



spar nord



**Risk Report 2019**





The Risk Report has been prepared in accordance with the disclosure requirements under Part 8 of the CRR regulation and pertaining guidelines (EBA/GL/2016/11). Requirements on the disclosure of information about individual solvency need are anchored in the Executive Order on Calculation of Risk Exposure Amount, Own Funds and Solvency Need (Executive Order no. 295 of 27 March 2014).

The rules regarding the capital adequacy of credit institutions are laid down in European Parliament and Council Directive 2013/36/EU (CRD) and Regulation no. 575/2013 (CRR), including the associated delegated regulations and guidelines. The rules originate from the Basel III rules and determine the rules for the disclosure of capital adequacy requirements and risk management.

Spar Nord's disclosure of information pursuant to the regulatory framework relate to Spar Nord Bank A/S, CVR no. 13737584, and the subsidiary Aktieselskabet Skelagervej 15, which is fully consolidated in the Group. Unless otherwise explicitly stated in the report, figures express consolidated figures.

The disclosure requirements laid down in the CRR regulation and the pertaining guidelines are mainly published via this risk report. In addition, Spar Nord publishes quarterly "Additional Pillar 3 Disclosures" on its website at [www.sparnord.com/investor-relations/finansiel-kommunikation/risikorapporter/](http://www.sparnord.com/investor-relations/finansiel-kommunikation/risikorapporter/).

Figures in the risk report are presented in millions of Danish kroner, unless otherwise stated. Consequently, rounding differences may occur because grand totals are rounded and the underlying decimal places are now shown.

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# Introduction

The decent progress and broadly founded economic recovery in Denmark continued in 2019 with GDP growth, which is expected to read to the tune of 1.75%.

## Financial risk developments

The Bank's key ratios at end-2019 for the common equity tier 1 capital ratio and for the own funds ratio were 14.6% and 18.5%, respectively, thus exceeding the Bank's capital targets of 13.5% and 17.5% for the two ratios. The Bank has an excess capital coverage of DKK 2.8 billion or 5.0 percentage points relative to the calculated capital requirement.

At end-2019, the Bank's leverage ratio was 8.3%, which is comfortably above the statutory requirement of 3% and also above the Bank's own 6% target.

As such, the Bank is well prepared to meet the growing capital requirements in the form of both the SIFI buffer requirement and a higher countercyclical buffer requirement. Spar Nord must comply with a SIFI buffer requirement of 1.0% at end-2020, the first 0.5% of which was phased in by end-2019. It has been decided to increase the countercyclical buffer requirement in Denmark to 2.0% effective from the end of 2020.

At the end of 2019, Spar Nord issued Senior Non-Preferred bonds for DKK 2.6 billion in order to meet the minimum requirement for eligible liabilities, which is often referred to as MREL. The MREL requirement will for Spar Nord be phased in over the course of four years starting in January 2019. Fully phased-in by January 2022, the requirement will amount to around 28% of the Bank's risk exposure amount (REA).

The issuance of Senior Non-Preferred bonds was completed shortly after the Bank had been assigned a rating by rating agency Moody's Investor Service. Spar Nord holds the following ratings:

- Baseline credit assessment: baa1
- Bank deposit rating: A1 / P-1
- Outlook: Stable

The Bank is planning for similar issues of Senior Non-Preferred bonds in 2020 and 2021 so that total issuance by the end of 2022 will run to about DKK 7 billion.

On the credit side, developments were quite positive in 2019 with favourable macroeconomic conditions, including low interest rates and low unemployment, resulting in historically high credit quality among the Bank's retail and business customers and a very low level of loan impairments.

The situation for the Bank's agricultural customers developed favourably during 2019, allowing them once again to improve their earnings. The improved circumstances were felt especially among pig farmers, who are expected to realise improved earnings as a result of the increase in settlement prices, which was triggered by the outbreak of African swine fever in China. Overall, however, the agricultural sector remains challenged by high indebtedness, although slightly less so than one year before. It should also be noted that Spar Nord's exposure to the agricultural sector has been notably reduced in recent years, and at end-2019 the sector only accounted for some 5% of the Bank's loans, advances and guarantees.

## Growing importance of non-financial risks

As expected, 2019 brought enhanced focus on non-financial risks, including compliance risk, risk of money-laundering and terrorist financing, IT security and other operational risks, including model risk and reputational risk.

For a number of years, Spar Nord has focused on managing non-financial risks, and the Bank has therefore dedicated substantial resources to onboarding new staff and implementing new systems and strengthened procedures in the various risk areas.

As a result of the ever more digitised world and generally enhanced focus in the financial sector, IT risks, model risks and product risks are being given more attention. Going forward, focus will also centre on climate impacts on the Bank's risk exposure.

Generally speaking, non-financial risks will be an area of enhanced focus in future, and investment initiatives in the area will be intensified in order to keep abreast of the rapid progress in the area.

## Outlook

Overall, developments in key macroeconomic conditions, including interest rate levels, employment, property prices, etc. are still expected to be favourable for the credit quality of Danish banks, while they will continue to put earnings on the traditional deposit and lending business under pressure.

Positive growth is also projected for 2020, albeit on a slightly lower level than in 2019.

## Business model

Founded in Aalborg, Denmark, in 1824, Spar Nord has historically been rooted in northern Jutland, and continues to be a market leader in this region.

In the period from 2002 to 2010 Spar Nord established and acquired 27 local banks (branches) outside northern Jutland, and in 2012 the Bank merged with Sparbank, which had 23 branches. Concurrently with these developments, Spar Nord adjusted the branch network and now has a nationwide distribution network comprising 49 local banks.

Spar Nord offers all types of financial services, consultancy and products, focusing its business on retail customers and SMEs in the local areas in which the Bank is represented.

The Spar Nord Group consists of two earnings entities: Spar Nord's Local Banks and the Trading Division. The Group also has a number of staff and support divisions at its Aalborg headquarters.

### Vision and strategy

Developments in the banking market and the challenges they entail would seem to imply a need for fundamental changes to the way in which you run a bank.

Spar Nord's starting point is that the Bank's greatest strength, also in an increasingly digital world, remains its ability to be a personal and attentive bank. No matter what tomorrow brings, people will always desire a bank that is close to its customers in every sense of the term, and which knows and understands their needs and wants.

Therefore, Spar Nord's vision – the landmark which all staff members should steer for – is to become Denmark's most personal bank.

As part of its efforts to bring the vision within reach, Spar Nord pursues a strategy that builds on the current trends in the banking market, including digitalisation, low interest rate levels and stricter requirements resulting from new regulation.

Spar Nord bases its strategy on an increasingly digital world and banking market, but a market in which many future customers will still wish to speak personally with an adviser about their financial affairs. At the same time, having strong digital offerings in the future will be paramount for Spar Nord. This is the foundation for Spar Nord's strategic ambition of being "The personal bank in a digital world".

### Customers

Spar Nord's primary target groups are retail customers and small and medium-sized businesses in the local areas where the Bank has a presence. In special cases, we offer asset financing abroad (primarily in Germany). Leasing products are offered to business customers in addition to traditional bank financing options.

As an entity, the Trading Division serves customers from Spar Nord's Local Banks as well as large retail customers and institutional clients in the field of equities, bonds, fixed income, forex products, asset management and international transactions.

Finally, under the umbrella concept SparXpress, the Bank offers consumer financing through retail stores, gift voucher solutions via shopping centres and shopping centre associations and direct loans on the website, sparxpres.dk.

In its retail segment, Spar Nord gives priority to full-service customers in the sense that it wants to be a banker for financially sound customers and their entire families, thus catering to all their banking needs. The Bank focuses its day-to-day operations on retaining existing full-service customers, turning existing non-regular customers into full-service customers and attracting new customers with good potential.

In the business customer segment, Spar Nord focuses on sound businesses across industry sectors. In other words, it is to a large degree the structure of a local business community and the local focus that determine the distribution of industry sectors in the individual banking areas.

Spar Nord's credit exposure at Group level is characterised by an exposure to retail customers that is higher than the sector average and generally good sector diversification in its business customer portfolio.

Spar Nord generally aims to be the customer's primary banker and that customers conduct their basic banking business with the Bank. However, after a concrete assessment Spar Bank may accept that the customer also banks with another one or two institutions, provided the Bank knows the extent of credit facilities granted by these institutions.

### Distribution

The 49 local bank branches throughout Denmark constitute the backbone of Spar Nord's distribution network. Spar Nord gives very high priority to personalised advisory services in its physical branches, supplementing them with self-service solutions such as well-functioning online banking and mobile platforms.

# Risk management

Risk assumption is a natural component of banking operations, placing heavy demands on the Bank's risk management organisation and risk management environment.

The following risks are considered the most important for Spar Nord:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk

For a more detailed description of risk management in the individual risk areas, including a description of policy, monitoring and reporting, reference is made to the respective sections.

Disclosure obligations with respect to management systems, cf. Article 435(2)(a)-(c) of the CRR Regulation, are described on pages 26-30 of the annual report.

## 3 Risk management organisation

In accordance with Danish legislation, Spar Nord has established a two-tier management structure consisting of a Board of Directors and an Executive Board. Moreover, Spar Nord has established segregation of functions between entities entering into business transactions with customers or otherwise

assuming risk on behalf of the Bank, and entities in charge of risk management.

The structure of Spar Nord's risk management organisation is shown in figure 3.1.

### 3.1 Board of Directors

It is the duty of the Board of Directors to handle the overall and strategic management with a view to running a healthy and competitive bank, thus securing long-term value for the Bank's stakeholders.

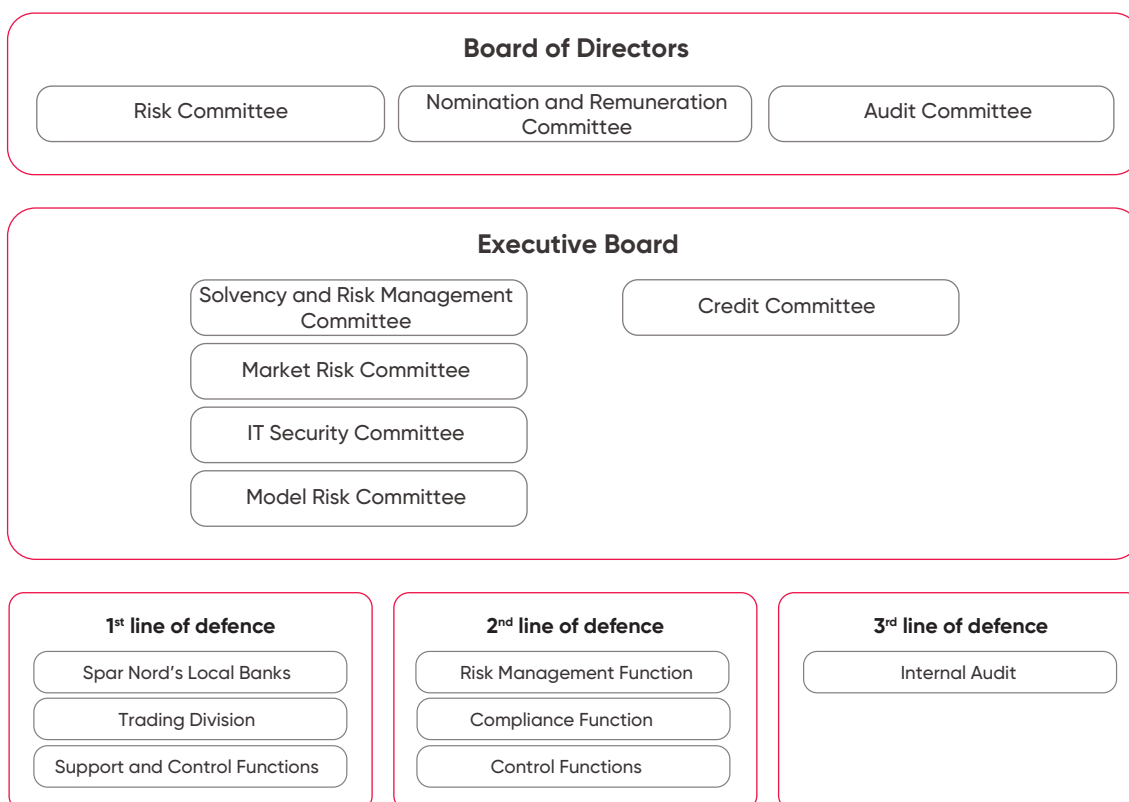
Using Spar Nord's strategic objectives as its point of departure, the Board of Directors determines the Bank's risk profile, which describes the risk within the Bank's most important risk types that the Board of Directors is willing to undertake while meeting the objectives set forth in the strategy.

The objective is to ensure cohesion between Spar Nord's vision and strategy while ensuring that Spar Nord's risk profile is appropriate at all times, having regard to the Bank's capital and liquidity situation.

The Board of Directors has defined a number of risk policies that set out the overall handling and management of the Bank's risks. These policies are reviewed and approved by the Board of Directors at least once a year.

Figure 3.1

**Risk management organisation**



## Section 3

### Risk management

In order to underpin the management structure, the Board of Directors has drafted written guidelines for the Executive Board, specifying the areas of responsibility and scope of action. As required and at least once a year, the Board of Directors must assess and update these guidelines.

#### 3.2. Executive Board

In accordance with the guidelines and risk policies issued by the Board of Directors, the Executive Board handles the day-to-day management.

The Executive Board must ensure that the Bank's risk policies and guidelines are implemented in the Bank's day-to-day operations while also ensuring that business procedures or work descriptions have been prepared for all important areas.

The Executive Board delegates specific guidelines and authorisations to selected departments of the Bank with a view to the practical implementation of the guidelines and policies adopted by the Board of Directors.

#### 3.3 Board committees

The Board of Directors has set up a Risk Committee, a Nomination and Remuneration Committee and an Audit Committee charged with arranging the preparatory work for the Board of Directors' consideration of matters relating to respective topics.

Establishing these board committees help ensure a better utilisation of the special competences held by the board members, thus ensuring in-depth dealing with the board material. The sole purpose of the committees is to facilitate the transaction of business by the Board of Directors and they have no independent decision-making powers.

The terms of reference of the committees are available at [www.sparnord.com/committees](http://www.sparnord.com/committees), which also provides a presentation of the members and their qualifications.

##### 3.3.1 Risk Committee

The principal purpose of the Risk Committee is to handle risk-related matters, including to review and assess the adequacy and efficiency of Spar Nord's policies, instructions and systems. The Risk Committee also serves to advise the Board of Directors on the Bank's overall current and future risk profile and strategy and to ensure the correct implementation of the risk strategy in the Bank.

The Risk Committee consists of three independent board members. The Committee held four meetings in 2019.

##### 3.3.2 Nomination and Remuneration Committee

The principal purpose of the Nomination and Remuneration Committee is to facilitate the decisions to be taken by the Board of Directors with respect to remuneration, including the remuneration policy, and other related decisions that may influence the Bank's risk management. The Committee also serves to facilitate work related to the process of board evaluation, nominating new board candidates, etc.

The Nomination and Remuneration Committee consists of three board members, two of which are independent members and one a member elected by the employees. The Committee held three meetings in 2019.

##### 3.3.3 Audit Committee

The principal purpose of the Audit Committee is to monitor and control accounting and auditing matters, including informing the Board of Directors of the outcome of the statutory audit. Its duties also include monitoring the efficiency of the Bank's internal control system, internal audit and risk management systems for financial reporting purposes.

The Audit Committee consist of three members, two of whom are independent. The Committee held six meetings in 2019.

#### 3.4 Risk committees

The Executive Board has set up a number of committees which in specific areas contribute to Spar Nord's risk management, preparing issues and themes for consideration by the Executive Board and Board of Directors.

##### *Solvency and Risk Management Committee*

The Solvency and Risk Management Committee is composed of a member of the Executive Board, Trading Division, Credit Rating, Finance & Accounts and Risk Management. The Committee meets every quarter and serves to formulate targets and principles for calculating adequate own funds and the individual solvency need. The Solvency and Risk Management Committee prepares a recommendation for the individual solvency need and passes it on to the Board of Directors for approval. The Committee handles input from the Market Risk, IT Security and Model Risk Committees to ensure that any capital consequences are dealt with by the primary capital and solvency authority.

##### *Market Risk Committee*

The Market Risk Committee is composed of a member of the Executive Board, Trading Division, Finance & Accounts and Risk Management. The Committee meets every quarter to review developments in Spar Nord's positions, risks as well as the liquidity situation and expectations regarding market developments and future plans.



## Section 3

# Risk management

### *IT Security Committee*

The IT Security Committee is composed of a member of the Executive Board, the IT department, Risk Management and selected heads of business areas. The Committee serves to advise on and deal with any issues that may arise in relation to the information policy and related rules, procedures and contingency plans.

### *Model Risk Committee*

The Model Risk Committee is composed of a member of the Executive Board, Risk Management and Credit Rating. The Committee meets once every quarter to discuss and monitor Spar Nord's model risk management.

### *Credit Committee*

The Credit Committee is composed of a member of the Executive Board, Credit Rating and Corporate Banking. The Committee deals with credit facilities that exceed Credit Rating's authorisation limits or involve a matter of principle. The Committee meets several times a week. Frequently, matters that have been dealt with by the Credit Committee will be prepared for subsequent discussion among all members of the Board of Directors.

### **3.5 1<sup>st</sup> line of defence**

The business units Spar Nord's Local Banks and Trading Division together with the support and control functions represent the 1<sup>st</sup> line of defence. The Bank's day-to-day risk management is handled through risk policies, instructions, limits and a number of internal controls. The day-to-day management of the Bank's risks is carried out for all of the Bank's principal risk areas, including credit, market, liquidity and operational risk. In order to support the business units in relation to preventing money-laundering and terrorist financing, the Bank has also established an Anti-Money Laundering (AML) function, which is part of the 1<sup>st</sup> line of defence.

### **3.6 2<sup>nd</sup> line of defence**

The Bank's 2<sup>nd</sup> line of defence is composed of several organisational entities, including the risk management function and the compliance function, which has key assignments of monitoring, controlling and reporting the Bank's risks and control environment.

### *Risk Management Function*

The Risk Management Function is responsible for providing an overview of the Bank and its risk exposure to be able to assess whether such risk exposure is adequately addressed. The Risk Management Function's area of responsibility comprises the Bank's risk-prone activities across various risk areas and organisational units and risks deriving from outsourced functions. The Risk Management Function also serves as a secretariat to the Bank's Risk Committee and will assist the Risk Committee providing information about the Bank's risk exposure.

The Chief Risk Officer reports directly to the Bank's Executive Board. The Risk Management Function reports to the Board of Directors on a quarterly basis. The activities of the Risk Management Function are rooted in the annual plan adopted by the Board of Directors.

Dismissal of the Chief Risk Officer is subject to the prior approval of the Board of Directors.

### *Compliance Function*

The Compliance Function is charged with assessing and checking Spar Nord's compliance with applicable legislation, banking sector standards and Spar Nord's internal guidelines, advising on how to reduce compliance risk.

The Head of Compliance reports directly to the Bank's Executive Board. The Compliance Function reports to the Executive Board on a quarterly basis and to the Board of Directors twice a year. The activities of the Compliance Function are rooted in the annual plan adopted by the Board of Directors.

Dismissal of the Compliance Officer is subject to the prior approval of the Board of Directors.

### **3.7 3<sup>rd</sup> line of defence**

The Internal Audit Department serves as the 3<sup>rd</sup> line of defence and is responsible for planning and performing an audit to obtain reasonable assurance as to whether the consolidated financial statements and the parent company financial statements are free from material misstatement. The Internal Audit Department also serves as a secretariat to the Bank's Risk Committee.

It reports directly to the Board of Directors and regularly reports on an ongoing basis to the Executive Board and the Board of Directors. The Internal Audit Department bases its activities on the annual plan adopted by the Board of Directors. These activities include test examinations of business procedures and internal control systems in key areas subject to risk, including in connection with preparing the financial statements.

Dismissal of the Bank's head of internal audit is subject to the prior approval of the Board of Directors.

### **3.8 Reporting**

To ensure an adequate decision-making basis for the Executive Board and the Board of Directors, management receives a substantial volume of reporting material pertaining to the Bank's principal risk areas.

Figure 3.2 shows the risk reports submitted to the Board of Directors, including their frequency, use and the primary contents of the reports. The Board of Directors is continually involved in defining the contents to be reported on.

## Section 3

# Risk management

Figure 3.2

### Risk policies – guidelines – risk reporting

| RISK POLICIES AND GUIDELINES |                     |  |
|------------------------------|---------------------|--|
| Governance                   | Frequency           |  |
| Risk policy                  | Annually            | Capital policy and Capital contingency plan  |
|                              |                     | Credit policy  |
|                              |                     | Data protection policy   |
|                              |                     | Information security policy  |
|                              |                     | Insurance policy   |
|                              |                     | IT risk management policy  |
|                              |                     | Liquidity policy and Funding and liquidity contingency plan  |
|                              |                     | Market risk policy   |
|                              |                     | Model risk policy  |
|                              |                     | Operational risk policy  |
|                              |                     | Policy on risk tolerance and risk-mitigating anti-money laundering measures  |
|                              |                     | Policy on Spar Nord's disclosure obligations   |
|                              |                     | Product policy   |
| Guidelines                   | Annually            | Section 70 instruction – Board guidelines to the Executive Board   |
| RISK REPORTING               |                     |  |
| Risk area                    | Frequency           |  |
| Overall risk management      | On an ongoing basis | <i>Audit report</i><br>- Review of various risk areas  |
|                              | Quarterly           | <i>Internal Risk Report</i><br>- Combined overview of developments in key risks<br>- Monitoring of Spar Nord's risk profile<br>- Follow-up on indicators defined in the recovery plan  |
|                              | Quarterly           | <i>Individual solvency need (ICAAP)</i><br>- Assessment of the risk profile and calculation of adequate own funds.<br>- Conclusions reached in respect of stress test and an assessment of the capital needs in respect of the individual risks. Once a year, an extended version of the report is prepared.   |
|                              | Semi-annually       | <i>Compliance report</i><br>- Review of the most significant compliance controls<br>- Progress on ongoing tasks<br>Once a year, an extended version of the report is prepared.   |
|                              | Semi-annually       | <i>DPO Report</i><br>- Review of the most important controls relative to compliance with the GDPR and the Danish Data Protection Act<br>- Progress on ongoing tasks<br>Once a year, an extended version of the report is prepared.   |
| Credit risk                  | Annually            | Credit and balance sheet report<br>- Review and analysis of assets, including a specific review of individual exposures<br>- Analysis and assessment of future trends for important lines of business and asset areas  |
|                              | Semi-annually       | Reporting on credit-weak exposures<br>- Review of weak credit-weak exposures larger than DKK 50 million  |
|                              | Monthly             | Reporting on credit facility extensions in excess of DKK 10 million<br>- Credit facility extensions in excess of DKK 10 million that have not been considered by the Board of Directors  |
|                              | Monthly             | <i>Reporting on individual unauthorised overdrafts in excess of DKK 1 million</i><br>- Overview of all individual unauthorised overdrafts in excess of DKK 1 million   |
|                              | Monthly             | <i>Reporting on statistics of unauthorised overdrafts</i><br>- Overview of unauthorised overdraft statistics in all banking areas  |
| Market risk                  | Monthly             | <i>Market risk report</i><br>- Overview of and developments in current interest, equity and foreign-exchange risks<br>- Trend in utilisation of the frameworks and instructions defined  |
| Liquidity risk               | Monthly             | <i>Liquidity report</i><br>- Overview of and developments in short-term and long-term liquidity risk<br>- Trend in utilisation of the frameworks and instructions defined  |
|                              | Annually            | <i>Calculation and assessment of liquidity position and liquidity risks – internal liquidity adequacy assessment process (ILAAP)</i><br>- Combined calculation and assessment of Spar Nord's liquidity position and liquidity risks<br>The assessment supports Spar Nord's liquidity management and is a component of the statement of the individual solvency need. |
| IT risk                      | Quarterly           | <i>Reporting from IT security</i><br>- Significant events after breach of IT security<br>- Awareness activities carried out  |

# Capital and solvency need

## Developments in 2019

Spar Nord recorded solid earnings in 2019, which contributed to securing Spar Nord a strengthened capital position relative to the beginning of 2019.

Spar Nord increased its capital ratios while also growing its business. In addition, a significant share of earnings for the year was allocated for distribution of dividends to Spar Nord's shareholders. The Board of Directors proposes dividend payment for 2019 of DKK 3.5 per share, for a total amount of DKK 431 million, equal to 41% of the profit for the year. Total dividends including interest on issued additional tier 1 capital represented 45% of profit for the year.

The capital ratios meet Spar Nord's capital requirement and capital targets.

The excess capital coverage fell from 6.6 to 5.0 percentage points, primarily because of a higher combined capital buffer requirement.

The combined capital buffer requirement will rise from 1.9% to 4.0% of the total risk exposure amount. The increase is attributable to the activation of countercyclical capital buffer requirements for Danish credit exposures of 1.0%, and the capital conservation buffer requirement will increase from 1.9% to 2.5%. In addition, the SIFI buffer requirement will be phased in at a rate of 0.5%.

The excess capital coverage is expected to fall to about 3.5% during 2020 because the countercyclical buffer requirement will rise to 1.5% at 30 June 2020 and subsequently to 2.0% at end-2020 for Danish exposures. In addition, Spar Nord must comply with a SIFI buffer requirement of 1.0% at end-2020.

