Risk report 2020

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. 2155 of 3 December 2020).

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/.

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 not shown.

Contents

Section 1

Introduction

The COVID-19 pandemic was the dominant theme of 2020, and one which only very few people could have predicted at the beginning of the year. The global pandemic has had huge human and economic repercussions, resulting in changes to the overall risk picture, both for the Bank and for the sector. Despite mounting uncertainty, government intervention and expectations of financial challenges in many industries, Spar Nord performed quite well in 2020.

Financial risks impacted by COVID-19

On the capital side, COVID-19-driven changes, such as the suspension of dividend payments for 2019, the release of the countercyclical capital buffer, early implementation of the SME supporting factor and a drop in lending due to government relief packages, resulted in historically high capital ratios at the end of 2020.

The common equity tier 1 capital ratio and the own funds ratio were thus 17.2% and 21.0%, respectively, which is notably higher than the Bank's capital targets of 13.5% and 17.5%, respectively, for the two ratios. Relative to the capital requirement, the excess coverage is 7.6%-points, or DKK 4.2 billion. The strong capital ratios also support the eligible liabilities (MREL). At end-2020, the MREL ratio was calculated at 25.8%, which is comfortably above the Bank's MREL and combined buffer requirement of 19.6%.

Overall, the Bank is estimated to have a solid capital position, making it well prepared to withstand any potential negative financial repercussions of the COVID-19 crisis.

The effects which resulted in high capital ratios have also had a positive impact on the Bank's liquidity. The short-term liquidity coverage ratio (LCR) has thus been calculated at 241%, which is well above both the statutory requirements and the Bank's own targets. The long-term strategic liquidity is calculated at DKK 30 billion, which is also well above the Bank's own targets.

On the credit side, developments in 2020 were marked by considerable uncertainty and elevated risk levels due to the COVID-19 pandemic. The Bank helped distressed customers by providing COVID-19-related financing in 2020. Since Denmark imposed lockdown measures in March, the Bank has expected to record an increase in loan impairment and credit losses on its customers, resulting in a gradual increase in impairment charges and especially management estimates. The Bank has found objective evidence of credit impairment due to COVID-19 on a few large exposures and has recognised new impairment charges of about DKK 100 million in that connection. Furthermore, a management estimate of DKK 320 million has been made to cover any future losses resulting from the financial challenges which the COVID-19 pandemic is expected to cause.

As a result of the government-funded relief packages, which were extended on several occasions over the course of the year, and the fact that the Bank has no major exposures to individual industries particularly challenged by COVID-19, the Bank has so far not recorded any substantial credit losses related to COVID-19.

For agricultural customers, the situation generally developed favourably in 2020. High settlement prices for pork early in the year and stable milk prices enabled agricultural customers to reduce their debts and strengthen their financial position over the course of 2020. The closure of the mink farming industry in Denmark only has a marginally adverse impact on the Bank, as this industry only accounts for 0.1% of total loans, advances and guarantees.

Retained focus on non-financial risks

The outbreak of COVID-19 turned everyday life upside down for most people. Social distancing requirements have resulted in an increase in home working, more online meetings and, as a result, mounting pressure on IT infrastructure, but this did not cause any increase in operational loss events in 2020. However, as the Bank has experienced an increase in the volume and scope of external fraud committed against its customers, continued efforts are made to improve the control environment with respect to non-financial risks.

One of the principal operational risks facing the Bank and the sector in general remains the risk of cyber attacks, which was emphasised by an updated risk assessment by the Centre for Cyber Security at the end of December. The Bank continually monitors risks and events and regularly takes measures to strengthen efforts to combat IT crime. No material cybercrime-related losses or events were recorded in 2020.

True impact will materialise in 2021

While Spar Nord generally made it through 2020 unscathed, the true financial repercussions of COVID-19 are not expected to materialise until in 2021, in part because the termination of the government relief packages is expected to adversely affect banking customers.

In terms of macroeconomic developments, 2020 is expected to end with a historical drop in Danish GDP of around 4% and a small increase in unemployment. Although expectations for 2021 remain positive, they are subject to great uncertainty and to a large extent depend on whether a third COVID-19 wave strikes and how quickly an effective vaccine will be rolled out.

On 22 December, Spar Nord announced the signing of an agreement to acquire BankNordik's Danish activities. The Danish Competition and Consumer Authority and the Danish FSA have both approved the acquisition, which will take effect on 1 February 2021. The agreement primarily covers retail customers, and taking over this customer portfolio will not change the Bank's risk profile to any significant extent.

Section 2

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, which will be expanded to 51 local banks in 2021.

Spar Nord offers all types of financial services, consultancy and products, focusing its business on retail customers and small and medium-sized enterprises (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, including leases for the business segment and the Trading Division. The Group also has a number of staff and support divisions at its Aalborg headquarters.

Vision and strategy

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 important financial decisions.

Customers

Spar Nord's two primary target groups are retail customers and small and medium-sized businesses in the local areas where the Bank has a presence.

In its retail segment, Spar Nord gives priority to full-service customers. This means that Spar Nord intends 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.

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.

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 generally aims to be the customer's primary banker and that customers conduct their basic banking business with the Bank.

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.

Section 3
Risk Management

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

The following risks are considered the most important for the Bank:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk, including IT security

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 30-35 of Spar Nord's Annual Report.

3.1 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, the Bank 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.

3.2 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.

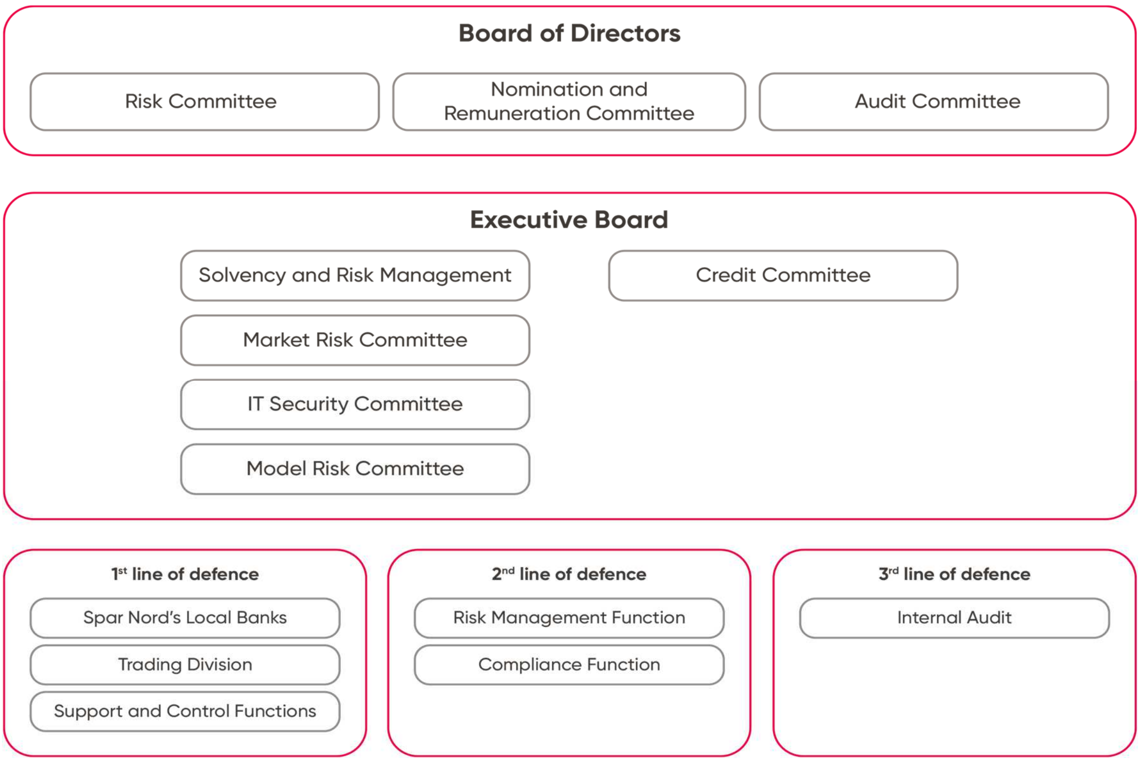
Using the strategic objectives as its point of departure, the Board of Directors determines a risk profile, which describes the risk within the Bank's most important risk types that the Board of Directors is willing to undertake while meeting the objectives set forth in the strategy.

The objective is to ensure cohesion between Spar Nord's vision and strategy while ensuring that the 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.

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.

Figure 3.1
Risk management organisation



Risk Management

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 the respective topics.

Establishing these board committees helps ensure a better utilisation of the specific 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, 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 the Bank'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 2020.

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 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, one of which is an independent member and one a member elected by the employees. The Committee held five meetings in 2020.

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 2020.

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

The Executive Board must ensure that 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.

3.5 Executive Board 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.

3.5.1 Solvency and Risk Management Committee
The Solvency and Risk Management Committee is composed of a member of the Executive Board, Trading Division, Credit Department, 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 and the Credit Committee to ensure that any capital consequences are dealt with by the primary capital and solvency authority.

3.5.2 Market Risk Committee
The Market Risk Committee is composed of a member of the Executive Board and members of the 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.

3.5.3 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.

3.5.4 Model Risk Committee
The Model Risk Committee is composed of a member of the Executive Board, Risk Management and Credit Department. The Committee meets once every quarter to discuss and monitor the management of model risks and to consider recommendations of newly developed and revised models prior to approval and implementation.

3.5.5 Credit Committee
The Credit Committee is composed of two members of the Executive Board and one member from the Credit Department. The Committee deals with credit facilities that exceed the Credit Department'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.

3.6 1st line of defence
The business units Spar Nord's Local Banks and Trading Division together with the support and control functions represent the 1st line of defence. The Bank's day-to-day risk management is handled through risk policies, instructions, limits and a number of internal controls and is performed in all major 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, an Anti-Money Laundering (AML) function has been established, which is part of the 1st line of defence.

3.7 2nd line of defence
The 2nd line of defence is composed of the risk management function and the compliance function. The functions have key assignments of monitoring, controlling and reporting the Bank's risks and control environment.

3.7.1 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 in providing information about the Bank's risk exposure.

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.

The Chief Risk Officer reports directly to the Executive Board. Dismissal of the Chief Risk Officer is subject to the prior approval of the Board of Directors.

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

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.

The Head of Compliance reports directly to the Executive Board. Dismissal of the Head of Compliance is subject to the prior approval of the Board of Directors.

3.8 3rd line of defence
The Internal Audit Department serves as the 3rd 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 Risk Committee.

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.

It reports directly to the Board of Directors and regularly reports on an ongoing basis to the Executive Board and the Board of Directors. Dismissal of the head of Internal Audit is subject to the prior approval of the Board of Directors.

3.9 Reporting
To ensure an adequate decision-making basis for the Executive Board and the Board of Directors, management receives reporting material pertaining to the 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 and guidelines

Governance	Frequency	
Risk policy	Annually	Data protection policy
		Data governance policy
		Insurance policy
		Information security policy
		Capital policy and Capital contingency plan
		Credit policy
		Liquidity and funding policy and Funding and liquidity contingency plan
		Market risk policy
		Model risk policy
		IT risk management 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	Audit report: Review of risk areas
	Quarterly	Internal Risk Report: Combined overview of developments in key risks. Monitoring of Spar Nord's risk profile. Follow-up on indicators defined in the recovery plan.
	Quarterly	Individual solvency need: (ICAAP): Assessment of the risk profile and calculation of adequate own funds. 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	Compliance report: Review of the most significant compliance controls. Progress on ongoing tasks. Once a year, an extended version of the report is prepared.
	Semi-annually	DPO Report: Review of the most important controls relative to compliance with the GDPR and the Danish Data Protection Act. Progress on ongoing tasks. Once a year, an extended version of the report is prepared.
Credit risk	Annually	Credit and balance sheet report: Review and analysis of assets, including a specific review of individual exposures. Analysis and assessment of future trends for important lines of business and asset areas
	Semi-annually	Reporting on credit weak exposures: : Review of weak credit-weak exposures larger than DKK 50 million.
	Monthly	Reporting on credit facility extensions in excess of DKK 10 million. Credit facility extensions in excess of DKK 10 million that have not been considered by the Board of Directors.
	Monthly	Reporting on individual unauthorised overdrafts in excess of DKK 1 million. Overview of all individual unauthorised overdrafts in excess of DKK 1 million.
	Monthly	Reporting on statistics of unauthorised overdrafts: Overview of unauthorised overdraft statistics in all banking areas.
Market risk	Monthly	Market risk report: Overview of and developments in current interest, equity and foreign-exchange risks Trend in utilisation of the frameworks and instructions defined.
Liquidity risk	Monthly	Liquidity report: Overview of and developments in short-term and long-term liquidity risk.
	Annually	Calculation and assessment of liquidity position and liquidity risks – internal liquidity adequacy assessment process (ILAAP): Combined calculation and assessment of Spar Nord's liquidity position and liquidity risks. The assessment supports Spar Nord's liquidity management and is a component of the statement of the individual solvency need.
IT risk	Quarterly	Reporting from IT security Significant events after breach of IT security Awareness activities carried out.

Section 4

Capital and solvency need

Developments in 2020

Spar Nord's capital position was strongly impacted by the COVID-19 pandemic, which has resulted in a number of EU initiatives aimed at the capital area.

Earnings were adversely affected by management impairment charges derived from the uncertain macroeconomic outlook.

However, the Bank still realised satisfactory results in 2020, which contributed to its historically strong capital position as measured by the realised capital ratios. At the beginning of 2020, Spar Nord also suspended dividend payments for 2019 due to COVID-19-derived uncertainty, and this move has also been highly supportive of the capital ratios.

COVID-19 prompted EU initiatives in terms of handling the transitional arrangement for IFRS 9 effects. In addition, adjustments for the handling of exposures to small and medium-sized enterprises (SMEs) were brought forward from mid-2021 to mid-2020.

Both these initiatives had a positive impact on the Bank's capital position at end-2020.

The Board of Directors proposes dividend payment for 2020 of DKK 1.5 per share, for a total amount of DKK 185 million, equal to 25% of the profit for the year. Total dividends including interest on issued additional tier 1 capital represents 32% of profit for the year.

The excess capital coverage rose from 5.0 to 7.6 percentage points. This development is primarily explained by satisfactory performance despite COVID-19-related impairment, suspended dividends for 2019 and the release of the countercyclical buffer. In addition, the SIFI buffer requirement was phased-in by an additional 0.5% at end-2020 and is now fully phased in at 1%.

