A long cable-stayed bridge spans across a vast blue ocean under a clear sky. The bridge's structure, including its tall concrete piers and the network of cables, is reflected in the water's surface. The perspective is from a low angle, looking down the length of the bridge towards the horizon.

Individual Solvency Need

Nordea Bank Danmark Group
30 September 2016

Nordea

1 Introduction

This report presents the individual solvency need (tilstrækkelig basiskapital og solvensbehov for pengeinstitutter) for the Nordea Bank Danmark Group and its legal entities, Nordea Bank Danmark A/S and Nordea Kredit Realkreditaktieselskab. The purpose of this report is to fulfil external disclosure requirements regarding the solvency need according to EU regulation No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and the Danish Financial Business Act (Lov om finansiel virksomhed jf. lovbekendtgørelse nr. 182 af 18. februar 2015) and Danish Executive Order no. 295 (27 March 2014) "Bekendtgørelse om opgørelse af risikoeksponeringer, kapitalgrundlag og solvensbehov". An update of the individual solvency need is published each quarter and is available on Nordea's Investor Relations website (nordea.com/ir) and links can be found on each legal entity's website. Details about the Nordea Bank Danmark Group's risk profile and key exposures are available in the annually disclosed Capital and Risk Management (Pillar 3) report for the Nordea Bank Danmark Group, also available on Nordea's Investor Relations website. Reference to the individual solvency need reporting is made in the annual report and the interim report for Nordea Bank Danmark A/S and Nordea Kredit Realkreditaktieselskab.

The Internal Capital Adequacy Assessment Process (ICAAP) reports for the Nordea Bank Danmark Group and Nordea Kredit Realkreditaktieselskab are produced at least annually. The reports are approved by the respective Board of Directors and presented to the Financial Supervisory Authority.

1.1 Main conclusions

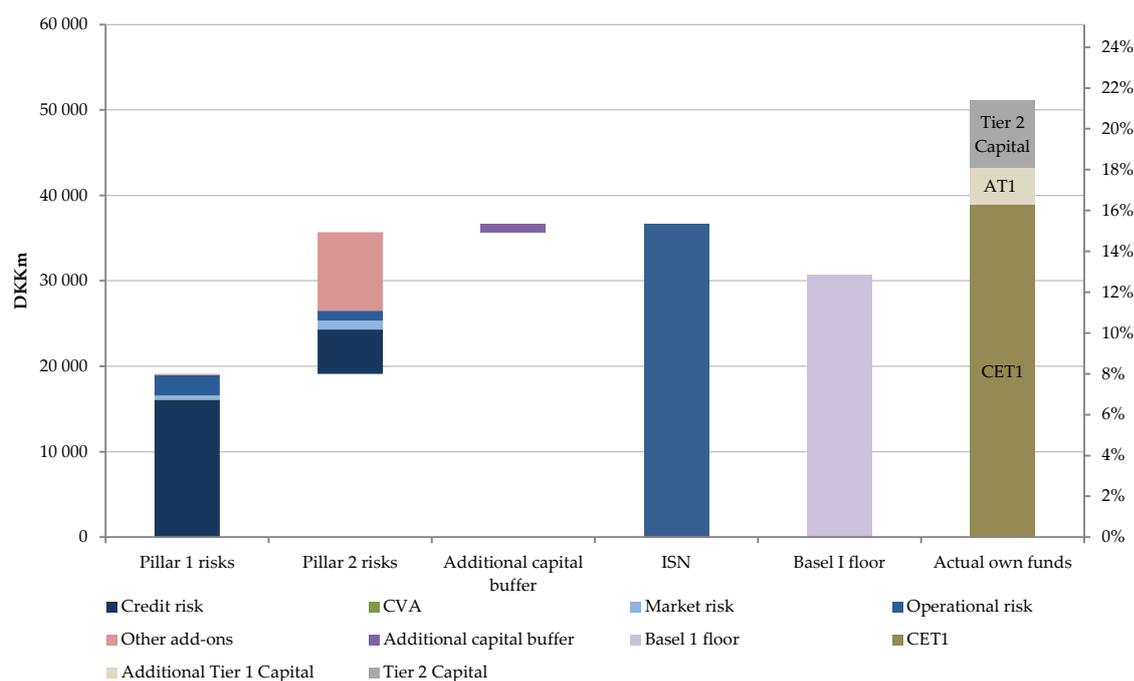
- Outcome from the Supervisory Review and Evaluation Process (SREP) led to a change in the ISN ratio in Q3 2016. Pillar II SREP add-ons are adjusted for the SREP 2016 results.
- The ISN levels have been increased to 15.3% for Nordea Bank Danmark, 13.7% for Nordea Bank A/S and 13.1% for Nordea Kredit Realkreditaktieselskab (Q2 2016: 14.5%, 13.2% and 11.8%, respectively).
- The SREP add-ons relate to corporate risk exposure adjustments and inadequate second line of defence and its involvement in the governance of the IRB system and modelling. Included is also an add-on for operational risk from inspections relating to IT and key processes.
- The Nordea Bank Danmark Group and its individual legal entities are well capitalised at end-Q3 2016 and have access to available capital from Nordea Bank AB (publ), the parent company of the Nordea Bank Danmark Group, if necessary.
- The CET1 ratio for the Nordea Bank Danmark Group was 16.3% (Q2 2016: 15.7%).
- The Nordea Bank Danmark Group and its legal entities conduct capital adequacy stress testing in collaboration with the Nordea Group to ensure that adequate capital is available within the Nordea Bank Danmark Group and its parent company in the event of, for instance, severe credit losses or changes in regulatory capital requirements. Stress testing is also made using Finanstilsynets scenarios and methods.