In Q4 2019, Spar Nord issued its first batch of Senior Non-Preferred bonds to be able to comply with the MREL requirement defined.

### TOTAL RISK EXPOSURE AMOUNT

# DKK 56.0 billion

2018: DKK 53.9 billion

### COMMON EQUITY TIER 1 CAPITAL RATIO

# 14.6%

2018: 14.0%

### OWN FUNDS RATIO

# 18.5%

2018: 18.0%

### INDIVIDUAL SOLVENCY NEED

# 9.5%

2018: 9.5%

### EXCESS CAPITAL COVERAGE IN PERCENTAGE POINTS

# 5.0

2018: 6.6

### LEVERAGE RATIO

# 8.3%

2018: 8.7%

## Definition of capital requirements

The regulatory capital requirements express the amount of capital a bank must reserve to cover the risk it undertakes in the course of its operations in the fields of credit risk, market risk and operational risk.

Spar Nord must ensure that it has access to sufficient capital to support its future business activities and growth. At the same time, Spar Nord must be able to overcome cyclical downturns. The Bank should thus be able to absorb unexpected substantial credit losses, substantial negative changes in the value of market risk-related positions or losses caused by operational risk events.

## Section 4

# Capital and solvency need

### 4.1 Capital policy

The capital policy forms the foundation of Spar Nord's risk profile in terms of capital. The capital policy aims to ensure that Spar Nord consistently complies with applicable legislation in respect of the following three areas:

- Calculation of risk exposure, own funds and capital requirement
- Individual solvency need and supervision procedures
- Market discipline through a number of disclosure obligations

The capital policy defines targets for the common equity tier 1 ratio and the own funds ratio. Spar Nord's capital targets at end-2019 are:

- A common equity tier 1 capital ratio of 13.5%
- An own funds ratio of 17.5%

In its endeavours to comply with the described targets, Spar Nord has adopted a number of guidelines intended to ensure that the management of Spar Nord's capital matters is appropriate and adequate and in compliance with applicable legislation.

In its capital policy, Spar Nord has also defined a target for its leverage ratio. It has been assessed that based on the overall risk profile Spar Nord should have a leverage ratio of at least 6%.

Lastly, the capital policy covers Spar Nord's dividend policy, which in 2019 expressed an intention to distribute ordinary dividends in the range of 40–50% of the net profit for the year. In 2020, this range will be adjusted to an intention to distribute 30–50% of the net profit for the year as ordinary dividends.

### 4.2 Development in capital ratios

Applying the IFRS 9 transitional arrangements, at year-end 2019 Spar Nord had a common equity tier 1 capital ratio of 14.6%, an own funds ratio of 18.5% and an individual solvency need ratio of 9.5%. The excess coverage is 5.0 percentage points compared to Spar Nord's capital requirement. The excess coverage is specified in figure 4.13. Capital ratios and the relevant excess coverage are shown in figure 4.1

Figure 4.1

**Capital adequacy and excess coverage using the IFRS 9 transitional arrangement**

| %   | 2019 | 2018 |
|---|------|------|
| Common equity tier 1 capital ratio                  | 14.6 | 14.0 |
| Tier 1 capital ratio                                | 16.1 | 15.6 |
| Own funds ratio                                     | 18.5 | 18.0 |
| Individual solvency need                            | 9.5  | 9.5  |
| <b>Percentage points</b>                            |      |      |
| Excess coverage, common equity tier 1 capital ratio | 5.0  | 6.6  |
| Excess coverage, own funds ratio                    | 5.0  | 6.6  |

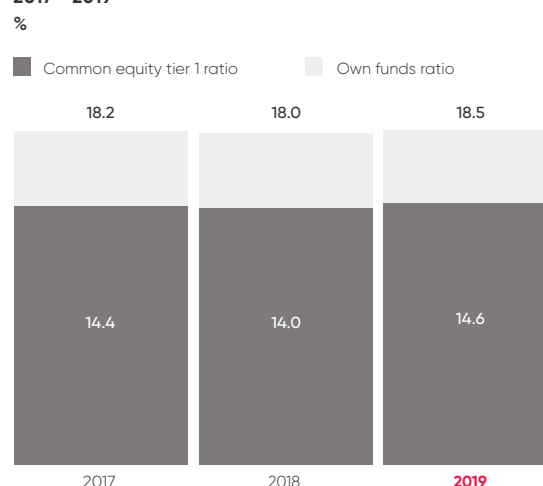
Figure 4.2

**Capital adequacy and excess coverage on full phasing-in of IFRS 9**

| %   | 2019 | 2018 |
|---|------|------|
| Common equity tier 1 capital ratio                  | 14.3 | 13.6 |
| Tier 1 capital ratio                                | 15.8 | 15.2 |
| Own funds ratio                                     | 18.1 | 17.6 |
| Individual solvency need                            | 9.5  | 9.4  |
| <b>Percentage points</b>                            |      |      |
| Excess coverage, common equity tier 1 capital ratio | 4.6  | 6.2  |
| Excess coverage, own funds ratio                    | 4.6  | 6.2  |

Figure 4.3

**Common equity tier 1 ratio and own funds ratio 2017 – 2019**



### 4.3 Own funds

Own funds are composed of common equity tier 1, additional tier 1 capital and tier 2 capital.

Common equity tier 1 capital, tier 1 capital and own funds are calculated with a view to calculating the capital ratios. The capital ratios express Spar Nord's capital resources to comply with Spar Nord's targets as per the capital policy as well as the regulatory requirements.

#### 4.3.1 IFRS 9

Spar Nord implemented IFRS 9 in 2018. The new accounting rules resulted in an increase in the total allowance account from 31 December 2017 to 1 January 2018. Developments in the allowance account resulted in a reduction of Spar Nord's equity at 1 January 2018 of DKK 195 million after tax.

As a result of the new accounting rules, a transitional arrangement in relation to the IFRS 9 effect has been incorporated in CRR. The transitional arrangement may be applied in order to phase-in the effect of IFRS 9 when calculating own funds. The transitional arrangement is divided into two components:



## Section 4

### Capital and solvency need

- The static component: The initial cost of changing accounting rules
- The dynamic component: Costs caused by any deterioration of the macroeconomic outlook. The dynamic component is calculated as current developments in the allowance account for stages 1 and 2 between 1 January 2018 and a given future reporting date.

For capital adequacy purposes, Spar Nord has opted to apply the transitional arrangement relative to both the static and the dynamic component.

Using the transitional arrangement means that the effect of IFRS 9 is recognised in own funds over a five-year period.

The transitional arrangement is shown in figure 4.4. The figure shows that in 2019 Spar Nord can, by using the IFRS 9 transitional arrangement, recognise 85% of the current cost related to IFRS 9 as an increase in the common equity tier 1 capital.

Figure 4.4

#### IFRS 9 transitional arrangement

|  | 2018       | 2019       | 2020     | 2021     | 2022     | 2023     |
|--|------------|------------|----------|----------|----------|----------|
| Transitional arrangement (%)                           | 95         | 85         | 70       | 50       | 25       | 0        |
| Static component in DKKm after tax                     | 185        | 166        | 136      | 97       | 49       | 0        |
| Dynamic component in DKKm after tax                    | 21         | 22         | -        | -        | -        | -        |
| <b>Total effect of IFRS 9 transitional arrangement</b> | <b>206</b> | <b>188</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>-</b> |

The positive effect of the selected transitional arrangement is shown in figure 4.4, which shows that the common equity tier 1 capital increased by DKK 188 million at end-2019. Reference is made to "Additional Pillar 3 Disclosures Q4 2019", tab 2, regarding the impact of IFRS 9.

#### 4.3.2 Issued capital instruments

Spar Nord has issued additional tier 1 capital with a total principal of DKK 850 million, distributed on two loans of DKK 400 million and DKK 450 million, respectively.

Spar Nord has issued tier 2 capital with a total principal of DKK 1,329 million, distributed on four issues of DKK 429 million (SEK 600 million), DKK 400 million, DKK 350 million and DKK 150 million, respectively.

Spar Nord's additional tier 1 (AT1) capital and tier 2 capital (T2) was issued on terms that meet the requirements for inclusion in own funds under CRR. Capital issues are therefore recognised in own funds with the principal adjusted for the permitted treasury holding of AT1 and T2 instruments issued by the bank itself and any related expenses not incurred.

Figure 4.5 provides an overview of Spar Nord's capital issues, which are included in the calculation of own funds.

Figure 4.5

#### Additional tier 1 capital and tier 2 capital issued

| DKKm                                     | Principal | First call date | Maturity date |
|--|-----------|-----------------|---------------|
| Additional tier 1 capital - DK0030362512 | 400       | 10.06.2020      | Perpetual     |
| Additional tier 1 capital - DK0030386297 | 450       | 06.12.2021      | Perpetual     |
| Tier 2 capital - NO0010808033            | 429       | 18.10.2022      | 18.10.2027    |
| Tier 2 capital - DK0030422357            | 400       | 19.06.2023      | 19.06.2028    |
| Tier 2 capital - DK0030431341            | 150       | 29.05.2024      | 29.05.2029    |
| Tier 2 capital - DK0030432075            | 350       | 29.05.2024      | 29.05.2029    |

See "Additional Pillar 3 Disclosures Q4 2019", tab 4, for more information on Spar Nord's issued capital instruments.

#### 4.3.3 Calculated own funds

In 2019, own funds grew by DKK 645 million. Own funds are mainly impacted by developments in the following three areas:

- Profit for the year after tax
- Provision for expected dividends for 2019
- Lower deductions for capital shares

Profit for the year after tax and before interest on additional tier 1 capital added DKK 1,059 million. Of this amount, a DKK 431 million provision has been made covering proposed dividends for 2019, equal to DKK 3.5 per share.

In 2019, DKK 49 million was paid on issued additional tier 1 capital.

As shown in figure 4.6, the total deduction for capital shares is reduced by DKK 142 million. The reduction is partly due to a higher deduction threshold due to an increase in common equity tier 1 capital after deductions. Moreover, there was a reduction in total holdings of capital shares in the financial sector.

## Section 4

### Capital and solvency need

Figure 4.6

#### Calculation of own funds

| DKK m  | 2019          | 2018         |
|--|---------------|--------------|
| Share capital  | 1,230         | 1,230        |
| Retained earnings  | 7,579         | 7,043        |
| IFRS 9 transitional arrangement  | 188           | 206          |
| Revaluation reserves   | 92            | 103          |
| Proposed dividend  | -431          | -431         |
| Intangible assets  | -143          | -146         |
| Deduction – Holdings of insignificant CET1 instruments                   | -205          | -376         |
| Deduction – Holdings of significant CET1 instruments                     | -71           | -35          |
| Prudent valuation  | -21           | -21          |
| Adjustment, permitted holding of treasury shares                         | -25           | -23          |
| Customer holdings of Spar Nord shares based on loan financing            | 0             | -1           |
| <b>Common equity tier 1 capital after primary deductions</b>             | <b>8,192</b>  | <b>7,549</b> |
| Additional tier 1 (AT1) capital  | 843           | 843          |
| Deduction – Holdings of insignificant CET1 instruments                   | -3            | -5           |
| <b>Tier 1 capital (incl. additional tier 1 capital) after deductions</b> | <b>9,032</b>  | <b>8,387</b> |
| Tier 2 capital   | 1,308         | 1,314        |
| Deduction – Holdings of insignificant CET1 instruments                   | -5            | -10          |
| <b>Own funds after deductions</b>  | <b>10,335</b> | <b>9,691</b> |

#### 4.4 Total risk exposure amount

The total risk exposure amount (REA) is used for determining the minimum capital requirement and also for calculating capital ratios, buffer requirements and the individual solvency need. The risk exposure represents the basis for determining the capital that must be reserved relative to the risk undertaken by Spar Nord in activities involving credit and market risk. Finally, operational risk is a component of the total risk exposure amount.

Spar Nord calculates the total risk exposure amount for credit and market risk using the standardised approach under CRR (Basel III). The market value approach is used for calculating counterparty risk, while the exposure to operational risk is calculated using the basic indicator approach. In addition, Spar Nord uses the comprehensive approach for financial collateral.

Figure 4.7 shows Spar Nord's use of capital models.

Figure 4.7

#### Spar Nord's use of capital models

|                                  |                          |
|----------------------------------|--------------------------|
| Credit risk                      | Standardised approach    |
| Counterparty risk                | Market value approach    |
| Valuation of collateral security | Comprehensive method     |
| Market risk                      | Standardised approach    |
| Operational risk                 | Basic indicator approach |
| CVA – Credit Value Adjustment    | Standardised approach    |

#### 4.4.1 Calculated risk exposure

In 2019, Spar Nord's total risk exposure amount rose by DKK 2.1 billion to stand at DKK 56.0 billion at end-2019.

In 2019, the total risk exposure amount for credit risk increased by DKK 3.0 billion to stand at DKK 47.1 billion at end-2019. Of this amount, risk exposure from OTC derivatives with financial counterparties (CVA risk) accounted for DKK 160 million.

The amounts take into consideration the fact that the IFRS 9 transitional arrangement results in higher risk exposure. The effect was calculated at DKK 188 million at end-2019.

Spar Nord's business volume surged in 2019. Total lending including balances with credit institutions rose by DKK 7.2 billion, causing a general increase in risk exposure in several areas, as shown in figure 4.8. As shown in the figure, risk exposures rose primarily for corporates. The second-highest increase in exposure was in the retail segment.

Figure 4.8 also shows a reduction in exposures in default. As described in the Bank's stock exchange announcement for Q3 2019, this development was primarily due to the fact that a review was performed of all significant exposures subject to individual impairment. As a result of this review, exposures totalling DKK 948 million were recategorised from stage 3 to stage 2 and stage 1 in accordance with IFRS 9, which also results in a decline in exposures categorised as in default.

High-risk exposures also showed a decrease. The exposure category primarily includes loans for project funding in the property sector.

Risk exposure derived from market risk was reduced by DKK 785 million to DKK 3.3 billion in 2019, primarily because of lower exposure to debt instruments. The gross interest rate risk has resulted in a fall in REA under the general interest rate risk of DKK 895 million. Reference is made to figure 7.3 in section 7 for a description of this development. The principal reason is that hedging of interest rate risk in DKK is to a greater extent made using DKK-based instruments.

REA derived from specific risk increased by DKK 169 million.

As shown in figure 4.8, exposure in other risk areas was on a level with end-2018.

The risk exposure amount for operational risk fell by DKK 150 million to DKK 5.6 billion.

The total risk exposure amount is shown in figure 4.8.

## Section 4

# Capital and solvency need

Figure 4.8

### Total risk exposure amount

| DKKbn   | Risk exposure |               |
|---|---------------|---------------|
|   | 2019          | 2018          |
| <b>Credit risk, incl. CVA</b>                         |               |               |
| - Central governments or central banks                | 0             | 0             |
| - Regional or local authorities                       | 3             | 0             |
| - Public-sector entities                              | 39            | 39            |
| - Institutions  | 544           | 406           |
| - Corporates  | 21,125        | 17,949        |
| - Retail  | 15,803        | 14,833        |
| - Exposures secured by mortgage on immovable property | 2,548         | 2,215         |
| - Exposures in default                                | 935           | 2,586         |
| - High-risk exposures                                 | 908           | 1,400         |
| - Exposures in units or CIU                           | 4             | 10            |
| - Equity exposures                                    | 3,049         | 2,728         |
| - Other items   | 1,949         | 1,751         |
| CVA risk  | 160           | 112           |
| <b>Total credit risk, incl. CVA</b>                   | <b>47,068</b> | <b>44,029</b> |
| <b>Market risk</b>                                    |               |               |
| - Debt instruments                                    | 2,947         | 3,683         |
| - Shares etc.   | 297           | 324           |
| - Foreign-exchange risk                               | 91            | 115           |
| - Commodity risk                                      | 4             | 3             |
| <b>Total market risk</b>                              | <b>3,340</b>  | <b>4,125</b>  |
| <b>Total operational risk</b>                         | <b>5,555</b>  | <b>5,705</b>  |
| <b>Total</b>  | <b>55,963</b> | <b>53,858</b> |

### 4.5 Individual solvency need

The Danish Financial Business Act stipulates requirements for the individual solvency need and any additional capital requirements. These requirements are to cover the risks not sufficiently covered by the minimum requirement of 8% pursuant to CRR. Such risks include business risks and special credit risks.

Spar Nord uses the so-called 8+ approach recommended by the Danish Financial Supervisory Authority in its guidelines. The 8+ approach is based on the statutory minimum capital requirement of 8.0% of the total risk exposure amount (Pillar 1) plus add-ons for risks and matters not fully reflected in the calculation of the total risk exposure amount. In other words, ordinary risks are assumed to be covered by the 8% requirement, and, consequently a position has to be taken on the extent to which an institution has additional risks that necessitate an add-on to the calculated solvency need (Pillar 2).

In the guidelines issued by the Danish Financial Supervisory Authority, benchmarks have been defined within a number of risk areas determining when the Authority basically finds that Pillar 1 is insufficient, and that an add-on to the individual solvency need is required. In addition, to the extent possible methods have been introduced for calculating the amount of the add-on within the individual risk areas.

Based on the guidelines issued by the Danish Financial Supervisory Authority, the Board of Directors determines Spar Nord's adequate own funds and individual solvency need based on the recommendation of the Solvency and Risk Management Committee.

Spar Nord's calculation method follows the guidelines issued by the Danish Financial Supervisory Authority and is based on an assessment of risks within the following ten key areas:

1. Earnings
2. Growth in lending
3. Credit risks
  - Credit risk attaching to large customers in financial difficulty
  - Concentration risk: Individual customers
  - Concentration risk: Industries
  - Concentration, collateral
  - Concentration, geography
  - Other credit risks
4. Market risks
  - Interest rate risk
  - Equity risk
  - Foreign exchange risk
  - Credit spread risk
5. Liquidity risk
6. Operational risk
7. Leverage
8. Regulatory maturity of capital instruments
9. Large corporates – sensitivity matrix for borrower interest rate risk
10. Other risks
  - The Bank's business profile
  - Strategic risks
  - Reputational risks
  - Properties
  - Other

The impact of the individual areas on the solvency need has been calculated directly using the methods designated by the Danish FSA in its guidelines, and by making supplementary calculations and own models.

In Spar Nord's opinion, the risk factors applied in the model cover all risk areas required by legislation. At end-2019, the adequate own funds amounted to DKK 5,328 billion, which is DKK 237 million up on end-2018. The increase was driven by factors such as a higher premium for credit spread risk and developments in the total risk exposure amount.

Spar Nord's total risk exposure amount rose from DKK 53.9 billion at end-2018 to DKK 56.0 billion at end-2019. At end-2019, the solvency need ratio amounted to 9.5%, which was unchanged from 2018.

Figure 4.9 shows the adequate own funds broken down by risk area.

## Section 4

# Capital and solvency need

Figure 4.9

### Adequate own funds by risk area

| DKKmn                          | 2019         | % of<br>REA *) | 2018         | % of<br>REA *) |
|--------------------------------|--------------|----------------|--------------|----------------|
| <b>Minimum 8% requirement</b>  |              |                |              |                |
| Credit risk, incl. CVA         | 3,765        | 6.7%           | 3,522        | 6.5%           |
| Market risk                    | 267          | 0.5%           | 330          | 0.6%           |
| Operational risk               | 444          | 0.8%           | 456          | 0.8%           |
| <b>Total</b>                   | <b>4,477</b> | <b>8.0%</b>    | <b>4,309</b> | <b>8.0%</b>    |
| <b>Add-on to solvency need</b> |              |                |              |                |
| Credit risk                    | 231          | 0.4%           | 334          | 0.6%           |
| Market risk                    | 425          | 0.8%           | 328          | 0.6%           |
| Operational risk etc.          | 195          | 0.3%           | 120          | 0.2%           |
| <b>Total add-on</b>            | <b>851</b>   | <b>1.5%</b>    | <b>782</b>   | <b>1.5%</b>    |
| <b>Total</b>                   | <b>5,328</b> | <b>9.5%</b>    | <b>5,091</b> | <b>9.5%</b>    |

\* REA = Risk Exposure Amount

### 4.6 Capital buffers

By virtue of the implementation of the Capital Requirements Directive, CRD IV, into the Danish Financial Business Act, Danish financial institutions must comply with a number of buffer requirements. A common feature of all buffer requirements is that only common equity tier 1 (CET1) capital may be used for meeting a bank's capital requirement. If a financial institution fails to meet the capital buffer requirements, it would face restrictions in terms of making dividend payments and other distributions.

The combined capital buffer requirement consists of requirements for a countercyclical capital buffer, a capital conservation buffer and a systemic buffer. In addition, a buffer requirement applies to banks designated as SIFIs.

The Minister for Industry, Business and Financial Affairs may determine the countercyclical buffer requirement if financial matters are considered to result in higher socioeconomic risks.

In 2018, the Minister for Industry, Business and Financial Affairs resolved to determine a countercyclical buffer requirement on recommendation from the Systemic Risk Council. The countercyclical buffer requirement at end-2019 was 1.0%. In 2019, the Systemic Risk Council recommended two increases to the countercyclical buffer requirement, which were subsequently approved by the Minister for Industry, Business and Financial Affairs, and the countercyclical buffer requirement will rise in Q2 2020 to 1.5% and to 2.0% at the end of 2020.

The Systemic Risk Council expects to recommend an additional 0.5%-point increase to the buffer ratio in Q1 2020 effective from Q1 2021 at the earliest, unless the risk accumulation in the financial systems slows down significantly.

The capital conservation buffer requirement serves to ensure a more robust financial sector in terms of a strengthened common equity tier 1 capital ratio. Phasing in of the buffer requirement commenced

in 2016, and it is now fully phased-in at 2.5% of the total risk exposure amount.

The SIFI buffer requirement depends on the individual bank's systemic importance. However, a SIFI will not be subject to both a SIFI buffer requirement and a systemic buffer requirement but only the higher of the two in case a systemic buffer requirement is determined.

After being designated a SIFI institution, Spar Nord is subject to a 1.0% SIFI buffer requirement, which must be complied with by the end of 2020. Half of the SIFI buffer requirement was phased in at end-2019. This means Spar Nord recognises a capital requirement derived from the SIFI buffer requirement at end-2019 equal to 0.5% of the risk exposure amount.

The Minister for Industry, Business and Financial Affairs may determine a systemic buffer requirement to counteract and limit long-term non-cyclical systemic or macro-prudential risks that are not comprised by CRR. No systemic buffer has been implemented that will affect Spar Nord.

### 4.6.1 Calculated combined buffer requirement

The institutionspecific countercyclical buffer requirement was DKK 557 million at end-2019. The buffer was calculated on the basis of the geographic distribution of Spar Nord's credit exposure. The breakdown of credit exposures relevant for calculating the countercyclical buffer is shown in figure 4.10.

Figure 4.10

### CREDIT EXPOSURE, GEOGRAPHICAL BREAKDOWN

|                 | 2019     |             | 2018     |             |
|-----------------|----------|-------------|----------|-------------|
|                 | Exposure | Buffer rate | Exposure | Buffer rate |
| Denmark         | 97.5     | 1.0         | 97.8     | 0.0         |
| Germany         | 0.5      | 0.0         | 0.5      | 0.0         |
| Sweden          | 0.3      | 2.5         | 0.3      | 2.0         |
| Norway          | 0.3      | 2.5         | 0.4      | 2.0         |
| United Kingdom  | 0.3      | 1.0         | 0.1      | 1.0         |
| USA             | 0.1      | 0.0         | 0.1      | 0.0         |
| Other countries | 0.9      | -           | 0.8      | -           |

In addition to the countercyclical buffer requirement, Spar Nord also needs to reserve capital for the capital conservation buffer requirement. The requirement is calculated on the basis of the total risk exposure amount, and at end-2019 it stood at 2.5% of the total risk exposure amount.

At end-2019, Spar Nord's combined buffer requirement consisted of the institutionspecific countercyclical buffer requirement, the capital conservation buffer requirement and the SIFI buffer requirement. The calculated combined buffer requirement is shown in figure 4.11.



## Section 4

### Capital and solvency need

Figure 4.11

#### Combined buffer requirement

|  | 2019         | 2018         |
|--|--------------|--------------|
| Total risk exposure amount (DKKm)                              | 55,963       | 53,858       |
| Institution-specific countercyclical buffer requirement (%)    | 1.0          | 0.0          |
| Capital conservation buffer requirement (%)                    | 2.5          | 1.9          |
| SIFI buffer requirement (%)                                    | 0.5          | 0.0          |
| Institution-specific countercyclical buffer requirement (DKKm) | 557          | 8            |
| Capital conservation buffer requirement (DKKm)                 | 1,399        | 1,010        |
| SIFI buffer requirement (%)                                    | 280          | 0            |
| <b>Combined buffer requirement (DKKm)</b>                      | <b>2,236</b> | <b>1,018</b> |

In 2019, the combined buffer requirement in Spar Nord increased by DKK 1,217 million. This was a combination of an increase in the capital conservation buffer requirement from 1.875% to 2.5%, the introduction of the countercyclical buffer requirement of 1.0% and the phasing-in of the SIFI buffer requirement. In addition, an increase of the total risk exposure amount results in a higher combined buffer requirement.