TOTAL RISK EXPOSURE AMOUNT

DKK 54.9 billion

2019: DKK 56.0 billion

COMMON EQUITY TIER 1 CAPITAL RATIO

17.2%

2019: 14.6%

OWN FUNDS RATIO

21.0%

2019: 18.5%

INDIVIDUAL SOLVENCY NEED

9.9%

2019: 9.5%

EXCESS CAPITAL COVERAGE IN PERCENTAGE POINTS

7.6

2019: 5.0

LEVERAGE RATIO

8.6%

2019: 8.3%

Definition of capital requirements

The regulatory capital requirements express the capital a bank must reserve to cover the risk undertaken by the bank as part of its operations in the fields of credit risk, market risk and operational risk.
Spar Nord must ensure that it has access at all times 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 the Bank 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. The capital targets at end-2020 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 the Bank's capital matters is appropriate and adequate and in compliance with applicable legislation.

The capital policy also defines a target for the leverage ratio of at least 6%.

Lastly, the capital policy covers Spar Nord's dividend policy, which in 2020 expressed an intention to distribute ordinary dividends in the range of 30-50% of the net profit for the year.

4.2 Development in capital ratios

Applying the IFRS 9 transitional arrangements, at year-end 2020 Spar Nord had a common equity tier 1 capital ratio of 17.2%, an own funds ratio of 21.0% and an individual solvency need ratio of 9.9%. The excess coverage is 7.6 percentage points compared to the capital requirements.

The calculated capital ratios are shown in figure 4.1 and illustrated in figure 4.3. The excess coverage is also shown in figure 4.1 and further specified in figures 4.12 and 4.13.

Figure 4.2 shows the ratios on full phasing-in of IFRS 9.

Figure 4.1

Capital ratios and excess coverage using the IFRS 9 transitional arrangement

%	2020	2019
Common equity tier 1 capital ratio	17.2	14.6
Tier 1 capital ratio	18.6	16.1
Own funds ratio	21.0	18.5
Individual solvency need	9.9	9.5
Percentage points		
Excess coverage, common equity tier 1 capital ratio	7.6	5.0
Excess coverage, own funds ratio	7.6	5.0

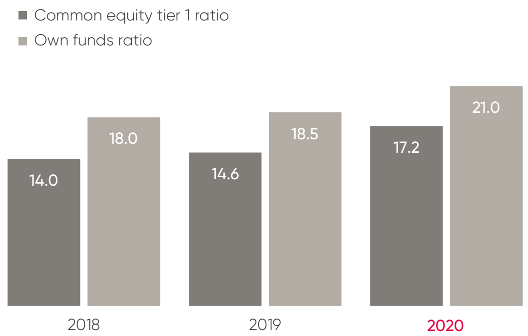
Figure 4.2

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

%	2020	2019
Common equity tier 1 capital ratio	16.5	14.3
Tier 1 capital ratio	17.9	15.8
Own funds ratio	20.4	18.1
Individual solvency need	9.9	9.5
Percentage points		
Excess coverage, common equity tier 1 capital ratio	6.9	4.6
Excess coverage, own funds ratio	6.9	4.6

Figure 4.3

Common equity tier 1 ratio and own funds ratio
%



4.3 Regulatory relief due to COVID-19

COVID-19 has prompted a range of initiatives from the Danish authorities and the European Commission. Three areas in particular have had a significant influence on Spar Nord's capital position:

- Release of the countercyclical buffer requirement in Denmark
- Adjustment of the handling of exposures to small and medium-sized enterprises (SME) – new definition and risk weighting brought forward
- Adjustment of the transitional arrangement for capital purposes regarding IFRS 9 effects

In March 2020, the countercyclical capital buffer requirement for Danish exposures was reduced to 0% for an indefinite period. The effect hereof is shown in section 4.7.1.

The EU has decided to advance the date of application of a new and simplified definition of SME exposures, which was originally to have been implemented on 30 June 2021. The initiative was brought forward due to COVID-19. Banks can now obtain a discount for SME exposures that are not in default, regardless of the size of the exposure. Reference is made to section 4.5.1, which provides a review of risk exposure developments.

Capital and solvency need

An adjusted IFRS 9 transitional arrangement has also been implemented. The effect of this initiative depends on the future development in the impairment account for stage 1 and stage 2 exposures. This is described in section 4.4.1, which reviews the effects of this transitional arrangement.

In addition to the initiatives described above, a number of other regulatory measures have been taken, which have an immaterial or no effect on Spar Nord's capital position.

4.4 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 the Bank's capital resources to comply with own targets as per the capital policy as well as the regulatory requirements.

4.4.1 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.

As a result of the new accounting rules, a transitional arrangement in relation to the IFRS 9 effect has been incorporated in CRR. This transitional arrangement has subsequently been adjusted due to COVID-19. The transitional arrangement may be applied in order to phase-in the effect of IFRS 9 when calculating own funds. The transition arrangement was originally divided into a static and a dynamic component, but now consists of two dynamic components and one unchanged static component.

- The static component: The initial cost of changing accounting rules
- Two dynamic components: Costs caused by any deterioration of the macroeconomic outlook. The dynamic components are calculated as current developments in the allowance account for stages 1 and 2 for two different periods. The two periods are 1 January 2018 to 31 December 2019 and 1 January 2020 to the date of calculation.

For capital adequacy purposes, Spar Nord has opted to apply the transitional arrangement relative to both the static and the dynamic components. The Bank has also opted to address the risk exposure by increasing the original exposure by the IFRS 9 effects.

Using the transitional arrangement means that the effect of IFRS 9 after tax is recognised in own funds according to a fixed transitional arrangement that expires at the end of 2024.

The transitional arrangement is shown in figure 4.4. The figure shows that 70% and 100%, respectively, of the calculated IFRS 9 effects after tax can be recycled to common equity tier 1 capital in 2020.

Figure 4.4

IFRS 9 transitional arrangement

	2019	2020	2021	2022	2023	2024
Transitional arrangement (%)	85	70	50	25	0	0
Transitional arrangement (%) – COVID-19 initiative	-	100	100	75	50	25
Static component in DKKm*	166	136	97	49	0	0
Dynamic component (18-19) in DKKm*	22	18	13	6	0	0
Dynamic component (20-) in DKKm*	0	278	-	-	-	-
Total effect	**188**	**433**	**0**	**0**	**0**	**0**

*) After tax

The effect of the selected transitional arrangement is shown in figure 4.4, which shows that the common equity tier 1 capital increased by DKK 433 million at end-2020. The principal factors underlying the IFRS 9 effect is that static effect of the transition to IFRS 9 and the management impairment estimates made in 2020 and placed in stages 1 and 2.

Reference is made to "Additional Pillar 3 Disclosures Q4 2020", tab 2, regarding the impact of IFRS 9.

4.4.2 Issued capital instruments

Spar Nord has issued additional tier 1 capital with a total principal of DKK 780 million, distributed on two loans of DKK 450 million and DKK 330 million, respectively. The latter issuance was made in 2020.

In 2020, Additional Tier 1 (AT1) capital with a principal of DKK 400 million was repaid. The issued loan was repaid in connection with first call.

Spar Nord has issued tier 2 capital with a total principal of DKK 1,344 million, distributed on four issues of DKK 444 million (SEK 600 million), DKK 400 million, DKK 350 million and DKK 150 million, respectively.

The Bank'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 capital issues, which are included in the calculation of own funds.

Capital and solvency need

Figure 4.5

Additional tier 1 capital and tier 2 capital issued

DKKm	Principal	First call date	Expiry date
Additional tier 1 capital - DK0030386297	450	06.12.2021	Perpetual
Additional tier 1 capital - DK0030465083	330	15.04.2025	Perpetual
Tier 2 capital - NO0010808033	444	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 2020", tab 4, for more information on issued capital instruments.

4.4.3 Calculated own funds

As shown in figure 4.6, own funds increased by DKK 1,179 million in 2020 to DKK 11,514 million. Own funds were primarily affected by developments in the following areas:

- Profit for the year after tax
- Adjustment for transitional arrangement for dynamic IFRS 9 component
- Provision for expected dividends for 2020
- Suspension of dividend payment for 2019
- Lower total deductions for insignificant investments in CET1 instruments issued by financial sector entities
- Growth in the value of significant investments in CET1 instruments issued by financial sector entities
- Redemption and issuance of additional tier 1 (AT1) capital

Profit for the year after tax and before interest on additional tier 1 capital added DKK 737 million to own funds. Of this amount, a DKK 185 million provision has been made covering proposed dividends for 2020, equal to DKK 1.5 per share.

In 2020, DKK 49 million was paid on issued additional tier 1 capital.

As shown in figure 4.6, the total deduction for CET1 instruments issued by financial sector entities is reduced by DKK 51 million. The reduction is due to a higher deduction threshold due to an increase in common equity tier 1 capital after deductions. In addition, the value of investments in significant CET1 instruments issued by financial sector entities has increased, which seen in isolation increases the deduction. Investments in insignificant CET1 instruments issued by financial sector entities were at the same level as at year-end 2019.

The distinction between insignificant and significant investments is defined by the ownership interest. An ownership interest of less than 10% is defined as insignificant investments, while ownership interests of more than 10% are thus defined as significant investments.

Figure 4.6

Calculation of own funds

DKKm	2020	2019
Share capital	1,230	1,230
Retained earnings	8,266	7,579
IFRS 9 transitional arrangement	433	188
Revaluation reserves	100	92
Proposed dividend	-185	-431
Intangible assets	-141	-143
Deduction – Investments in insignificant CET1 instruments	-132	-205
Deduction – Investments in significant CET1 instruments	-95	-71
Prudent valuation	-26	-21
Adjustment, permitted holding of treasury shares	-27	-25
Customer holdings of Spar Nord shares based on loan financing	0	0
Common equity tier 1 capital after primary deductions	**9,422**	**8,192**
Additional tier 1 (AT1) capital	773	843
Deduction – Holdings of insignificant AT1 instruments	-2	-3
Tier 1 capital (incl. additional tier 1 capital) after deductions	**10,193**	**9,032**
Tier 2 capital	1,324	1,308
Deduction – Holdings of insignificant T2 instruments	-3	-5
Own funds	**11,514**	**10,335**

4.5 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.

The calculation of the total risk exposure amount for credit and market risk is made using the standardised approach. 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, the comprehensive approach is used for financial collateral.

Figure 4.7 shows the Bank'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

Capital and solvency need

4.5.1 Calculated risk exposure

In 2020, Spar Nord's total risk exposure amount fell by DKK 1.1 billion to stand at DKK 54.9 billion at end-2020. This is shown in figure 4.8, which shows the calculation of the capital requirement and the total risk exposure amount.

In 2020, the total risk exposure amount for credit risk fell by DKK 1.8 billion to stand at DKK 45.3 billion at end-2020. Of this amount, risk exposure from OTC derivatives with financial counterparties (CVA risk) accounted for DKK 0.3 billion.

As described in section 4.3, an adjusted definition and management of SME exposures were implemented at 30 June 2020. Seen in isolation, this initiative has reduced the Bank's risk exposure by around DKK 1.3 billion.

The amounts take into consideration the fact that the IFRS 9 transitional arrangement results in higher risk exposure. The effect was calculated at DKK 0.4 billion at end-2020.

Figure 4.8 shows that the reduction is attributable to the calculated risk exposure to companies. The initiative to manage SME exposures and a reduction in exposures explain this development.

Figure 4.8

Calculation of capital requirements and risk exposure

DKKm	Capital requirement		Risk exposure	
Credit risk, incl. CVA	**2020**	**2019**	**2020**	**2019**
Central governments or central banks	0	0	0	0
Regional governments or local authorities	0	0	3	3
Public-sector entities	3	3	37	39
Institutions	48	43	596	544
Corporates	1,410	1,690	17,619	21,125
Retail customers	1,334	1,264	16,681	15,803
Secured by mortgages on immovable property	248	204	3,105	2,548
Exposures in default	88	75	1,101	935
Items associated with particularly high risk	67	73	832	908
Claims in the form of CIU	0	0	2	4
Equity exposures	266	244	3,325	3,049
Other items	137	156	1,715	1,949
CVA risk	21	13	262	160
Total credit risk, incl. CVA	**3,622**	**3,765**	**45,277**	**47,068**
Market risk				
Debt instruments	285	236	3,563	2,947
Shares, etc.	27	24	334	297
Foreign exchange risk	7	7	91	91
Commodity risk	0	0	6	4
Total market risk	**320**	**267**	**3,994**	**3,340**
Total operational risk	**448**	**444**	**5,594**	**5,555**
Total	**4,389**	**4,477**	**54,865**	**55,963**

Secondarily, the risk exposure to retail customer is increased while mortgage on real property, mainly towards retail customers, has also increased.

Risk exposure derived from market risk increased by DKK 0.7 billion to DKK 4.0 billion in 2020, primarily because of higher exposure within debt instruments. Developments in the gross interest rate risk and the bond portfolio have resulted in a higher risk exposure. Reference is made to figure 7.3 in section 7 for a description of this development.

As shown in figure 4.8, exposure in other risk areas was on a level with end-2019 figures.

The risk exposure amount for operational risk rose by DKK 39 million to DKK 5.6 billion.

4.6 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 (FSA) 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 the bank has additional risks that necessitate an add-on to the calculated solvency need (Pillar 2).

In the guidelines issued by the Danish FSA, 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 FSA, 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.

Capital and solvency need

The calculation method follows the guidelines issued by the Danish FSA 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
    - IFRS 9 transitional arrangement phase-out
    - Deduction in own funds for non-performing exposures

The impact of the individual areas on the solvency need has been calculated in part using the methods designated by the Danish FSA in its guidelines, and partly 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

As shown in figure 4.9, the adequate own funds amounted to DKK 5,413 million at end-2020, which is DKK 85 million up on end-2019. The increase was mainly due to a higher add-on for operational risk and market risk, including add-ons for credit spread risk. The reduction in the total risk exposure amount limits the increase in the adequate own funds.

The total risk exposure amount fell from DKK 56.0 billion at end-2019 to DKK 54.9 billion at end-2020. At end 2020, the solvency need ratio amounted to 9.9%, which means the ratio has increased by 0.4 of a percentage point relative to end-2019.

