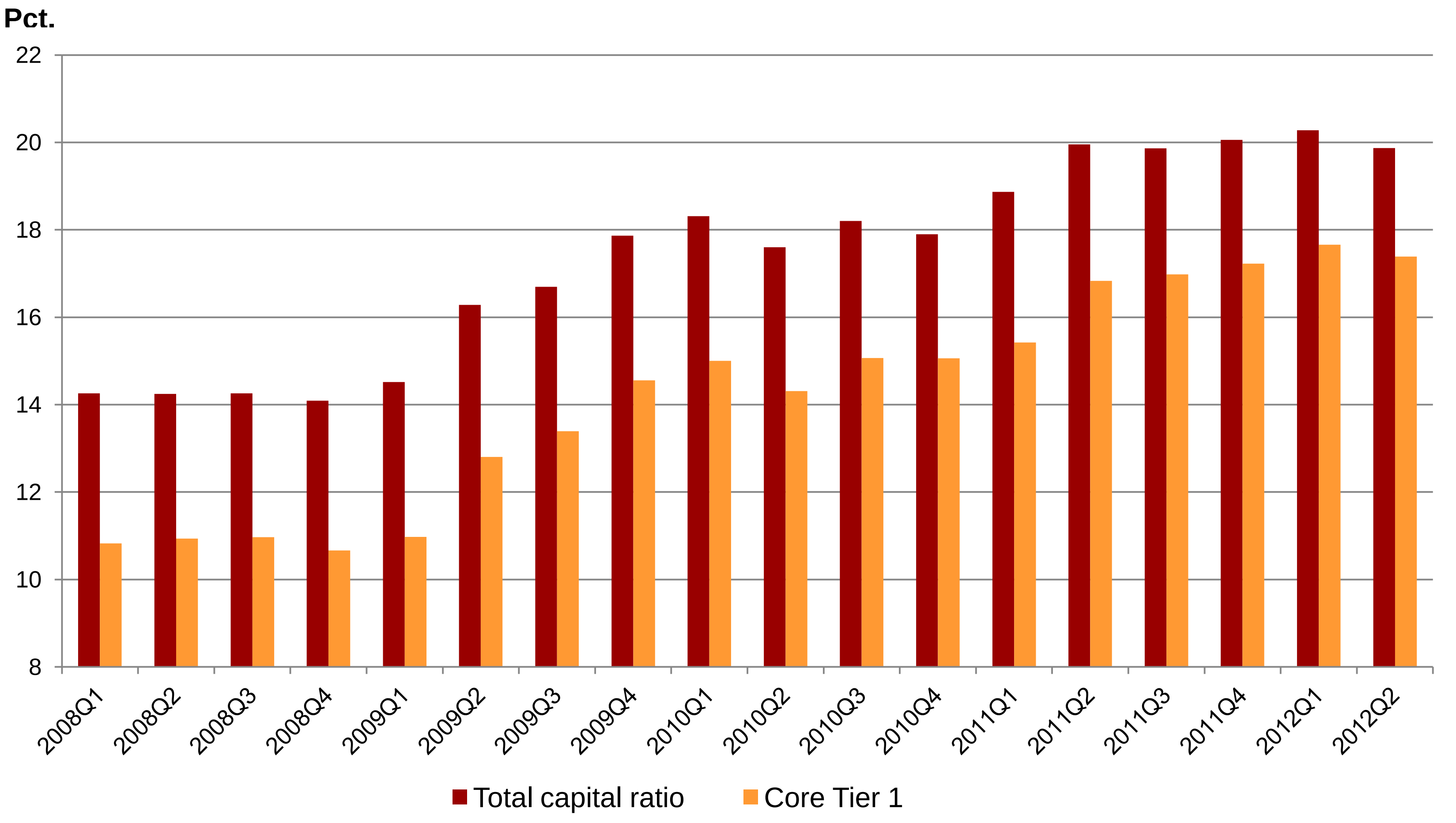
Capital Ratios – Sector total



Potential Problems in a Small Group of Banks

- In general, the Danish banking sector is robust.
- However, a small group of banks are on intensified supervision due to potential solvency problems during the next 12-18 months.

	Market share of challenged banks
	Q2.2012
Loans	3.2 percent
Total assets	2.3 percent