- In addition to capital requirements Nordea Kredit Realkreditaktieselskab have to meet a debt buffer requirement. The debt buffer is a way of implementing MREL in BRRD for mortgage institutions and is phased in, starting from 15 June 2016 with 0.6% of mortgage loans growing to 2.0% when fully implemented in 2020. The debt buffer requirement needs to be met by own fund instruments (Additional Tier 1 or Tier 2 Capital) or unsecured senior debt not used to cover capital requirements.

2 Definition of the individual solvency need

The definition of the individual solvency need and changes in methodology are described below.

Figure 1 Individual solvency need, capital constraints and actual capital at end-Q3 2016 for the NBD Group



The Nordea Bank Danmark Group and its legal entities use a Pillar 1 plus Pillar 2 approach in calculating the individual solvency need. Each component and its capital requirement are shown graphically for the Nordea Bank Danmark Group in Figure 1 above. This methodology uses the Pillar 1 capital requirements for credit risk, Credit Value Adjustment (CVA), market risk and operational risk as outlined in the Capital Requirements Regulation (CRR) as the starting point for its risk assessment. For each of these types, the risk is measured solely according to models and processes approved by the Financial Supervisory Authority for use in the calculation of legal capital requirements.

In addition, Pillar 2 risks, i.e. risks not included in the CRR or not adequately covered, are considered – specifically concentration risk, interest rate risk in the banking book, market risk in internal defined pension plans, real estate risk, sovereign risk and business risk.

The concentration risk for the Nordea Bank Danmark Group is calculated on a stand-alone basis by scaling the Nordea Group allocated concentration risk with a factor of 2.8. The scaling factor adjust the difference between the concentration risk of Nordea Bank Danmark within the Nordea Group and the concentration risk calculated for the Nordea Bank Danmark Group as a stand-alone entity using the Swedish FSAs

concentration risk model. The scaling factor was changed in 2016 Q1 to adjust for changes in the Nordea internal concentration risk model.

Also included in the Pillar 2 requirement are a number of temporary capital add-ons for changes pending on approvals by FSAs and other add-ons of which some are related to the SREP.

There are two add-ons pending approvals. The first relates to a credit process change that was implemented in Q4 2012. Household customers with OEI and without individually assessed provision have since then been classified as non-defaulted as opposed to previously. The Danish Financial Supervisory Authority has required Nordea Bank Danmark A/S to allocate a temporary capital buffer, identical to the decrease in Risk Exposure Amount (REA), netted with reversals of capital shortfall as long as the approval process for the above mentioned change is ongoing. In Q3 2016 this add-on amounted to DKK 1 241m. The second add-on pending on approvals relates to changes made in the Danish scorecards not yet implemented in the Pillar 1 framework. This add-on amounts to DKK 164m.

There are three other add-ons, the first reflect that the current average Actual Default Frequency (ADF) exceeds the Probability of Default (PD) used in the Pillar 1 capital requirements for the IRB corporate and institutions portfolio. This capital add-on is 11.5 % of the credit risk Pillar 1 capital requirement for the IRB corporate and institutions portfolio. In Q3 2016 this capital add-on amounted to DKK 1 066m.

The second reflects the risk of late registration of OEI in the Household portfolio and amounts to DKK 200m. A capital add-on reflecting this risk has been included for a few years but the add-on has been reduced as the number of unidentified OEI customers has been very low in the recently reviewed branch regions.