Figure 4.9

Adequate own funds by risk area

DKKm/% of REA*	2020		2019	
Minimum 8% requirement				
Credit risk, incl. CVA	3,622	6.6	3,765	6.7
Market risk	320	0.6	267	0.5
Operational risk	448	0.8	444	0.8
Total	**4,389**	**8.0**	**4,477**	**8.0**
Add-on to solvency need				
Credit risk	236	0.4	231	0.4
Market risk	505	0.9	425	0.8
Operational risk	242	0.4	165	0.3
Other risks	41	0.1	30	0.1
Add-on, if required by law	0	0.0	0	0.0
Total add-on	**1,024**	**1.9**	**851**	**1.5**
Total	**5,413**	**9.9**	**5,328**	**9.5**

*) Risk Exposure Amount

4.7 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 a capital conservation buffer, a countercyclical capital buffer and a potential systemic buffer. In addition, a buffer requirement applies to banks designated as systemically important financial institutions (SIFIs).

The capital conservation buffer requirement serves to ensure a more robust financial sector in terms of a strengthened common equity tier 1 capital ratio. The capital conservation buffer requirement has been set at 2.5% of the total risk exposure amount.

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

The COVID-19 pandemic has affected the countercyclical buffer requirement as the Danish Minister for Industry, Business and Financial Affairs in March 2020 opted to release the requirement relating to Danish exposures for an indefinite period. This initiative caused a drop in the combined capital buffer requirement equal to 1.0 percentage point of the risk exposure amount placed in Denmark.

Capital and solvency need

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. The SIFI buffer requirement was phased in at a rate of 0.5% at end-2019 and 0.5% at end-2020. This means that, at end-2020, the Bank must comply with a fully phased-in SIFI buffer requirement of 1.0% 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.

4.7.1 Calculated combined buffer requirement

At end-2020, the combined capital buffer requirement consists of the requirements for the capital conservation buffer, the countercyclical buffer and the SIFI buffer. The calculated combined buffer requirement is shown in figure 4.10.

Figure 4.10

Combined buffer requirement

	2020	2019
Total risk exposure amount (DKKm)	54,865	55,963
Capital conservation buffer requirement (%)	2.5	2.5
Institution-specific countercyclical buffer requirement (%)	0.0	1.0
SIFI buffer requirement (%)	1.0	0.5
Capital conservation buffer requirement (DKKm)	1,372	1,399
Institution-specific countercyclical buffer requirement (DKKm)	2	557
SIFI buffer requirement (DKKm)	549	280
Combined buffer requirement (DKKm)	**1,922**	**2,236**

As shown in figure 4.10, the combined buffer requirement fell by DKK 314 million in 2020. This is a combination of an increase in the SIFI buffer requirement of 0.5% and the release of the countercyclical buffer requirement for Danish exposures. In addition, a decline in the total risk exposure amount results in a lower combined buffer requirement.

The capital conservation buffer requirement is calculated on the basis of the total risk exposure amount, and at end-2020 it stood at 2.5% of the total risk exposure amount. The percentage requirement was unchanged at end-2020 compared with end-2019.

The institution-specific countercyclical buffer requirement was DKK 2 million at end-2020. The buffer was calculated on the basis of the geographic distribution of the Bank's credit exposure. The breakdown of credit exposures relevant for calculating the countercyclical buffer is shown in figure 4.11. The figure shows that the Bank is principally exposed to Denmark, as a result of which the release of the countercyclical buffer requirement in Denmark has contributed to a drop in the combined capital buffer requirement.

Figure 4.11

Geographical breakdown of credit exposures

	2020		2019	
%	Exposure	Buffer rate	Exposure	Buffer rate
Denmark	96.8	0.0	97.5	1.0
Germany	1.0	0.0	0.5	0.0
Sweden	0.3	0.0	0.3	2.5
Norway	0.4	1.0	0.3	2.5
United Kingdom	0.3	0.0	0.3	1.0
USA	0.1	0.0	0.1	0.0
Other countries	1.2	0,0	0.9	0.0

The SIFI buffer requirement has been set at 1.0% of the total risk exposure amount. The requirement is now fully phased on. The requirement has risen by 0.5% since end-2019, as a result of which the combined buffer requirement has increased, other things being equal.

The standard layout to be used for publishing information regarding compliance with the requirement as to a countercyclical capital buffer appears from "Additional Pillar 3 Disclosures Q4 2020", tabs 31-32.

4.8 Excess coverage relative to capital requirement

Figure 4.12 shows that the common equity tier 1 capital at end-2020 was 17.2%, which equates to an excess coverage of 7.6 percentage points relative to the CET1 capital requirement.

Figure 4.12

Excess coverage relative to common equity tier 1 (CET1) requirement

DKKm/% of REA*	2020		2019	
Basic requirement of 4.5%	2,469	4.5	2,518	4.5
Add-on to solvency need	576	1.0	479	0.9
Combined buffer requirement	1,922	3.5	2,236	4.0
Capital requirement from additional tier 1 capital	244	0.4	159	0.3
Capital requirement from tier 2 capital	33	0.1	29	0.1
Capital requirements	**5,244**	**9.6**	**5,421**	**9.7**
Common equity tier 1 capital	9,422	17.2	8,192	14.6
Excess coverage	**4,178**	**7.6**	**2,772**	**5.0**

*) Risk Exposure Amount

Capital and solvency need

At end-2020, the own funds ratio stood at 21.0%, corresponding to an excess coverage of 7.6 percentage points relative to the total capital requirement, as shown in figure 4.13.

Figure 4.13

Excess coverage relative to capital requirement

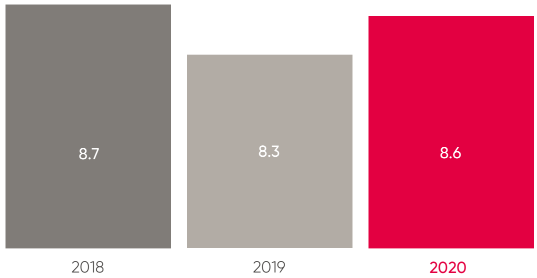
DKKm/% of REA*	2020		2019	
Minimum 8% requirement	4,389	8.0	4,477	8.0
Add-on to solvency need	1,024	1.9	851	1.5
Combined buffer requirement	1,922	3.5	2,236	4.0
Capital requirements	**7,335**	**13.4**	**7,564**	**13.5**
Own funds	11,514	21.0	10,335	18.5
Excess tier 2 capital	0	0.0	0	0.0
Excess coverage	**4,178**	**7.6**	**2,772**	**5.0**

*) Risk Exposure Amount

Figure 4.15 illustrates the calculated leverage ratio for the period 2018-2020.

Figure 4.15

Leverage ratio



4.9 Leverage ratio

The leverage ratio is calculated as tier 1 capital relative to total leverage 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 its 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 its leverage ratio was calculated at 8.6% at end-2020, as shown in figure 4.14. 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 8.3%.

Figure 4.14

Leverage ratio

%	2020	2019
Leverage ratio – IFRS 9 transitional arrangement	8.6	8.3
Leverage ratio – fully phased-in IFRS 9	8.3	8.1

4.10 Minimum requirements for eligible liabilities

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 be returned to the market with adequate capitalisation to ensure market confidence.

BRRDII is an updated Bank Recovery and Resolution Directive implemented in Danish legislation at the end of 2020 and resulting in adjustments to the determination of the MREL:

- Loss absorption amount: Determined as the solvency need
- Recapitalisation amount: Determined as the solvency need plus the combined buffer requirement with the exception of the countercyclical buffer requirement.

In addition, Spar Nord must comply with a special requirement equal to the combined buffer requirement. See section 4.7.

The MREL is being phased in by 25% a year between early 2019 and mid-2022. At end-2020, the MREL was phased in by 50%. The separate requirement has been fully phased in equal to the combined buffer requirement, which is described in section 4.7.

The Danish FSA has determined Spar Nord's MREL at 15.6% at 28 December 2020. Fully phased-in, the MREL has been determined at 22.5% at 1 July 2022. Spar Nord regularly monitors a calibrated MREL adjusted to applicable buffer requirements and the currently calculated solvency requirements.

The calibrated MREL requirement is higher than the requirement determined by the Danish FSA and is shown in figure 4.16.

Capital and solvency need

At year end-2020, the MREL requirement was calibrated to 16.1%, and a fully phased-in MREL requirement is calculated at 23.2%. The calibrated MREL requirement is calculated at a higher amount than the requirement set by the Danish FSA, as the FSA has based its calculation on the calculated solvency need at end-2019. The solvency need at end-2020 has been calculated at a higher level, as described in section 4.6. The solvency need thus has a direct impact on the MREL requirement, which is calibrated at a higher level.

Figure 4.16

MREL and buffer requirement – calibrated

%	31.12.20	01.07.22
Solvency need ratio	9.9	9.9
Requirement for loss-absorption amount	**9.9**	**9.9**
Solvency need ratio	9.9	9.9
Capital conservation buffer requirement	2.5	2.5
SIFI buffer requirement	1.0	1.0
Phasing in	-7.1	0.0
Requirement for recapitalisation amount	**6.3**	**13.4**
Total MREL	**16.1**	**23.2**
Capital conservation buffer requirement	2.5	2.5
SIFI buffer requirement	1.0	1.0
Countercyclical buffer requirement	0.0	0.0
Total MREL and combined buffer requirement	**19.6**	**26.7**

It is expected that the MREL in all material aspects will be met with convertible instruments ("contractual bail-in"), including common equity tier 1 capital 1, additional tier 1 and tier 2 capital, with a term to maturity of more than 12 months. In addition, capital defined as Senior Non-Preferred may be used. 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.

It is also possible to comply with the requirement by partly using senior issues, always provided that the subordination requirement is complied with in accordance with BRRDII.

The subordination requirement corresponds to the MREL and defines the scope of how large a proportion of the capital base which must be subordinated. Compliance with the separate requirement by way of the combined capital buffer requirement forms part of the compliance with the subordination requirement.

Spar Nord had not recognised senior issues in its eligible liabilities at end-2020. At end-2020, Spar Nord had issued Senior Non-Preferred (SNP) bonds for a nominal amount of DKK 2.7 billion. In 2021, the Bank expects to issue additional Senior Non-Preferred bonds to the tune of DKK 2 billion.

Spar Nord's issue of Senior Non-Preferred with a total principal of DKK 2,675 million is distributed on three issues of DKK 925 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 issues.

Figure 4.17

Issued Senior Non-Preferred (SNP)

DKKm	Principal	First call date	Expiry date
SNP bonds - DK0030454046	925	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 end-2020, the excess coverage with respect to the total MREL and combined buffer requirement is calculated at DKK 3.4 billion, which equals an excess coverage of 6.2 percentage points relative to the calibrated MREL requirement. This is shown in figure 4.18. The defined and calibrated requirements were both met at end-2020, as the calibrated requirement has been set 0.5 percentage point higher than the requirement laid down by the Danish FSA.

Figure 4.18

Excess coverage calibrated MREL requirement

DKKm/%	31.12.20
Own funds	11,514
Non-preferred senior capital	2,650
Other MREL eligible liabilities	0
Total capital	**14,164**
Deduction - separate combined buffer requirement	-1,922
Total MREL eligible assets	**12,241**
MREL- and combined buffer percentage	25.8
MREL percentage	22.3
MREL- and combined buffer requirement	10,774
MREL requirement	8,851
Excess coverage - MREL requirement	3,390
Excess coverage MREL requirement in percentage points	6.2

Capital and solvency need

4.11 Internal ratings-based models

Spar Nord has applied internal models in its credit risk management for more than ten years, and since 2018 the Bank has worked intensively to prepare an application for permission to switch to the use of internal ratings-based 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, the Bank 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 appropriate capital application. These expected lower risk weights will contribute to underpinning the Bank'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 substantially under the coming CRR II and CRR III regulation.

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 credit risk
- Market risk
- Operational risk
- CVA (Credit Valuation Adjustment)
- Leverage ratio requirements for SIFI institutions
- Handling of IRB modelling

Spar Nord expects to handle new capital requirements concerning counterparty credit risk by mid-2021. In addition, new regulatory requirements concerning credit risk, market risk, operational risk and CVA are not expected to come into force until at the beginning of 2023 at the earliest.

Section 5

Liquidity risk and funding

Developments in 2020

At end-2020, Spar Nord's liquidity situation has been strengthened relative to 2019. The LCR thus stood at 241% at end-2020, against 195% at end-2019. The strategic liquidity is calculated at DKK 30.0 billion, which is an increase of as much as DKK 6.6 billion compared with 2019.

At end-2020, Spar Nord's total funding amounted to DKK 77.0 billion, which is an increase of DKK 5.9 billion relative to end-2019. Deposits at end-2020 accounted for 76% of the total funding, thus remaining the Bank's most significant source of funding.

LIQUIDITY COVERAGE RATIO (LCR)

241%

2019: 195%

STRATEGIC LIQUIDITY

DKK 30.0 billion

2019: DKK 23.4 billion

ASSET ENCUMBRANCE RATIO

4.3%

2019: 5.0%

Definition of liquidity risk

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.

Spar Nord Bank is generally exposed to liquidity risks when lending, investment and funding activities result in a cash flow mismatch.

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 the business model.

The aim of the liquidity policy is to ensure that the Bank 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 the Bank 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 Bank's Liquidity Coverage Ratio (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 Supervisory Diamond.

Section 5

Liquidity risk and funding

Figure 5.1

Liquidity management at Spar Nord

	Short-term liquidity management		Liquidity stress test	Management of funding sources and needs	Long-term liquidity management
Objective	Ensuring that, in the short operational term, the Bank will be able to meet its obligations at all times Ensure compliance with intraday liquidity	Ensuring that, in the short term (30 days), Spar Nord has adequate high-quality liquid assets to withstand a severe stress scenario Ensuring compliance with the Liquidity Coverage Ratio (LCR), see CRR	Ensuring that Spar Nord is aware of future liquidity and refinancing risks Stress tests are prepared for a 12-month term	Ensuring that Spar Nord has a diversified and balanced funding structure Ensuring that Spar Nord maintains an overview of future funding needs broken down by funding sources	Ensuring that Spar Nord has hedged any long-term mismatch between deposits and lending Ensuring compliance with the Danish FSA's Funding Ratio (as per the Supervisory Diamond) and the Net Stable Funding Ratio (as per CRR)
Management tool	Decentralised instruction target	Decentralised instruction target	Central instruction target	Central instruction target	Central instruction target
Monitoring/ control	Liquidity management function	Liquidity management function	Funding	Funding	Funding
Report recipient	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
Model	Managing intra-day liquidity	GAP analysis/ Simulation tool	GAP analysis/ projection	GAP analysis/ projection	GAP analysis
Ratios/model for follow-up	Requirement for intra-day liquidity	Liquidity Coverage Ratio 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 the Bank's short-term liquidity, including the daily management of LCR and intraday liquidity and ongoing preparation of stress tests.