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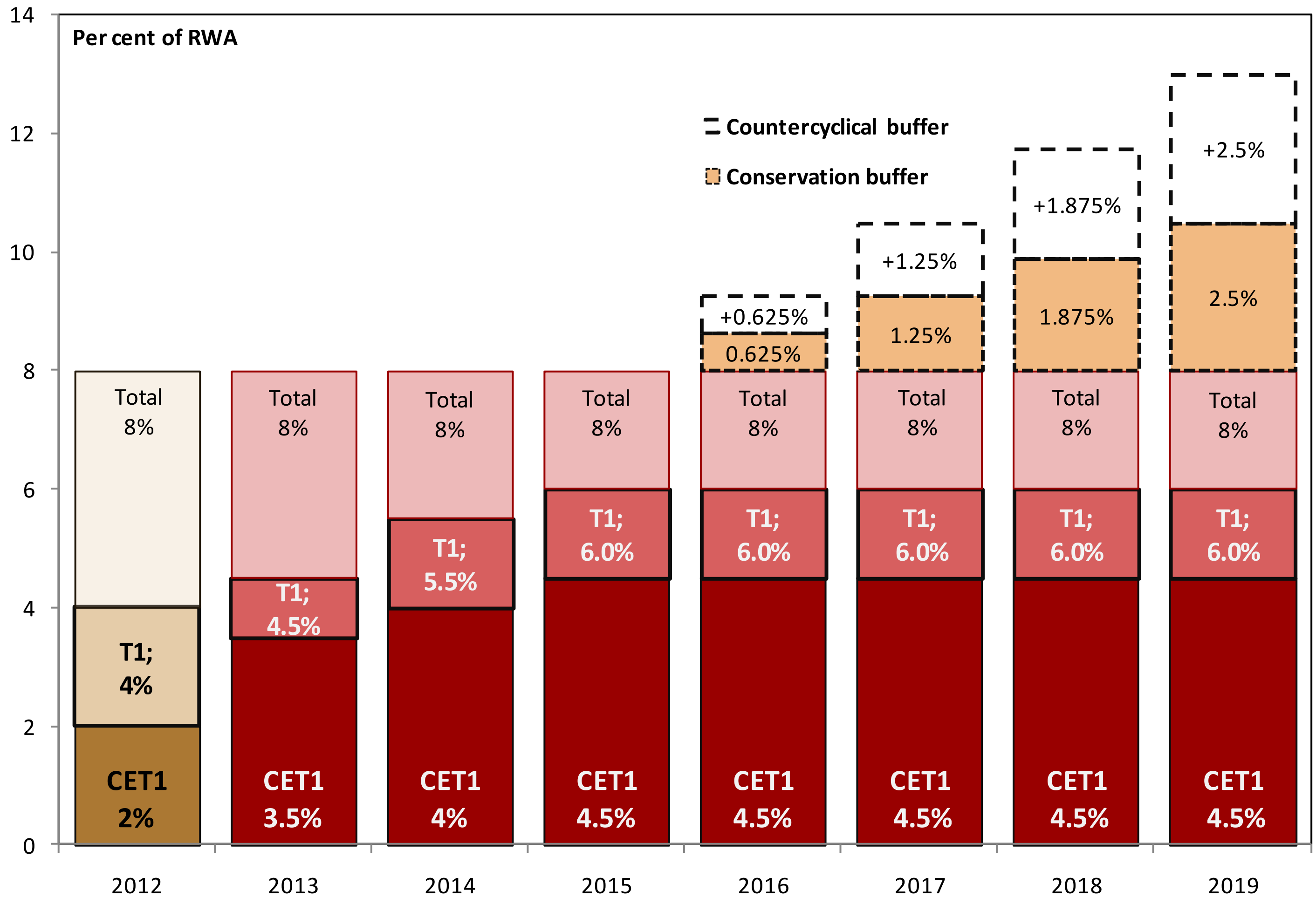
Phasing-in of New Capital Requirements, 2013-19



... Includes tougher requirements on the quality of the capital (phasing-in)

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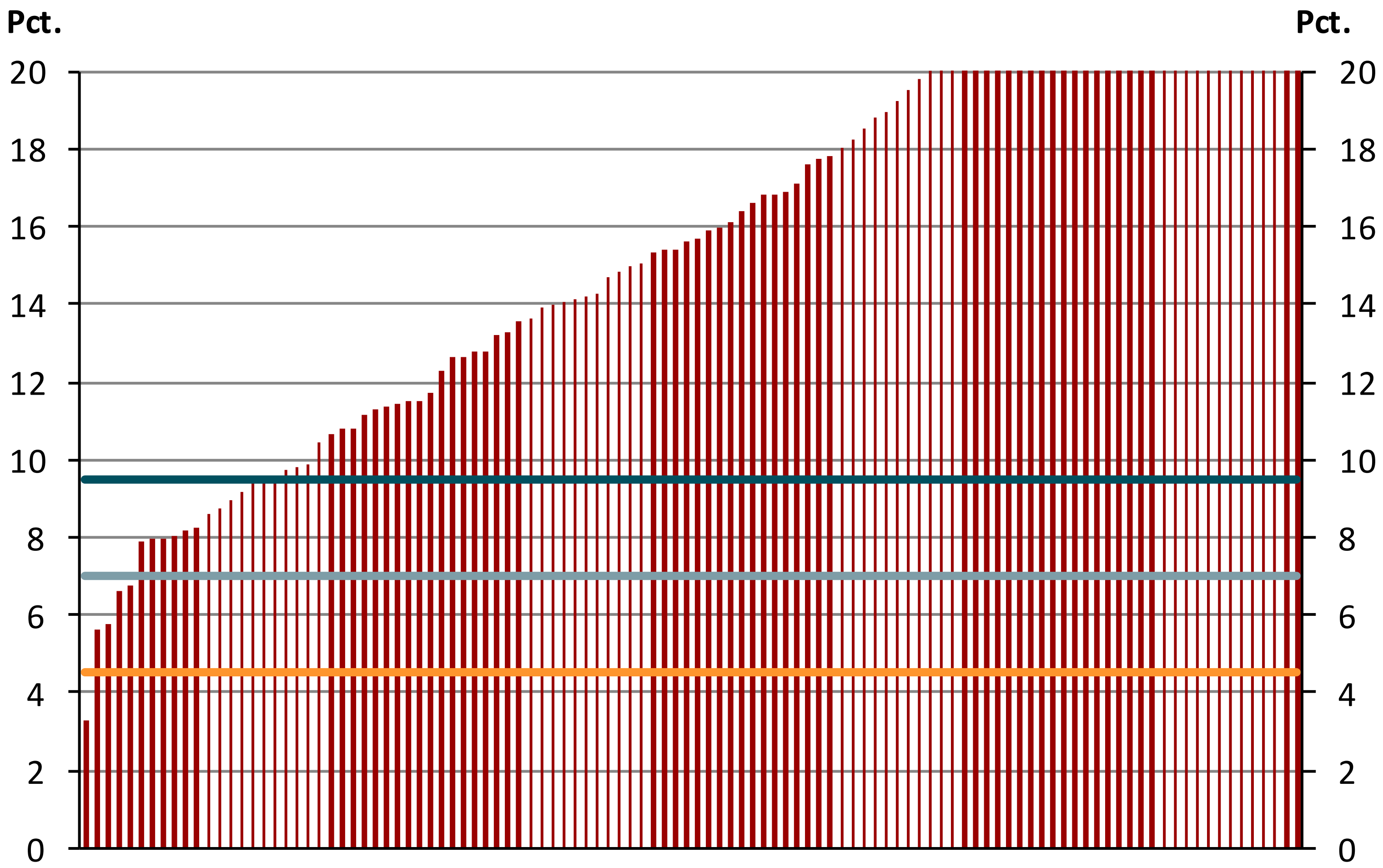
Common Equity Tier 1, Status 2012.Q2