The standard layout to be used for publishing information regarding the requirement as to compliance with the requirement as to a countercyclical capital buffer appears from "Additional Pillar 3 Disclosures Q4 2019", tabs 28-29.

#### 4.7 Excess capital coverage relative to statutory requirement

Figure 4.12 shows that Spar Nord's common equity tier 1 capital at end-2019 was 14.6%, which equates to an excess coverage of 5.0 percentage points relative to the CET 1 capital requirement.

Figure 4.12

#### Excess coverage relative to common equity tier 1 (cet1) requirement

| DKKm/%  | 2019         |            | 2018         |            |
|---|--------------|------------|--------------|------------|
| Basic requirement of 4.5%                               | 2,518        | 4.5        | 2,424        | 4.5        |
| Add-on to solvency need                                 | 479          | 0.9        | 440          | 0.8        |
| Combined buffer requirement                             | 2,236        | 4.0        | 1,018        | 1.9        |
| Capital requirement for additional tier 1 (AT1) capital | 159          | 0.3        | 117          | 0.2        |
| Capital requirement for tier 2 capital                  | 29           | 0.1        | 0            | 0.0        |
| <b>Capital requirements</b>                             | <b>5,421</b> | <b>9.7</b> | <b>3,999</b> | <b>7.4</b> |
| Common equity tier 1 capital                            | 8,192        | 14.6       | 7,549        | 14.0       |
| <b>Excess coverage</b>                                  | <b>2,772</b> | <b>5.0</b> | <b>3,551</b> | <b>6.6</b> |

At end-2019, Spar Nord's own funds ratio stood at 18.5%, corresponding to an excess coverage of 5.0 percentage points relative to the total capital requirement.

Figure 4.13

#### Excess coverage relative to capital requirement

| DKKm/%                      | 2019         |             | 2018         |             |
|-----------------------------|--------------|-------------|--------------|-------------|
| Minimum 8% requirement      | 4,477        | 8.0         | 4,309        | 8.0         |
| Add-on to solvency need     | 851          | 1.5         | 782          | 1.5         |
| Combined buffer requirement | 2,236        | 4.0         | 1,018        | 1.9         |
| <b>Capital requirements</b> | <b>7,564</b> | <b>13.5</b> | <b>6,109</b> | <b>11.3</b> |
| Own funds                   | 10,335       | 18.5        | 9,691        | 18.0        |
| Excess tier 2 capital       | 0            | 0.0         | 31           | 0.1         |
| <b>Excess coverage</b>      | <b>2,772</b> | <b>5.0</b>  | <b>3,551</b> | <b>6.6</b>  |

#### 4.8 Leverage ratio

The leverage ratio is calculated as tier 1 capital relative to total risk exposure amount. Spar Nord has put in place procedures intended to mitigate the risk of excess leverage and to ensure identification, management and monitoring of Spar Nord's leverage exposure. In addition, methodologies have been developed to measure risks connected with excess leverage and other methodologies designed for assessing significant changes in leverage ratio.

A threshold value for how low the leverage ratio may be has not yet been introduced by legislation. However, it has been decided that the implementation of CRR II contains a 3.0% threshold, corresponding to a maximum leverage of about 33 times the tier 1 capital. Spar Nord complies with this target and with its own minimum target of 6% by a fair margin, as Spar Nord's leverage ratio was calculated at 8.3% at end-2019. This calculation was made based on the calculated own funds, which complies with the rules for a transitional IFRS 9 arrangement. Using a core capital calculated relative to a fully phased-in set of rules, the leverage ratio would be calculated at 8.1%.

Figure 4.14

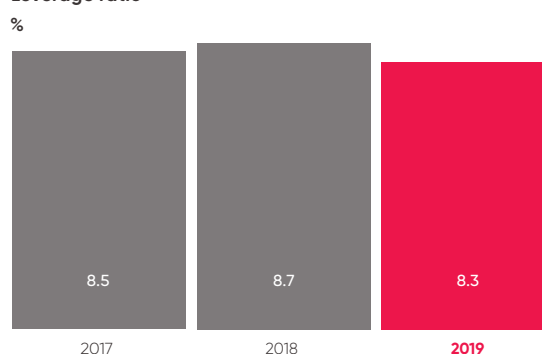
#### Leverage ratio

| %  | 2019 | 2018 |
|--|------|------|
| Leverage ratio – Transitional arrangement IFRS 9/CRR | 8.3  | 8.7  |
| Leverage ratio – fully phased-in IFRS 9/CRR          | 8.1  | 8.4  |

Figure 4.15 shows the calculated leverage ratio for the period 2017-2019.

Figure 4.15

#### Leverage ratio



## Section 4

### Capital and solvency need

#### 4.9 Systemically important financial institution

On 2 January 2019, Spar Nord was designated as a systemically important financial institution (SIFI). Being assigned SIFI status will result in stricter capital requirements and generally stricter requirements on the Bank's risk management process. Spar Nord will thus be subject to a SIFI buffer requirement of 1.0%, which must be complied with by end-2020, with 0.5% at end-2019.

Spar Nord was designated SIFI on the basis of a decision by the Danish Ministry of Industry, Business and Financial Affairs that the model for identifying systemically important financial institutions needed to be adjusted. One of the results hereof was that the threshold value for deposits was lowered from 5.0% to 3.0% of the sector's total deposits. The adjustment was made ensure that institutions in Denmark that are considered systemically important are designated as such.

#### 4.10 MREL

Pursuant to the Danish Financial Business Act, plans for winding up distressed banks are prepared by the Danish FSA and Finansiel Stabilitet. In connection with such plans, minimum requirements for eligible liabilities (MREL) must be defined.

The general resolution principle for SIFIs is that it should be possible to restructure them so they can return them to the market with adequate capitalisation to ensure market confidence.

Spar Nord's MREL requirements have been determined at twice the solvency need plus twice the combined buffer requirement with the exception of the countercyclical buffer requirement, which is only included once in the MREL requirement.

The MREL requirements for Spar Nord will be phased in by 25% a year during the period from early 2019 to late 2022.

The Danish FSA has determined Spar Nord's MREL requirement at 1 January 2020 to be 19.5% and 27.9% at 1 January 2022. Spar Nord regularly monitors a calibrated MREL requirement adjusted to applicable buffer requirements and currently calculated solvency requirements. The calibrated MREL requirement is on a level with the requirement determined by the FSA and is shown in figure 4.16. At 1 January 2020, the MREL requirement will be calibrated to 19.6% and a fully phased-in MREL requirement will be calculated at 28.0%.

Figure 4.16

#### MREL requirement – calibrated

| %   | 01.01.20    | 01.01.22    |
|---|-------------|-------------|
| Solvency ratio                                | 9.5         | 9.5         |
| Capital conservation buffer requirement       | 2.5         | 2.5         |
| SIFI buffer requirement                       | 0.5         | 1.0         |
| Countercyclical buffer requirement            | 1.0         | 2.0         |
| <b>Requirement for loss-absorption amount</b> | <b>13.5</b> | <b>15.0</b> |
| Requirement for recapitalisation amount       | 6.1         | 13.0        |
| <b>Total MREL requirement</b>                 | <b>19.6</b> | <b>28.0</b> |

It is expected that the recapitalisation amount will have to be met with convertible instruments ("contractual bail-in"), including tier 1, additional tier 1 and tier 2 capital, with a term to maturity of more than 12 months. In addition, Spar Nord will be able to apply a new type of capital referred to as Senior Non-Preferred. Senior Non-Preferred ranks ahead of the existing capital instruments (common equity tier 1 (CET1) capital, tier 1 and tier 2 capital), and must also have a term to maturity of more than 12 months.

In December 2019, Spar Nord issued Senior Non-Preferred bonds for a nominal amount of DKK 2.6 billion. Spar Nord is planning to issue bonds to the tune of DKK 7 billion before the end of 2021.

Spar Nord's issue of Senior Non-Preferred with a total principal of DKK 2,645 million is distributed on three issues of DKK 895 million (SEK 1,250 million), DKK 1,350 million and DKK 400 million, respectively.

Figure 4.17 provides an overview of Spar Nord's Senior Non-Preferred.

Figure 4.17

#### Issued Senior Non-Preferred (SNP)

| DKKm                     | Prin-<br>cipal | First<br>call date | Maturity<br>date |
|--------------------------|----------------|--------------------|------------------|
| SNP bonds - DK0030454046 | 895            | 05.12.2022         | 05.12.2023       |
| SNP bonds - DK0030454129 | 1,350          | 05.12.2024         | 05.12.2025       |
| SNP bonds - DK0030454202 | 400            | 05.12.2024         | 05.12.2025       |

On the basis of Spar Nord's total risk exposure amount at 1 January 2020, the excess coverage with respect to the MREL requirement is calculated at DKK 1.9 billion, which equals an excess coverage of 3.5 percentage points relative to the calibrated MREL requirement. Spar Nord's defined and calibrated MREL requirements were both met at 1 January 2020, as the calibrated MREL requirement has been set 0.1 percentage point higher than the requirement laid down by the Danish FSA.

The calculation of the excess coverage relative to the calibrated MREL requirement takes into account a reduction of the calculated own funds due to the transitional IFRS 9 arrangement. See figure 4.4.

## Capital and solvency need

Figure 4.18

**Excess coverage calibrated MREL requirement**

| %   | 01.01.2020    |
|---|---------------|
| Own funds                                   | 10,295        |
| Non-preferred senior capital                | 2,620         |
| Other non-MREL-eligible liabilities         | 0             |
| <b>Total MREL-eligible assets</b>           | <b>12,915</b> |
| MREL capital ratio                          | 23.1          |
| MREL requirement in %-points                | 19.6          |
| MREL requirement                            | 10,974        |
| Excess coverage                             | 1,941         |
| <b>Excess coverage in percentage points</b> | <b>3.5</b>    |

#### 4.11 Internal ratingsbased models

Spar Nord has resolved to prepare an application for permission to switch to the use of internal ratingsbased models (IRB) for calculating risk exposure derived from credit risk. This is based on the SIFI designation, which has resulted in a wish to further balance the Bank's credit risk management approach.

The Bank currently employs the standard method for calculating its risk exposure. By using internal ratings-based models, Spar Nord may allocate appropriate risk weights for its credit risk assets. Owing to the generally strong credit quality of Spar Nord's exposures, it is expected that Spar Nord may achieve lower risk weights, thus attaining a more optimum capital application. These expected lower risk weights will contribute to underpinning Spar Nord's competitive strength going forward.

Spar Nord expects to file an application with the Danish FSA in 2022.

#### 4.12 Future legislation

The rules for calculating risk exposure are expected to change dramatically under the CRR/II CRR/III designations.

CRR II and CRR III are expected overall to lead to changed regulation in all areas related to the calculation of risk exposure:

- Credit risk, including counterparty risk
- Market risk
- Operational risk
- CVA (Credit Value Adjustment)
- Leverage ratio requirements for SIFI institutions
- Handling of IRB modelling

Spar Nord expects to handle new capital requirements concerning counterparty risk by mid-2021. In addition, it is expected that new measures with respect to credit risk, operational risk and CVA will become effective in early 2023 and, lastly, that a new calculation method for market risk (FRTB) will take effect in mid-2023.

# Liquidity risk

LCR

## 195 %

2018: 174%

STRATEGIC LIQUIDITY

## DKK 23.4 billion

2018: DKK 21.8 billion

ASSET ENCUMBRANCE RATIO

## 5.0 %

2018: 3.0%

## Definition of liquidity risk

Spar Nord Bank is generally exposed to liquidity risks when lending, investment and funding activities result in a cash flow mismatch. Liquidity risk means that Spar Nord cannot meet its payment obligations while also meeting the statutory liquidity requirements. Moreover, a liquidity risk exists if the lack of financing/funding prevents Spar Nord from adhering to the adopted business model, or if Spar Nord's costs for procurement of liquidity rise disproportionately.

## Developments in 2019

Compared with end-2018, Spar Nord's liquidity situation remained at a strong level at end-2019. At 31 December 2019, Spar Nord's LCR ratio was thus calculated at 195% compared with 174% at end-2018. Spar Nord's strategic liquidity is calculated at DKK 23.4 billion, which is an increase of DKK 1.6 billion compared with 2018.

At end-2019, Spar Nord's total funding was DKK 71.1 billion, which is an increase of DKK 7.2 billion compared with end-2018. Deposits at end-2019 accounted for 75% of total funding, thus remaining Spar Nord's most significant source of funding.

### 5.1 Liquidity policy

The liquidity policy determines Spar Nord's overall risk profile for liquidity risks and financing structure, as well as the overall organisational delegation of responsibilities in the liquidity area with a view to profitably supporting Spar Nord's business model.

The aim of the liquidity policy is to ensure that Spar Nord has a liquidity risk that at all times bears a natural relation to Spar Nord's overall risk profile. In addition, the liquidity policy is intended to ensure that Spar Nord continuously handles and manages its liquidity appropriately and is capable of meeting its payment obligations as and when due while complying with applicable legislation and supporting future activities and growth. Lastly, the policy is intended to ensure a financing structure that ensures a correlation between risk and price.

Spar Nord's objective is for the LCR to amount to at least 125% in compliance with the regulation on LCR. In addition, Spar Nord aims to stay below the funding ratio and liquidity benchmark threshold values in the Diamond Test Model.



## Section 5

# Liquidity risk

Figure 5.1

Liquidity management at Spar Nord

|                                       | Short-term:<br>Liquidity management  |   | Liquidity stress test  | Management of funding<br>sources and needs   | Long-term liquidity<br>management   |
|---------------------------------------|--|---|--|--|---|
| <b>Objective</b>                      | Ensuring that, in the short operational term, Spar Nord will be able to meet its obligations at all times<br><br>Ensuring compliance with intraday liquidity | Ensuring that, on a 30-day horizon, the Bank has adequate high-quality liquid assets to withstand a tough stress scenario<br><br>Ensuring compliance with Liquidity Coverage Ratio (LCR), cf. CRR | Ensuring that Spar Nord becomes aware of future liquidity and refinancing risks<br><br>Stress tests are prepared for a 12-month term | Ensuring that Spar Nord has a diversified and balanced funding structure<br><br>Ensuring that Spar Nord has an overview of future funding needs broken down on funding sources | Ensuring that Spar Nord had hedged any long-term mismatch between deposits and lending<br><br>Ensuring compliance with Danish FSA's Funding Ratio, cf. Diamond Test Model and Net Stable Funding Ratio, cf. CRR |
| <b>Management tool</b>                | Decentralised instruction target   | Decentralised instruction target  | Central instruction target   | Central instruction target   | Central instruction target  |
| <b>Monitoring/<br/>control</b>        | Liquidity management function  | Liquidity management function   | Funding  | Funding  | Funding   |
| <b>Report recipient</b>               | Head of Trading Division, Executive Board and Board of Directors   | Head of Trading Division, Executive Board and Board of Directors  | Executive Board and Board of Directors   | Executive Board and Board of Directors   | Executive Board and Board of Directors  |
| <b>Model</b>                          | Management of intraday liquidity   | GAP analysis/<br>Simulation tool  | GAP analysis/<br>projection  | GAP analysis/<br>projection  | GAP analysis/<br>projection   |
| <b>Ratios/model<br/>for follow-up</b> | Intraday liquidity requirement   | Liquidity Coverage Ratio<br>30-day rule   | Liquidity stress test  | Liquidity projection   | Strategic liquidity   |

### 5.2 Management, monitoring and reporting

On the basis of the policies and objectives defined by the Board of Directors, the Executive Board has defined operational frameworks and specific limits for the liquidity function in the Trading Division, which is responsible for managing Spar Nord's short-term liquidity. Funding in the Finance & Accounts Department is responsible for managing and monitoring Spar Nord's long-term liquidity.

The Finance & Accounts Department is responsible for calculating, monitoring and checking that Spar Nord's liquidity risk does not exceed the allocated limits. The department regularly reports to the Executive Board, the Board of Directors and the Danish FSA.

### 5.3 Short-term liquidity

Spar Nord employs fixed models to monitor and manage its short-term liquidity, including the daily management of LCR and intraday liquidity and ongoing preparation of stress tests.

At end-2019, LCR was calculated at 195%, which is comfortably above Spar Nord's target LCR of at least 125%. The excess coverage of 70 percentage points relative to Spar Nord's target corresponds to DKK 6.8 billion in excess liquidity. Calculated relative to the statutory requirement of 100%, the excess liquidity amounted to DKK 9.2 billion. At end 2018, LCR was calculated at 174%.

Figure 5.2

Liquidity coverage ratio (LCR)  
%

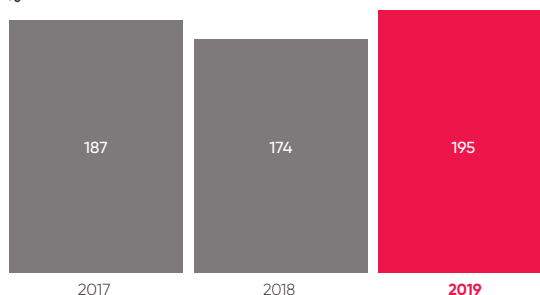


Figure 5.3

Liquidity coverage ratio

| DKKm                           | 2019       | 2018       |
|--------------------------------|------------|------------|
| Liquidity resources            | 18,928     | 16,513     |
| Liquidity Coverage Requirement | 9,717      | 9,471      |
| <b>LCR (%)</b>                 | <b>195</b> | <b>174</b> |

The liquidity reserve according to LCR basically consists of central bank reserves and government debt (Level 1A assets) and mortgage bonds offering particularly high liquidity and very high credit quality (Level 1B assets).

## Section 5

### Liquidity risk

Reference is made to "Additional Pillar 3 Disclosures Q4 2019", tab 27, regarding Liquidity Coverage Ratio.

#### 5.4 Long-term liquidity

Spar Nord calculates its strategic liquidity as deposits excl. repo transactions, senior loans, issued bonds, subordinated debt and equity less lending excl. reverse repo transactions. On the other hand, subordinated debt, additional tier 1 capital, senior loans and issued bonds due within 12 months are not included in the calculation of strategic liquidity.

At end-2019, Spar Nord had strategic liquidity of DKK 23.4 billion. This level reflects strengthened liquidity of DKK 1.6 billion relative to end-2018, when strategic liquidity was calculated at DKK 21.8 billion.

Compared with 2018, Spar Nord increased its lending, banking and leasing activities by DKK 3.6 billion, while deposits rose by DKK 2.5 billion in the same period. The issuance of MREL capital improves liquidity by DKK 2.6 billion, while a positive consolidation also contributes to a generally improved strategic liquidity.

Figure 5.4

**Strategic liquidity DKKbn**

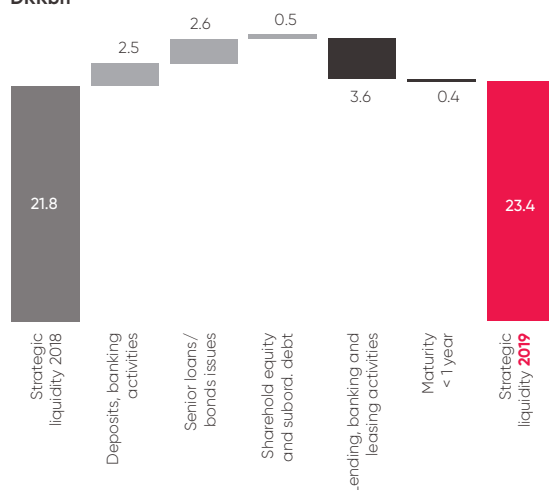
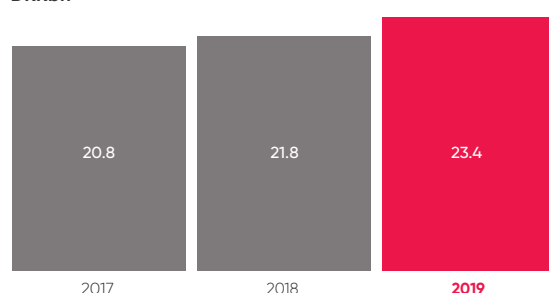


Figure 5.5

**Strategic liquidity DKKbn**



#### 5.5 Stress testing

In accordance with the Executive Order on Management and Control of Banks etc., Spar Nord prepares internal liquidity stress tests based on LCR. The stress tests span a 12-month period and are calculated using three permanently defined scenarios: a business-specific, a market-specific and a mixed scenario, all of which are calculated without any management intervention. The stress tests prepared have lived up to Spar Nord's internal targets throughout the period.

Figures 5.6 and 5.7 below show the result of a liquidity projection in a severe stress scenario, in which Spar Nord operates with a 3-month survival period in its liquidity management. In addition to money and capital market funding falling due, the stress scenario includes a massive stress on the deposit base, continued lending growth and stress on the bond portfolio.

At end-2019, the projection shows that Spar Nord's liquidity resources will be reduced by DKK 7.0 billion over the 12-month projection period, but also that in a severe stress scenario Spar Nord complies with the LCR statutory requirement in the full 12-month projection period.

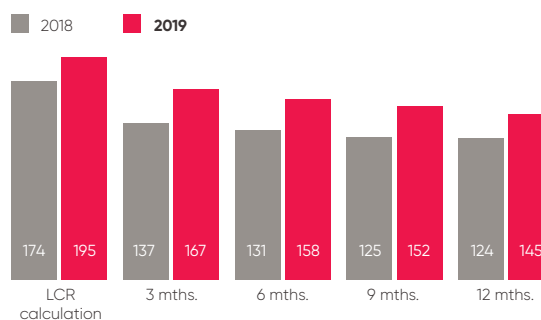
Figure 5.6

**Run-off of liquidity resources in a hard stress scenario**

| DKKm/%             | Liquidity resources |        | Accumulated run-off |      |
|--------------------|---------------------|--------|---------------------|------|
|                    | 2019                | 2018   | 2019                | 2018 |
| Calculation period | 18,928              | 16,513 |                     |      |
| 3 months           | 14,880              | 12,414 | -21                 | -25  |
| 6 months           | 13,642              | 11,507 | -28                 | -30  |
| 9 months           | 12,748              | 10,668 | -33                 | -35  |
| 12 months          | 11,914              | 9,863  | -37                 | -40  |

Figure 5.7

**LCR projected in a severe stress scenario %**



## Section 5

### Liquidity risk

#### 5.6 Liquidity indicator

The liquidity indicator of the Danish FSA is based on a projected version of LCR using an adjusted calculation of the numerator, while the time horizon for the denominator is extended to cover the period up to 3 months inclusive.

Since the liquidity indicator was implemented in the Supervisory Diamond, Spar Nord has realised a level notably above the 100% requirement.

#### Liquidity indicator

%



#### 5.7 Funding and maturity structure

Spar Nord's operations are predominantly funded through four funding sources:

- Customer deposits
- Loans or repo transactions from other credit institutions and Danmarks Nationalbank (the central bank)
- Issued bonds and senior loans, including Senior Non-Preferred
- Subordinated debt and equity

From an overall perspective, Spar Nord's funding at end-2019 increased by DKK 7.2 billion to DKK 71.1 billion compared with end-2018. The most important change in Spar Nord's funding structure is an increase in deposits and issuance of MREL capital like issued bonds. Deposits rose by DKK 2.5 billion, which was primarily driven by deposits on demand. In December 2019, Spar Nord issued MREL capital totalling DKK 2.6 billion. Lastly, an increase in the use of repos and repurchases and consolidation for the year contribute to overall developments in Spar Nord's funding at end-2019. Deposits remain Spar Nord's largest source of funding, and at end-2019 it represented 75.0% of Spar Nord's total funding.

At end-2019 Spar Nord's total long-term funding (deposits on demand and funding with a term to maturity of more than 12 months) amounts to 91.9%, which is a small reduction compared with end-2018.

Figure 5.9

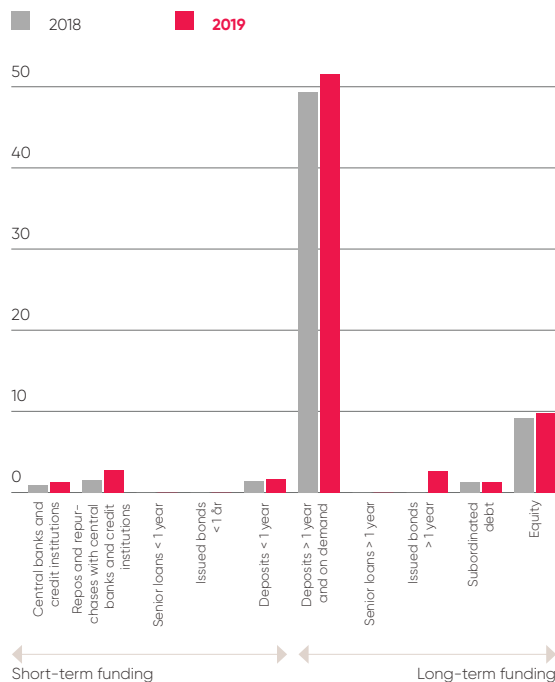
#### Funding structure

| DKKbn/%  | 2019          | 2018          | 2019         | 2018         |
|--|---------------|---------------|--------------|--------------|
| Central banks and credit institutions                            | 1,298         | 947           | 1.8          | 1.5          |
| Repos and repurchases with central banks and credit institutions | 2,764         | 1,519         | 3.9          | 2.4          |
| Senior loans < 1 year  | 0             | 0             | 0.0          | 0.0          |
| Issued bonds < 1 year  | 0             | 0             | 0.0          | 0.0          |
| Deposits < 1 year  | 1,661         | 1,469         | 2.3          | 2.3          |
| Deposits > 1 year and on demand                                  | 51,618        | 49,304        | 72.6         | 77.3         |
| Senior loans > 1 year  | 0             | 0             | 0.0          | 0.0          |
| Issued bonds > 1 year  | 2,637         | 0             | 3.7          | 0.0          |
| Subordinated debt  | 1,322         | 1,332         | 1.9          | 2.1          |
| Equity   | 9,761         | 9,241         | 13.7         | 14.5         |
| <b>Total</b>   | <b>71,061</b> | <b>63,812</b> | <b>100.0</b> | <b>100.0</b> |

Figure 5.10

#### Funding structure

(DKKbn)



#### 5.8 Liquidity contingency plan

Spar Nord has prepared a liquidity contingency plan pursuant to the Danish Executive Order on Management and Control of Banks. This plan contains a catalogue of possible courses of action for strengthening Spar Nord's liquidity in a critical situation. The catalogue contains a more detailed description of the expected impact and time span of the individual actions.