As shown in figure 5.3 and illustrated in figure 5.2, LCR was calculated at 241% at end-2020, which is well above the target LCR of at least 125%. The excess coverage of 116 percentage points relative to the target corresponds to DKK 11.5 billion in excess liquidity. Calculated relative to the statutory requirement of 100%, the excess liquidity amounted to DKK 14.0 billion. At end 2019, LCR was calculated at 195%.

Figure 5.2

Liquidity Coverage Ratio (LCR)

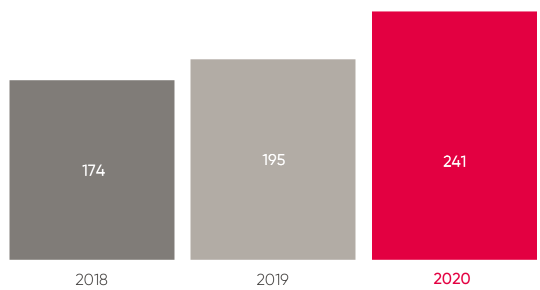


Figure 5.3

Liquidity Coverage Ratio (LCR)

DKKm	2020	2019
Liquidity resources	23,844	18,928
Liquidity Coverage Requirement	9,876	9,717
LCR (%)	**241**	**195**

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).

Reference is made to "Additional Pillar 3 Disclosures Q4 2020", tab 30, regarding Liquidity Coverage Ratio.

Liquidity risk and funding

5.4 Long-term liquidity

Strategic liquidity is calculated as deposits excl. repo transactions, senior loans, issued bonds, subordinated debt and equity less lending excl. reverse repo transactions. However, subordinated debt, additional tier 1 capital, senior loans and issued bonds with a contractual due date within 12 months are not included in the calculation of strategic liquidity.

At end-2020, Spar Nord had strategic liquidity of DKK 30.0 billion. This level reflects significantly strengthened liquidity of DKK 6.6 billion relative to end-2019, when strategic liquidity was calculated at DKK 23.4 billion.

Developments in strategic liquidity in 2020 are illustrated in figure 5.4, and figure 5.5 shows developments in the period 2018-2020.

Compared with 2019, the Bank increased its deposits by DKK 4.8 billion, while loans and advances fell by DKK 0.6 billion in the same period. Finally, a positive consolidation for the period also contributes to an overall improvement in strategic liquidity.

Figure 5.4

Development in strategic liquidity
DKKbn

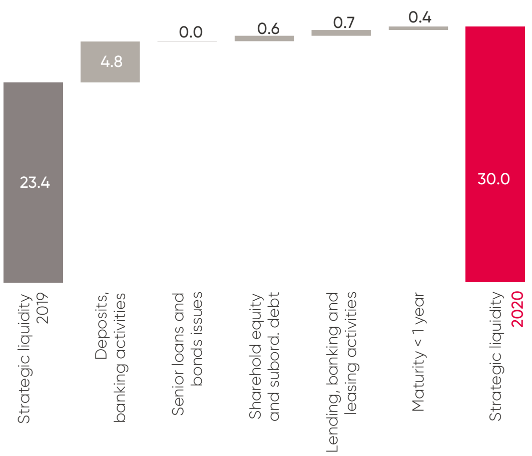
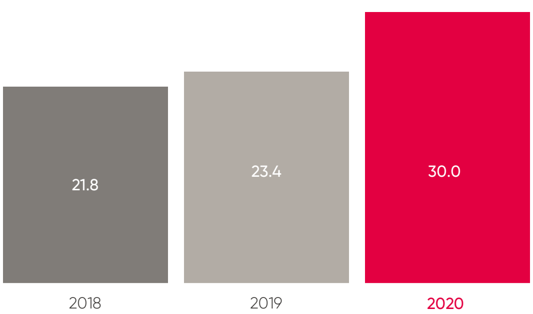


Figure 5.5

Strategic liquidity



5.5 Stress test

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 scenarios are calculated without any management intervention. The stress tests prepared have lived up to the Bank'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-2020, the projection in figure 5.6 shows that liquidity resources will be reduced by DKK 7.7 billion over the 12-month projection period, but also that in a severe stress scenario the Bank complies with the LCR statutory requirement in the full 12-month projection period.

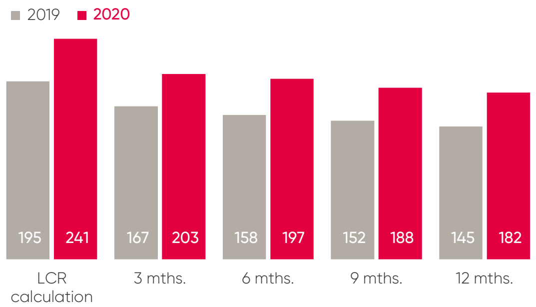
Figure 5.6

Run-off of liquidity resources in a severe stress scenario

	Liquidity resources		Accumulated run-off	
DKKm / %	**2020**	**2019**	**2020**	**2019**
Calculation period	23,844	18,928		
3 months	19,407	14,880	-19	-21
6 months	18,441	13,642	-23	-28
9 months	17,046	12,748	-29	-33
12 months	16,111	11,914	-32	-37

Figure 5.7

LCR projected in a severe stress scenario
%



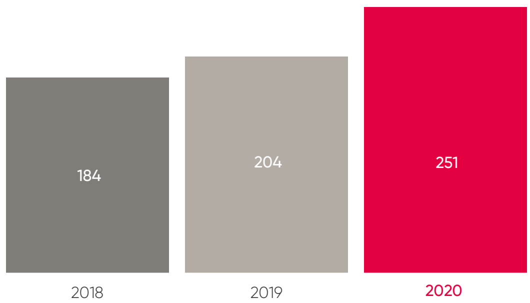
Liquidity risk and funding

5.6 Liquidity benchmark

The liquidity indicator of the Danish FSA is based on a projected version of LCR using an adjusted calculation of liquidity in 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, as witnessed by the historical comparison in figure 5.8.

Figure 5.8
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 the central bank of Denmark
- Issued bonds and senior loans, including Senior Non-Preferred
- Subordinated debt and equity

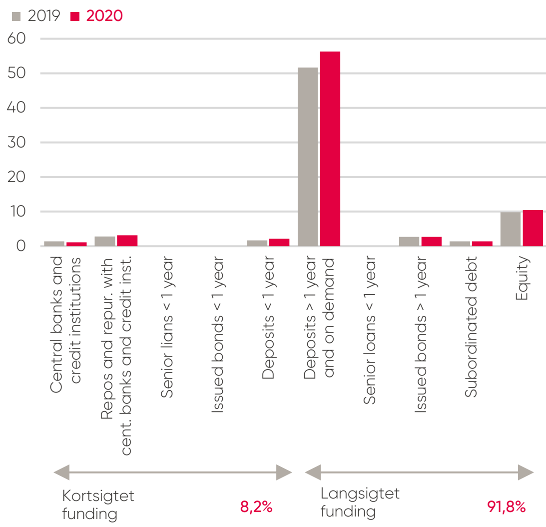
Spar Nord's funding structure is shown in figure 5.9. From an overall perspective, the Bank's funding at end-2020 increased by DKK 5.9 billion to DKK 77.0 billion compared with end-2019. The principal change in Spar Nord's funding is a DKK 5.1 billion increase in deposits (incl. repo), which was primarily driven by deposits on demand. Deposits remain Spar Nord's largest source of funding, and at end-2020 it represented 75.9% of Spar Nord's total funding.

Figure 5.9
Funding structure

DKKm/%	2020	2019	2020	2019
Central banks and credit institutions	1,065	1,298	1.4	1.8
Repos and repurchases with central banks and credit institutions	3,102	2,764	4.0	3.9
Senior loans < 1 year	0	0	0.0	0.0
Issued bonds < 1 year	0	0	0.0	0.0
Deposits < 1 year	2,121	1,661	2.8	2.3
Deposits > 1 year and on demand	56,295	51,618	73.1	72.6
Senior loans > 1 year	0	0	0.0	0.0
Issued bonds > 1 year	2,670	2,637	3.5	3.7
Subordinated debt	1,333	1,322	1.7	1.9
Equity	10,390	9,761	13.5	13.7
Total	**76,976**	**71,061**	**100.0**	**100.0**

As shown in figure 5.10, Spar Nord's total long-term funding (deposits on demand and funding with a term to maturity of more than 12 months) amounted to 91.8% at year-end 2020, which is close to the level of year-end 2019.

Figure 5.10
Funding structure
DKKbn



5.8 Contingency liquidity 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 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.

5.9 Encumbered assets

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 the Bank'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 Bank provides collateral for numerous other purposes, including clearing activities.

The primary sources of asset encumbrance are:

1. Encumbrance triggered by activities in the securities market:
   - Repo and reverse repo transactions
   - Repurchase transactions with the central bank of Denmark
   - Securities lending
2. Collateral for derivative transactions:
   - CSA collateral for the market value of derivative transactions
   - CSA collateral for the clearing of derivative transactions
   - Collateral for stock lending
3. 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 shows the asset encumbrance ratio at year-end and an average for 2020 and 2019.

Figure 5.11

Asset encumbrance ratio

	End of year		Average	
DKKm	**2020**	**2019**	**2020**	**2019**
Encumbered assets	4,643	3,470	4,515	4,912
Assets and collateral	112,533	102,350	106,201	98,058
Asset encumbrance ratio	**4.1**	**3.4**	**4.3**	**5.0**

The average asset encumbrance ratio amounts to 4.3% of the total assets plus collateral received that can form the basis for encumbrance in 2020. This is 0.7 percentage points lower than in 2019, when the average ratio was 5.0%.

Reference is made to "Additional Pillar 3 Disclosures Q4 2020", tabs 33-36, regarding encumbered assets.

5.10 Rating

In 2019, Spar Nord was assigned a rating by Moody's, which at end-2020 is unchanged with a stable outlook and the following ratings:

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

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. The use of the 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 regular calculations of Spar Nord's NSFR, the Bank is believed to be comfortably positioned in terms of a future NSFR liquidity requirement of 100%.

Section 6

Credit risk

Developments in 2020

Spar Nord experienced a small drop in gross lending of DKK 0.5 billion excl. reverse repo business in 2020. The decline covers opposite trends consisting of an increase of DKK 0.8 billion to retail customers and DKK 0.8 billion in lease loans, against a drop in DKK 2.0 billion in loans to business customers, including public-sector companies.

The increase in retail customer activity was driven by factors such as customer inflows and a high level of activity especially in the housing market. The drop in business lending was mainly due to customer reluctance to make new investments and the effects of COVID-19 relief packages.

Spar Nord has found objective evidence of credit impairment due to COVID-19 on a few large exposures and has recognised new impairment charges of about DKK 100 million in that connection.

The Bank does not have substantial exposure to individual industries that are particularly challenged by the COVID-19 pandemic.

A management estimate of DKK 320 million has been recognised specifically to cover any future losses resulting from the financial challenges which COVID-19 is expected to cause.

The facilitation of mortgage loans developed favourably in 2020 with an increase of DKK 5.9 billion (6.7%), driven principally by positive trends in lending to retail customers.

The total profit impact from losses and impairment charges was DKK 309 million in 2020.

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 attaching to 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 45.3 billion

2019: DKK 47.1 billion

LOANS EXCL. REVERSE (GROSS)

DKK 44.1 billion

2019: DKK 44.6 billion

IMPAIRMENT RATIO
(IMPACT ON OPERATIONS)

0.44%

2019: 0.03%

TOTAL IMPAIRMENT

2.5%

2019: 2.2%

NPL RATIO

3.4%

2019: 3.7%

SUSPENDED-INTEREST LOANS

0.4%

2019: 0.4%

UNSECURED SHARE (EXCL. REVERSE)

29.7%

2019: 33.8%

Section 6

Credit risk

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 the credit policy is to ensure that earnings and risks are balanced, and that the assumption of risk is always quantified.

It is the Bank's policy that credit must always be granted on the basis of insight into the customer'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. In addition, the Bank applies the basic rule of not granting loans and credit facilities based on collateral alone. Thus, the customer should show the determination and have the ability to repay loans without the Bank having to realise the collateral. For purposes of assessing creditworthiness, the Bank applies statistical rating models which risk-classify its customers.

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

Climate and sustainability considerations are included in the assessment of business customers in particular. Businesses with a high climate impact face special market terms and conditions, more stringent regulatory requirements and an increased requirement to invest in climate measures. Climate challenges may affect the robustness of a business and will potentially impair its earnings capacity and growth opportunities. Other things being equal, this could limit the creditworthiness of a business. Companies with an environmentally sustainable profile are estimated to have a better foundation for tackling the challenges imposed by rising climate considerations. A satisfactory climate profile is considered a favourable component in the assessment of customers.

In the efforts to ensure sound risk diversification of the Bank's credit exposure, a number of internal credit targets have been defined.

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.

Exposure caps have been determined on the basis of the following rules:

- Exposure is capped at DKK 750 million for exposure groups within the same legal entity with more stringent requirements for collateral to secure exposure amounts exceeding DKK 500 million. The unsecured share in the exposure group must not exceed DKK 250 million.
- Exposure is capped at DKK 1 billion for exposure groups consisting of customers who, financially, legally and in terms of risk, are independent of each other and are only affiliated because of a common administrative organ. The unsecured share in the exposure group must not exceed DKK 250 million, and individual exposures in the group must not exceed the limits set out in the first bullet.
- For unrated customers subject to supervision by the Danish FSA, exposure is capped at DKK 1 billion.

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.

The Bank pursues the policy that business customers' share of total loans and advances guarantees cannot exceed 70% of total loans, advances and guarantees excl. reverse lending.

This means the Bank has set a minimum limit of 30% for retail customers' share of total loans and advances guarantees. There is no upper limit for retail customers' share of total loans, advances and guarantees because a high proportion of loans to retail customers is considered a strength in terms of credit.

To ensure a strongly diversified customer portfolio and prevent large concentration risks in individual industries, targets have been set for the maximum distribution of exposure to selected industries. The exposure targets are shown in figure 6.1.