18 banks below 9.5 pct. 5 banks below 7 pct. 1 bank below4.5 pct.

How about the Denominator?

- ”If we don’t get the risk weights right”
- High capital requirements → incentive to RWA optimisation
- RWA differences to be adressed
  - Should be based on actual differences in risk
- Need for improved comparability

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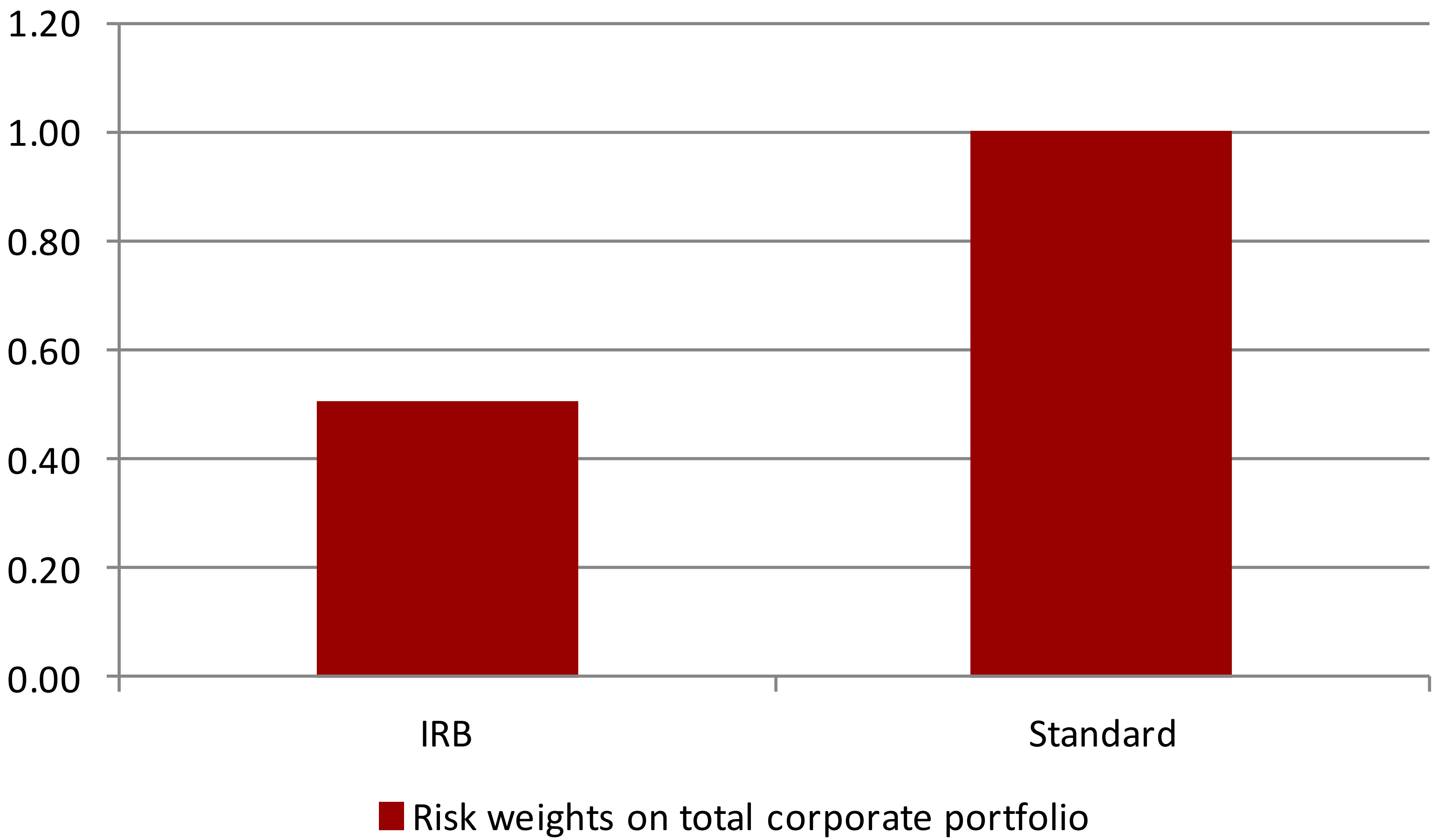
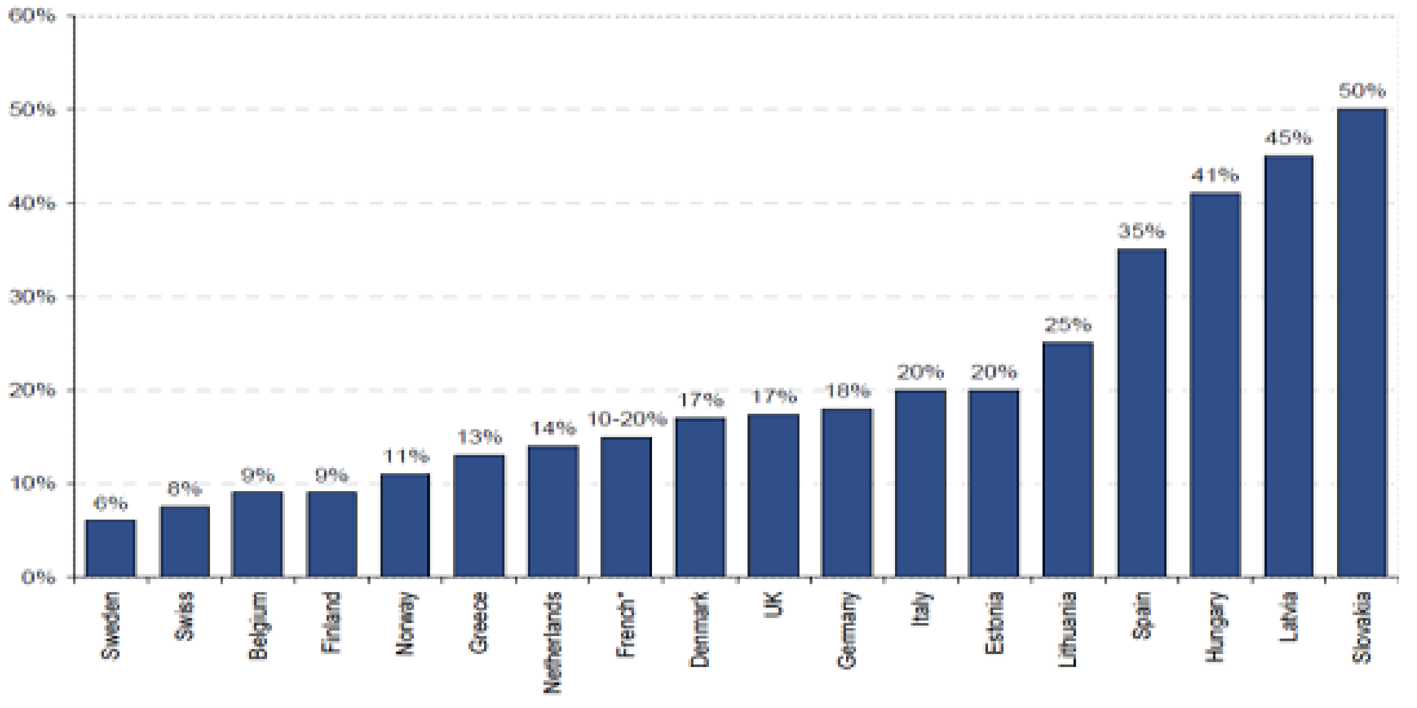
Focus on Risk Weights, IRB vs. Standard Method



IRB: Average for the IRB-banks

Risk Weights in Percent - Mortgage Loans, Basel II

Figure 5. Mortgage Risk Weights by Country – Low Historic Loss Rate Leads to Lower Weights



Source: Riksbanken, Citi Research Estimates. Note: For France, estimated range based on sample of selected French banks. For Spain, risk weights are 35% below 80% LTV, 100% between 80-95% LTV, 150% above 95% LTV.

Risk Weight - Analysis

- Basel and EU are currently both doing studies on risk weights – comparisons of risk weights across countries and credit institutions.
- In Basel the analyses focus on low default portfolios: sovereign, credit institutions and large corporate exposures.
- EBA has supplemented the low default portfolio analyses by analyses of residential mortgage exposure and SMEs.
- Analyses on risk weights are a strategic focus area in DFSA.