The liquidity contingency plan is applied if Spar Nord can only meet the predetermined liquidity instructions with difficulty and with resulting sharply increased funding costs.

## Section 5

### Liquidity risk

#### 5.9 Asset encumbrance

Assets encumbrance may constitute a funding risk if Spar Nord has many encumbered assets relative to its balance sheet total. Extensive asset encumbrance may also have a negative impact on the potential for procuring unsecured financing, as increased asset encumbrance contributes to deteriorate the position of this type of creditors.

As part of its business model, Spar Nord has been active in the money and derivatives market for many years, for which reason a proportion of Spar Nord's assets will regularly be encumbered. They may serve as collateral on procurement of funding through repo transactions or as collateral for market values related to interbank derivatives transactions. Moreover, the Spar Nord provides collateral for numerous other purposes, including clearing activities.

The primary sources of asset encumbrance are:

Encumbrance triggered by activities in the securities market:

- Repo and reverse repo transactions
- Repurchase transactions with Danmarks Nationalbank
- Securities lending

Collateral for derivative transactions:

- CSA collateral for the market value of derivative transactions
- CCP collateral for the clearing of derivative transactions
- Collateral for stock lending

Other assets:

- Collateral furnished with clearing systems
- Paid-in margins and default funds
- Offsetting, cf. netting agreements
- Security provided for mortgage loans

The primary collateral received derives from reverse repo transactions, which is lending against security – most often Danish mortgage bonds.

Figure 5.11

#### Asset encumbrance ratio

| DKKmn                          | End of year |             | Average     |             |
|--------------------------------|-------------|-------------|-------------|-------------|
|                                | 2019        | 2018        | 2019        | 2018        |
| Asset encumbrance              | 3,470       | 2,184       | 4,912       | 2,746       |
| Assets and collateral          | 102,350     | 88,506      | 98,058      | 91,060      |
| <b>Asset encumbrance ratio</b> | <b>3.4%</b> | <b>2.5%</b> | <b>5.0%</b> | <b>3.0%</b> |

The average ratio of Spar Nord's total asset encumbrance amounts to 5.0% of the total assets plus collateral received that can form the basis for encumbrance in 2019. This is an increase of 2.0 percentage points from 3.0% in 2018.

Reference is made to "Additional Pillar 3 Disclosures Q4 2019", tabs 30-33, regarding asset encumbrance.

#### 5.10 Rating

The Bank carried out a rating process with Moody's in 2019. The Bank now has the following ratings with a stable outlook:

- Baseline credit assessment: baa1
- Bank deposit rating: A1 / P-1
- Senior unsecured: A1
- Senior Non-Preferred: A3
- Subordinated: Baa2

#### 5.11 Future legislation

The European Commission's proposal for CRR II has been finally adopted, as a result of which the liquidity requirement in the form of the Net Stable Funding Ratio (NSFR) will apply from mid-2021. NSFR seeks to ensure stable funding profiles for the individual banks, the focus being the relationship between the term of individual assets and funding. The NSFR ratio is to be calculated for a 12-month horizon.

On the basis of preliminary calculations and assessments of the principles underlying the calculation of NSFR, Spar Nord is believed to be ready for a future NSFR liquidity requirement of 100%.



# Credit risk

## Developments in 2019

In 2019, Spar Nord generally experienced satisfactory developments in loan portfolio quality. In recent years, the credit quality of retail and business customers has been historically strong, and the overall positive trend continued in 2019.

In 2019, Spar Nord's business volume was broadly founded. Gross lending amounted to DKK 44.6 billion at end-2019, which was DKK 3.3 billion, or 7.9%, higher than at the beginning of the year.

The positive development was driven by an increase in bank and leasing loans, among other things. Mortgage loans arranged for retail and business customers rose by DKK 7.8 billion (9.6%).

The Bank recorded a lower risk level for its agricultural customers than in 2018 as higher settlement prices for pig farmers contributed to an increase in earnings. Overall, however, the agricultural sector remains challenged.

## Definition of credit risk

Credit risk is the risk of loss as a result of borrowers or other counterparties defaulting on their payment obligations, including the risks concerning customers in financial difficulty, risks relating to large exposures, concentration risks and risks attaching to granted, unutilised credit lines.

Credit risk also includes settlement and counterparty risk. Settlement risk is the risk arising when payments are settled, such as payments in respect of currency transactions and transactions in financial instruments. The risk arises when Spar Nord transfers payments before it has attained full assurance that the counterparty has met all its obligations.

Counterparty risk is the risk of loss resulting from a customer's default on over-the-counter derivatives and securities financing instruments.

### RISK EXPOSURE, CREDIT

# DKK 47.1 billion

2018: DKK 44.0 billion

### LOANS EXCL. REVERSE (GROSS)

# DKK 44.6 billion

2018: DKK 41.3 billion

### IMPAIRMENT RATIO (IMPACT ON OPERATIONS)

# 0.03%

2018: 0.3%

### TOTAL IMPAIRMENTS

# 2.2%

2018: 3.3%

### NPL RATIO

# 3.7%

2018: 7.0%

### SUSPENDED-INTEREST LOANS

# 0.4%

2018: 0.8%

### UNSECURED SHARE (WITHOUT REVERSE)

# 40.1%

2018: 42.3%

## 6.1 Credit policy

Spar Nord's overall credit risk is controlled on the basis of its credit policy, which the Board of Directors determines in conjunction with the general policies and frameworks for risk assumption. The pivotal objective of Spar Nord's credit policy is to ensure that earnings and risks are balanced, and that the assumption of risk is always quantified.

It is Spar Nord's policy that credit must always be granted on the basis of insight into the custom-

## Section 6

### Credit risk

er's financial position and that credit quality – the customer's ability and intention to meet current and future obligations – is a key parameter in all customer relations.

Spar Nord aims to develop long-term relationships with customers and does not want to use risk appetite as a competitive parameter. Spar Nord only wants to conclude transactions that conform to good banking practice and do not jeopardise Spar Nord's reputation and professional profile.

As a basic rule, Spar Nord does not grant loans and credit facilities based on collateral alone. Thus, the customer should show the intention and have the ability to repay loans without Spar Nord having to realise the collateral.

In its endeavours to ensure sound risk diversification of its credit exposure, Spar Nord has introduced a number of internal targets.

In order not to lose its freedom of action towards a customer, the Bank generally aims not to increase its exposure towards a customer to such an extent that the customer would not be creditworthy in other banks. Consequently, Spar Nord has introduced a cap on individual exposures of DKK 500 million, of which the unsecured share of credit exposure may not exceed DKK 250 million in respect of any facility.

Exposures to financial institutions under supervision and repo and reverse transactions are not comprised by this restriction.

In determining the amount of exposure, generally accepted credit risk adjustments are made, as appears from the section regarding large exposures in the CRR Regulation. The statutory limitations apply to trading partners in the financial sector with an external credit rating at investment grade level. For other trading partners in the financial sector, an internally-fixed cap of DKK 700 million applies.

Spar Nord has set targets for the industry diversification of loans, advances and guarantees, which means that brackets have been fixed for the desired share of total exposure that major lines of industry may represent.

**Figure 6.1**  
**Targets for industry diversification**

| %  | Maximum share of total exposure <sup>*)</sup> |
|--|---|
| Agricultural sector                                    | 10  |
| Property sector  | 15  |
| of which speculative <sup>**) property financing</sup> | 5   |
| Financing and insurance                                | 10  |
| Industry and raw materials development                 | 10  |
| Trade  | 15  |
| Energy supply  | 8   |

\* Excl. reverse repo transactions

\*\* CRR 575/2013 Article 4(79)

Finally, in its credit policy Spar Nord pursues a principle that it wants insight into any exposures that its customers may have towards other financial institutions.

#### 6.2 Management, monitoring and reporting

Although Spar Nord's business model is characterised by decentralised decision-making powers, the credit process is managed centrally.

As concerns new customers, the facility authorisation right is generally half of that for existing customers. The powers of authority in the credit area are governed by two factors: The individual local managers' ability and requirements and the wish that a certain share of authorisations from the local banks is dealt with by Credit Rating. Decentralised facility authorisation rights are maximised at DKK 10 million for existing customers.

Customer advisers, in consultation with local managers, handle the day-to-day management of Spar Nord's credit risks. If a credit facility exceeds the local loan approval limits, it will be passed on and dealt with by Credit Rating, the Credit Committee or the Board of Directors. Credit Rating may authorise credit lines up to DKK 50 million for existing customers and DKK 25 million for new customers.

The Credit Committee may authorise exposures up to DKK 100 million, and up to DKK 50 million for new facilities. Exposures exceeding DKK 100 million and new exposures exceeding DKK 50 million are subject to approval by the Board of Directors. However, the Credit Committee may authorise credit facility extensions of up to DKK 50 million relative to the most recent authorisation given by the Board of Directors.

Overall monitoring of Spar Nord's credit risk exposure is managed by the Credit Quality Department. The department oversees changes in the credit quality of exposures and undertakes systematic credit quality control of the credit portfolio.

New retail customer exposures in excess of DKK 100,000 and business customer exposures in excess of DKK 300,000 are systematically screened with a view to being selected for a manual credit quality assessment. The selection is made on the basis of a combination of risk parameters, which combined, or separately, indicate an increased level of risk. New customers with weak credit quality are registered on an ongoing basis.

Spar Nord has developed IT tools for controlling and monitoring credit risks. Spar Nord's credit analysis system is used for monitoring purposes, and key data regarding credit exposures and customers' financial affairs are recorded in the system. This is done to detect danger signals at an early stage and also to monitor changes in the credit quality of portfolios and organisational units.

## Section 6

### Credit risk

Every month a statistically-based rating of both retail and business customers is performed. Rating systems are used at the local level to grant credit facilities. Thus, customers in the rating categories accorded the least risk exposure are more likely to be given higher credit limits or extensions than those with the greatest risk exposure. The systems are also used for managing overdrafts and for pricing purposes to help ensure a correlation between the risk assumed by the customer and the price paid.

As a component of Spar Nord's credit processing, all non-defaulting customers are risk-classified according to the probability that the individual customer defaults within the next 12 months. Customers are divided into categories 1 to 8, with category 8 containing customers subject to the highest risk. Customers for which OEL has been identified and which are not in default are placed in rating category 9. The probability of default is estimated statistically by means of Spar Nord's rating systems which are based on various models for the different customer segments.

The model applied to business customers employs three components: An accounting component used to risk-classify the customer based on its most recent financial statements. A behavioural component that classifies the customer based on its account behaviour and credit authorisation history. The third component is a cyclical component used to adjust the classification based on cyclical trends.

New business customers are classified based on the accounting component and the cyclical component until the sixth month, after which time the behavioural component is also applied.

For retail customers, the model is exclusively based on a behavioural component and a cyclical component.

New retail customers are risk-classified according to an application scoring model that is based on classical credit performance indicators, such as assets, pay, disposable income, etc. This model is based on a combination of a statistical and an expert model. After six months, customers are subjected to a behavioural scoring scrutiny, and the results obtained using the two models are co-weighted in the transitional period until the twelfth month, after which the rating is based on the behavioural component exclusively.

In addition to the above-mentioned models, Spar Nord applies a qualitative risk classification, in which the Spar Nord adviser flags the credit quality as weak if a customer shows signs of default risk. For retail customers, these signs of default risk may for instance be divorce, unemployment, etc., and for business customers they could be marketing difficulties, the loss of key employees or suppliers, etc.

If a retail customer is flagged as having a weak credit quality but is not in default, the customer will be downgraded by one rating category; it should be noted that a customer flagged as having a weak credit quality does not generally qualify for rating in the best rating categories (1 and 2).

Business customers are rated based on two categories, customers flagged as having a weak credit quality and customers not flagged, using two different models. However, both models are based on the same components.

#### 6.3 Credit exposure

Spar Nord's total credit exposure is attributable partly to activities related to loans and guarantees, partly to trading activities involving bonds and financial instruments, etc.

Figure 6.2 shows Spar Nord's total credit exposure (carrying amount) at end-2019 and end-2018.

Spar Nord's impairment account amounted to a total of DKK 1.5 billion at 31 December 2019. Of this amount, provisions for unutilised credit lines amounted to DKK 9 million.

Figure 6.2

#### Credit exposure on provisions and fair value adjustment for financial reporting purposes

| DKKm   | 2019          | 2018          |
|--|---------------|---------------|
| Reverse repo transactions with customers                                   | 8,155         | 4,779         |
| Loans and advances at amortised cost                                       | 43,157        | 39,551        |
| <b>Loans, advances and other receivables at amortised cost</b>             | <b>51,312</b> | <b>44,330</b> |
| Contingent liabilities   | 14,766        | 12,092        |
| <b>Net credit exposure relating to loans, advances and guarantees</b>      | <b>66,078</b> | <b>56,422</b> |
| Impairments of loans and provisions against guarantees, etc.               | 1,493         | 1,868         |
| <b>Gross credit exposure relating to loans, advances and guarantees</b>    | <b>67,571</b> | <b>58,290</b> |
| <b>Net credit exposure relating to loans, advances and guarantees</b>      | <b>66,078</b> | <b>56,422</b> |
| Cash balances and demand deposits with central banks                       | 1,152         | 1,029         |
| Reverse repo transactions with credit institutions                         | 924           | 931           |
| Due from credit institutions and central banks                             | 663           | 469           |
| <b>Credit exposure for financial reporting purposes lending activities</b> | <b>68,817</b> | <b>58,850</b> |
| Positive fair value of derivatives, etc.                                   | 828           | 862           |
| Credit exposure relating to assets in the trading book                     | 16,630        | 16,293        |
| Assets in strategic business partners                                      | 1,514         | 1,545         |
| Associates   | 470           | 333           |
| <b>Credit exposure for financial reporting purposes</b>                    | <b>88,260</b> | <b>77,883</b> |

Figure 6.3

#### Impairment account for loans, advances and guarantees

|           | Impairment account |       |
|-----------|--------------------|-------|
| DKKm      | 2019               | 2018  |
| Spar Nord | 1,503              | 1,945 |

## Section 6

### Credit risk

#### 6.4 Loans, advances and guarantees

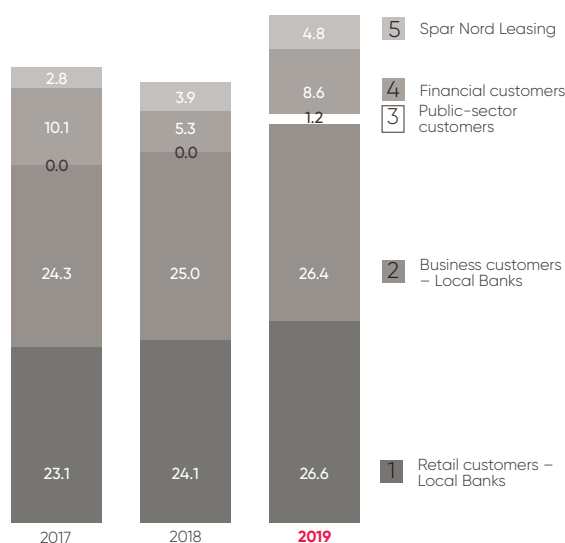
Spar Nord's total loans, advances and guarantees before impairments were DKK 67.6 billion at end-2019, which is DKK 9.3 billion higher than at end-2018. The development reflects a DKK 3.4 billion increase in repo transactions to a total of DKK 8.2 billion at end-2019, while bank lending rose DKK 3.3 billion to DKK 44.6 billion at end-2019, corresponding to lending growth of 7.9% in 2019. Furthermore, guarantees rose by DKK 2.6 billion to stand at DKK 14.8 billion at 31 December 2019.

Customers are categorised into five groups as part of the ongoing risk monitoring: 1) Retail customers – Local Banks, 2) Business customers – Local Banks, 3) Public-sector customers, 4) Financial customers and 5) Spar Nord Leasing.

The development in these customer groups appears from figure 6.4.

Figure 6.4

#### Exposures by category (DKKbn)



The credit exposure to retail customers at Spar Nord's Local Banks rose DKK 2.5 billion during 2019, equal to 10.4%, while the credit exposure to business customers rose DKK 1.4 billion, or 5.6%. For public-sector companies, the credit exposure rose from DKK 0.1 billion to DKK 1.2 billion. Lastly, the credit exposure to leasing customers increased 21.6% to DKK 0.9 billion.

The credit exposure to financial customers increased by DKK 3.3 billion during 2019 due to an increase in repo/reverse transactions.

#### 6.4.1 Breakdown by industry

Figure 6.5 shows the breakdown of Spar Nord's loans, advances and guarantees by industry at end-2019 and end-2018 and the average industry breakdown at sector level for 2019.

As appears from figure 6.5, retail customers account for a large share of Spar Nord's loans, advances and guarantees, and the distribution of loans to business customers is not notably different from the sector as a whole.

Figure 6.5

#### Breakdown by industry

| DKKbn/%                               | Loans and guarantees |              | Loans and advances |              | Loans, advances and guarantees The Sector |
|---------------------------------------|----------------------|--------------|--------------------|--------------|---|
|                                       | 2019                 | 2019         | 2018               | 2019         | 2018                                      |
| Public authorities                    | 1,200                | 1.8          | 0.1                | 2.3          | 4.4                                       |
| Agriculture, hunting and forestry     | 2,818                | 4.2          | 5.1                | 4.9          | 3.7                                       |
| Fisheries                             | 114                  | 0.2          | 0.2                | 0.2          | 0.0                                       |
| Industry and raw materials extraction | 2,964                | 4.4          | 4.8                | 4.8          | 6.7                                       |
| Energy supply                         | 1,712                | 2.5          | 2.7                | 3.1          | 1.9                                       |
| Building and construction             | 2,525                | 3.7          | 4.5                | 4.0          | 2.1                                       |
| Trade                                 | 4,175                | 6.2          | 6.8                | 7.2          | 5.1                                       |
| Transport, hotels and restaurants     | 2,615                | 3.9          | 3.7                | 4.6          | 3.0                                       |
| Information and communication         | 285                  | 0.4          | 0.4                | 0.4          | 0.8                                       |
| Financing and insurance               | 11,375               | 16.8         | 13.8               | 20.7         | 22.1                                      |
| Real estate                           | 7,310                | 10.8         | 10.3               | 11.1         | 12.0                                      |
| Other business areas                  | 3,737                | 5.5          | 6.1                | 6.3          | 4.7                                       |
| <b>Business customers, total</b>      | <b>40,829</b>        | <b>60.4</b>  | <b>58.5</b>        | <b>69.7</b>  | <b>70.2</b>                               |
| <b>Total retail customers</b>         | <b>26,742</b>        | <b>39.6</b>  | <b>41.5</b>        | <b>30.3</b>  | <b>29.8</b>                               |
| <b>Total</b>                          | <b>67,571</b>        | <b>100.0</b> | <b>100.0</b>       | <b>100.0</b> | <b>100.0</b>                              |

Figure 6.6

#### Customers by industry net of reverse repo transactions

| DKKbn/%                               | Loans and guarantees |              |              |
|---------------------------------------|----------------------|--------------|--------------|
|                                       | 2019                 | 2019         | 2018         |
| Public authorities                    | 1,200                | 2.0          | 0.1          |
| Agriculture, hunting and forestry     | 2,818                | 4.7          | 5.5          |
| Fisheries                             | 114                  | 0.2          | 0.2          |
| Industry and raw materials extraction | 2,964                | 5.0          | 5.2          |
| Energy supply                         | 1,672                | 2.8          | 2.7          |
| Building and construction             | 2,525                | 4.2          | 4.9          |
| Trade                                 | 4,175                | 7.0          | 7.4          |
| Transport, hotels and restaurants     | 2,615                | 4.4          | 4.0          |
| Information and communication         | 285                  | 0.5          | 0.4          |
| Financing and insurance               | 3,385                | 5.7          | 6.4          |
| Real estate                           | 7,310                | 12.3         | 11.2         |
| Other business areas                  | 3,737                | 6.3          | 6.6          |
| <b>Business customers, total</b>      | <b>32,799</b>        | <b>55.2</b>  | <b>54.9</b>  |
| <b>Total retail customers</b>         | <b>26,617</b>        | <b>44.8</b>  | <b>45.1</b>  |
| <b>Total</b>                          | <b>59,416</b>        | <b>100.0</b> | <b>100.0</b> |

## Section 6

### Credit risk

As shown in figure 6.7, Spar Nord's impairment balance amounted to DKK 1.5 billion, equal to 2.2% of Spar Nord's total loans, advances and guarantees at end-2019.

The total impairment account fell by DKK 0.4 billion in 2019, primarily due to improved credit quality, as a greater number of customers are no longer expected to result in a loss in the most likely scenario. Loans totalling DKK 0.5 billion were written off in 2019.

The industry breakdown of impairments in 2019 relative to impairments at the beginning of the year is shown in figure 6.7.

Figure 6.7

#### Impairments – by industry

| DKKm/%                                | 2019         | 2018         | 2019         | 2018         | The Sector 2018 |
|---------------------------------------|--------------|--------------|--------------|--------------|-----------------|
| Public authorities                    | 0            | 0            | 0.0          | 0.0          | 0.0             |
| Agriculture, hunting and forestry     | 413          | 596          | 27.1         | 30.7         | 23.0            |
| Fisheries                             | 1            | 1            | 0.1          | 0.1          | 0.0             |
| Industry and raw materials extraction | 85           | 88           | 5.1          | 4.5          | 7.0             |
| Energy supply                         | 15           | 21           | 0.9          | 1.1          | 1.8             |
| Building and construction             | 55           | 87           | 3.0          | 4.5          | 4.1             |
| Trade                                 | 96           | 132          | 5.6          | 6.8          | 7.2             |
| Transport, hotels and restaurants     | 94           | 106          | 5.8          | 5.4          | 6.5             |
| Information and communication         | 9            | 6            | 0.6          | 0.3          | 0.6             |
| Financing and insurance               | 80           | 119          | 4.7          | 6.1          | 4.9             |
| Real estate                           | 195          | 198          | 11.5         | 10.2         | 10.1            |
| Other business areas                  | 79           | 117          | 10.6         | 6.0          | 5.7             |
| <b>Business customers, total</b>      | <b>1,122</b> | <b>1,194</b> | <b>74.7</b>  | <b>75.6</b>  | <b>70.8</b>     |
| <b>Total retail customers</b>         | <b>381</b>   | <b>422</b>   | <b>25.3</b>  | <b>24.4</b>  | <b>29.2</b>     |
| <b>Total</b>                          | <b>1,503</b> | <b>1,945</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b>    |

Figure 6.8

#### Loans, advances and guarantees by exposure size \*)

| Number/%     | 2019           | 2018           | 2019         | 2018         |
|--------------|----------------|----------------|--------------|--------------|
| 0 – 0.1      | 52,678         | 53,178         | 0.9          | 1.1          |
| 0.1 – 0.5    | 36,243         | 35,747         | 10.1         | 10.9         |
| 0.5 – 1.0    | 14,078         | 13,985         | 11.6         | 12.6         |
| 1.0 – 5.0    | 9,439          | 8,304          | 26.5         | 24.7         |
| 5.0 – 10.0   | 1,009          | 931            | 9.2          | 9.4          |
| 10.0 – 20.0  | 432            | 419            | 7.9          | 8.7          |
| 20.0 – 50.0  | 263            | 238            | 11.5         | 11.4         |
| 50.0 – 100.0 | 91             | 86             | 9.0          | 9.1          |
| 100.0 –>     | 48             | 47             | 13.3         | 12.1         |
| <b>Total</b> | <b>114,281</b> | <b>112,935</b> | <b>100.0</b> | <b>100.0</b> |

\*) Excl. reverse repo transactions and SparXpres

Impairment of exposures to customers in the agricultural sector fell by DKK 183 million in 2019, ending at DKK 413 million, equal to 14.7% of exposures against 20.1% at the beginning of the year.