Figure 6.1

Exposure target for industries

%	Maximum share of total exposure*
Agricultural sector	10
Property sector	15
of which speculative** property financing	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)

Credit risk

In addition, the Bank has defined a target that the sum of the 20 largest customers must not account for more than 150% of the Bank's common equity tier 1 capital, which at end-2020 was calculated at DKK 9.4 billion. See figure 4.6 in section 4.

The credit policy includes a principle that the Bank wants insight into any exposures that its customers may have towards other financial institutions.

Spar Nord has defined rules for the financing of rental properties and commercial properties, which are shown in figure 6.2.

Figure 6.2

Threshold values for property letting

	Solvency ratio (%)	Return on debt (%)	Debt service ability
Residential rental property	> 20	> 5	> 1.2
Let all-year residences with less than 4 units	> 50	> 10	> 2.5
Office/retail	> 25	> 6	> 1.4
Other (industry/skilled trades, etc.)	> 30	> 7	> 1.4

The main rules for project financing of properties are shown in figure 6.3.

Figure 6.3

Project financing of properties

%	Maximum loan-to-value ratio (LTV)*
Projects sold	100
Projects let	80
Projects not sold or let	50
Land purchase – crude soil	50
Land purchase – developed soil	50

*) Maximum LTV of cost price

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 with respect to customer base.
- The wish that a certain share of authorisations from the local banks is always dealt with by the Credit Department.

Decentralised facility authorisation rights are maximised at DKK 10 million for existing customers.

Customer advisers, where relevant in consultation with relationship managers in retail and business banking, 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 the Credit Department, the Credit Committee or the Board of Directors. The Credit Department may authorise credit lines up to DKK 50 million for existing customers and DKK 25 million for new customers. In addition, the Credit Committee may authorise credit lines up to DKK 100 million for existing customers and up to DKK 50 million for new customers. Exposures exceeding DKK 100 million for existing customers and exposures exceeding DKK 50 million for new customers 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 credit risk exposure is managed by the Risk Management Department, which oversees changes in the credit quality of all 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.

The Bank has developed IT tools for centralised and decentralised monitoring and controlling of credit risks. 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.

The Bank's rating system regularly calculates a statistically based rating of both retail and business customers. This monthly updated rating combined with an application score for new customers is included in the decentralised credit assessment of the individual loan case, and together with other parameters it decides the extent of the decentralised authorisation power. 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 risk categorisation based on ratings is also used in early warning processes, in the Bank's impairment processes (IFRS 9), for managing overdrafts and for pricing purposes to help ensure a correlation between the risk assumed by the customer and the price paid.

Credit risk

The Bank's rating system risk-classifies all non-defaulting customers into rating categories according to the probability that the individual customer defaults within the next 12 months.

The probability of default is estimated on the basis of statistical models adapted to the individual customer segment. On the basis of this probability, customers are classified into rating categories from 1 to 8, with category 8 containing customers with the highest risk of default. Customers with objective evidence of impairment (OEI) but without a need for impairment are placed in rating category 9, while OEI customers with a need for impairment and other customers in default are placed in rating category 11.

The model applied to business customers employs three components:

1. An accounting component used to risk-classify the customer based on its most recent financial statements.
2. A behavioural component that classifies the customer based on its account behaviour and credit history.
3. A cyclical component that adjusts the risk classification to current and expected cyclical developments.

New business customers are classified based on the accounting and cyclical components during the first six months, after which time the behavioural component is also applied in the overall rating.

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 and disposable income. This model is based on a combination of a statistical and an expert model. After six months, when a record of the customer's account behaviour has been established, customers are subjected to behavioural scoring scrutiny.

In addition to the above-mentioned models, Spar Nord applies a qualitative risk classification, in which the 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 and unemployment, and for business customers they could be marketing difficulties, the loss of key employees or loss of suppliers agreements. The flagging of weak credit quality is assessed and made as soon as it is considered likely that the customer will become financially challenged, which is thus often before the situation is discernible in data for the statistically based models. Customers flagged as having a weak credit quality are reviewed at least once a year.

If a retail customer is flagged as having a weak credit quality but is not in default, the customer will automatically be downgraded by one rating category; it should be noted that a customer flagged as having a weak credit quality can never qualify for rating in the best rating categories (1 and 2).

Business customers are divided into two categories, customers flagged as having a weak credit quality and customers not flagged, and rated separately using two different models. While both models are based on the same components, the result of the rating calculation in the model for customers flagged as having a weak credit quality will typically lead to a lower rating.

If the adviser or another person believes that the rating of a major business customer does not reflect their true creditworthiness, for example due to inefficiencies in the data or otherwise, a process will be identified to evaluate and, where relevant, change the rating (rating override).

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 6.4 shows total credit exposure (carrying amount) at end-2020 and end-2019.

Figure 6.4

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

DKKm	2020	2019
Lending, reverse repo transactions	9,819	8,155
Lending, banking and leasing activities	42,494	43,157
Loans, advances and other receivables at amortised cost	**52,312**	**51,312**
Contingent liabilities	15,591	14,766
Net credit exposure relating to loans, advances and guarantees	**67,903**	**66,078**
Impairment of loans and provisions against guarantees, etc.	1,699	1,493
Gross credit exposure relating to loans, advances and guarantees	**69,603**	**67,571**
Cash balances and demand deposits with central banks	1,126	1,152
Balances at notice with the central bank	61	0
Reverse repo transactions with credit institutions	343	924
Due from credit institutions and central banks	855	663
Credit exposure for financial reporting purposes lending activities	**70,289**	**68,817**
Positive fair value of derivatives, etc.	777	828
Credit exposure relating to assets in the trading book	21,791	16,630
Assets in strategic business partners	1,554	1,514
Associates	529	470
Credit exposure for financial reporting purposes	**94,939**	**88,260**

Credit risk

The Bank's impairment account amounted to a total of DKK 1.7 billion at 31 December 2020, as shown in figure 6.5. Of this amount, provisions for unutilised credit lines amounted to DKK 17 million.

Figure 6.5

Impairment account for loans, advances and guarantees

DKKm	2020	2019
Impairment account	1,717	1,503

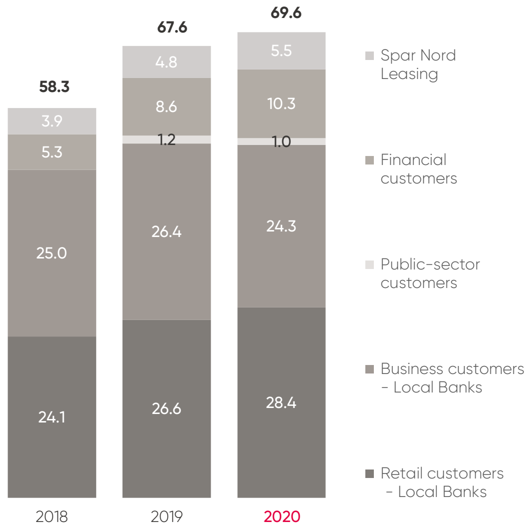
6.4 Loans, advances and guarantees

As shown in figure 6.6, total loans, advances and guarantees before impairment were DKK 69.6 billion at end-2020, which is DKK 2.0 billion higher than at end-2019. The development reflects a DKK 1.7 billion increase in repo transactions to a total of DKK 9.8 billion at end-2020, while bank lending fell DKK 0.5 billion to DKK 44.1 billion at end-2020, equivalent to a drop in lending of 1.1% in 2020. Furthermore, guarantees rose by DKK 0.8 billion to stand at DKK 15.6 billion at 31 December 2020.

Customers are divided into five groups as part of the ongoing risk monitoring: Retail customers – Local Banks, Business customers – Local Banks, Public-sector customers, Financial customers and Spar Nord Leasing. The development in these customer groups appears from figure 6.6.

Figure 6.6

Exposure by category
DKKbn



The credit exposure to retail customers at Spar Nord's Local Banks rose DKK 1.8 billion during 2020, equal to 7.0%, while the credit exposure to business customers fell DKK 2.1 billion, or 7.6%. For public-sector companies, the credit exposure fell from DKK 1.2 billion to DKK 1.0 billion. Lastly, the credit exposure to leasing customers increased 15.7% to DKK 0.8 billion.

The credit exposure to financial customers increased by DKK 1.7 billion during 2020 due to an increase in reverse repo transactions.

6.4.1 Breakdown by industry

Figure 6.7 shows the breakdown of loans, advances and guarantees by industry at end-2020 and end-2019 and the average industry breakdown at sector level at end-2019.

Figure 6.7 shows that retail customers account for more than 40% of the Bank's loans, advances and guarantees and that the Bank has as a higher proportion of retail customers than the sector as a whole. For the other industries, the Bank does not differ significantly from the sector distribution.

Figure 6.7

Loans, advances and guarantees by industry

		Spar Nord		Sector
DKKm/%	**2020**	**2020**	**2019**	**2019**
Public authorities	978	1.4	1.8	4.6
Agriculture, hunting and forestry	2,987	4.3	4.2	3.9
Fisheries	123	0.2	0.2	0.0
Industry and raw materials extraction	2,562	3.7	4.4	6.9
Energy supply	1,871	2.7	2.5	1.9
Building and construction	2,591	3.7	3.7	2.2
Trade	3,449	5.0	6.2	5.3
Transport, hotels and restaurants	2,487	3.6	3.9	3.1
Information and communication	254	0.4	0.4	0.9
Financing and insurance	13,020	18.7	16.8	22.9
Real estate	6,802	9.8	10.8	12.5
Other business areas	3,979	5.7	5.5	4.9
Business customers, total	**41,103**	**59.1**	**60.4**	**69.1**
Total retail customers	**28,500**	**40.9**	**39.6**	**30.9**
Total	**69,603**	**100.0**	**100.0**	**100.0**

Figure 6.8

Loans, advances and guarantees by industry net of reverse repo transactions

DKKm/%	2020	2020	2019
Public authorities	978	1.6	2.0
Agriculture, hunting and forestry	2,987	5.0	4.7
Fisheries	123	0.2	0.2
Industry and raw materials extraction	2,562	4.3	5.0
Energy supply	1,786	3.0	2.8
Building and construction	2,591	4.3	4.2
Trade	3,449	5.8	7.0
Transport, hotels and restaurants	2,487	4.2	4.4
Information and communication	254	0.4	0.5
Financing and insurance	3,287	5.5	5.7
Real estate	6,802	11.4	12.3
Other business areas	3,979	6.7	6.3
Business customers, total	**31,284**	**52.3**	**55.2**
Total retail customers	**28,500**	**47.7**	**44.8**
Total	**59,784**	**100.0**	**100.0**

Credit risk

Loans, advances and guarantees by exposure size are shown in figure 6.9 broken down by main customers.

Figure 6.9

Loans, advances and guarantees by exposure size* by main customers

	Number		Share	
Number/%	**2020**	**2019**	**2020**	**2019**
DKK 0 - 0.1 million	49,974	52,678	0.9	0.9
DKK 0.1 - 0.5 million	36,530	36,243	10.3	10.1
DKK 0.5 - 1 million	14,763	14,078	12.3	11.6
DKK 1 - 5 million	10,106	9,439	27.3	26.5
DKK 5 - 10 million	1,110	1,009	9.7	9.2
DKK 10 - 20 million	458	432	8.0	7.9
DKK 20 - 50 million	275	263	10.9	11.5
DKK 50 - 100 million	94	91	8.3	9.0
>DKK 100 million	44	48	12.3	13.3
Total	**113,354**	**114,281**	**100.0**	**100.0**

*) Excl. reverse repo transactions and SparXpres

As concerns size of exposures, Spar Nord's credit portfolio is considered to be well-diversified, because 60.5% of the total exposure is attributable to exposures below DKK 10 million each, and the Bank only has 44 exposures that exceed DKK 100 million.

Figure 6.10

Loans, advances and guarantees broken down by region (%)

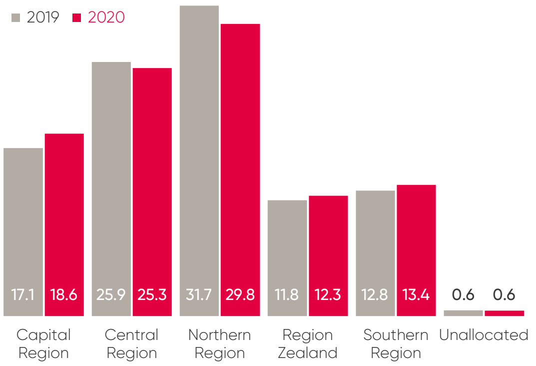


Figure 6.10 also shows a satisfactory geographical spread in the credit portfolio. At end-2020, the North Denmark Region accounted for 29.8% of the Bank's total loans, advances and guarantees, and developments in 2020 have contributed to a more even geographical diversification.

6.4.2 Retail customers with Spar Nord's Local Banks

The total credit exposure to retail customers at Spar Nord's Local Banks amounted to DKK 28.4 billion at end-2020 compared with DKK 26.6 billion at end-2019. The credit exposure to retail customers amounts to 40.9% of the Bank's total credit exposure.

As shown in figure 6.11, home loans for retail customers amounted to DKK 6.6 billion, equal to 15.1% of total loans and advances net of reverse and guarantees. Of this amount, mortgage loans accounted for DKK 2.1 billion, or 31.3%.

The geographical breakdown of retail lending for property finance is also shown in figure 6.11 and is in line with the Bank's overall business volume, as the largest proportion is located in the North Denmark Region (DKK 2.2 billion, or 32.9%).

Figure 6.11

Home loans – gross residual debt and mortgage share broken down by region

DKKm/mortgage share	**2020**		**2019**	
Capital Region	706	30.7	588	26.9
Zealand region	1,086	34.4	1,391	18.9
Southern Denmark Region	979	26.4	1,977	22.6
Central Region	1,689	28.0	965	31.8
North Denmark Region	2,188	34.5	858	20.4
Total	**6,648**	**31.3**	**5,778**	**23.4**

Figure 6.12 illustrates exposures to retail customer by rating category, and figure 6.13 shows the average rating since 2018. The figures show a positive trend in credit quality in the retail customer portfolio in 2020. This is driven by a positive development in customer savings capacity, a decline in unauthorised overdrafts and increased wealth due to the overall increase in property prices.