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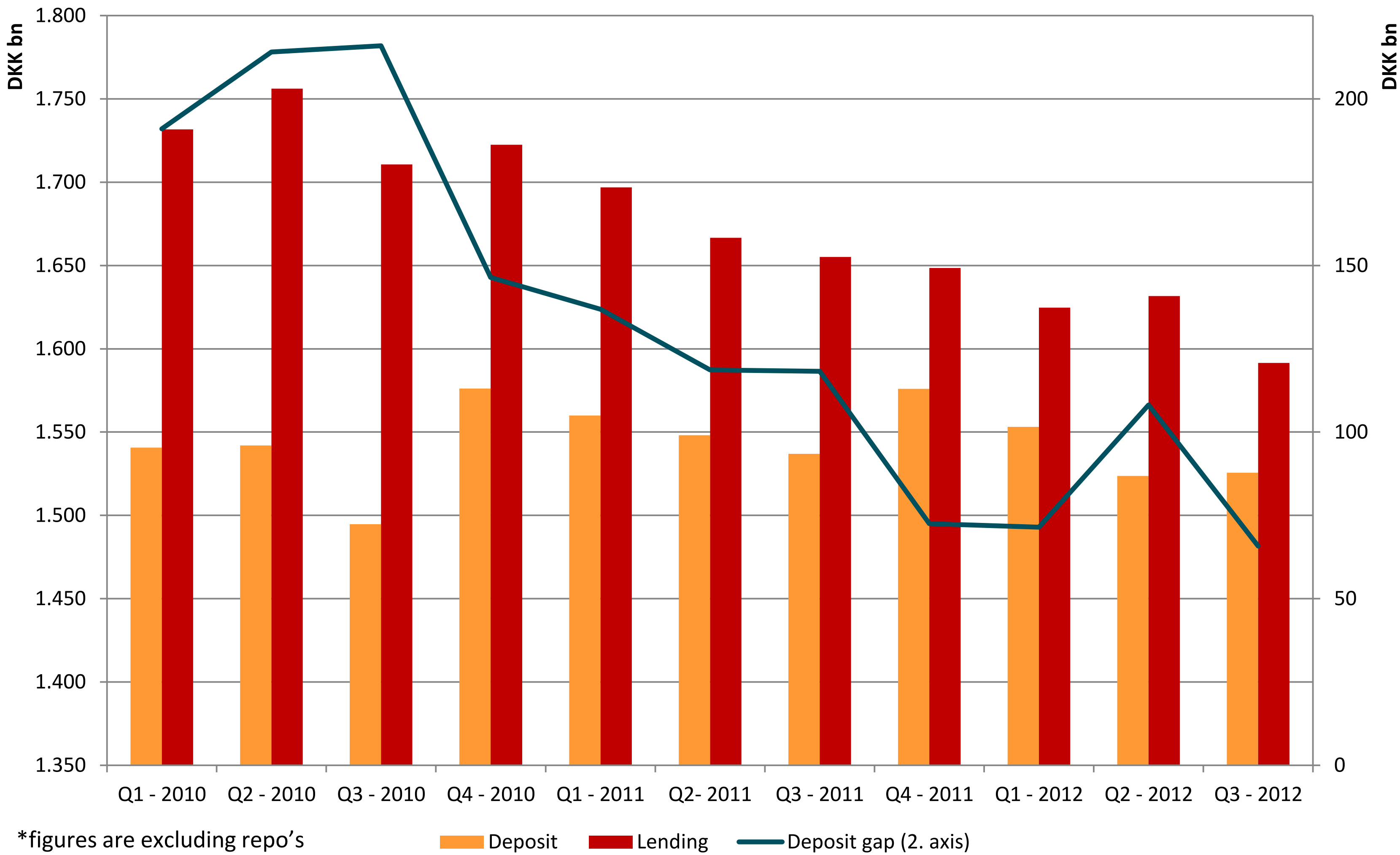
Reduced Deposit Deficit



*figures are excluding repo's

Funding

- Largest banks have access to funding from international capital markets
- The funding situation has improved considerably due to reduced deposit deficit. Overall, small and medium-sized banks have closed the funding gap by balancing loans and deposits
- A few smaller banks are still challenged by the expiration of the state guaranteed issuances in 2012 and 2013

New Liquidity Regulations

- Liquidity buffers to address a 30 day time period of market distress:
    - **Liquidity Coverage Ratio (LCR)**
        - (”Stock of high quality liquid assets” / ”Net cash outflows over a 30 day time period”) > 100 %
- Stable funding structure -based on more long term financing:
    - **Net Stable Funding Ratio (NSFR)**
        - (”Available amount of stable funding” / ”Required amount of stable funding”) > 100 %
- Liquidity regulations will put pressure on bank earnings

LCR in Denmark ...

- Today - LCR reporting from the largest banks til DFSA and Nationalbanken.
- The sample of banks to report LCR will be enlarged.
- In time - i.e. before legal LCR implementation required - the DFSA will require all banks to report LCR.
- Important that banks prepare for the new liquidity regulation and reporting requirements.
- In the liquidity regulation Financial Business Act Section 152 will be replaced by LCR.