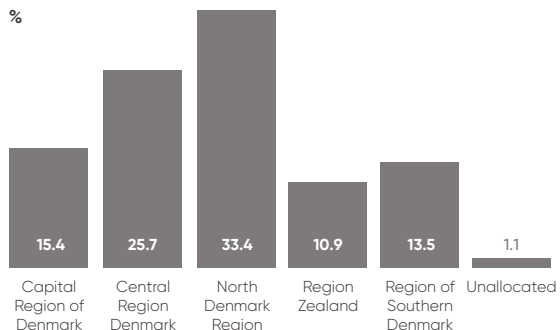
As concerns size of exposures, Spar Nord's credit portfolio is considered to be well-diversified, because 58.3% of the total exposure is attributable to exposures below DKK 10 million each, and because Spar Nord only has 48 exposures that exceed DKK 100 million.

Figure 6.9

#### Loans, advances and guarantees broken down by region 2019



#### Loans, advances and guarantees broken down by region 2018



Spar Nord's credit portfolio is also considered to have an excellent geographical spread. At end-2019, the North Denmark Region accounted for 31.6% of Spar Nord's total loans, advances and guarantees, while the balance is spread over the other regions in Denmark.

#### 6.4.2 Retail customers at spar nord's local banks

The total credit exposure to retail customers at Spar Nord's Local Banks amounted to DKK 26.6 billion at end-2019 compared with DKK 24.1 billion at end-2018. The credit exposure to retail customers amounts to 39.4% of Spar Nord's total credit exposure. As appears from figure 6.11, the average credit quality of retail customers has developed favourably over the past few years and is currently at a very satisfactory level.

The Bank's rating model for retail customers involves model uncertainty. The Bank has taken model uncertainty into account by making management estimates in respect of retain customers.

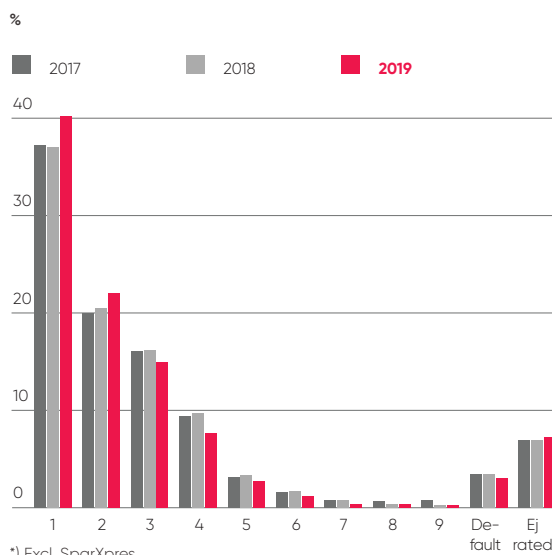


## Section 6

### Credit risk

Figure 6.10

**Exposures to retail customers by rating categories \*)**



\*) Excl. SparXpres.

Figure 6.11

**Average rating category \*)**

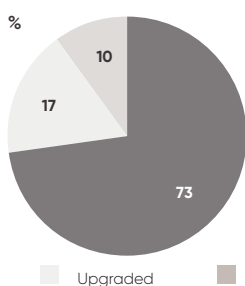
|                         | 2019 | 2018 | 2017 |
|-------------------------|------|------|------|
| Average rating category | 2.4  | 2.6  | 2.6  |

\*) Exposures after impairments

The figures below show the share of retail customers who migrated into better rating categories, the share of retail customers with unchanged credit quality and the share of retail customers who migrated into higher-risk rating categories during 2019 and 2018.

Figure 6.12

**Migration – share retail customers 2018-2019**



**Migration – share retail customers 2017-2018**

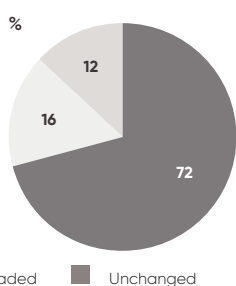
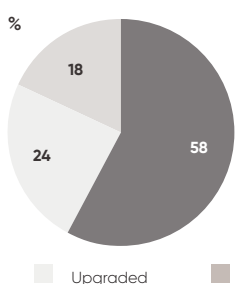
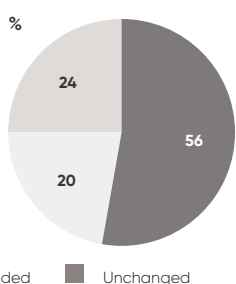


Figure 6.13

**Migration – exposure retail customers 2018-2019**



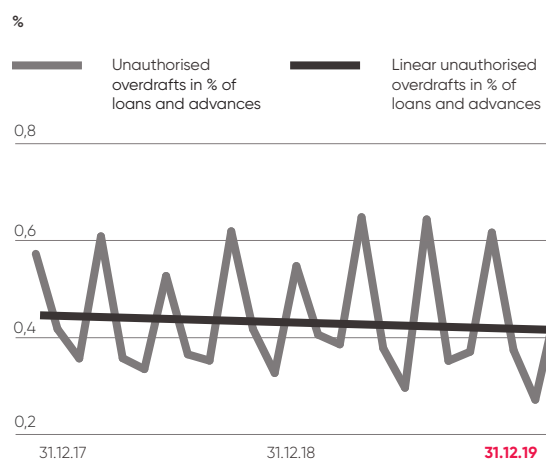
**Migration – exposure retail customers 2017-2018**



As appears from figure 6.12 and 6.13, more customers migrated towards stronger rating categories in 2019 than customers who migrated to weaker rating categories – both in terms of numbers and exposure amounts.

Figure 6.14

**Retail customers – Local Banks – Developments in unauthorised overdrafts/arrears \*)**



\*) Excl. SparXpres

The overall positive development in the retail customer portfolio is corroborated by the trend in retail customers' unauthorised overdrafts. Retail customers' unauthorised overdrafts have remained at a low level in recent years, averaging less than 0.5%.

#### 6.4.3 Business customers at the local banks

The total credit exposure to business customers at Spar Nord's Local Banks amounted to DKK 26.4 billion at end-2019 compared with DKK 25.0 billion at end-2018. The DKK 1.4 billion increase is attributable to a DKK 1.4 billion increase in lending and an unchanged level of guarantees of DKK 3.8 billion.

The credit exposure to business customers in the local banks amounted to 39.0% of Spar Nord's total credit exposure.

The Bank's rating model for business customers includes a business cycle model, which has shown instability in specific variables ("consumption expectations"). This has resulted in unintentional volatility in risk levels in recent years. In 2018, the business cycle variable had a large negative impact, while in 2019 it had a major positive impact.

The Bank is monitoring developments and has made a management estimate to address the uncertainty attaching to the business cycle variable.

Comments on developments in the agricultural segment are shown in section 6.7.2.

## Section 6

### Credit risk

Figure 6.15

**Exposures to business customers by rating category\*)**

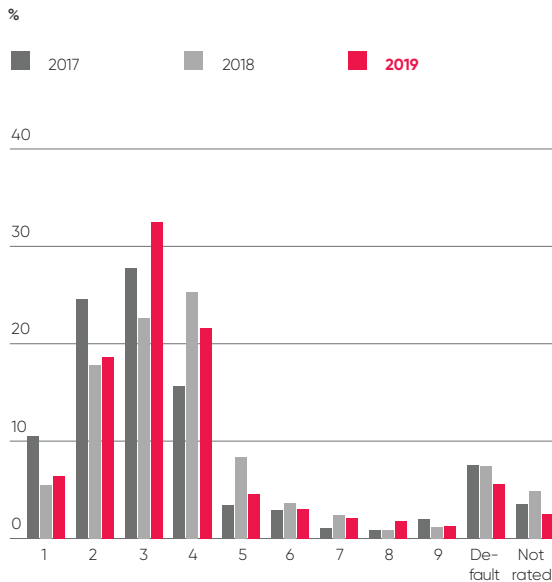


Figure 6.16

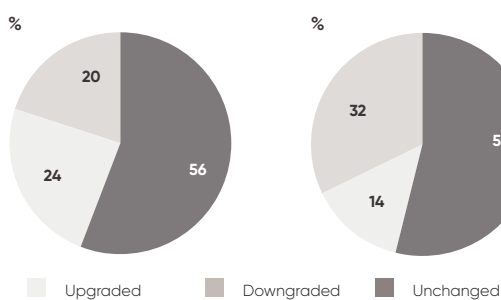
**Average rating category \*)**

|                         | 2019 | 2018 | 2017 |
|-------------------------|------|------|------|
| Average rating category | 3.7  | 3.8  | 3.4  |

\*) Exposure after impairments excl. public-sector customers.

Figure 6.17

**Migration – share business customers 2018-2019**



**Migration – share business customers 2017-2018**

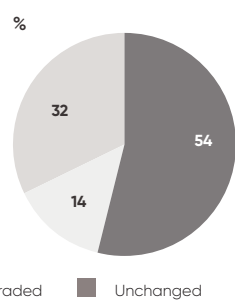
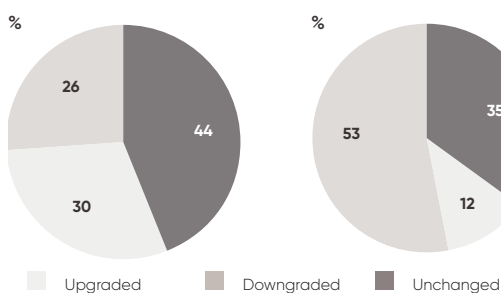


Figure 6.18

**Migration – exposure business customers 2018-2019**



**Migration – exposure business customers 2017-2018**

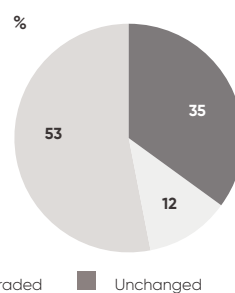
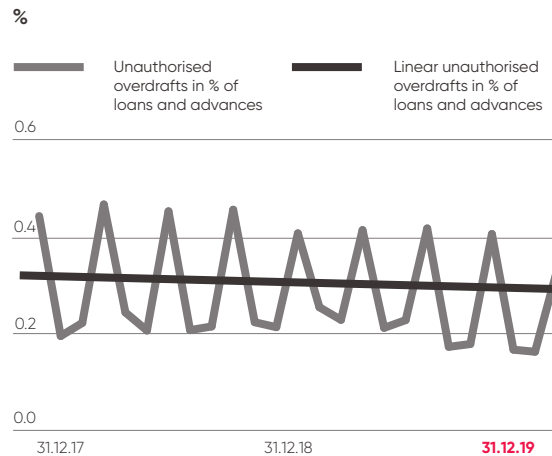


Figure 6.19

**Non-agricultural business customers – Local Banks – Development in unauthorised overdrafts/arrears**



As was the case for retail customers, business customers' unauthorised overdrafts and past due exposures remained at a stable, low level of less than 0.4% in the period 2017-2019.

#### 6.4.4 Mortgage loans arranged

In addition to lending on Spar Nord's own books, a major part of Spar Nord's business consists of arranging mortgage loans on behalf of Totalkredit and DLR Kredit.

At end-2019, Spar Nord had arranged mortgage loans for a total of DKK 88.6 billion to its customers. Of this amount, mortgage loans arranged from Totalkredit amounted to DKK 77.1 billion and from DLR Kredit DKK 11.5 billion.

The cooperation with Totalkredit and DLR Kredit is based on the principle that in case of losses on the loans arranged by Spar Nord, a setoff will be made against the commission paid to Spar Nord for its loan-arranging services, or that – for some exposure categories – Spar Nord will be asked to provide a direct guarantee.

Spar Nord pursues a practice of recording losses arisen on an ongoing basis, recognising them in the Bank's impairments etc., so no losses are offset against future commission.

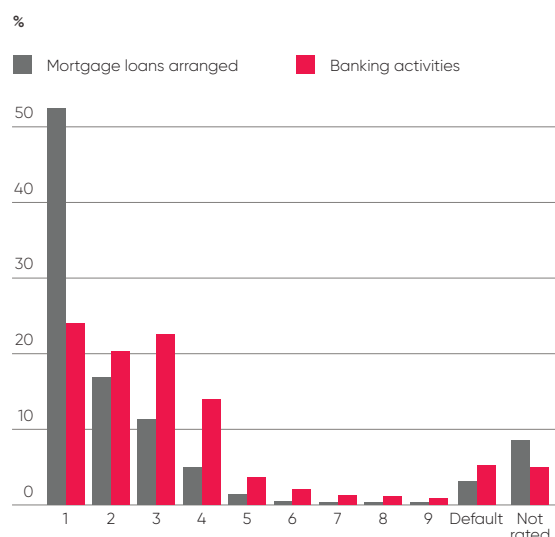
Figure 6.20 shows the breakdown on rating categories for customers who have taken out mortgage loans with Totalkredit and DLR Kredit. As appears, mortgage loans arranged for customers in the best rating categories represent the bulk of the group.

## Section 6

### Credit risk

Figure 6.20

**Mortgage loans arranged DLR and Totalkredit and bank exposure, by rating category**



#### 6.4.5 Lease activities

Spar Nord's total credit exposure in the leasing area amounted to DKK 4.8 billion at end-2019, which is DKK 0.9 billion, or 21.6%, more than at end-2018. Credit exposure in the leasing area equals 7.1% of Spar Nord's total loans, advances and guarantees.

Figure 6.22 shows developments in the volume of repossessed leasing equipment, which remains at a very low level.

In the context of risks, it is important to note that leasing lending is always backed by security in the assets, either through charges or ownership.

Figure 6.21

**Leasing loans by line of business**

| %                                     | 2018         |              | 2019         |              |
|---------------------------------------|--------------|--------------|--------------|--------------|
|                                       | 2018         | 2019         | 2019         | 2018         |
| Public authorities                    | 0.0          | 0.0          | 0.0          | 0.0          |
| Agriculture, hunting and forestry     | 13.5         | 13.1         | 10.3         | 15.9         |
| Fisheries                             | 0.0          | 0.0          | 0.0          | 0.0          |
| Industry and raw materials extraction | 13.1         | 14.3         | 20.8         | 21.0         |
| Energy supply                         | 8.7          | 9.3          | 5.0          | 7.0          |
| Building and construction             | 14.0         | 13.4         | 5.7          | 11.0         |
| Trade                                 | 9.4          | 9.6          | 6.0          | 7.5          |
| Transport, hotels and restaurants     | 22.9         | 22.7         | 22.5         | 20.8         |
| Information and communication         | 0.8          | 0.3          | 0.3          | 0.3          |
| Financing and insurance               | 1.7          | 1.2          | 0.8          | 0.8          |
| Real estate                           | 2.3          | 2.3          | 19.7         | 1.8          |
| Other business areas                  | 13.2         | 13.3         | 8.1          | 13.5         |
| <b>Business customers, total</b>      | <b>99.5</b>  | <b>99.7</b>  | <b>99.2</b>  | <b>99.5</b>  |
| <b>Total retail customers</b>         | <b>0.5</b>   | <b>0.3</b>   | <b>0.8</b>   | <b>0.5</b>   |
| <b>Total</b>                          | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> |

Figure 6.22

**Repossessed equipment**

| DKKm                         | 2019 | 2018 |
|------------------------------|------|------|
| Repossessed equipment, total | 5    | 7    |

The impairment account for customers with both bank and leasing loans is shown in the Bank's combined impairment account in figure 6.31, while the impairment account for customers who only have lease business is DKK 31.3 million.

#### 6.4.6 Financial customers

Spar Nord's credit exposure to financial customers was DKK 8.6 billion at end-2018, equivalent to 12.8% of Spar Nord's total loans, advances and guarantees. The exposure consists primarily of reverse repo transactions of DKK 8.2 billion and own liabilities, etc.

Figure 6.23

**Credit exposure to financial customers**

| DKKm  | 2019         | 2018         |
|---|--------------|--------------|
| Reverse repo transactions                           | 8,155        | 4,779        |
| Spar Nord's own commitments and key customers, etc. | 482          | 523          |
| <b>Total financial customers</b>                    | <b>8,637</b> | <b>5,302</b> |

#### 6.5 Credit quality

Figure 6.24 shows a breakdown of Spar Nord's customers by the credit quality categories used by the Danish Financial Supervisory Authority. Categories 2a and 3 comprise low-risk customers, categories 2c and 2b comprise heightened-risk customers while customers in financial difficulty are placed in category 1 (OEI).

Figure 6.24

**Credit quality 2019**

| %                                     | 1          | 2c         | 2b         | 2a/3        | Exposure     |
|---------------------------------------|------------|------------|------------|-------------|--------------|
| Public authorities                    | 0.0        | 0.0        | 0.0        | 1.8         | 1.8          |
| Agriculture, hunting and forestry     | 1.2        | 0.1        | 0.4        | 2.4         | 4.2          |
| Fisheries                             | 0.0        | 0.0        | 0.0        | 0.1         | 0.2          |
| Industry and raw materials extraction | 0.3        | 0.0        | 0.5        | 3.6         | 4.4          |
| Energy supply                         | 0.0        | 0.0        | 0.0        | 2.5         | 2.5          |
| Building and construction             | 0.3        | 0.0        | 0.2        | 3.3         | 3.7          |
| Trade                                 | 0.3        | 0.1        | 0.4        | 5.4         | 6.2          |
| Transport, hotels and restaurants     | 0.4        | 0.3        | 0.2        | 3.0         | 3.9          |
| Information and communication         | 0.0        | 0.0        | 0.0        | 0.4         | 0.4          |
| Financing and insurance               | 0.2        | 0.0        | 0.1        | 16.5        | 16.8         |
| Real estate                           | 0.7        | 0.2        | 0.3        | 9.6         | 10.8         |
| Other business areas                  | 0.2        | 0.0        | 0.2        | 5.1         | 5.5          |
| <b>Business customers, total</b>      | <b>3.7</b> | <b>0.8</b> | <b>2.3</b> | <b>53.7</b> | <b>60.4</b>  |
| <b>Total retail customers</b>         | <b>1.1</b> | <b>0.1</b> | <b>1.5</b> | <b>36.9</b> | <b>39.6</b>  |
| <b>Total</b>                          | <b>4.8</b> | <b>0.9</b> | <b>3.8</b> | <b>90.5</b> | <b>100.0</b> |

## Section 6

### Credit risk

#### Credit quality 2018

| %                                     | 1          | 2c         | 2b         | 2a/3        | Exposure     |
|---------------------------------------|------------|------------|------------|-------------|--------------|
| Public authorities                    | 0.0        | 0.0        | 0.0        | 0.1         | 0.1          |
| Agriculture, hunting and forestry     | 2.2        | 0.1        | 0.4        | 2.4         | 5.1          |
| Fisheries                             | 0.0        | 0.0        | 0.0        | 0.2         | 0.2          |
| Industry and raw materials extraction | 0.5        | 0.0        | 0.6        | 3.7         | 4.8          |
| Energy supply                         | 0.0        | 0.0        | 0.1        | 2.6         | 2.7          |
| Building and construction             | 0.3        | 0.1        | 0.2        | 3.9         | 4.5          |
| Trade                                 | 0.4        | 0.1        | 0.4        | 6.0         | 6.8          |
| Transport, hotels and restaurants     | 0.5        | 0.0        | 0.1        | 3.1         | 3.7          |
| Information and communication         | 0.0        | 0.0        | 0.0        | 0.3         | 0.4          |
| Financing and insurance               | 0.4        | 0.0        | 0.1        | 13.2        | 13.8         |
| Real estate                           | 0.9        | 0.1        | 0.5        | 8.8         | 10.3         |
| Other business areas                  | 0.3        | 0.0        | 0.3        | 5.5         | 6.1          |
| <b>Business customers, total</b>      | <b>5.6</b> | <b>0.5</b> | <b>2.7</b> | <b>49.7</b> | <b>58.5</b>  |
| <b>Total retail customers</b>         | <b>1.5</b> | <b>0.1</b> | <b>2.0</b> | <b>38.0</b> | <b>41.5</b>  |
| <b>Total</b>                          | <b>7.1</b> | <b>0.5</b> | <b>4.7</b> | <b>87.7</b> | <b>100.0</b> |

#### 6.6 Collateral

An important component of Spar Nord's management of credit risks is to reduce the risk attaching to individual exposures by accepting collateral, such as mortgages and charges over physical assets, securities and guarantees, etc. Mortgages and charges on real property, securities and vehicles make up the most common type of collateral. Mortgages on property are by far the most important collateral type provided to Spar Nord.

Mortgages on real property consist mainly of mortgages on private housing.

Figure 6.25

#### Geographical breakdown of mortgages

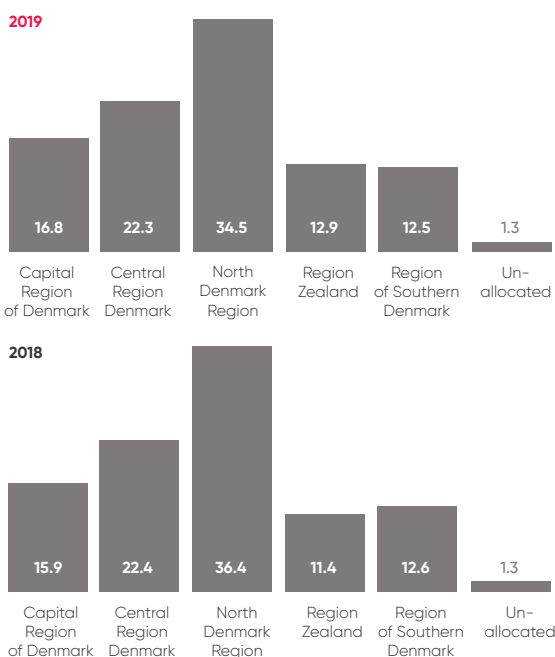


Figure 6.26

#### Mortgages broken down by property type

| DKKm/%                 | 2019         | 2019          | 2018         | 2018          |
|------------------------|--------------|---------------|--------------|---------------|
| Private housing        | 60.3         | 16,927        | 57.2         | 14,741        |
| Holiday homes          | 3.7          | 1,051         | 3.9          | 1,000         |
| Offices and businesses | 15.7         | 4,419         | 15.4         | 3,890         |
| Agriculture            | 7.6          | 2,141         | 8.3          | 2,130         |
| Other                  | 12.6         | 3,541         | 15.3         | 4,003         |
| <b>Total</b>           | <b>100.0</b> | <b>28,079</b> | <b>100.0</b> | <b>25,763</b> |

Figure 6.27

#### Unsecured share of exposure

| %                              | 2019        | 2018        |
|--------------------------------|-------------|-------------|
| <10                            | 46.3        | 42.1        |
| 10-50                          | 20.8        | 21.0        |
| 50-75                          | 7.6         | 9.2         |
| >75                            | 25.4        | 27.8        |
| <b>Average unsecured share</b> | <b>35.3</b> | <b>38.8</b> |

Figures 6.27 and 6.28 show that the total unsecured share at end-2019 was 35.3%, against 38.8% at end-2018. Net of reverse repo transactions, the total unsecured share amounted to 40.1%. At end-2018, the unsecured share without reverse repo transactions was 42.3%.

The property value under mortgages broken down by property type in figure 6.26 is calculated at DKK 28.1 billion, while only DKK 17.3 billion is recorded as security on properties in figure 6.29. This is because the former amount represents the amount mortgaged to Spar Nord and is recorded as collateral accepted, while the latter amount is the share actually used for calculating collateral regarding a specific exposure. Some exposures are smaller than the collateral value, and collateral has also been provided by customers who do not currently have any facilities. A haircut of 5% of the value is made when the property collateral is allocated to the exposures.

Figure 6.28

#### Unsecured share of credit exposure

| DKKm/%                                | 2019          |             | 2018          |             |
|---------------------------------------|---------------|-------------|---------------|-------------|
| Public authorities                    | 1,200         | 100.0       | 43            | 99.8        |
| Agriculture, hunting and forestry     | 644           | 22.8        | 884           | 29.8        |
| Fisheries                             | 41            | 35.7        | 44            | 35.2        |
| Industry and raw materials extraction | 926           | 31.2        | 912           | 32.6        |
| Energy supply                         | 614           | 35.9        | 614           | 38.9        |
| Building and construction             | 928           | 36.8        | 828           | 31.6        |
| Trade                                 | 1,556         | 37.3        | 1,547         | 38.9        |
| Transport, hotels and restaurants     | 786           | 30.1        | 596           | 27.7        |
| Information and communication         | 156           | 54.7        | 110           | 48.7        |
| Financing and insurance               | 2,124         | 18.7        | 2,152         | 26.8        |
| Real estate                           | 2,686         | 36.7        | 2,471         | 41.1        |
| Other business areas                  | 1,644         | 44.0        | 1,654         | 46.6        |
| <b>Business customers, total</b>      | <b>13,305</b> | <b>32.6</b> | <b>11,857</b> | <b>34.8</b> |
| <b>Total retail customers</b>         | <b>10,519</b> | <b>39.3</b> | <b>10,772</b> | <b>44.5</b> |
| <b>Total</b>                          | <b>23,823</b> | <b>35.3</b> | <b>22,629</b> | <b>38.8</b> |

## Section 6

### Credit risk

Figure 6.29

#### Credit risk mitigation by virtue of collateral

| DKKm  | 2019          | 2018          |
|---|---------------|---------------|
| Real property   | 17,263        | 15,701        |
| Custody accounts/securities                             | 9,467         | 6,118         |
| Guarantees/sureties                                     | 481           | 449           |
| Vehicles  | 653           | 658           |
| Cash  | 366           | 389           |
| Other collateral  | 4,401         | 4,380         |
| <b>Other collateral, total</b>                          | <b>32,631</b> | <b>27,695</b> |
| Spec. secured trans. (mortgage credit inst. guarantees) | 7,124         | 4,790         |
| <b>Total collateral, excluding Spar Nord Leasing</b>    | <b>39,754</b> | <b>32,485</b> |
| Collateral accepted, Spar Nord Leasing                  | 3,993         | 3,177         |
| <b>Total</b>  | <b>43,747</b> | <b>35,662</b> |

Spar Nord monitors the value of collateral provided on an ongoing basis. When the risk associated with a counterparty increases, monitoring of the collateral provided will be intensified.