Figure 6.12

Exposures to retail customers by rating categories excl. SparXpres

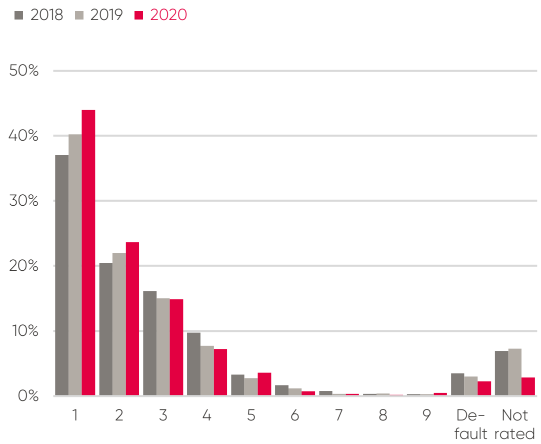


Figure 6.13

Average risk category*

	2020	**2019**	**2018**
Average risk category	2.2	2.4	2.6

*) Exposure after impairment

As appears from figure 6.13, the average credit quality of retail customers has developed favourably over the past few years with a decreasing average risk rating. However, some uncertainty attaches to the rating model for retail customers, primarily as a result of unintended instability in the business cycle component.

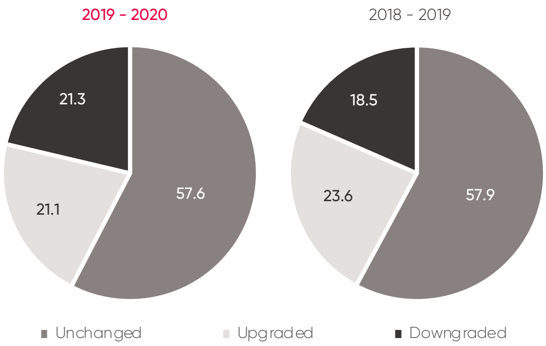
Back tests show that the model in 2020 had a tendency to slightly underestimate the risk levels (slightly more cases of default have been found than estimated by the model). However, the deviation diminished as the year progressed, and satisfactory convergence was achieved towards the end of the year.

The Bank takes the above-mentioned model uncertainty into consideration by closely monitoring model performance and regularly adjusting a dedicated management estimate to cover the uncertainty.

Figure 6.14 shows the share of retail customer exposures which migrated into better rating categories, the share with an unchanged rating category and the share of retail customer exposures which migrated into higher-risk rating categories in 2020 and 2019.

Figure 6.14

Rating migration – exposures to retail customers (%)



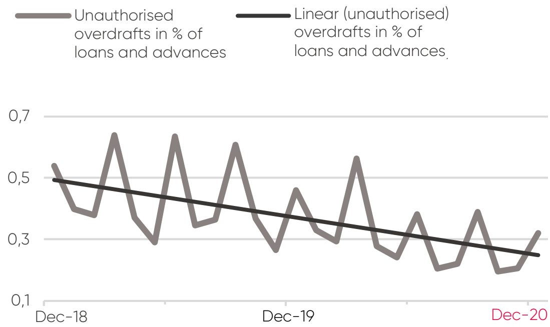
Measured by exposure, the share of customers who in 2020 migrated towards weaker rating categories and the share migrating towards stronger rating categories were at the same level.

The improvement in the average rating category shown in figure 6.13 is mainly due to the inflow of new customers with high credit ratings, which did not previously have a rating.

The overall positive development in the retail customer portfolio is corroborated by the trend in retail customers' unauthorised overdrafts, which is shown in figure 6.15. The figure shows that retail customers' non-authorised overdrafts in 2020 were quite low at around 0.3%.

Figure 6.15

Retail customers - Local Banks - Developments in unauthorised overdrafts/arrears excl. SparXpres



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 24.3 billion at end-2020 compared with DKK 26.4 billion at end-2019. The DKK 2.1 billion fall is attributable to a DKK 1.8 billion drop in loans and advances and a DKK 0.3 billion decrease in guarantees.

The credit exposure to business customers in the local banks amounted to 35.0% of the total credit exposure.

Figure 6.16 illustrates exposures to business customer by rating category, and figure 6.17 shows the average rating since 2018. As illustrated by the figures, credit quality in the portfolio of business customers showed a negative development in 2020 because of an increase in the average rating.

The Bank's rating model for business customers includes a business cycle component. The component includes forward-looking expectation variables which are to take account of business cycle expectations relative to factors such as COVID-19.

In recent years, the business cycle component has proven to be unintentionally volatile and adversely affects the end-2020 risk level in the overall rating model for business customers. Currently, the model variables concerning consumption expectations and industrial confidence give rise to the negative effect.

Back tests thus show that the model overestimated the risk level in 2020 (fewer defaults than estimated by the model). A negative effect of COVID-19 has been included which is not yet reflected in corporate earnings due to factors such as various government relief packages.

The Bank is regularly monitoring developments and has continually made management estimates (model uncertainty) to address the uncertainty attaching to the business cycle variable.

Figure 6.16
Exposures to business customers by rating category excl. public-sector customers

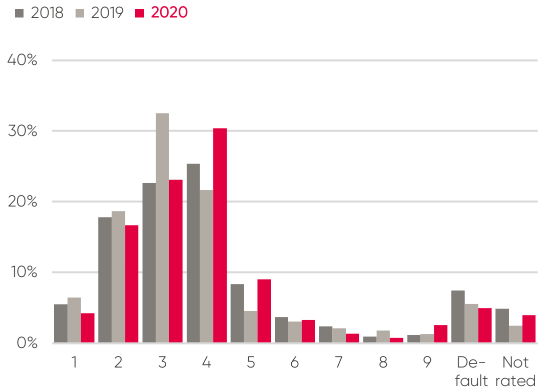


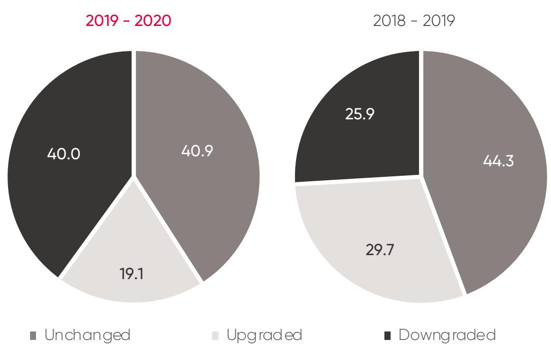
Figure 6.17
Average risk category*

	2020	2019	2018
Average risk category	3.9	3.6	3.9

*) Exposure after impairment excl. public-sector customers.

Figure 6.18 shows the share of business customer exposures which migrated into better rating categories, the share of business customer exposures with unchanged credit quality and the share of business customer exposures which migrated into higher-risk rating categories during 2020 and 2019.

Figure 6.18
Rating migration – exposures to business customers (%)

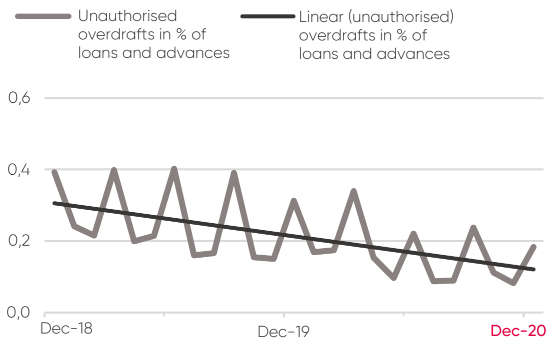


Measured by exposure size, more customers migrated towards weaker rating categories in 2020 than customers who migrated to stronger rating categories. The main reason is the effect of the business cycle variable described above. In 2020, the business customer model generally overestimated the risk level, which was also the case at the end of the year.

Spar Nord adjusts its management estimate, which in terms of impairment adjusts the model uncertainties, while the effect with respect to the calculated rating is not adjusted.

As was the case for retail customers, business customers' unauthorised overdrafts and arrears developed favourably during the period 2018 to 2020 to stand at a low level in 2020. The figure dropped below 0.2% in 2019 and stayed at around 0.1% in 2020, as shown in figure 6.19.

Figure 6.19
Non-agricultural business customers - Local Banks - development in unauthorised overdrafts/arreas



6.4.4 Facilitation of mortgage loans

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

The facilitation of mortgage loans developed favourably in 2020 with an increase of 6.7% relative to end-2019, equal to DKK 5.9 billion. Retail customers accounted for DKK 5.5 billion, and business customers for DKK 0.4 billion.

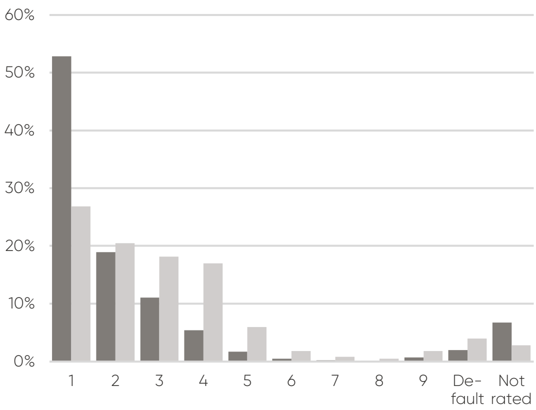
At end-2020, mortgage loans for a total of DKK 94.5 billion had been facilitated to customers. Of this amount, mortgage loans facilitated from Totalkredit amounted to DKK 83.0 billion and from DLR Kredit DKK 11.5 billion.

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 full or partial setoff will be made against the commission paid to Spar Nord for its loan-facilitation services.

Spar Nord pursues a practice of recording losses arisen on an ongoing basis, recognising them in loan impairment etc., so no losses are offset against future commission.

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

Figure 6.20
Mortgage loans arranged DLR and Totalkredit and bank exposure, by rating category



6.4.5 Leasing activities
Spar Nord's total credit exposure in the leasing area amounted to DKK 5.5 billion at end-2020. Of this amount, DKK 2.4 billion was for customers affiliated with Spar Nord Leasing. The total credit exposure in the leasing area rose by DKK 0.8 billion, and was 15.7% higher than at year-end 2019. Credit exposure in the leasing area equals 8.0% of Spar Nord's total loans, advances and guarantees.

In the context of risks, it is important to note that leasing loans are always backed by security in the assets through ownership.

Figure 6.21 shows leasing loan percentages broken down by industry and the relevant impairment account.

The impairment account for customers with both bank and leasing loans is shown in the combined impairment account in figure 6.32. The impairment account for customers who only have lease business is DKK 41.6 million.

Figure 6.21
Leasing loans by industry

	Loans and advances		Impairment account	
%	**2020**	**2019**	**2020**	**2019**
Public authorities	0.0	0.0	0.0	0.0
Agriculture, hunting and forestry	14.2	13.5	10.4	10.3
Fisheries	0.0	0.0	0.0	0.0
Industry and raw materials extraction	12.3	13.1	16.2	20.8
Energy supply	9.0	8.7	5.8	5.0
Building and construction	14.7	14.0	5.9	5.7
Trade	8.5	9.4	7.0	6.0
Transport, hotels and restaurants	22.7	22.9	28.0	22.5
Information and communication	0.6	0.8	0.7	0.3
Financing and insurance	1.3	1.7	1.3	0.8
Real estate	1.9	2.3	8.4	19.7
Other business areas	13.8	13.2	15.9	8.1
Business customers, total	**99.1**	**99.5**	**99.6**	**99.2**
Total retail customers	**0.9**	**0.5**	**0.4**	**0.8**
Total	**100.0**	**100.0**	**100.0**	**100.0**

Figure 6.22
Repossessed equipment

DKKm	**2020**	**2019**
Repossessed equipment, total	3	5

6.4.6 Financial customers
Credit exposures to financial customers cover reverse repo transactions and own commitments and key customers. As shown in figure 6.23, these amounted to DKK 10.3 billion at end-2020. This equals 14.8% of Spar Nord's total loans, advances and guarantees. The exposure consists primarily of reverse repo transactions of DKK 9.8 billion and own commitments, etc. in the amount of DKK 0.5 billion.

Figure 6.23
Credit exposure to financial customers

DKKm	**2020**	**2019**
Reverse repo transactions	9,819	8,155
Own commitments and key customers, etc.	475	482
Total financial customers	**10,294**	**8,637**

6.5 Collateral

An important component of the credit risk management efforts 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.

Mortgages on real property consist mainly of mortgages on private housing. Figure 6.24 shows the geographical breakdown of mortgages on property, and figure 6.25 sets forth the distribution of property mortgage by property type. The figures are based on collateral values.

Figure 6.24

Geographical breakdown of mortgages
%

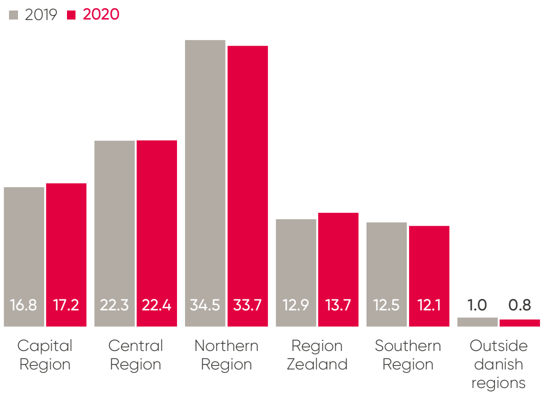


Figure 6.25

Mortgages broken down by property type

DKKm/%	2020		2019	
Private housing	18,863	62.3	16,927	60.3
Holiday homes	1,153	3.8	1,051	3.7
Offices and businesses	4,495	14.8	4,419	15.7
Agriculture	2,168	7.2	2,141	7.6
Other	3,600	11.9	3,541	12.6
Total	**30,278**	**100.0**	**28,079**	**100.0**

The property value under mortgages broken down by property type in figure 6.25 is calculated at DKK 30.3 billion, while only DKK 17.2 billion is recorded as security on properties in figure 6.26. 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% is made when the property collateral is allocated to the exposures.

Figure 6.26 shows credit risk mitigation by virtue of collateral.

Compared with previous risk reports, Spar Nord changed its principle for calculating its unsecured shares in 2020, so that rights of subrogation in the issued loss guarantees against facilitated mortgage loans are now included as a specific collateral. The change concerns figures 6.26 and 6.29.