..... Banks should begin prepare for the new liquidity regulation

NSFR in Denmark …

”Simplified NSFR”:

Funding ratio: lending/(deposits + issued bonds [maturity > 1 yr.] + subordinated debt + equity)

Funding ratio			
2010.Q4		2012.Q2	
Total banking sector	0.88	Total banking sector	0.73

Threshold in supervisory diamond: Funding ratio < 1

Exceedings of funding ratio in supervisory diamond			
2010.Q4		2012.Q2	
Total banking sector	12	Total banking sector	4

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Close Supervision of Credit Quality

- High frequency of on-site inspections in risky banks – the loan books of banks on intensified supervision are inspected every year
- The Danish FSA goes through individual credit files on-site
- We normally evaluate 30-60 per cent of the loan book individually
- The Danish FSAs risk evaluation of the loans is based on an evaluation of the borrowers' economic situation and mark-to-market values with additional haircuts on the collaterals.
- The Danish FSA has experienced experts in the valuation of property. In ¾ of the inspections they participate in, their mark-to-market values are lower than the valuations done by the banks.

Additional Clarification of Write-down Procedures etc.

- The Danish FSA has in the years of crisis demanded further write-downs in many banks.

- In December 2011 the Danish FSA published prices per acre farming land that the banks must use in the valuation of the individual loans to farmers.

- New impairment rules from 2012.Q2 implies that commercial property loans must be written down to the market value of the property.

➢ Increased transparency on write-downs.

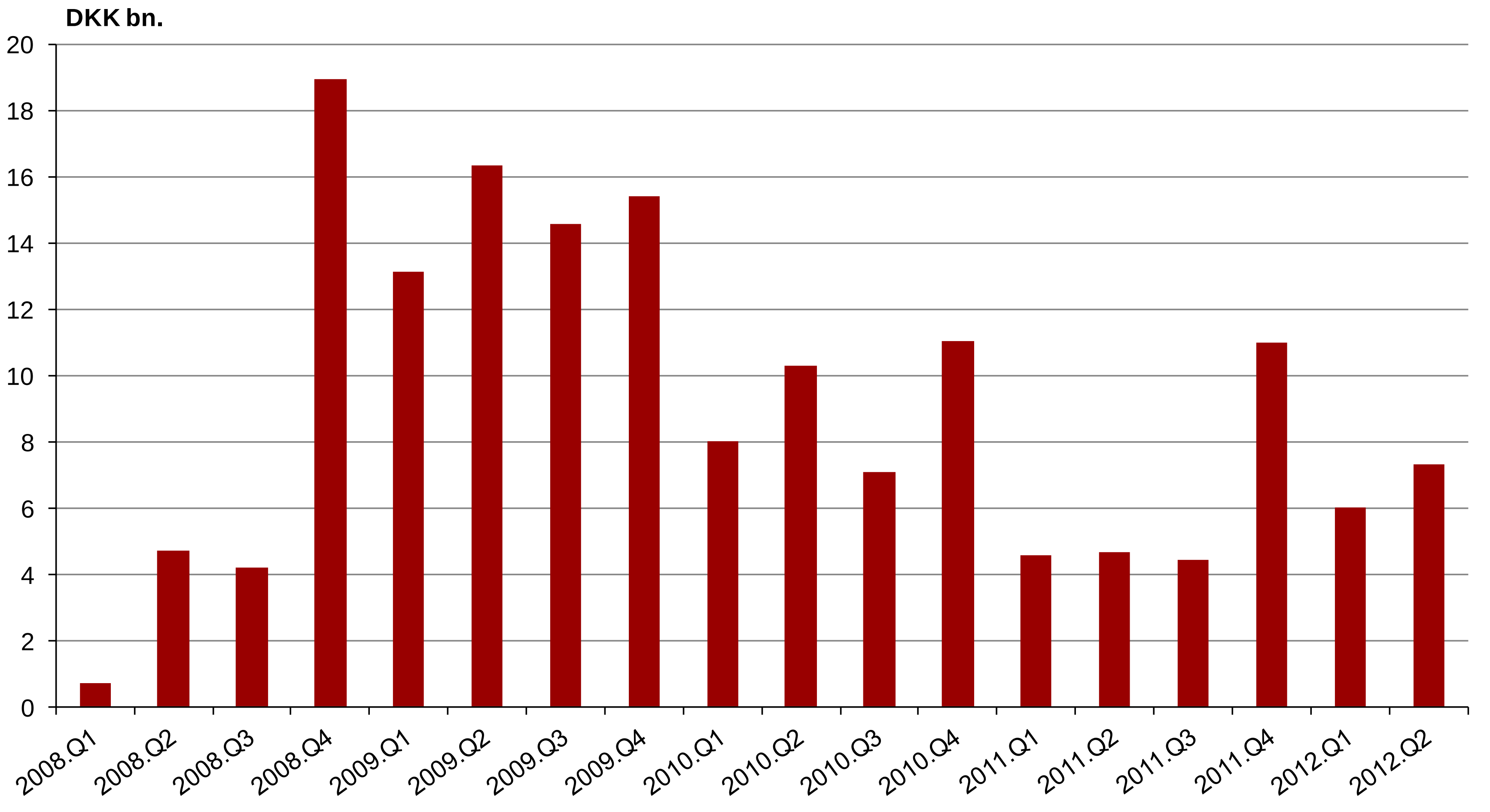
New Impairment Rules– Example of Property Lending

- A property acquired by Company A in 2008 for 100 million DKK is financed with 5 million DKK equity, 60 million DKK mortgage and 35 million DKK bank loan. The Company has no other assets or liabilities.
- The property has now fallen to 70 million DKK in value. Equity is negative by 25 million DKK.
- The borrower is thus in serious financial difficulties and an impairment charge needs to be carried out.
- Under previous regulations the bank could set the loan impairment charge to zero, if the cash flow on the property (or the development opportunities) deemed it reasonable that the borrower would be able to pay back the loan within e.g. 15 years.
- Now the financial institution must write down the loan to 10 million DKK (minus costs). This reflects the fact that the property alone has a market value of 70 million DKK. Thus the bank loan, with a worthless debtor, can not have a book value in excess of 10 million DKK when there is a mortgage of 60 million DKK.