#### 6.7 Impairment of loans and advances, etc.

A review of IFRS 9 is provided in the accounting policies in the financial statements.

Spar Nord's total value adjustment must be supplemented by calculated impairments in stages 1 and 2 of DKK 420 million and model-calculated stage 3 impairments of DKK 21 million.

Impairment losses are calculated individually as concerns all customers with objective evidence of impairment (OEI). The expected cash flow is calculated, comprising conservatively assessed values and realisable costs for any assets that might have to be sold to cover the outstanding debt

An exposure need not be in default before impairment is recognised and approval procedures regarding any new extension of credit are tightened.

Figure 6.30

#### Impaired claims

| 2019<br>DKKm                            | Exposure     | Individually<br>value-adjusted |
|---|--------------|--------------------------------|
| Insolvent liquidation and bankruptcy    | 106          | 40                             |
| Debt collection and restructuring, etc. | 67           | 34                             |
| Other financial difficulty              | 2,018        | 1,009                          |
| <b>Total individual impairments</b>     | <b>2,191</b> | <b>1,083</b>                   |
| Impairments in stages 1 and 2           |              | 420                            |
| Total impairments                       |              | 1,503                          |

| 2018<br>DKKm                            | Exposure     | Individually<br>value-adjusted |
|---|--------------|--------------------------------|
| Insolvent liquidation and bankruptcy    | 66           | 48                             |
| Debt collection and restructuring, etc. | 179          | 85                             |
| Other financial difficulty              | 3,179        | 1,367                          |
| <b>Total individual impairments</b>     | <b>3,424</b> | <b>1,500</b>                   |
| Impairments in stages 1 and 2           |              | 414                            |
| Non-individually impaired in stage 3    |              | 31                             |
| Total impairments                       |              | 1,945                          |

Figure 6.31

#### Losses and individual impairment

| 2019<br>DKKm                          | In default<br>and im-<br>paired | Impairment<br>account |
|---------------------------------------|---------------------------------|-----------------------|
| Public authorities                    | 0                               | 0                     |
| Agriculture, hunting and forestry     | 559                             | 379                   |
| Fisheries                             | 6                               | 0                     |
| Industry and raw materials extraction | 128                             | 58                    |
| Energy supply                         | 19                              | 7                     |
| Building and construction             | 117                             | 30                    |
| Trade                                 | 106                             | 57                    |
| Transport, hotels and restaurants     | 180                             | 73                    |
| Information and communication         | 7                               | 6                     |
| Financing and insurance               | 68                              | 44                    |
| Real estate                           | 351                             | 131                   |
| Other business areas                  | 89                              | 45                    |
| <b>Business customers, total</b>      | <b>1,630</b>                    | <b>831</b>            |
| <b>Total retail customers</b>         | <b>562</b>                      | <b>252</b>            |
| <b>Total</b>                          | <b>2,191</b>                    | <b>1,083</b>          |

| 2018<br>DKKm                          | In default<br>and im-<br>paired | Impairment<br>account |
|---------------------------------------|---------------------------------|-----------------------|
| Public authorities                    | 0                               | 0                     |
| Agriculture, hunting and forestry     | 1,077                           | 567                   |
| Fisheries                             | 0                               | 0                     |
| Industry and raw materials extraction | 231                             | 54                    |
| Energy supply                         | 21                              | 8                     |
| Building and construction             | 175                             | 55                    |
| Trade                                 | 166                             | 91                    |
| Transport, hotels and restaurants     | 260                             | 82                    |
| Information and communication         | 8                               | 4                     |
| Financing and insurance               | 214                             | 90                    |
| Real estate                           | 410                             | 149                   |
| Other business areas                  | 135                             | 76                    |
| <b>Business customers, total</b>      | <b>2,697</b>                    | <b>1,176</b>          |
| <b>Total retail customers</b>         | <b>727</b>                      | <b>324</b>            |
| <b>Total</b>                          | <b>3,424</b>                    | <b>1,500</b>          |

Figure 6.32

#### Impairment account

| DKKm                                  | Impairment<br>account<br>2019 | Impairment<br>account<br>2018 |
|---------------------------------------|-------------------------------|-------------------------------|
| Public authorities                    | 0                             | 0                             |
| Agriculture, hunting and forestry     | 413                           | 596                           |
| Fisheries                             | 1                             | 1                             |
| Industry and raw materials extraction | 85                            | 88                            |
| Energy supply                         | 15                            | 21                            |
| Building and construction             | 55                            | 87                            |
| Trade                                 | 96                            | 132                           |
| Transport, hotels and restaurants     | 94                            | 106                           |
| Information and communication         | 9                             | 6                             |
| Financing and insurance               | 80                            | 119                           |
| Real estate                           | 195                           | 198                           |
| Other business areas                  | 79                            | 117                           |
| <b>Business customers, total</b>      | <b>1,122</b>                  | <b>1,471</b>                  |
| <b>Total retail customers</b>         | <b>381</b>                    | <b>474</b>                    |
| <b>Total</b>                          | <b>1,503</b>                  | <b>1,945</b>                  |



## Section 6

### Credit risk

In 2019, Spar Nord recorded a decline in credit exposure to customers with individual impairment of DKK 1,233 million.

At end-2019, the impaired claims represented 3.2% of total credit exposure compared with 5.8% in 2018. The total impairment account fell DKK 0.4 billion in 2019.

The total impact on operations of DKK 22 million compared with an impact on operations of DKK 173 million in 2018 should primarily be seen in the context of the generally improved customer credit quality.

Retail customers (excl. SparXpres) represented an income of DKK 5 million, while SparXpres resulted in an expense of DKK 56 million. For business customers, there was an expense of DKK 30 million, while the impact on operations from agriculture was an income of DKK 59 million.

Figure 6.33

#### Profit impact from losses and impairment of loans, advances and guarantees - by line of business

2019

| DKKm                                  | Profit impact | Depreciation |
|---------------------------------------|---------------|--------------|
| Public authorities                    | 0             | 0            |
| Agriculture and forestry              | -59           | 132          |
| Fisheries                             | 0             | 0            |
| Industry and raw materials extraction | 6             | 10           |
| Energy supply                         | -7            | 0            |
| Building and construction             | -7            | 22           |
| Trade                                 | 8             | 46           |
| Transport, hotels and restaurants     | 42            | 58           |
| Information and communication         | 3             | 0            |
| Financing and insurance               | -18           | 33           |
| Real estate                           | 13            | 23           |
| Other business areas                  | -10           | 28           |
| <b>Business customers, total</b>      | <b>-28</b>    | <b>352</b>   |
| <b>Total retail customers</b>         | <b>51</b>     | <b>193</b>   |
| <b>Total</b>                          | <b>22</b>     | <b>546</b>   |

2018

| DKKm                                  | Profit impact | Depreciation |
|---------------------------------------|---------------|--------------|
| Public authorities                    | 0             | 0            |
| Agriculture and forestry              | 106           | 78           |
| Fisheries                             | 0             | 0            |
| Industry and raw materials extraction | -14           | 3            |
| Energy supply                         | -10           | 0            |
| Building and construction             | 2             | 9            |
| Trade                                 | 62            | 15           |
| Transport, hotels and restaurants     | -7            | 4            |
| Information and communication         | 2             | 0            |
| Financing and insurance               | 14            | 11           |
| Real estate                           | -52           | 2            |
| Other business areas                  | 17            | 12           |
| <b>Business customers, total</b>      | <b>119</b>    | <b>134</b>   |
| <b>Total retail customers</b>         | <b>54</b>     | <b>79</b>    |
| <b>Total</b>                          | <b>173</b>    | <b>213</b>   |

The impact on Spar Nord's profits from impairment amounted to an expense of DKK 22 million in 2019, equal to 0.03% of total loans, advances and guarantees.

#### 6.7.1 Forbearance

A loan facility is defined as being subject to forbearance if the conditions regarding interest payments and/or repayments have been relaxed on account of the borrower's financial difficulty or if the loan has been refinanced on more lenient terms. Forbearance must be approved by Credit Rating. Customers who have been granted forbearance must as a minimum be flagged as having a weak credit quality and also be assessed in relation to OEI.

In addition to decentralised registration, customers flagged as having a weak credit quality and OEI with an indication of forbearance will be monitored centrally and reported on periodically.

Figure 6.34 shows a breakdown of loans and advances subject to forbearance.

In 2019, Spar Nord performed a review of all exposures subject to individual impairment in order to ensure that exposures remain in the right stages in accordance with IFRS 9.

As a result of this process, stage 3 loans were reduced by a total of DKK 1,246 million through recategorisation to stage 2 and stage 1, while some loans were written off. Overall, NPL loans were reduced by DKK 1,296 million to DKK 2,004 million, and the share of non-performing loans (NPL ratio) was thus 3.7% at end-2019.

An amount of DKK 546 million was written off in 2019, and individual impairments totalling DKK 638 million were reversed – both items being materially affected by the review.

Figure 6.34

#### Loans and advances subject to forbearance

| 2019<br>DKKm   | Business<br>customers | Agriculture | Retail cus-<br>tomers | Total      |
|----------------|-----------------------|-------------|-----------------------|------------|
| Non-performing | 204                   | 59          | 129                   | 392        |
| Performing     | 10                    | 7           | 10                    | 28         |
| <b>Total</b>   | <b>215</b>            | <b>66</b>   | <b>139</b>            | <b>419</b> |

| 2018<br>DKKm   | Business<br>customers | Agriculture | Retail cus-<br>tomers | Total        |
|----------------|-----------------------|-------------|-----------------------|--------------|
| Non-performing | 531                   | 407         | 237                   | 1,175        |
| Performing     | 17                    | 1           | 14                    | 33           |
| <b>Total</b>   | <b>549</b>            | <b>409</b>  | <b>251</b>            | <b>1,208</b> |

## Section 6

### Credit risk

#### Non-Performing

An exposure is defined as "Non-performing" (NPL), if:

The exposure has been in arrears (i.e. if any amount of interest, fees or instalments remains unpaid) for more than 90 days; or it is considered unlikely that the debtor will fully meet its payment obligations without realising collateral.

In addition, an exposure in IFRS 9 "stage 3" is always defined NPL even if the above criteria are not met.

Figure 6.35

| NPL ratio  | 2019   | 2018   |
|------------|--------|--------|
| NPL (DKKm) | 2,004  | 3,300  |
| Exposure   | 54,079 | 47,354 |
| NPL ratio  | 3.7    | 7.0    |

In 2019, the Bank increased management estimates by DKK 263 million to a total of DKK 303 million. The amount relates to three different issues:

Due to the change in calculation method of individual impairments on agricultural customers, it has subsequently proved necessary to allocate an amount to the risk of declining land prices (DKK 169 million). The assessment offsets any valuation uncertainty. The management estimate is calculated as DKK 15,000 per hectare of eligible land.

Recently, the Bank's rating model has underestimated the number of defaults, and therefore an amount is allocated to cover the increased risk (DKK 82 million).

For system reasons, discounting of collateral values has not been performed in the individual impairment calculations, which has resulted in the impairment need being underestimated (DKK 53 million).

Figure 6.36

#### Losses and impairment on loans, advances and guarantees

| DKKm  | 2019       | 2018       |
|---|------------|------------|
| Losses, including losses covered by provisions/impairment charges | 545        | 215        |
| Covered by provisions/impairment charges                          | -463       | -139       |
| <b>Losses not covered by provisions/impairments</b>               | <b>82</b>  | <b>75</b>  |
| New provisions/impairments, excluding sector-targeted solutions   | 720        | 655        |
| Reversal of provisions/impairments                                | -699       | -452       |
| Interest accrued on loans subject to impairments                  | -21        | -33        |
| <b>Net provisions/impairments</b>                                 | <b>-1</b>  | <b>171</b> |
| <b>Recoveries of prior losses</b>                                 | <b>-65</b> | <b>-77</b> |
| <b>Losses and impairments for the year</b>                        | <b>16</b>  | <b>169</b> |
| Other losses  | 6          | 4          |
| <b>Total losses and impairments for the year</b>                  | <b>22</b>  | <b>173</b> |
| <b>Impact on income statement</b>                                 | <b>22</b>  | <b>173</b> |

Figure 6.37

#### Losses and value adjustments and suspended-interest loans

| DKKm   | 2019         | 2018         |
|--|--------------|--------------|
| Gross loans, advances and guarantees, end of year                      | 67,571       | 58,290       |
| <b>Total losses and impairments for the year</b>                       | <b>22</b>    | <b>173</b>   |
| - in % of loans, advances and guarantees                               | 0.03         | 0.3          |
| <b>Impairment account</b>  | <b>1,503</b> | <b>1,945</b> |
| - in % of loans, advances and guarantees                               | 2.2          | 3.3          |
| <b>Contractual suspended-interest loans, year-end</b>                  | <b>303</b>   | <b>476</b>   |
| - in % of loans, advances and guarantees                               | 0.4          | 0.8          |
| <b>Impairment account in % of contractual suspended-interest loans</b> | <b>496</b>   | <b>409</b>   |

Exposures for which interest accrual has been suspended fell from DKK 476 million at end-2018 to DKK 303 million at end-2019.

#### 6.7.2 Agriculture

Loans, advances and guarantees to agricultural customers amounted to DKK 2.8 billion, equal to 4.2% of Spar Nord's total loans, advances and guarantees. Of this amount, leasing loans account for DKK 0.6 billion and guarantees for DKK 0.2 billion.

Figure 6.38 shows developments in credit quality among agricultural customers at Spar Nord's Local Banks in the period from 2017 to 2019.

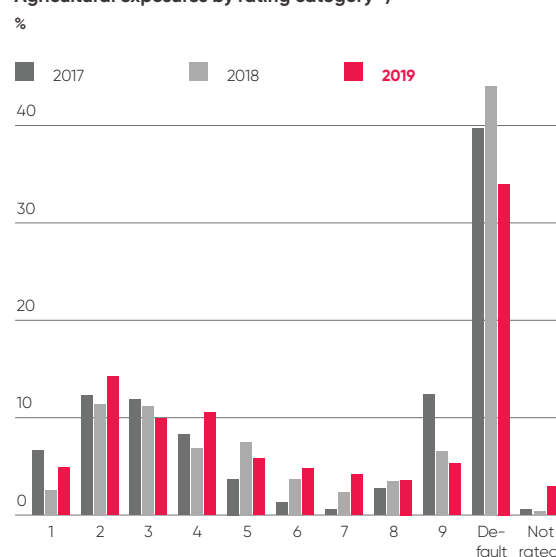
As appears from figures 6.38 and 6.39, the average credit quality of agricultural customers improved in 2019.

The positive development was attributable to a reduction in the "Default" exposure category.

The impact on profits from impairment of agricultural loans amounted to an income of DKK 59 million in 2019 compared with an expense of DKK 106 million in 2018.

Figure 6.38

#### Agricultural exposures by rating category \*)



\*) Excl. leasing

## Section 6

### Credit risk

Figure 6.39

#### Average risk level – agriculture \*)

|                         | 2017 | 2018 | 2019 |
|-------------------------|------|------|------|
| Average rating category | 6.2  | 6.4  | 6.1  |

\*) Exposures after impairments

The agricultural sector generally developed favourably in 2019 after the 2018 challenges of drought, low settlement prices of pork and an unfavourable ratio of milk and pork prices to feed prices. The positive development resulted in satisfactory yields in plant cultivation and for milk farmers.

Pig farmers experienced a particularly positive development in settlement prices, which were quite low going into 2019, but which improved noticeably to a very high level in step with the escalation of swine fever in China and South-East Asia. Lower feed prices also improved the ratio of milk and pork prices to feed prices, which is now at a highly satisfactory level.

The mink farming industry was challenged and saw prices drop further to DKK 200 against a production price of around DKK 270.

Spar Nord's total impairment of agricultural loans amounted to DKK 413 million at end-2019, equal to 14.7% of Spar Nord's total loans, advances and guarantees to the industry. At end-2018, the corresponding figures were DKK 596 billion and 20.0%.

Spar Nord's total exposure to dairy and pig farmers was reduced by DKK 0.2 billion in 2019, equal to a reduction of 16.3%.

Figure 6.40

#### Agricultural exposures by production line

| 2019<br>DKKm      | Loans and<br>guarantees | Non-<br>performing<br>loans | Of which<br>impaired | Share<br>impaired |
|-------------------|-------------------------|-----------------------------|----------------------|-------------------|
| Cattle farmers    | 616                     | 8                           | 203                  | 33.0              |
| Pig farmers       | 481                     | 27                          | 200                  | 41.6              |
| Plant cultivation | 545                     | 14                          | 85                   | 15.6              |
| Mink farmers      | 113                     | 2                           | 46                   | 40.3              |
| Leasing           | 647                     | 1                           | 8                    | 1.2               |
| Miscellaneous     | 415                     | 1                           | 17                   | 4.0               |
| <b>Total</b>      | <b>2,818</b>            | <b>52</b>                   | <b>559</b>           | <b>19.8</b>       |

| 2018<br>DKKm      | Loans and<br>guarantees | Non-<br>performing<br>loans | Of which<br>impaired | Share<br>impaired |
|-------------------|-------------------------|-----------------------------|----------------------|-------------------|
| Cattle farmers    | 725                     | 17                          | 462                  | 63.7              |
| Pig farmers       | 586                     | 38                          | 296                  | 50.5              |
| Plant cultivation | 697                     | 76                          | 229                  | 32.8              |
| Mink farmers      | 111                     | 0                           | 46                   | 41.1              |
| Leasing           | 515                     | 0                           | 26                   | 5.1               |
| Miscellaneous     | 334                     | 1                           | 18                   | 5.4               |
| <b>Total</b>      | <b>2,969</b>            | <b>132</b>                  | <b>1,077</b>         | <b>36.3</b>       |

Figure 6.41

#### Agricultural impairment by production line

| 2019<br>DKKm/%    | Impair-<br>ment<br>account | Written<br>off | Impair-<br>ment for<br>the year | Impair-<br>ment<br>ratio of<br>exposure | Percent-<br>age of<br>impaired |
|-------------------|----------------------------|----------------|---------------------------------|---|--------------------------------|
| Cattle farmers    | 177                        | 5              | -61                             | 28.8                                    | 87.1                           |
| Pig farmers       | 113                        | 50             | -25                             | 23.5                                    | 56.5                           |
| Plant cultivation | 72                         | 75             | 32                              | 13.2                                    | 84.5                           |
| Mink farmers      | 28                         | 2              | 4                               | 25.0                                    | 61.9                           |
| Leasing           | 3                          | 0              | -9                              | 0.5                                     | 42.1                           |
| Miscellaneous     | 20                         | 0              | 1                               | 4.7                                     | 116.8                          |
| <b>Total</b>      | <b>413</b>                 | <b>132</b>     | <b>-59</b>                      | <b>14.7</b>                             | <b>74.0</b>                    |

| 2018<br>DKKm/%    | Impair-<br>ment<br>account | Written<br>off | Impair-<br>ment for<br>the year | Impair-<br>ment<br>ratio of<br>exposure | Percent-<br>age of<br>impaired |
|-------------------|----------------------------|----------------|---------------------------------|---|--------------------------------|
| Cattle farmers    | 249                        | 60             | -5                              | 34.3                                    | 53.8                           |
| Pig farmers       | 192                        | 6              | 32                              | 32.7                                    | 64.8                           |
| Plant cultivation | 104                        | 3              | 59                              | 14.9                                    | 45.6                           |
| Mink farmers      | 25                         | 6              | 14                              | 22.1                                    | 53.9                           |
| Leasing           | 13                         | 0              | 4                               | 2.5                                     | 49.4                           |
| Miscellaneous     | 14                         | 2              | 2                               | 4.2                                     | 77.5                           |
| <b>Total</b>      | <b>596</b>                 | <b>77</b>      | <b>106</b>                      | <b>20.1</b>                             | <b>55.4</b>                    |

Spar Nord pursues the principle that if agricultural customers with a weak capital position fail to deliver positive returns at the breakeven prices fixed by Spar Nord of DKK 9.50/kg (without supplementary payment) for pork, and DKK 2.20/kg for milk (without supplementary payment), this is defined as OEI. Breakeven prices are calculated based on financing at a 4% average interest rate for all the interest-bearing debt except for mortgage debt, for which the interest rate is fixed using fixed-rate bonds loans with long maturities. If these breakeven prices cannot be achieved in financial statements and budgets, the exposure will be subjected to an impairment calculation.

Spar Nord anticipates that conditions for milk farmers will remain unchanged in 2020. Pig farmers are expected to experience highly favourable conditions due to persistently strong sales to China. The spreading of swine fever to Europe is believed to represent a risk and could affect Danish exports if swine fever should break out in Germany and, not least, in case of an outbreak in Denmark. The production of mink is trending lower, but this is not expected to lead to price increases in 2020.

Spar Nord's calculation of collateral values of agricultural properties is in accordance with the Danish FSA's most recent guidelines, which means that the land values in Spar Nord's market area range between DKK 125,000 and DKK 160,000 per hectare.

Farm buildings are assessed in relation to their age, condition, etc. and are measured at fair value.

## Section 6

### Credit risk

Other agricultural assets such as livestock, stocks, equipment, etc. are recognised at 80% of their carrying amount.

In addition to the individual impairment charges, where the maximum collateral value is based on the Danish FSA's recommended land and building values, a management estimate has been made to set off any valuation uncertainty. The management estimate is calculated as DKK 15,000 per hectare of eligible land. The total management estimate for agricultural is DKK 184 million, of which DKK 169 million relates to land prices and DKK 15 million to discounting of collateral.

#### 6.8 Credit risk exposure to financial counterparties

As part of its trading in securities, foreign currency and derivative instruments and its payment services, etc., the Bank will experience credit risk exposure to financial counterparties.

Spar Nord's Management allocates lines for credit risk exposure to financial counterparties, based on the specific counterparty's risk profile, rating, amount of exposure and solvency. The risks and lines of financial instruments are monitored on a day-to-day basis.

A major source of financial credit risk is Spar Nord's balances with credit institutions. The credit risk relates to international credit institutions, for which Spar Nord has provided cash collateral for financial transactions, or Danish credit institutions with which Spar Nord's Trading Division has customer relations.

Figure 6.42  
Due from credit institutions  
by product type

| DKKm/%                              | 2019         | 2018         | 2019         | 2018         |
|-------------------------------------|--------------|--------------|--------------|--------------|
| Certificates of deposit             | 0            | 0            | 0.0          | 0.0          |
| Reverse repo transactions           | 924          | 931          | 51.7         | 58.1         |
| Deposits and unlisted bonds         | 0            | 0            | 0.0          | 0.0          |
| Current accounts                    | 279          | 172          | 15.6         | 10.7         |
| CSA accounts, etc.                  | 384          | 297          | 21.5         | 18.5         |
| Market value, derivatives           | 201          | 203          | 11.2         | 12.7         |
| <b>Due from credit institutions</b> | <b>1,789</b> | <b>1,603</b> | <b>100.0</b> | <b>100.0</b> |

Figure 6.43  
Due from credit institutions  
by rating

| DKKm/%                              | 2019         | 2018         | 2019         | 2018         |
|-------------------------------------|--------------|--------------|--------------|--------------|
| AAA                                 | 924          | 931          | 51.7         | 58.1         |
| AA                                  | 177          | 148          | 9.9          | 9.2          |
| A                                   | 505          | 426          | 28.3         | 26.6         |
| BBB                                 | 169          | 82           | 9.5          | 5.1          |
| BB                                  | 1            | 0            | 0.1          | 0.0          |
| Not rated                           | 12           | 16           | 0.7          | 1.0          |
| <b>Due from credit institutions</b> | <b>1,789</b> | <b>1,603</b> | <b>100.0</b> | <b>100.0</b> |

89.9% of Spar Nord's receivables from credit institutions concerns banks with an A rating or higher. Of the total receivables from credit institutions in the amount of DKK 1.8 billion, 51.7% is attributable to exposures with an AAA rating. Balances with unrated credit institutions are attributable exclusively to Danish credit institutions.

#### 6.9 Counterparty risk

Counterparty risk is the risk of loss because a financial counterparty or an institutional customer defaults on its obligations under a financial contract. In addition, settlement risks may arise when financial contracts are concluded and settled, as principals in different currencies are not necessarily exchanged at the same time or securities are not received simultaneously with the appropriate payment.

Utilisation of lines with respect to financial counterparties is calculated on a gross basis as weighted principals of all transactions concluded, to which is added the sum of all positive market values, while negative market values are not offset. The size of principal weighting for the individual financial transactions is calculated based on the volatility of interest rates and currencies, and due consideration is paid to the term to maturity of the specific financial transaction.