The third reflects the increased requirements in the SREP which relates to corporate risk exposure adjustments and inadequate second line of defence and its involvement in the governance of the IRB system and modelling. Included is also an add-on for operational risk from inspections relating to IT and key processes. The add-on amounts to DKK 9006m. Part of the adjustments that are ongoing due to SREP 2015 is reversal of changes made in Pillar 1 REA. Before the changes are in effect, and are included in the relevant risk measure, these are reported as other risks in Pillar 1, in Q3 2016 they amounted to DKK 155m.

Finally, a temporary capital allocation is designated to provide buffers above current capital requirements in the event of unexpected changes to the capital base and/or risk exposure amount, as well as a precautionary action to compensate for the continuation of slow economic growth and uncertain macro environment causing uncertainty regarding the future risk picture. To reflect the current conditions in the agricultural sector and low interest rates impact on customers holding swap contracts, part of this additional buffer has been earmarked as specific capital add-ons to cover these specific credit risks. Once we have gathered experience with the application of the new collective provisioning model and the process has matured these specific capital add-ons will be reversed.

For now both of these specific capital add-ons will be kept due to the increased uncertainty following the Brexit referendum, which could negatively impact the export to the UK (agriculture) and has already decreased the interest rates (negatively impacting the swap-counterparts). The total capital add-on amounts held in Q3 2016 was DKK 150m and DKK 100m for increased risk for customers in agriculture sector and customers with swap contracts, respectively.

Pillar 2 add-ons for sovereign risk, which amounts to DKK 83m, is low and has not been separated from the management buffer in previous ISNs. To be consistent with the granular approach chosen for other add-ons the pillar 2 add-ons for sovereign risk is presented on a separate line in this ISN report.

For the Nordea Bank Danmark Group and Nordea Bank Danmark A/S, the general management buffer is the difference between the measured Pillar 1 and Pillar 2 risks (including the temporary allocations) and the individual solvency need. The individual solvency need before management buffer of 14.9% for the Nordea Bank Danmark Group allows for an internal buffer at end-Q3 of 40 bps, which amounts to DKK 956m. For Nordea Kredit Realkreditaktieselskab the buffer is the difference between the measured Pillar 1 and Pillar 2 risks and the 13.1% individual solvency need, which amounts to DKK 259m.

In addition to the individual solvency need, there are regulatory capital constraints related to large exposures and the Basel I floor. At end-Q3 2016, the Basel I floor is a constraint for Nordea Kredit Realkreditaktieselskab and increase the capital requirement by DKK 5 678m.

3 Individual solvency need and own funds

3.1 Individual solvency need

The individual solvency need for the Nordea Bank Danmark Group and its legal entities at end-Q3 2016 is presented in detail in the table 1 and 2 below. In table 2 the distribution of specific risks has been updated in comparison to Q2 2016, in order to reflect the Joint Decision on Capital 2016 and to align the mapping closer to the regulatory reporting on Nordea's ISN.

Table 1 Individual solvency need for the Nordea Bank Danmark Group and its legal entities at end-Q3 2016

Capital requirements DKKmn	Nordea Bank Danmark Group	Nordea Bank Danmark A/S	Nordea Kredit Realkredit aktieselskab
Credit risk	16 062	15 614	4 823
- of which counterparty credit risk	19	19	0
<i>Credit risks measured by the IRB approach</i>	<i>14 690</i>	<i>11 063</i>	<i>4 821</i>
- of which corporate	8 872	6 485	2 234
- of which institutions	371	374	0
- of which retail	5 200	4 027	2 551
- of which other	247	177	36
<i>Credit risks measured by the standardised approach</i>	<i>1 372</i>	<i>4 550</i>	<i>2</i>
- of which corporate	278	1 463	0
- of which institutions	114	94	0
- of which retail	403	0	0
- of which equity	19	2 560	2
- other items	558	432	0
Market risk	516	369	0
- of which trading book, internal approach	299	299	0
- of which trading book, standardised approach	148	2	0
- of which banking book, standardised approach	68	68	0
Operational risk	2 378	2 201	283
Credit Value Adjustment Risk (CVA)	5	5	0
Other risks	155	78	72
Pillar 2 Credit risk	2 515	692	391
- of which concentration risk	2 183	361	391
- of which for increased risk for customers with swap contacts	100	100	0
- of which for increased risk for customers in agriculture sector	150	150	0
- of which sovereign risk	83	82	1
Pillar 2 Market risk	1 028	1 028	34
- of which IRR in the banking book	941	941	34
- of which real estate risk	0	0	0
- of which pension plans	87	87	0
Pillar 2 Business risk	1 377	1 324	28
Pillar 2 Add-ons for changes pending on approvals	1 405	1 170	235
- of which OEI adjustment	1 241	1 006	235
- of which new scorecards	164	164	0
Pillar 2 Other add-ons	10 272	7 875	2 330
- of which corporate and bank ADF/PD adaption	1 066	791	258
- of which late registration of OEI in household portfolio	200	200	0
- of which due to SREP	9 006	6 884	2 072
Additional internal buffer	956	913	259
Individual solvency need (adequate own funds)	36 668	31 269	8 454
Adjusted individual solvency need (adjusted adequate own funds)	36 668	31 269	8 454
Additional regulatory capital requirement due to transition rules	0	0	5 678
Capital requirement according to transition rules	36 668	31 269	14 132