Loan Impairments – still a Range of Subjective Judgements

- New rules narrow the range of impairments due to subjective judgement
- However impairment calculation is still based on best estimate assessment and range of assumptions.
  - E.g. on Commercial property and property value assessment
    - *rate of return*
    - *rental income (contractual terms, estimated rent value etc.)*
    - *cash flow and profitability*
    - *idle capacity*
    - *sales expenses*
    - *alternative property employment*
  - Sustainability of contractual rental income

Loan Loss Impairments all Sectors



Effect of New Impairment Rules in 2012 Q2

- Banks' impairments increased from about 6 bn. DKK in 2012 Q1 to around 7.5 bn. DKK in 2012 Q2
  - An effect of the new impairment rules was expected in 2012 Q2 but the overall effect for the banking sector is modest.

- A number of banks are still challenged by relatively high impairments. That is, the dispersion in impairments in per cent of the loan book is high.
  - 10 per cent of the banks have impairment ratios of at least 1.76 per cent of the loan book in 2012 H1 (compared to an average of 0.57 per cent).

➢ "Denmark's tougher loan impairment standard is credit positive for the country's banks even as it risks reducing capital" (Moody's)

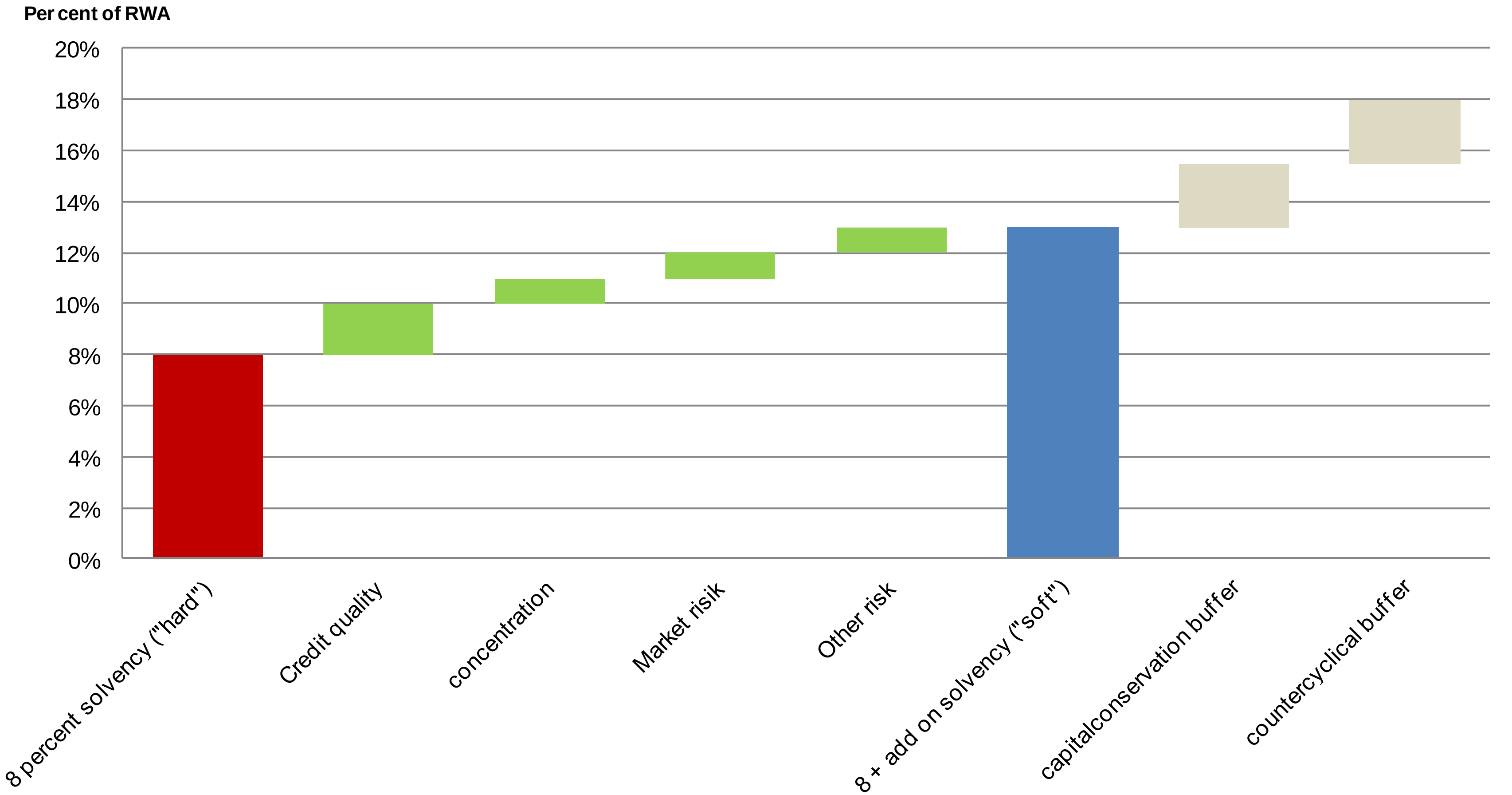
8+: New Method for Credit Institutions' Solvency Needs

- 8 percent will cover normal risk
- ”+” will mainly be related to credit quality and concentration in loan portfolio
    - Focus on key risks (weak customers)
    - Will increase average solvency need
- Based on previous experience with a simple 8+ approach (”credit reservation”) about half of the banks are expected to get a higher solvency need.