Figure 6.26

Credit risk mitigation by virtue of collateral

DKKm	2020	2019
Properties	17,183	15,728
Custody accounts/securities	11,219	9,436
Guarantees/sureties	635	468
Vehicles	566	616
Cash	681	360
Other collateral	3,769	4,313
Other collateral, total	**34,053**	**30,920**
Spec. secured trans. (mortgage credit inst. guarantees)	13,165	12,603
Total collateral, excluding Spar Nord Leasing	**47,218**	**43,523**
Collateral accepted, Spar Nord Leasing	4,603	3,993
Total	**51,821**	**47,515**

The Real Estate industry is monitored closely by Spar Nord. As shown in figure 6.8, the industry represents the largest share (11.4%) after retail customers (47.7%) of total exposures excl. reverse.

Figure 6.27 shows exposure details and details on collateral received for the Real Estate industry.

Figure 6.27

Exposure and collateral for the Real Estate industry

DKKm	2020
Total exposure	**6,802**
- Of which loans and advances	5,610
- Of which guarantees	1,192
Total collateral	**4,904**
Mortgage on real property	3,492
- Of which first mortgage	2,385
- Of which second mortgage	1,107
Other collateral	1,412

Of the DKK 6.8 billion exposure to the Real Estate industry, Spar Nord has collateral totalling DKK 4.9 billion, with property mortgages accounting for 71.2%, or DKK 3.5 billion, of which 68.3% are first mortgages and 31.7% are second mortgages. The share of financing granted without corresponding security in the form of mortgaged property is for subsidised housing associations and owner associations.

Figure 6.28 shows collateral broken down by rating category.

Credit risk

Figure 6.28

Collateral by rating category
%

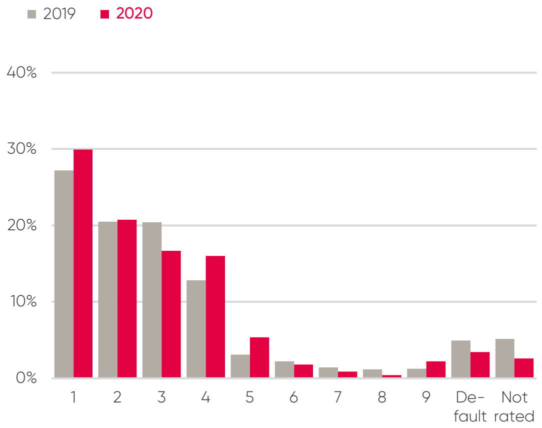


Figure 6.29 shows exposures broken down by various unsecured ranges, and figure 6.30 shows the breakdown by industry of unsecured amounts and percentages. The figures show that the total unsecured share at end-2020 was 25.5%, against 29.7% at end-2019. Net of reverse repo transactions, the total unsecured share amounted to 29.7%. At end-2019, the unsecured share without reverse repo transactions was 33.8%.

Figure 6.29

Unsecured share of exposure

%	**2020**	**2019**
< 10	57.7	53.0
10 - 50	19.5	19.8
50 - 75	6.0	6.4
> 75	16.8	20.8
Average unsecured share	**25.5**	**29.7**

Figure 6.30

Unsecured amounts and unsecured share of exposure broken down by industry

DKKm/%	**2020**		**2019**	
Public authorities	978	100.0	1,200	100.0
Agriculture, hunting and forestry	530	17.7	569	20.2
Fisheries	24	19.4	40	35.1
Industry and raw materials extraction	597	23.3	874	29.5
Energy supply	489	26.1	566	33.0
Building and construction	638	24.6	865	34.3
Trade	944	27.4	1,486	35.6
Transport, hotels and restaurants	492	19.8	740	28.3
Information and communication	101	39.8	143	50.1
Financing and insurance	2,069	15.9	2,059	18.1
Real estate	1,898	27.9	2,250	30.8
Other business areas	1,412	35.5	1,560	41.7
Business customers, total	**10,172**	**24.7**	**12,350**	**30.2**
Total retail customers	**7,610**	**26.7**	**7,705**	**28.8**
Total	**17,782**	**25.5**	**20,055**	**29.7**

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.

6.6 Impairment and provisions – loans and advances

Spar Nord's impairment charges are calculated in accordance with the IFRS 9 accounting standard. See the Annual Report for a review.

As shown in figure 6.31, the combined impairment account rose by DKK 0.2 billion in 2020 due primarily to COVID-19-related uncertainty. Weaker ratings on business customers due to negative future expectations have resulted in a migration of exposures from stage 1 to stage 2 and higher model-calculated impairment on exposures which remained in either stage 1 or stage 2.

Developments were more positive for retail customers, as impairment charges were reduced by DKK 53 million with no impact from the management estimate. This is supported by the fact that the share of exposures and impairment in stage 3 declined during 2020, because only few of the Bank's customers to date have encountered financial difficulty caused by COVID-19.

Because of uncertainty relating to COVID-19, a management estimate totalling DKK 320 million has been made. Most of this estimate is placed in stage 2, which contributes to the sharp increase in impairment charges in this stage, as shown in figure 6.31.

Figure 6.31

Development in exposures and impairment by stage

	2020		**2019**	
DKKm	**Commitment**	**Impairment**	**Commitment**	**Impairment**
Stage 1	49,513	196	49,526	155
Stage 2	8,264	580	7,699	265
Stage 3	2,007	941	2,191	1,083
Total	**59,784**	**1,717**	**59,416**	**1,503**

As shown in figure 6.32, the combined impairment account amounted to DKK 1.7 billion, equal to 2.5% of Spar Nord's total loans, advances and guarantees at end-2020.

The Bank has found objective evidence of credit impairment due to COVID-19 on a few semi-large exposures in affected industries (tourism, restaurants, conferences/fairs) and has recognised new impairment charges of about DKK 100 million in relation thereto.

The Bank does not have substantial exposure to individual industries that are particularly challenged by the COVID-19 pandemic.

Credit risk

For single customers in certain industries, a substantial drop in revenue has been recorded, and in some cases large losses. However, the COVID-19-related restrictions have not resulted in a noticeable increase in bankruptcies.

Figure 6.32

Impairment – by industry

DKKm/%	Spar Nord 2020	Spar Nord 2019	Spar Nord 2020	Spar Nord 2019	Sector 2019
Public authorities	0	0	0.0	0.0	0.0
Agriculture, hunting and forestry	334	413	19.5	27.5	23.0
Fisheries	2	1	0.1	0.1	0.0
Industry and raw materials extraction	84	85	4.9	5.7	7.0
Energy supply	30	15	1.7	1.0	1.8
Building and construction	62	55	3.6	3.6	4.1
Trade	146	96	8.5	6.4	7.2
Transport, hotels and restaurants	155	94	9.0	6.3	6.5
Information and communication	8	9	0.5	0.6	0.6
Financing and insurance	111	80	6.5	5.3	4.9
Real estate	175	195	10.2	13.0	10.1
Other business areas	126	79	7.3	5.2	5.7
Business customers, total	**1,233**	**1,122**	**71.8**	**74.7**	**70.8**
Total retail customers	**484**	**381**	**28.2**	**25.3**	**29.2**
Total	**1,717**	**1,503**	**100.0**	**100.0**	**100.0**

Figure 6.33 shows a calculation of impaired clams.

The total value adjustment must be supplemented by calculated impairment in stages 1 and 2 of DKK 777 million and model-calculated stage 3 impairment of DKK 78 million.

Impairment charges 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.

In 2020, Spar Nord recorded a decline in credit exposure to customers with individual impairment of DKK 184 million. At end-2020, the impaired claims represented 2.9% of total credit exposure compared with 3.2% in 2019.

Figure 6.33

Impaired claims

2020

DKKm	Exposure	Value-adjusted individually
Insolvent liquidation and bankruptcy	65	44
Debt collection and restructuring, etc.	94	40
Other financial difficulty	1,848	856
Total individual impairment	**2,007**	**941**
Impairment in stages 1 and 2		777
Non-individually impaired in stage 3		0
Total impairment		**1,717**

2019

DKKm	Exposure	Value-adjusted individually
Insolvent liquidation and bankruptcy	106	40
Debt collection and restructuring, etc.	67	34
Other financial difficulty	2,018	1,009
Total individual impairment	**2,191**	**1,083**
Impairment in stages 1 and 2		420
Non-individually impaired in stage 3		0
Total impairment		**1,503**

Credit risk

Figure 6.34 shows non-performing exposures broken down by industry and the relevant impairment account.

Figure 6.34

Losses and individual impairment

2020 **DKKm**	**In default and impaired**	**Impairment account**
Public authorities	0	0
Agriculture, hunting and forestry	426	289
Fisheries	2	1
Industry and raw materials extraction	138	44
Energy supply	19	9
Building and construction	116	25
Trade	145	84
Transport, hotels and restaurants	176	77
Information and communication	7	4
Financing and insurance	86	31
Real estate	214	66
Other business areas	142	67
Business customers, total	**1,471**	**696**
Total retail customers	**536**	**245**
Total	**2,007**	**941**

2019 **DKKm**	**In default and impaired**	**Impairment 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
Business customers, total	**1,630**	**831**
Total retail customers	**562**	**252**
Total	**2,191**	**1,083**

Figure 6.35 shows developments in profit impact from losses and impairment of loans, advances and guarantees by industry.

Figure 6.35

Profit impact from losses and impairment of loans, advances and guarantees brown down by industry

2020 **DKKm**	**Profit impact**	**Depreciation**
Public authorities	0	0
Agriculture, hunting and forestry	-74	13
Fisheries	1	0
Industry and raw materials extraction	-1	1
Energy supply	14	0
Building and construction	2	2
Trade	59	12
Transport, hotels and restaurants	60	2
Information and communication	-1	0
Financing and insurance	30	6
Real estate	36	63
Other business areas	50	8
Business customers, total	**176**	**107**
Total retail customers	**133**	**60**
Total	**309**	**167**

2019 **DKKm**	**Profit impact**	**Depreciation**
Public authorities	0	0
Agriculture, hunting 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
Business customers, total	**-28**	**352**
Total retail customers	**51**	**193**
Total	**22**	**546**

The total profit impact from losses and impairment charges was DKK 309 million in 2020, corresponding to 0.44% of total loans, advances and guarantees. The DKK 309 million profit impact breaks down into DKK 133 million on retail customers, DKK 250 million on business customers and an income of DKK 74 million on agricultural customers. In 2020, a profit impact of more than DKK 400 million was attributable to COVID-19.

In 2020, the Bank increased its management estimates by DKK 267 million to a total of DKK 570 million. The amount relates to four different issues:

1. COVID-19 (DKK 320 million). Despite relief packages, the socio-economic repercussions of COVID-19 are still subject to great uncertainty, which is reflected by this estimate.
2. Declining land prices (DKK 147 million). The assessment offsets valuation uncertainty. The estimate is calculated as DKK 15,000 per hectare of eligible land.
3. Model uncertainty (DKK 66 million). The Bank's rating models have historically shown an unintentional volatility in risk level adjustment via macroeconomic variables, and therefore an amount is allocated to cover the increased risk.
4. Errors in discounting of collateral (DKK 37 million). Spar Nord's data processing centre currently does not have a solution to discount collateral in the individual impairment calculations, which results in too low impairment charges, which is offset by this estimate.

6.6.1 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 the Credit Department. Customers who have been granted forbearance must be flagged for OEI.

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

Figure 6.36 shows a breakdown of loans and advances subject to forbearance broken down by performing and non-performing and by business, agricultural and retail customers.

Figure 6.36

Loans and advances subject to forbearance

2020

DKKm	Business	Agriculture	Retail	Total
Non-Performing	199	28	145	**372**
Performing	5	6	5	**16**
Total	**204**	**34**	**151**	**388**

2019

DKKm	Business	Agriculture	Retail	Total
Non-Performing	204	59	129	**392**
Performing	10	7	10	**28**
Total	**215**	**66**	**139**	**419**

Figure 6.37 shows a calculation of the NPL ratio. 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, a stage 3 exposure is always defined as NPL in IFRS 9 even if the above criteria are not met.

Figure 6.37

NPL ratio

	2020	2019
NPL (DKK millions)	1,873	2,004
Exposure (DKKm)	54,884	54,079
NPL ratio	3.4	3.7

Stage 3 loans were reduced by a total of DKK 131 million through recategorisation to stage 2 and stage 1, while some loans were written off. Overall, NPL loans were reduced by DKK 131 million to DKK 1,873 million, and the share of non-performing loans (NPL ratio) was thus 3.4% at end-2020.

As shown in figure 6.38, an amount of DKK 167 million was written off in 2020, and individual impairment charges totalling DKK 138 million were reversed.

Figure 6.38

Losses and impairment on loans, advances and guarantees

DKKm	2020	2019
Losses, incl. losses covered by provisions/ impairment and impairment losses taken over	167	545
Covered by provisions/impairment and impairment losses taken over	-138	-463
Losses not covered by provisions/impairment	**29**	**82**
New provisions/impairment charges, excluding sector-targeted solutions	758	720
Reversal of provisions/impairment	-406	-699
Interest accrued on loans subject to impairment	-16	-21
Net provisions/impairment	**336**	**-1**
Recoveries of prior losses	**-64**	**-65**
Losses and impairment for the year	**300**	**16**
Other losses	9	6
Total losses and impairment for the year	**309**	**22**

As shown in figure 6.39, exposures for which interest accrual has been suspended fell from DKK 303 million at end-2019 to DKK 275 million at end-2020.

Figure 6.39

Developments in losses and value adjustments and suspended-interest loans

DKKm	2020	2019
Gross loans, advances and guarantees, end of year	69,603	67,571
Total losses and impairment for the year	**309**	**22**
– in % of loans, advances and guarantees	0.44	0.0
Impairment account	**1,717**	**1,503**
– in % of loans, advances and guarantees	2.5	2.2
Contractual non-performing loans, year-end	**275**	**303**
– in % of loans, advances and guarantees	0.4	0.4
Impairment account in % of contractual non-performing loans	**625**	**496**

6.7 Agriculture

Loans, advances and guarantees to agricultural customers amounted to DKK 3.0 billion, equal to 4.3% of total loans, advances and guarantees. Of this amount, leasing loans amounted to DKK 0,8 billion. Lending to the agricultural sector rose by DKK 170 million from 2019 to 2020, of which leasing loans rose by DKK 142 million.

Figures 6.40 and 6.41 show developments in credit quality among agricultural customers at Spar Nord's Local Banks in the period from 2018 to 2020.

As appears from figures 6.40 and 6.41, the average credit quality of agricultural customers improved in 2020. The positive development was attributable to a decrease in the Default rating category for agricultural customers.