Table 2 Key solvency figures for the Nordea Bank Danmark Group and its legal entities at Q3 2016

	Nordea Bank Danmark Group	Nordea Bank Danmark A/S	Nordea Kredit Realkredit aktieselskab
DKKm			
Individual solvency need pct. for Credit risk	8,9%	8,1%	8,8%
Individual solvency need pct. for Market risk	0,6%	0,6%	0,1%
Individual solvency need pct. for Operational risk	1,5%	1,4%	0,7%
Individual solvency need pct. for CVA	0,0%	0,0%	0,0%
Individual solvency need pct. for Other risks	4,3%	3,5%	3,5%
Individual solvency need pct. incl. additional internal buffers	15,3%	13,7%	13,1%
Individual solvency need pct. excl. additional internal buffers	14,9%	13,3%	12,7%
Common Equity Tier 1 Capital	38 957	37 844	20 038
Tier 1 Capital	43 306	42 225	20 038
Own funds	51 182	50 167	22 191
Total Risk Exposure Amount	238 942	228 328	64 724
Total Risk Exposure Amount incl Basel 1 floor	384 242	310 554	176 647
Common Equity Tier 1 ratio	16,3%	16,6%	31,0%
Tier 1 ratio	18,1%	18,5%	31,0%
Total capital ratio	21,4%	22,0%	34,3%
Basel 1 floor Common Equity Tier 1 ratio	10,2%	12,3%	11,5%
Basel 1 floor Funds incl transition rules	13,4%	16,1%	12,7%

3.2 Own funds

The own funds for the Nordea Bank Danmark Group and its legal entities at end-Q3 2016 is presented in detail in table 3 below.

Table 3 Own funds excluding profit for the Nordea Bank Danmark Group and its legal entities at end-Q3 2016

	Nordea Bank Danmark Group	Nordea Bank Danmark A/S	Nordea Kredit Realkredit aktieselskab
DKKm			
Own funds			
Paid up instruments	5 000	5 000	1 717
Share premium	0	0	0
Capital instruments eligible as CET 1 capital	5 000	5 000	1 717
Retained earnings/other reserves/accumulated other comprehensive income	35 020	35 020	18 584
Other CET1 instruments	1 255	0	0
Income (positive/negative) from current year	2 955	2 957	1 193
Common Equity Tier 1 capital before deductions	44 229	42 976	21 494
Proposed/actual dividend	-2 955	-2 957	-1 193
Deferred tax assets	0	0	0
Goodwill and other intangible assets	-1 743	-1 702	0
Deductions for defined pension fund asset	-159	-159	0
IRB provisions excess (+) / shortfall (-)	-611	-446	-328
Other items, net	196	131	65
Deductions from Common Equity Tier 1 capital	-5 272	-5 132	-1 456
Additional Tier 1 Capital	4 348	4 382	0
Tier 1 capital (net after deduction)	43 306	42 225	20 038
of which Additional Tier 1 capital	4 348	4 382	0
Capital instruments and subordinated loans eligible as Tier 2 capital	7 519	7 519	2 203
Other Tier 2 instruments	0	0	0
Tier 2 capital (before deductions)	7 519	7 519	2 203
IRB provisions excess (+) / shortfall (-)	480	512	15
Other items, net	-122	-89	-66
Tier 2 capital (net after deductions)	7 876	7 942	2 153
Participations hold in insurance undert., reinsurance	0	0	0
Pension assets in excess of related liabilities	0	0	0
Total own funds	51 182	50 167	22 191