More Patience towards Challenged Banks

- More patience in application of the solvency need as long as the solvency is above 8 percent
- Counter cyclical in timing of implementation
- Capital requirements above 8 percent to be fullfilled with CET1 (equivalent to the CRD-buffers)
- Banks whose capital fall below the buffers will be subject to sanctions :
  - Banks will have to submit capital restoration plans
  - Restrictions on the distribution of profits, payments on Tier 1 and Tier 2 instruments
  - Restrictions on early repayment of capital
  - Other
- Withdrawal of license even if above 8 percent if not sufficient progress towards capital restoration

New Approach for Solvency Requirement



In addition: SIFI buffer capital requirement for SIFI banks

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Danish Banks in Distress since 2008

Private solutions:		Share of sector balance in per cent	Banks taken over by The Financial Stability Company:		Share of sector balance in per cent	Bank package
Jan-08	bankTrelleborg	0.19	Aug-08	Roskilde Bank	0.80	
Sep-08	Bonusbanken	0.04	Nov-08	EBH Bank	0.18	I
Oct-08	Forstædernes Bank	0.68	Feb-09	Fionia Bank	0.69	I
Oct-08	Lokalbanken i Nordsjælland	0.11	Mar-09	Løkken Sparebank	0.04	I
Nov-08	Sparekassen Spar Mors	0.02	Apr-09	Gudme Raaschou Bank	0.10	I
Feb-11	Sparekassen Midtfjord	0.01	Feb-10	Capinordic Bank	0.03	I
Feb-11	Lunde-Kvong Andelskasse	< 0.01	Sep-10	Eik Bank	0.40	I
Jun-11	Fruering-Vitved Sparekasse	< 0.01	Sep-10	EIK Bank Danmark	0.27	I
Jul-11	Ryslinge Andelskasse	< 0.01	Feb-11	Amagerbanken	0.66	III
Dec-11	Sparekassen Limfjorden	0.03	Jun-11	Fjordbank Mors	0.31	III
Apr-12	Spar Salling*	0.04	Oct-11	Max Bank	0.24	IV
			Apr-12	Sparekassen Østjylland	0.14	IV

* Contribution from Guarantee Fund for Depositors

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SIFI

- **Preparing future regulation on Systemically Important Financial Institutions (SIFIs) in Denmark.**

- An expert committee with an independent chairman has been set up under the auspices of the Ministry of Business and Growth.
- Based on the coming EU regulation the expert committee must clarify:
  - Which criteria are to be met for a bank to be a Danish SIFI
  - Which requirements are to be set for SIFIs. Efforts should be made to ensure equal competition between SIFIs and other credit institutions in Denmark, as well as fair conditions of competition compared with SIFIs in other countries.
  - Which instruments may be used in relation to SIFIs which experience difficulties.
- The expert committee must report to the Ministry of Business and Growth in 2012.

Coming Regulation on SIFIs

- International draft regulation related to domestic SIFIs is the starting point for the established expert committee regarding SIFIs in a Danish context.
- International consensus that a required SIFI buffer shall be met by CET1 capital.
- Additional SIFI requirements are discussed, e.g. regarding liquidity, recovery and resolution plans, enhanced supervision.
- Furthermore attention on a possible need to complement the current Danish resolution framework with additional tools.
- The committee must report its findings to the Ministry of Business and Growth before end 2012.

Task Force on Counteracting Price Bubbles on the Property Market

- New task force will suggest methods to make the Danish banks and mortgage credit institutions both more resistant towards future price bubbles in the property market and hamper their contribution to such bubbles
- Lessons to be learned from comparable countries?
- Considering effects from recent adjustments already made by the mortgage credit institutions
- Possible categories of tools/methods covering both mortgage credit institutions and universal banks
- Considering possible effects/effectiveness of the different tools
- If needed proposals for new legislation, new executive orders or new reporting requirements
- The first meeting took place on the 10th of October 2012 and the task force will submit its report at the beginning of 2013

The Macro-Prudential Council

- Macro prudential mandate
  - Representation of authorities
    - Danmarks Nationalbank,
    - Danish FSA,
    - Economic ministries,
    - Independent external experts

- Macro prudential tasks etc.
  - Monitoring systemic risks
  - Development of macro-prudential policies
  - Recommendation of macro-prudential policies
  - Address warnings and recommendations from ESRB
  - Countercyclical capitalbuffer
  - Recommendations on data collection and information sharing

- Macro prudential policy implementation
  - DFSA responsible for the implementation of recommendations etc.
  - Comply or explain

- Proposal to be put before Parliament in November 2012 in order for the Council to be set up in the first half of 2013.