Spar Nord's business procedures specify the maximum term to maturity for the individual financial transactions, and compliance is followed up on a daily basis, as is compliance with the granted lines.

In connection with lines granting and registration of lines, a check is performed to verify whether the registered lines accord with the authorisation details. Additionally, Spar Nord has a controller department that conducts random sampling of compliance as concern granting of lines, procedures and business procedures.

Figure 6.44  
Counterparty risk

| DKKm   | 2019       | 2018       |
|--|------------|------------|
| Derivatives with positive market value       | 828        | 862        |
| Netting                                      | 180        | 193        |
| <b>Exposure after netting</b>                | <b>648</b> | <b>669</b> |
| Collateral received                          | 34         | 31         |
| <b>Exposure after netting and collateral</b> | <b>614</b> | <b>637</b> |

## Section 6

### Credit risk

#### 6.9.1 Counterparty risk against financial and institutional customers

Before lines are granted to financial counterparties and institutional customers, a thorough credit assessment is made of the financial counterparties/institutional customers based on the financial statements of the individual credit institution/institutional customer. As concerns foreign and major Danish credit institutions, attention is also paid to how the credit institutions are rated by international rating bureaus, such as Standard & Poor's, Fitch or Moody's.

#### 6.9.2 Framework and collateral agreements

To mitigate counterparty risk, Spar Nord concludes framework, netting and collateral agreements to the extent possible. As concerns small Danish credit institutions, such agreements will be based on the framework agreement prepared by Finance Denmark for forex and securities transactions. When deemed necessary, the Bank will also conclude a collateral agreement, according to which it is agreed that if the net market value of the concluded financial contracts exceeds an individually fixed maximum for each credit institution, then appropriate collateral must be furnished, in most cases by way of cash deposits.

For foreign and large Danish credit institutions and institutional customers, netting and framework agreements will be based on the international ISDA Master Agreements, often with associated Credit Support Annexes (CSA), according to which it is agreed that if the net market value of the concluded financial contracts exceeds an individually fixed maximum for each agreement, then collateral will have to be exchanged, most frequently by way of cash deposits in EUR or DKK.

In addition, Global Master Repurchase Agreements (GMRA) and Global Master Securities Lending Agreements (GMSLA) will be concluded to secure reverse repo transactions and stock lending transactions.

Both Danish and foreign collateral agreements are followed up on a daily basis, as are exchanges of collateral in step with fluctuations in the market values of the transactions concluded. In addition, to the widest extent possible, Spar Nord settles transactions via CLS, VP or Euroclear, which serves to minimise settlement risks as much as possible.

Spar Nord is an indirect member of London Clearing House via selected clearing brokers, and expects to regularly clear a large share of the clearing-approved transactions.

#### 6.10 ECAI

Spar Nord has selected Standard & Poor's Ratings Services as its external credit assessment institution (ECAI) to provide credit assessment information on countries, counterparties and issues.

Rating information is used as an integral part of the dataflow at Spar Nord's data processing centre, which receives external credit ratings from Standard & Poor's Ratings Services via SIX Financial.

An IT update of credit rating from Standard & Poor's Ratings Services is undertaken on an ongoing basis.

The conversion of credit rating classes to credit quality steps is based on the conversion table issued by the Committee of European Banking Supervisors (CEBS). The individual credit quality steps are accorded a weighting to be used for the exposures on the individual credit quality steps when calculating the total risk exposure according to the standardised approach for credit risks pursuant to Articles 111-134 of the CRR.

Figure 6.45

ECAI exposure before and after deductions

| 2019<br>DKKmn | Exposure after<br>ECAI |               |
|---------------|------------------------|---------------|
|               | Exposure               | risk-weighted |
| Institutions  | 1,599                  | 529           |
| Other         | 210                    | 67            |
| <b>Total</b>  | <b>1,809</b>           | <b>596</b>    |

| 2018<br>DKKmn | Exposure after<br>ECAI |               |
|---------------|------------------------|---------------|
|               | Exposure               | risk-weighted |
| Institutions  | 1,938                  | 405           |
| Other         | 194                    | 49            |
| <b>Total</b>  | <b>2,132</b>           | <b>454</b>    |



## Section 6

### Credit risk

#### 6.11 Spar Nord's total credit exposure in relation to solvency ratio

The total credit exposure is the sum total of:

- Loans, advances and receivables
- Guarantees
- Unutilised credit limits
- Credit commitments
- Equity investments
- Non-current assets
- Intangible assets
- Other property, plant and equipment
- Counterparty risk
- Shares and corporate bonds

A total statement of Spar Nord's credit exposure shows an exposure of DKK 107.8 billion. This calculation corresponds to Spar Nord's credit risk, which is treated according to the standardised approach

In general, exposures rose by DKK 11.7 billion in 2019, equal to an 12.3% increase. Measured on the basis of average figures, this amounts to an increase of DKK 8.5 billion, equal to 8.7%.

Spar Nord's credit exposure is predominantly ascribable to Denmark. In 2019, debtors based in

Figure 6.46

#### Total credit exposure

| DKKkm  | 2019           | 2018          | Average 2019   | Average 2018  |
|--|----------------|---------------|----------------|---------------|
| Sovereigns or central banks                    | 1,132          | 1,076         | 1,495          | 871           |
| Regional or local authorities                  | 2,278          | 954           | 1,652          | 900           |
| Public-sector entities                         | 263            | 253           | 267            | 277           |
| Institutions                                   | 10,832         | 8,922         | 11,867         | 9,046         |
| Companies                                      | 37,566         | 30,966        | 34,503         | 32,523        |
| Of which SMEs                                  | 22,842         | 19,697        | 22,011         | 19,012        |
| Retail customers                               | 42,875         | 40,536        | 43,248         | 40,097        |
| Of which SMEs                                  | 15,346         | 14,998        | 15,600         | 14,420        |
| Exposures secured by mortgage on real property | 7,451          | 6,442         | 6,797          | 6,960         |
| Of which SMEs                                  | 921            | 829           | 866            | 1,210         |
| Exposures in default                           | 837            | 2,273         | 1,486          | 2,260         |
| High-risk exposures                            | 715            | 1,124         | 790            | 1,006         |
| Exp. with short-term rating                    | 0              | 0             | 0              | 0             |
| Exposures in units or CIU                      | 4              | 11            | 5              | 11            |
| Equity exposures                               | 1,809          | 1,591         | 1,762          | 1,435         |
| Other exposures                                | 2,023          | 1,854         | 1,917          | 1,945         |
| <b>Total</b>                                   | <b>107,785</b> | <b>96,001</b> | <b>105,789</b> | <b>97,328</b> |

Denmark accounted for 97% of Spar Nord's credit exposure. The geographical breakdown is shown in figure 6.47.

A major share of Spar Nord's business exposure is towards small and medium-sized enterprises (SMEs). At end-2019, the exposure to SMEs represented 36% of the total exposure.

Figure 6.47

#### Exposure categories by country

| DKKkm  | 2019           |              |                |               |                | 2018          |              |                |               |               |
|--|----------------|--------------|----------------|---------------|----------------|---------------|--------------|----------------|---------------|---------------|
|  | Denmark        | EU           | Rest of Europe | Rest of world | Total          | Denmark       | EU           | Rest of Europe | Rest of world | Total         |
| Sovereigns or central banks                    | 1,132          | 0            | 0              | 0             | <b>1,132</b>   | 1,076         | 0            | 0              | 0             | <b>1,076</b>  |
| Regional or local authorities                  | 2,274          | 4            | 0              | 0             | <b>2,278</b>   | 953           | 2            | 0              | 0             | <b>954</b>    |
| Public-sector entities                         | 263            | 0            | 0              | 0             | <b>263</b>     | 253           | 0            | 0              | 0             | <b>253</b>    |
| Institutions                                   | 9,994          | 782          | 48             | 8             | <b>10,832</b>  | 7,674         | 614          | 616            | 18            | <b>8,922</b>  |
| Companies                                      | 35,510         | 326          | 405            | 1,324         | <b>37,566</b>  | 30,131        | 360          | 436            | 38            | <b>30,966</b> |
| Retail customers                               | 42,343         | 127          | 235            | 169           | <b>42,875</b>  | 40,280        | 107          | 31             | 118           | <b>40,536</b> |
| Exposures secured by mortgage on real property | 7,417          | 8            | 11             | 15            | <b>7,451</b>   | 6,406         | 12           | 10             | 14            | <b>6,442</b>  |
| Exposures in default                           | 815            | 18           | 1              | 3             | <b>837</b>     | 2,231         | 35           | 3              | 5             | <b>2,273</b>  |
| High-risk exposures                            | 714            | 1            | 0              | 0             | <b>715</b>     | 1,121         | 3            | 0              | 0             | <b>1,124</b>  |
| Exposures with short-term rating               | 0              | 0            | 0              | 0             | <b>0</b>       | 0             | 0            | 0              | 0             | <b>0</b>      |
| Exposure in units or CIU                       | 4              | 0            | 0              | 0             | <b>4</b>       | 11            | 0            | 0              | 0             | <b>11</b>     |
| Equity exposures                               | 1,754          | 23           | 0              | 32            | <b>1,809</b>   | 1,554         | 20           | 0              | 16            | <b>1,591</b>  |
| Other exposures                                | 2,023          | 0            | 0              | 0             | <b>2,023</b>   | 1,854         | 0            | 0              | 0             | <b>1,854</b>  |
| <b>Total</b>                                   | <b>104,243</b> | <b>1,291</b> | <b>700</b>     | <b>1,551</b>  | <b>107,785</b> | <b>93,544</b> | <b>1,152</b> | <b>1,097</b>   | <b>209</b>    | <b>96,001</b> |

Figure 6.48

#### Credit risk mitigation by virtue of collateral

| DKKkm   | 2019                      |                            | 2018                      |                            |
|---|---------------------------|----------------------------|---------------------------|----------------------------|
|   | Exp. covered by guarantee | Other financial collateral | Exp. covered by guarantee | Other financial collateral |
| Institutions                                    | 2                         | 3,639                      | 1                         | 2,410                      |
| Companies                                       | 30                        | 8,893                      | 87                        | 5,524                      |
| Retail customers                                | 15                        | 593                        | 18                        | 440                        |
| Exposures secured by mortgages on real property | 0                         | 12                         | 0                         | 6                          |
| Exposures in default                            | 10                        | 7                          | 13                        | 25                         |
| High-risk exposures                             | 0                         | 3                          | 0                         | 15                         |
| <b>Total</b>                                    | <b>57</b>                 | <b>13,147</b>              | <b>119</b>                | <b>8,420</b>               |

Figure 6.49

#### SME exposures

| DKKkm  | 2019          | 2018          |
|--|---------------|---------------|
| Companies                                      | 22,842        | 19,697        |
| Retail customers                               | 15,346        | 14,998        |
| Exposures secured by mortgage on real property | 921           | 829           |
| <b>Total</b>                                   | <b>39,109</b> | <b>35,524</b> |

## Market risk

### Developments in 2019

In 2019, the net interest rate risk was mainly positive, averaging around DKK 61 million, which was on a level with 2018.

Compared with end-2018, the net interest rate risk increased by DKK 43 million to DKK 52 million at end-2019. The change was driven by an increase in net interest rate risk in the trading book of DKK 34 million and a DKK 9 million increase in net interest rate risk in the banking book.

The net portfolio of bonds was increased by DKK 58 billion in 2019. In 2019, the portfolio of mortgage bonds was increased by DKK 0.4 billion, while bonds issued by financial issuers were reduced by DKK 0.3 billion.

In addition, there was a marginal increase in foreign exchange risk in 2019 compared with 2018.

The portfolio of shares in the banking book and associates was increased by DKK 111 million in 2019 to DKK 2,078 million, among other things due to holdings in and acquisition of shares in Danske Andelskassers Bank.

The market value of shares held in the trading book fell by DKK 2 million to DKK 132 million in 2019.

The total risk exposure amount fell from DKK 4.1 billion to DKK 3.3 billion due to a lower gross interest rate risk.

#### RISK EXPOSURE, MARKET RISK

## DKK 3.3 billion

2018: DKK 4.1 billion

#### NET INTEREST RATE RISK

## DKK 52 million

2018: DKK 9 million

#### FOREIGN EXCHANGE RISK

## 1.3%

2018: 1.2%

#### EQUITY PORTFOLIO

## DKK 2.2 billion

2018: DKK 2.1 billion

### Definition of market risk

Market risk is an umbrella heading for the risk of loss caused by changes in the value of a portfolio of financial instruments due to fluctuations in exchange rates or prices in financial markets.

Market risk breaks down into:

- Interest rate risk
- Foreign-exchange risk
- Equity risk
- Commodity risk
- Option risk
- Own properties

Spar Nord deals and takes positions in products that involve a number of market-based risks. Most of Spar Nord's activities regarding trading and position-taking comprise relatively simple products, of which interest-based products are the most frequently traded. Spar Nord also deals and takes positions in shares and foreign exchange instruments, whereas trading in commodities is very limited.

## Section 7

# Market risk

### 7.1 Market risk policy

The market risk policy determines Spar Nord's overall risk profile for market risk, as well as the overall organisational delegation of responsibilities in the market risk area with a view to profitably supporting Spar Nord's business model.

The policy identifies and sets limits for the various types of market risk, setting out specific limits for how much risk Spar Nord is prepared to assume. Market risks for Spar Nord are the credit spread risk on the Bank's bond portfolio and the Bank's interest rate risk, equity risk in the banking book and the trading book and very limited foreign exchange, option and commodity risks. The policy establishes the methods to be used in calculating the various risk targets.

### 7.2 Management, monitoring and reporting

For its management of market risks, the Bank has established a three-tier instruction hierarchy. At the first tier, the Board of Directors issues the definition of the limits for Spar Nord, which are delegated to the Executive Board. At the second tier, the Executive Board delegates limits to the other entities of Spar Nord, with the Trading Division being the distinctly largest entity. At the third and last tier, the executives of the Trading Division are granted the limits within which they may operate.

The Finance & Accounts Department is responsible for estimating, monitoring, controlling and reporting market risks. Market risk is calculated for the following purposes:

- Regular follow-up on individual business units, both intraday and end of day
- Regular reporting to the Executive Board and the Board of Directors
- Reporting of regulatory capital

Market risks are controlled and monitored through an integrated risk management system, with day-to-day follow-up action taken with respect to all market risk categories for all units subject to instructions, and any failure to comply with instructions is reported upstream in the hierarchy.

### 7.3 Interest rate risk

The interest rate risk is the risk of loss due to interest rate fluctuations. Most of Spar Nord's interest rate risks in the banking book derives from bank activities like deposits and lending, leases, repo and reverse repo transactions, strategic loans and possibly hedge operations in relation thereto. Interest rate risks in the trading book occur in connection with trading and position-taking in bonds and fixed-income derivatives like interest rate swaps, futures and standard interest rate options.

Spar Nord's interest-rate risk both within the trading book and the banking is calculated on the basis of duration and agreed cash flow. For managing its portfolio of callable Danish mortgage bonds, Spar Nord uses model-based key risk indicators that provide for the embedded option component.

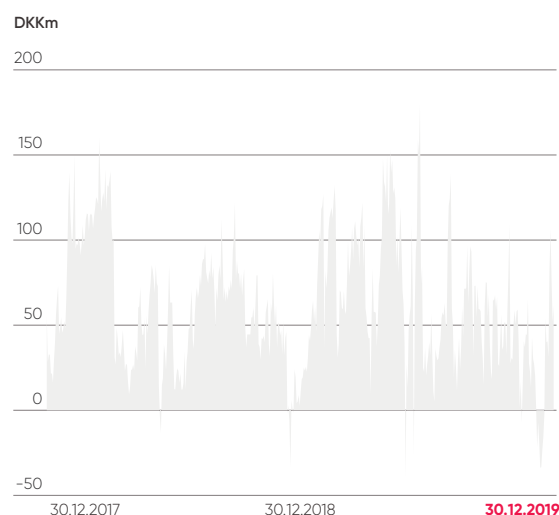
As concerns interest rate options, the above-mentioned key indicators are supplemented by the most important risk factors expressing sensitivity of the option premium on changes in the underlying parameters.

The interest rate risk is assessed on a daily basis, and decisions are made in light of expectations for macroeconomic developments and cyclical trends. Spar Nord converts the interest rate risk in foreign currencies into Danish kroner and offsets the negative interest rate risk against the positive one to calculate the net interest rate risk.

#### 7.3.1 Interest rate risk developments

Figure 7.1 shows the total net interest rate risk that Spar Nord will encounter if interest rates fall by 1 percentage point. This implies a parallel shift of all yield curves.

Figure 7.1  
Developments in net interest rate risk



## Section 7

### Market risk

Figure 7.2

#### Interest-rate risk by duration and currency

| 2019<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total     |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|-----------|
| DKK          | -6                    | 19                 | 23                   | 12                   | 11                      | 60        |
| EUR          | 3                     | -10                | -5                   | 0                    | -4                      | -15       |
| Other        | 2                     | 1                  | 4                    | 0                    | 0                       | 7         |
| <b>Total</b> | <b>-1</b>             | <b>11</b>          | <b>23</b>            | <b>12</b>            | <b>7</b>                | <b>52</b> |

| 2018<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total    |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|----------|
| DKK          | 10                    | 3                  | 23                   | 22                   | 18                      | 75       |
| EUR          | 8                     | 4                  | -20                  | -34                  | -32                     | -74      |
| Other        | 3                     | 3                  | 1                    | 1                    | 0                       | 7        |
| <b>Total</b> | <b>20</b>             | <b>9</b>           | <b>4</b>             | <b>-11</b>           | <b>-14</b>              | <b>9</b> |

Spar Nord's net interest rate risk was mainly positive in 2019 as Spar Nord was primarily exposed to a drop in market interest rates.

In addition, Spar Nord calculates the interest rate risk relative to duration and currencies. This shows the risk of changes for a given time interval on the yield curve.

Figure 7.2 shows the interest rate risk broken down on the individual time intervals, given a 1 percentage point fall in interest rates. At the end of 2019, the Spar Nord Group was exposed to interest rate falls in DKK and interest rate increases in EUR.

#### 7.3.2 Interest rate risk in the trading book

The interest rate risk attaching to positions in the trading book derives primarily from bonds, swaps and futures.

As appears from figure 7.3, the net interest rate risk attaching to the trading book amounted to DKK 41 million at end-2019, which is a DKK 34 million increase compared with end-2018. Spar Nord is exposed to interest rate falls in DKK and interest rate increases in EUR.

Figure 7.3

#### Interest rate risk in the trading book

| 2019<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total     |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|-----------|
| DKK          | -4                    | 17                 | 22                   | 9                    | 11                      | 54        |
| EUR          | 3                     | -10                | -7                   | -2                   | -5                      | -20       |
| Other        | 2                     | 1                  | 4                    | -1                   | 0                       | 7         |
| <b>Total</b> | <b>2</b>              | <b>8</b>           | <b>19</b>            | <b>6</b>             | <b>7</b>                | <b>41</b> |

| 2018<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total    |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|----------|
| DKK          | 7                     | 2                  | 22                   | 28                   | 18                      | 77       |
| EUR          | 8                     | 4                  | -21                  | -35                  | -33                     | -76      |
| Other        | 3                     | 3                  | 1                    | 0                    | 0                       | 7        |
| <b>Total</b> | <b>18</b>             | <b>9</b>           | <b>3</b>             | <b>-7</b>            | <b>-15</b>              | <b>7</b> |

#### 7.3.3 Interest rate risk in the banking book

The interest-rate risk attaching to positions in the banking book derives from fixed-rate deposits and lending from ordinary banking transactions, repo and reverse repo transactions, bonds, interest rate risk related to Spar Nord's funding, incl. subordinated debt and issued bonds.

Figure 7.4 shows the net interest rate risk in the banking book, given a 1 percentage point fall in interest rates broken down by duration and currency. The interest rate risk in Spar Nord's banking book was positive in the amount of DKK 11 million at end-2019, against a positive interest rate risk of DKK 1 million at end-2018.

The Bank applies two risk measures to manage interest rate risk in the banking book, changes in net interest income (NII) and net interest rate exposure (EVE). NII measures the impact on the income statement of a 100bp change in interest rates on all balance sheet items in the banking book over a period of 365 days. EVE is calculated as the change in the market value of assets and liabilities in the balance sheet and derivatives in the banking book. NII is calculated at DKK 76 million, and EVE is calculated at DKK 19 million at end-2019.

Figure 7.4

#### Interest rate risk in the banking book

| 2019<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total     |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|-----------|
| DKK          | -2                    | 2                  | 2                    | 3                    | 0                       | 5         |
| EUR          | 0                     | 0                  | 2                    | 3                    | 0                       | 5         |
| Other        | 0                     | 0                  | 0                    | 0                    | 0                       | 1         |
| <b>Total</b> | <b>-2</b>             | <b>2</b>           | <b>4</b>             | <b>6</b>             | <b>1</b>                | <b>11</b> |

| 2018<br>DKKm | Less than<br>3 months | 3 mths<br>– 1 year | 1 years<br>– 3 years | 3 years<br>– 7 years | More<br>than<br>7 years | Total    |
|--------------|-----------------------|--------------------|----------------------|----------------------|-------------------------|----------|
| DKK          | 3                     | 0                  | 1                    | -6                   | 0                       | -2       |
| EUR          | 0                     | 0                  | 1                    | 2                    | 0                       | 3        |
| Other        | -1                    | 0                  | 0                    | 1                    | 0                       | 1        |
| <b>Total</b> | <b>3</b>              | <b>1</b>           | <b>2</b>             | <b>-4</b>            | <b>0</b>                | <b>1</b> |

#### 7.3.4 Credit spread risk

Credit spread measures the creditworthiness of a bond issuer and expresses the additional return required for an investor to assume a risk in e.g. a mortgage bond instead of a government bond. A credit spread of an issued bond is derived from the bond price and the effective yield. The effective yield is compared to a risk-free reference rate, and the difference between the two rates equals the credit spread.

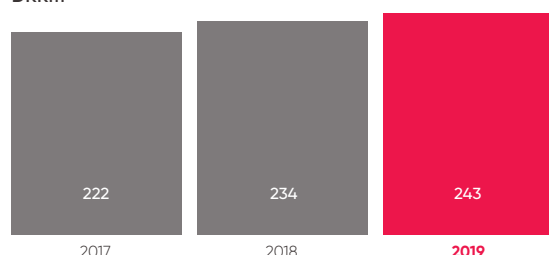
Credit spread risk is the risk that credit spreads on issuers on the bond portfolio should develop unfavourably. Losses may arise because of a change in the credit risk (credit spread) on mortgage bonds relative to government bonds. The risk is also relevant for bonds for which the overall interest rate risk has been hedged and for floating-rate bonds.

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### Market risk

Spar Nord applies a fixed model to measure credit spread risk. The model employs a credit spread premium, which is determined on the basis of historical fluctuations in credit spreads of the bond measured relative to a reference yield curve. The model builds on recognised statistical considerations, and the Bank is able to back-test the calculated results.

Figure 75  
Credit spread risk  
DKKm



#### 7.3.5 Other interest rate risk targets

Spar Nord has defined targets for changes in the yield structure as the general interest rate risk target assumes a parallel shift of the entire yield curve. Spar Nord also measures the convexity risk on interest-bearing debt instruments. Duration as a basis for the general interest rate risk target expresses the slope of the price curve, while convexity expresses the curvature of the yield curve.

#### 7.3.6 Bond portfolio

Spar Nord's bond portfolio is composed of 87.7% mortgage bonds, 6.7% bonds from financial issuers, 1.7% from corporate bonds and 3.8% government bonds.

The overall bond portfolio was unchanged relative to 31 December 2018. However, there was a change in the underlying composition as the portfolio of mortgage bonds was increased by DKK 0.4 billion, while bonds from financial issuers were reduced by DKK 0.3 billion.

At end-2019, 84.5% of the Spar Nord's bond portfolio had an AA rating or better.

Figure 76  
Bond portfolio by issuer type \*)

| DKKm/%             | 2019          | 2018          | 2019         | 2018         |
|--------------------|---------------|---------------|--------------|--------------|
| Mortgage bonds     | 14,026        | 13,598        | 87.7         | 85.4         |
| Financial issuers  | 1,077         | 1,422         | 6.7          | 8.9          |
| Credit bonds       | 277           | 259           | 1.7          | 1.6          |
| Government bonds   | 604           | 648           | 3.8          | 4.1          |
| <b>Total bonds</b> | <b>15,985</b> | <b>15,928</b> | <b>100.0</b> | <b>100.0</b> |

\*) Bond portfolio plus spot and forward purchases and sales

Figure 77

#### Bond portfolio by rating \*)

| DKKm/%             | 2019          | 2018          | 2019         | 2018         |
|--------------------|---------------|---------------|--------------|--------------|
| AAA                | 13,080        | 13,412        | 81.8         | 84.2         |
| AA                 | 425           | 439           | 2.7          | 2.8          |
| A                  | 1,551         | 1,151         | 9.7          | 7.2          |
| BBB                | 590           | 713           | 3.7          | 4.5          |
| BB                 | 80            | 66            | 0.5          | 0.4          |
| B                  | 6             | 12            | 0.0          | 0.1          |
| CCC                | 0             | 0             | 0.0          | 0.0          |
| CC                 | 0             | 0             | 0.0          | 0.0          |
| C                  | 0             | 0             | 0.0          | 0.0          |
| Not rated          | 254           | 134           | 1.6          | 0.8          |
| Unallocated        | 0             | 0             | 0.0          | 0.0          |
| <b>Total bonds</b> | <b>15,985</b> | <b>15,928</b> | <b>100.0</b> | <b>100.0</b> |

\*) Bond portfolio plus spot and forward purchases and sales

Figure 78

#### Bond portfolio 2019

| DKKm/%            | Origin         | Rating category |               |              |
|-------------------|----------------|-----------------|---------------|--------------|
| Mortgage bonds    | Denmark        | AAA             | 11,770        | 73.6         |
|                   |                | A               | 1,131         | 7.1          |
|                   |                | Unrated         | 4             | 0.0          |
|                   | Norway         | AAA             | 1,122         | 7.0          |
|                   |                |                 | <b>14,026</b> | <b>87.7</b>  |
| Financial issuers | Denmark        | AA-A            | 130           | 0.8          |
|                   |                | BBB-Unrated     | 658           | 4.1          |
|                   | Norway         | A-BBB           | 169           | 1.1          |
|                   | Sweden         | A               | 61            | 0.4          |
|                   | Finland        | A-BBB           | 53            | 0.3          |
|                   | Other          | AAA-Unrated     | 5             | 0.0          |
|                   |                |                 | <b>1,077</b>  | <b>6.7</b>   |
| Credit bonds      | Denmark        | BBB-Unrated     | 63            | 0.4          |
|                   | Other          | AA-Unrated      | 214           | 1.3          |
|                   |                |                 | <b>277</b>    | <b>1.7</b>   |
| Government bonds  | Denmark        | AAA-AA          | 518           | 3.2          |
|                   | Europe         | AAA             | 84            | 0.5          |
|                   | Outside Europe | AAA             | 3             | 0.0          |
|                   |                |                 | <b>604</b>    | <b>3.8</b>   |
| <b>Total</b>      |                |                 | <b>15,985</b> | <b>100.0</b> |
| Own bonds         | Denmark        | Unrated         | 10            |              |

## Section 7

### Market risk

#### Bond portfolio 2018

| DKKm/%            | Origin         | Rating cate-<br>gory |               |              |
|-------------------|----------------|----------------------|---------------|--------------|
| Mortgage bonds    | Denmark        | AAA                  | 11,970        | 75.2         |
|                   |                | A                    | 404           | 2.5          |
|                   |                | Unrated              | 5             | 0.0          |
|                   | Sweden         | AAA                  | 138           | 0.9          |
|                   | Norway         | AAA                  | 1,082         | 6.8          |
|                   |                |                      | <b>13,598</b> | <b>85.4</b>  |
| Financial issuers | Denmark        | AA-A                 | 192           | 1.2          |
|                   |                | BBB-Unrated          | 658           | 4.1          |
|                   | Norway         | A-BBB                | 328           | 2.1          |
|                   | Austria        | A-BBB                | 178           | 1.1          |
|                   | Sweden         | A-BBB                | 61            | 0.4          |
|                   | Other          | AAA-Unrated          | 6             | 0.0          |
|                   |                |                      | <b>1,422</b>  | <b>8.9</b>   |
| Credit bonds      | Denmark        | BBB-Unrated          | 79            | 0.5          |
|                   | Other          | AA-Unrated           | 180           | 1.1          |
|                   |                |                      | <b>259</b>    | <b>1.6</b>   |
| Government bonds  | Denmark        | AAA-AA               | 555           | 3.5          |
|                   | Europe         | AAA                  | 92            | 0.6          |
|                   | Outside Europe | AAA                  | 2             | 0.0          |
|                   |                |                      | <b>648</b>    | <b>4.1</b>   |
| <b>Total</b>      |                |                      | <b>15,928</b> | <b>100.0</b> |
| Own bonds         | Denmark        | Unrated              | 4             |              |

#### 7.4 Foreign exchange risk

Foreign exchange risk is the risk of loss on positions in foreign currency due to exchange rate fluctuations. Currency options are included in the calculation at the Delta-adjusted position.

The foreign exchange risk is illustrated in figure 79. The calculation is based on the assumption that all exchange rates develop unfavourably for Spar Nord by 2%.

Figure 79

#### Foreign exchange risk

| DKKm         | Foreign exchange position |           | Foreign exchange risk |            |
|--------------|---------------------------|-----------|-----------------------|------------|
|              | 2019                      | 2018      | 2019                  | 2018       |
| EUR          | 53                        | 37        | 1.1                   | 0.7        |
| SEK          | 1                         | 2         | 0.0                   | 0.0        |
| USD          | 3                         | 1         | 0.1                   | 0.0        |
| GBP          | 1                         | 3         | 0.0                   | 0.1        |
| CHF          | 0                         | 0         | 0.0                   | 0.0        |
| NOK          | 6                         | 7         | 0.1                   | 0.1        |
| JPY          | 0                         | 1         | 0.0                   | 0.0        |
| Other        | 1                         | 9         | 0.0                   | 0.2        |
| <b>Total</b> | <b>64</b>                 | <b>59</b> | <b>1.3</b>            | <b>1.2</b> |

Figure 79 shows that the foreign exchange risk at end-2019 amounted to DKK 64 million, equal to a risk increase of DKK 5 million compared with end-2018.

The change was caused by an increase in the EUR currency position and a reduction in the position of other currencies.

#### 7.5 Equity risk

Equity risk is the risk of losses caused by changes in equity prices. Equity positions are the calculated net value of long and short equity positions and equity-related instruments.

The calculation of equity positions is broken down by positions in the banking book and in the trading book.

##### 7.5.1 Shares in the trading book

Shares in the trading book are held for trading purposes.

Figure 7.10 shows that the holding of shares in the trading book was reduced from DKK 134 million at end-2018 to DKK 132 million at end-2019, which was due to a small decline in the Bank's portfolio of unlisted shares.

Figure 7.10

#### Equity risk in the trading book

| DKKm                                | 2019       | 2018       |
|-------------------------------------|------------|------------|
| Listed shares in the trading book   | 106        | 106        |
| Unlisted shares in the trading book | 26         | 28         |
| <b>Total</b>                        | <b>132</b> | <b>134</b> |

##### 7.5.2 Shares in the banking book

A salient feature of shares in the banking book is that they have not been acquired for trading purposes. In addition, Spar Nord makes a distinction between shares in strategic partners, including sector companies, associates and other shares in the banking book.

Shares in strategic partners in the financial sector are shares in companies whose purpose is to support financial institutions' business in the fields of mortgage credit, payment services, unit trusts, etc. Participation in the companies in question is considered a prerequisite for Spar Nord's operations.

In several of the sector companies, the shares are redistributed to the effect that the ownership interest of the respective institution will reflect its business volume with the sector company.

The shares are typically redistributed on the basis of the sector company's equity value. In light of this, Spar Nord adjusts the recognised value of these shares when new information is available that warrants a change of fair value measurement. In other sector companies, the shares are not redistributed, but are measured based on a fair value corresponding to the net asset value or another recognised valuation method (including discounting



## Section 7

### Market risk

of cash flows and market expectations with respect to equity return requirements). The adjustments of the values of the shares in these companies are recognised in the income statement.

Figure 7.11

#### Equity risk in the banking book

| DKKm   | 2019         | 2018         |
|--|--------------|--------------|
| Shares in credit and financing institutions        | 1,245        | 1,285        |
| Shares in unit trust man. companies                | 193          | 197          |
| Shares in pension institutions                     | 2            | 2            |
| Shares in data supplier                            | 0            | 0            |
| Shares in payment services business                | 8            | 0            |
| Other equities                                     | 67           | 60           |
| <b>Total shares in strategic business partners</b> | <b>1,514</b> | <b>1,545</b> |
|  |              |              |
| Realised gain                                      | 21           | 4            |
| Unrealised gain                                    | 69           | 186          |
|  |              |              |
| Associates   | 470          | 333          |
| Other shares in the banking book                   | 93           | 89           |
| <b>Total</b>                                       | <b>2,078</b> | <b>1,967</b> |

The total holding of shares in the banking book increased by DKK 111 million to DKK 2,078 million at end-2019.

Shares in strategic partners fell by DKK 31 million, primarily due to two opposite effects: a reduction in the portfolio of DLR shares in connection with a sale and redistribution and an increase from value adjustments of the portfolio.

The DKK 137 million increase in the value of associates was mainly due to Spar Nord's ownership interest in Danske Andelskassers Bank, with the share of the company's equity being increased based on their gain from selling shares in Sparinvest and general earnings. In addition, Spar Nord acquired additional shares in Danske Andelskassers Bank in 2019.

#### 7.6 Commodity risk

Spar Nord only accepts commodity risks to a very limited extent. The commodity exposure is calculated as a gross exposure, with setoffs only being made with respect to contracts having the same underlying commodity, the same maturity date, etc.

#### 7.7 Option risk

Spar Nord uses derivatives to hedge and manage Spar Nord's risks. These include options and products that contain an embedded option. Spar Nord's option risks originate primarily from interest and currency options and positions in callable mortgage bonds.

Option risks are calculated by computing the positions' Delta, Gamma, Vega and Theta risks.

#### 7.8 Sensitivity analysis

Figure 7.12 shows how Spar Nord's income statement will be impacted if interest rates change, if share prices fall or if all exchange rates develop unfavourably.

It appears from figure 7.12 that the impact of an interest rate increase will be a loss equal to 0.4% of shareholders' equity. Furthermore, the effect of a 10% decline in the value of the share portfolio both in banking and trading book will be a loss equal to 2.3% of shareholders' equity.

Figure 7.12

| Sensitivity analysis *)                                     | Profit impact |      | Impact on equity |      |
|---|---------------|------|------------------|------|
|   | 2019          | 2018 | 2019             | 2018 |
| DKKm/%  |               |      |                  |      |
| Interest rate increase of 1 %-point                         | -32           | -6   | -0,4             | -0,1 |
| Interest rate decrease of 1 %-point                         | 32            | 6    | 0,4              | 0,1  |
| Share price decrease of 10% in the trading book             | -10           | -10  | -0,1             | -0,1 |
| A fair value decrease of 10% for shares in the banking book | -197          | -186 | -2,2             | -2,2 |
| Unfavourable 2% exchange rate fluctuation                   | -1            | -1   | 0,0              | 0,0  |

The sensitivity information shows the impact of isolated changes in interest rates in the trading book, while the impact of changes in exchange rates and the share portfolio is shown for positions both in the banking book and the trading book. The impact on the operating profit and the impact on equity are calculated after tax.

#### 7.9 Own properties

Properties are recognised at cost upon acquisition and subsequently measured at fair value. The fair value is calculated on the basis of current market data according to an asset return model that includes the property's rental income and operating expenses, including property management services and maintenance.

Operating expenses and maintenance costs are calculated on the basis of the condition of the individual property, construction year, materials used, etc. The fair value of the property is determined based on the calculated return on its operation and the individually determined rate of return. The return rate is fixed on the basis of the location of the individual property, potential use, the state of maintenance, etc.

The fair value of the individual property is reassessed at least once a year based on the current letting market and the interest level. An external valuation is obtained from a real estate agent to support the calculation of fair value, including the rental rates and rates of return used.

In 2019, negative value adjustments totalling DKK 10 million were made on corporate properties, such adjustments being recognised directly in equity under other comprehensive income. Impairment losses totalling DKK 2 million (net) have been recognised under depreciation and impairment in the income statement. Reference is made to Spar Nord's Annual

# Section 7

## Market risk

Report for a more detailed description of the accounting treatment of properties.

Figure 7.13 shows Spar Nord’s properties broken down by the rates of return.

Figure 7.13

| Yield/return | 2019                 |                | 2018                 |                |
|--------------|----------------------|----------------|----------------------|----------------|
|              | Number of properties | Value year-end | Number of properties | Value year-end |
| DKKm         |                      |                |                      |                |
| -> 7%        | 11                   | 204            | 12                   | 212            |
| 7% – 8%      | 15                   | 320            | 16                   | 341            |
| 8% – 9%      | 14                   | 131            | 13                   | 130            |
| <b>Total</b> | <b>40</b>            | <b>656</b>     | <b>41</b>            | <b>683</b>     |

The most important assumptions when calculating the fair value of investment and domicile properties are the required rate of return and rent level.

Other things being equal, an increase of the required rate of return of 0.5 percentage point will reduce the fair value by DKK 44 million at end-2019, which is on the same level as at end-2018.

Other things being equal, an increase of the rent level of 5% will reduce the fair value by DKK 30 million at end-2019 – the same level as at end-2018.

|  |   |   |   |   |   |   |   |   |   |   |   |
|--|---|---|---|---|---|---|---|---|---|---|---|
|  | \ | \ | \ | \ | \ | \ | - | - | - | - | - |
|  |   | \ | \ | \ | \ | \ | - | - | - | - | - |
|  |   | \ | \ | \ | \ | \ | - | - | - | - | - |
|  |   |   | \ | \ | \ | \ | - | - | - | - | - |
|  |   |   |   | \ | \ | \ | - | - | - | - | - |
|  |   |   |   |   |   |   |   |   |   |   |   |
|  |   |   |   |   |   |   |   |   |   |   |   |
|  |   |   |   |   |   |   |   |   |   |   |   |
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|  |   |   |   |   |   |   |   |   |   |   |   |

# Operational risk

## Developments in 2019

In 2019, the Bank focused especially on strengthening its IT risk management and optimising internal processes and control levels in relation to Anti-Money Laundering (AML) and GDPR with a view to mitigating operational risk.

## Definition of operational risk

Operational risk is the risk of financial loss resulting from inefficient or deficient internal procedures, from human or systemic errors or from external events, including legal risks.

Operational risk also comprises model risk, which is the risk of loss resulting from decisions primarily based on results of internal models. Operational risk arises due to errors in the development, execution or use of such models.

Operational risks are categorised on the basis of the seven event types defined by Basel III:

- employment practices and workplace safety
- external fraud
- business disruption and systems failures
- internal fraud
- clients, products and business practice
- execution, delivery and process management
- damage to physical assets

## RISK EXPOSURE, OPERATIONAL RISK

# DKK 5.6 billion

2018: DKK 5.7 billion

### 8.1 Operational risk policy

Spar Nord's Board of Directors has defined a policy for operational risk, the aim of which is to provide an overview of Spar Nord's operational risk and thus to minimise the number of incidents and losses.

To ensure that operational risk is kept at an acceptable level, Spar Nord's Board of Directors has defined the Group's risk appetite. If risks are identified that exceed the defined risk appetite, action plans will be drawn up to mitigate such risks.

### 8.2 Management, monitoring and reporting

All of Spar Nord's activities are subject to operational risk, and therefore a key task is to limit the operational risk level as much as possible.

Operational risk is managed across Spar Nord through a comprehensive system of business procedures and control measures developed to ensure an optimum process environment.

Follow-up and reporting with respect to operational risk is anchored within the Risk Management Department, while the unit responsible for the relevant business activities and, the risk owners, are responsible for handling the risks. This helps ensure a clear segregation of controlling and operational functions.

Throughout Spar Nord, events that result in a loss of more than DKK 10,000 are recorded and categorised, and identified risks are recorded on an ongoing basis, followed up by reporting to the risk owners, the Executive Board and the Board of Directors.

Reporting to the Board of Directors, Executive Board and risk owners is done on a quarterly basis. The risk owners are informed about the loss events and new risks identified for the relevant business area during the period under review. The Board of Directors and the Executive Board receive a summary of significant new risks or any updates to existing risks. They also receive a statement of total loss events.

Loss events exceeding DKK 5 million will be reported separately to the Executive Board and Board of Directors.

The systematic registration and categorisation of loss events provide an overview of sources of loss and the experience base which the Bank uses proactively in its management of operational risks.

## Section 8

### Operational risk

#### 8.3 Loss events

Spar Nord's operational loss events are primarily broken down on the risk types "external fraud", "clients, products and business practices", and "execution/delivery and process management".

It appears from figure 8.1 showing no. of operational loss incidents broken down by risk type that external fraud in 2019 accounted for 59% of the events (2018: 55%), customers, products and business practice 30% (2018: 12%), while order execution and process management accounted for 11% (2018: 33%).

The majority of loss events consist of events with limited financial impact – primarily events concerning payment card abuse and online banking fraud. The rest of the loss incidents relate in particular to operational errors in traditional banking operations.

Figure 8.2 shows a breakdown of losses in 2019 by amounts: external fraud accounted for 48% (2018: 86%), business disruption and system errors 10% (2018: 5%), internal fraud 0% (2018: 1%), customers,

products and business practice 26% (2018: 5%) and order execution and process management 16% (2018: 3%).

Total losses in 2019 were notably lower than in 2018 because of a single loss event in 2018 which resulted in a loss of approximately DKK 45 million.

On the basis of the regular reporting provided to Spar Nord's Board of Directors and Executive Board, Management believes that the Bank has satisfactory measures to counter the risk of being exposed major operational losses.

#### 8.4. IT security

Information and information systems are vital to Spar Nord, and IT security is therefore essential to the Bank's credibility and continued existence. Spar Nord's IT security function, Executive Board and Board of Directors regularly review the Bank's IT security.

The work of the IT security function is based on a defined security and risk level aimed at ensuring that the Bank's day-to-day business and activities are consistently supported by a secure and reliable IT infrastructure. The IT security function is responsible for complying with the adopted IT security level and Spar Nord's IT contingency plan. The IT security function contributes to ensuring and controlling that Spar Nord's IT activities to the best possible extent are protected against internal and external threats. The IT security function is thus charged with ensuring compliance with legislative and sector-specific requirements, Spar Nord's own requirements and customer expectations in terms of Spar Nord's availability, confidentiality and integrity.

Spar Nord's activity in the area of IT security is based on regulatory requirements as well as considerations for day-to-day operations. All IT installations at Spar Nord and its service providers must operate according to documented schedules and guidelines. The operation must be secure and stable, a requirement ensured through the highest possible degree of automation and ongoing capacity adjustments. IT services run by external service providers must be based on written agreements. The Bank's IT security efforts include the preparation of contingency plans and recovery procedures and periodic test of such measures aimed to ensure continued operation at a satisfactory level in the case of extraordinary events.

In order to protect Spar Nord against the growing threat in the area of cyber security, the IT security function has regularly carried out awareness activities for employees and attended sector-specific collaboration to build internal knowledge about information security.

Figure 8.1

**No. of operational loss events broken down by risk type %**

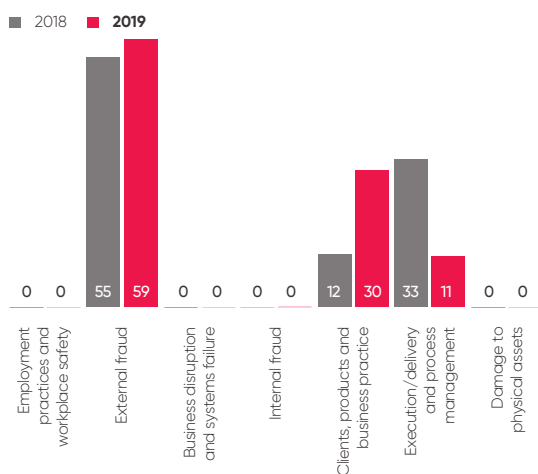
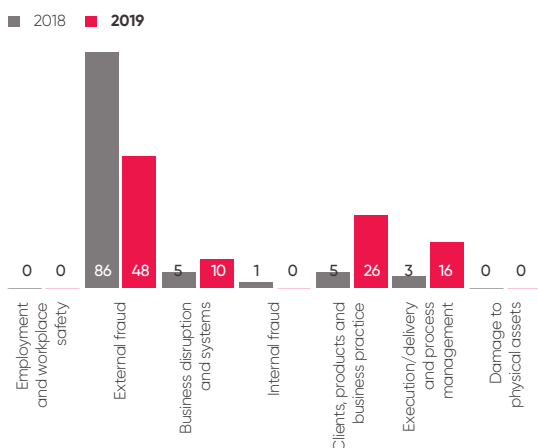


Figure 8.2

**Operational loss amounts broken down by risk type %**



## Section 8

# Operational risk

### 8.5 Compliance risk

Operational risks also includes compliance risks identified via the compliance function.

The compliance function is an independent function which serves to assess, check and report on the Bank's compliance with applicable legislation, practice and market standards. This helps mitigate the risk of sanctions being imposed on the Bank, a risk of loss of reputation or that the Bank or its customers suffer material financial losses.

The compliance function applies a risk-based approach to identifying areas to review. In 2019, the function focused on areas such as compliance with anti-money-laundering (AML) measures, the Market Abuse Regulation, governance rules and MiFID II.

The compliance function is anchored in the Legal Department and reports directly to the Executive Board and Board of Directors.

### 8.6 Money-laundering risk

The Bank retains a strong focus on AML-measures, including the risk-mitigating measures that must be implemented to prevent the Bank from being used for money-laundering activities and terrorism financing purposes. The prevention of money-laundering and terrorist financing is a high-priority area at Spar Nord, and as a bank we share a joint responsibility for ensuring that money-laundering and terrorist financing is prevented.

The AML function is charged with ensuring that the Bank complies with the Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism, EU Funds Transfer Regulation and EU anti-terrorism regulations.

In 2018, the AML function continued to focus on optimising and providing system support to the Bank's existing processes. In addition, new staff was onboarded in the AML function.

The Bank continues to record an increase in filings with the State Prosecutor for Serious Economic and International Crime (SØIK), which is a trend witnessed in the rest of the Danish financial sector. In 2019, Spar Nord had 1,750 filings with SØIK as compared with 1,071 cases in 2018.

The AML function is anchored in the Legal Department and reports directly to the Executive Board and Board of Directors.

### 8.7 GDPR

2019 was characterised by a consistent focus on implementing new processes and raising the skills level in the organisation in the area of data protection to reduce operational risk.

The Bank's data protection officer (DPO) applies a risk-based approach to identifying areas to review. In 2019, the DPO focused on areas such as compliance with supervision of data processors.

The DPO function is anchored in the Legal Department and reports directly to the Executive Board and Board of Directors.

### 8.8 Products and services

Risks associated with the implementation of new products and services are identified and assessed according to internal procedures prior to final approval by the Executive Board and/or Board of Directors.

Risk analysis and statements by selected consultation partners, including statements from the Bank's Finance Department, Legal Department and the Chief Risk Officer, help ensure comprehensive insight into the risks faced by the Bank and its customers. As prescribed by law, the Chief Risk Officer may require that a change to an existing product be treated as a new product.

The approval procedures are described in the Bank's product policies for financial products and other bank products, respectively. The policies are reviewed annually by the Bank's risk committee, which recommends the policies for final approval by the Board of Directors.

As part of the Bank's policy for financial products, a distribution strategy has been defined with the overall goal of ensuring that the Bank distributes the right products to the right customers.

# Risk statement

Spar Nord's Board of Directors approved Spar Nord's 2019 Risk Report on 6 February 2020.

The Board of Directors believes Spar Nord's risk management complies with applicable rules and standards, is appropriate and effective, and is consistent with Spar Nord's business model. In addition, in the opinion of the Board of Directors, Spar Nord's risk management systems are appropriate given Spar Nord's risk appetite and strategy, thus ensuring a going concern.

We believe that Spar Nord's general risk profile with respect to the business strategy, business model and key performance indicators provides a fair representation of Spar Nord's risk management, including of the adopted risk profile and risk appetite.

The Board of Directors' assessment is based on the business model and strategy adopted by it, and materials and reports submitted to it by the Executive Board, the Internal Audit Department, Spar Nord's Chief Risk Officer and Compliance Officer.

The core of Spar Nord's strategy, vision and fundamental values is for Spar Nord to be a strong and attractive bank for retail customers and small and medium-sized businesses in the local communities in which the Bank is present. Spar Nord strives to run a profitable business based on a pricing of its products that reflects the risk and capital tie-up that Spar Nord assumes. Spar Nord wants to maintain suitable and robust own funds supporting the business model at all times, based on an overall assessment of the business volume with customers and counterparties.

The Board of Directors' review of Spar Nord's business model and policies shows that the general requirements in respect of the individual risk areas are appropriately reflected in policies and specified limits, including in the Board of Directors' guidelines to the Executive Board, and powers delegated to other organisational units. The specified limits are believed to be defined in a way making them transparent and controllable.

In addition, the review shows that the actual risks are within the limits laid down in the individual policies and powers delegated, and in this light the Board of Directors believes that there is a correlation between business model, policies, guidelines and the actual risks within the individual areas.

More information and key performance indicators for Spar Nord's risk profile can be found in this Risk Report and in the risk sections of the Annual Report.

## Executive Board



**Lasse Nyby**

Chief Executive Officer



**John Lundsgaard**

Managing Director



**Lars Møller**

Managing Director

## Board of Directors



**Kjeld Johannesen**

Chairman of the Board of Directors



**Per Nikolaj Bukh**

Deputy Chairman of the Board of Directors



**Lene Aaen**



**Kaj Christiansen**



**Morten Bach  
Gaardboe**



**Laila Mortensen**



**Jannie Skovsen**



**Gitte Holmgaard  
Sørensen**



**John Sørensen**





The Risk Report has been prepared in a Danish and an English version. In case of discrepancy between the Danish-language original text and the English-language translation, the Danish text shall prevail.

**Spar Nord Bank A/S**

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