Figure 6.40

Agricultural exposures by rating category excl. leasing

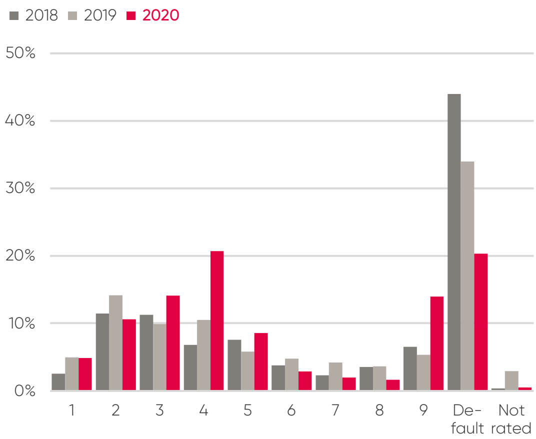


Figure 6.41

Average risk category – agriculture*

	2020	2019	2018
Average risk category	5.5	5.9	6.2

*) Exposure after impairment

Earnings in the agricultural sector were generally satisfactory in 2020. During the past couple of years, milk prices have been stable, providing acceptable earnings to dairy farmers. Grain prices have moved slightly lower to the benefit of feed purchasers but to the detriment of arable farmers, who should expect lower sales prices.

While still at acceptable levels, pork prices have fallen from record-high levels of early 2020 due to the outbreak of African swine fever in Germany. At the same time, the COVID-19 pandemic has affected all industries, and mink farmers in particular.

The mink industry was already suffering from low settlement prices, and the outbreak of COVID-19 in China, which is a very larger importer of mink fur, pushed prices even lower. On top of this comes the COVID-19-related culling of all mink in Denmark, which will de facto close down all mink production in the country.

Figures 6.42 and 6.43 show agricultural exposures, broken down by production line. Spar Nord's total impairment of agricultural loans amounted to DKK 334 million at end-2020, equal to 11.2% of total loans, advances and guarantees to the industry. At 31 December 2019, the corresponding figures were DKK 413 billion and 14.7%.

Spar Nord's total exposure to the agricultural sector was largely unchanged in 2020, but with minor reduction to cattle, pig and mink farmers and a small increase in exposure to arable farmers.

Figure 6.42

Agricultural exposures by production line

2020

DKKm	Loans and guarantees	Non-performing loans	Of which impaired	Share impaired
Cattle farmers	554	3	171	30.9
Pig farmers	451	0	133	29.5
Plant cultivation	624	8	74	11.8
Mink farmers	103	1	16	15.1
Leasing	789	1	6	0.8
Miscellaneous	466	2	27	5.8
Total	**2,987**	**14**	**426**	**14.3**

2019

DKKm	Loans and guarantees	Non-performing loans	Of which impaired	Share 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
Total	**2,818**	**52**	**559**	**19.8**

Credit risk

Figure 6.43

Agricultural exposures by production line

2020

DKKm/%	Impairment account	Written off	Impairment for the year	Impairment ratio of exposure	Percent-age of impaired
Cattle farmers	150	7	-22	27,1	87.4
Pig farmers	78	2	-37	17,3	72.2
Plant cultivation	60	4	-11	9,5	88.0
Mink farmers	25	0	-3	24,8	53.3
Leasing	4	0	1	0,6	69.5
Miscella-neous	17	0	-3	3,7	68.2
Total	**334**	**13**	**-74**	**11,2**	**78.4**

2019

DKKm/%	Impairment account	Written off	Impairment for the year	Impairment ratio of exposure	Percent-age of 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
Miscella-neous	20	0	1	4.7	116.8
Total	**413**	**132**	**-59**	**14.7**	**74.0**

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 the Bank 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.

Conditions for dairy farmers are expected to remain unchanged in 2021. For pig farmers, earnings are expected to be slightly lower, but still at acceptable levels. Figures for both production areas are subject to uncertainty due to COVID-19 and for pig farmers also the spread of African swine fever.

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 the Bank'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. 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, as described earlier. The management estimate is calculated as DKK 15,000 per hectare of eligible land. The total management estimate for agricultural is DKK 162 million, of which DKK 147 million relates to land prices, DKK 11 million to discounting of collateral and DKK 4 million to model uncertainty.

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. For counterparties subject to supervision by the Danish FSA, the exposure is capped at DKK 700 million. However, this cap does not apply to exposures to the Danish state, regions, municipalities, unit trusts that are entirely equity financed, and customers subject to supervision who have an official investment grade rating. For this type of exposure, the statutory limit applies. The risks and lines of financial instruments are monitored on a day-to-day basis.

A major source of financial credit risk is the Bank's balances with credit institutions. The credit risk relates to Danish and international credit institutions which are the Bank's trading partners.

Figure 6.44 shows Spar Nord's amounts due from credit institutions by product type, and figure 6.45 shows a breakdown by rating category.

Figure 6.44

Due from credit institutions by product type

DKKm/%	2020	2019	2020	2019
Certificates of deposit	61	0	4.2	0.0
Reverse repo transactions	343	924	23.6	51.7
Deposits and unlisted bonds	0	0	0.0	0.0
Current accounts	263	279	18.1	15.6
CSA accounts, etc.	592	384	40.8	21.5
Market value, derivatives	194	201	13.3	11.2
Due from credit institutions	**1,452**	**1,789**	**100.0**	**100.0**

Credit risk

Figure 6.45

Due from credit institutions by rating

DKKm/%	2020	2019	2020	2019
AAA	404	924	27.8	51.7
AA	179	177	12.3	9.9
A	754	505	51.9	28.3
BBB	103	169	7.1	9.5
BB	0	1	0.0	0.1
Not rated	13	12	0.9	0.7
Due from credit institutions	**1,452**	**1,788**	**100.0**	**100.0**

Figure 6.45 shows that 92.0% of Spar Nord's receivables from credit institutions concerns banks with an A rating or higher. Balances with unrated credit institutions are attributable mainly to Danish credit institutions. Other risks are mainly attributable to clearing centres.

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 relevant payment.

Utilisation of lines with respect to financial counterparties, see figure 6.46, 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 weighting of the principal of the individual financial transaction is based on the volatility of the interest rate and currency, and the term to maturity of the transaction is also taken into account.

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, the Bank has a controller department that conducts random sampling of compliance as concern granting of lines, procedures and business procedures.

Figure 6.46

Counterparty risk

DKKm	2020	2019
Derivatives with positive market value	777	828
Netting*	196	180
Exposure after netting	**581**	**648**
Collateral received	13	34
Exposure after netting and collateral	**568**	**614**

*) Netting of cleared transactions

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.

If the rating of a credit institution or institutional customer is lowered or withdrawn, the exposure will be reassessed. In addition, the financial statements of unrated credit institutions/institutional customers are regularly controlled, and any drop in the counterparty's equity of more than 5% will lead to a reassessment of the exposure. All exposures are reassessed at least every three years, and all exposures with size requiring the approval of Spar Nord's Board of Directors are reviewed at least once a year.

6.9.2 Framework and collateral agreements

To mitigate counterparty risk, Spar Nord will clear as many transactions as possible through a Central Clearing Counterparty (CCP) and makes framework, netting and collateral agreements to the extent possible.

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.

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.

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.

Credit risk

Spar Nord currently only has one agreement in which the amount of collateral depends on Spar Nord's or the counterparty's rating or equity. Agreements are generally concluded without this clause.

Both Danish and foreign collateral agreements are followed up on a daily basis, and so too are exchanges of collateral/repricing of transactions as the market values of the transactions fluctuate. 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.

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 6.47 shows ECAI exposure before and after deductions

Figure 6.47

ECAI exposure before and after deductions

2020

DKKm	Exposure	Exposure after ECAI risk-weighted
Institutions	1,691	572
Other	192	61
Total	**1,883**	**633**

2019

DKKm	Exposure	Exposure after ECAI risk-weighted
Institutions	1,599	529
Other	210	67
Total	**1,809**	**596**

6.11 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

The calculation of credit exposure, which is shown in figure 6.48, shows a total exposure of DKK 106.3 billion. This calculation corresponds to the Bank's credit risk, which is treated according to the standardised approach

As shown in figure 6.48, exposures generally declined by DKK 1.5 billion in 2020, equal to a decrease of 1.4%. Measured on the basis of average figures, this amounts to an increase of DKK 1.5 billion, equal to 1.4%.

Figure 6.48

Total credit exposure

	Net value of exposures		Average Net exposure	
DKKm	31.12.2020	31.12.2019	2020	2019
Central governments or central banks	1,359	1,132	1,414	1,495
Regional governments or local authorities	1,966	2,278	1,988	1,652
Public-sector entities	254	263	258	267
Institutions	5,777	10,832	9,990	11,867
Corporates	38,846	37,566	37,365	34,503
Of which SMEs	14,468	22,842	17,365	22,011
Retail customers	43,883	42,875	43,122	43,248
Of which SMEs	12,767	15,346	14,965	15,600
Secured by mortgages on immovable property	8,890	7,451	7,985	6,797
Of which SMEs	635	921	674	866
Exposures in default	1,033	837	852	1,486
Items associated with particularly high risk	616	715	627	790
Claims in the form of CIU	2	4	2	5
Equity exposures	1,962	1,809	1,892	1,762
Other items	1,716	2,023	1,780	1,917
Total	**106,304**	**107,785**	**107,276**	**105,789**

Credit risk

Figure 6.49

Exposure categories by country

	2020					2019				
DKKm	Denmark	EU	Rest of Europe	Rest of World	Total	Denmark	EU	Rest of Europe	Rest of World	Total
Central governments or central banks	1,359	0	0	0	1,359	1,132	0	0	0	1,132
Regional governments or local authorities	1,962	4	0	0	1,966	2,274	4	0	0	2,278
Public-sector entities	254	0	0	0	254	263	0	0	0	263
Institutions	4,093	720	960	5	5,777	9,994	782	48	8	10,832
Corporates	36,122	1,573	90	1,060	38,845	35,510	326	405	1,324	37,566
Retail customers	43,594	87	142	61	43,883	42,343	127	235	169	42,875
Secured by mortgages on immovable property	8,849	17	15	8	8,890	7,417	8	11	15	7,451
Exposures in default	1,008	15	8	2	1,033	815	18	1	3	837
Items associated with particularly high risk	615	1	0	0	616	714	1	0	0	715
Claims in the form of CIU	2	0	0	0	2	4	0	0	0	4
Equity exposures	1,910	14	0	38	1,962	1,754	23	0	32	1,809
Other items	1,716	0	0	0	1,716	2,023	0	0	0	2,023
Total	**101,483**	**2,432**	**1,214**	**1,174**	**106,304**	**104,243**	**1,291**	**700**	**1,551**	**107.785**

Spar Nord's credit exposure is predominantly ascribable to Denmark. In 2020, debtors based in Denmark accounted for 95% of Spar Nord's credit exposure. The geographical breakdown is shown in figure 6.49.

Market risk

Developments in 2020

In 2020, the net interest rate risk was mainly positive, averaging around DKK 80 million, which was an increase of DKK 19 million relative to 2019.

Compared with end-2019, the net interest rate risk increased by DKK 65 million to DKK 116 million at end-2020. The change was driven by an increase in net interest rate risk in the trading book of DKK 68 million and a DKK 4 million decrease in net interest rate risk in the banking book.

The net portfolio of bonds was increased by DKK 5 billion in 2020. The portfolio of mortgage bonds increased by DKK 5 billion, while there were small changes between government bonds, credit bonds and bonds issued by financial issuers.

Foreign exchange risk remains at a low level with only minor changes between the individual currencies.

The portfolio of shares in the banking book and associates was increased by DKK 92 million in 2020 to DKK 2.2 billion, which was mainly due to market value adjustments of the holding, a small sale of shares in VP Securities A/S and DLR and additional purchases in BI-Holding.

The market value of shares held in the trading book increased by DKK 12 million to DKK 144 million in 2020.

The total risk exposure amount rose from DKK 3.3 billion to DKK 4.0 billion especially due to an increase in the holding of mortgage bonds of DKK 5 billion.

RISK EXPOSURE, MARKET RISK

DKK 4.0 billion

2019: DKK 3.3 billion

NET INTEREST RATE RISK

DKK 116 million

2019: DKK 52 million

FOREIGN EXCHANGE RISK

DKK 1.3 million

2019: DKK 1.3 million

EQUITY PORTFOLIO

DKK 2.3 billion

2019: DKK 2.2 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 commodity derivatives 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 the Bank is prepared to assume. Market risk is comprised of:

- Interest rate risk in the trading book and the banking book
- Credit spread risk on the bond portfolio
- Equity risk in the trading book and the banking book
- Foreign exchange risk
- Option risk
- Commodity risk

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.

The Bank has been working to replace the data platform in the market risk area for some time. The project started on the administrative side, but in 2021 the Bank is expected to implement the final element of the project and replace the risk system used for risk and position management. At the end of 2021, the Bank is thus expected to use the same system for the management of market risk – a so-called front-to-back solution. Similarly, the Bank is working to simplify its systems by phasing out its own valuation and risk management models.

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.

The interest rate risk both within the trading book and the banking book 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.

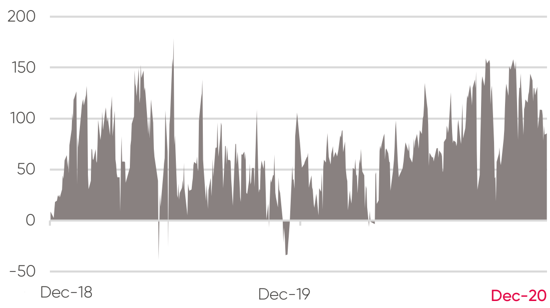
As concerns interest rate options, the above-mentioned key indicators are supplemented by the most important risk factors expressing sensitivity of the option premium on changes in the underlying parameters.

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 Developments in interest rate risk

Figure 7.1 shows the total net interest rate risk that Spar Nord will encounter if interest rates decrease by 1.0 percentage point. This implies a parallel shift of all yield curves.

Figure 7.1
Development in net interest rate risk
DKKm



Market risk

Figure 7.2

Interest rate risk by duration and currency

2020 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	15	28	45	3	14	**105**
EUR	1	-2	-1	26	-15	**8**
Other	2	0	0	0	0	**3**
Total	**18**	**25**	**44**	**29**	**0**	**116**

2019 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	-6	19	23	12	11	**60**
EUR	3	-10	-5	0	-4	**-15**
Other	2	1	4	0	0	**7**
Total	**-1**	**11**	**23**	**12**	**7**	**52**

The net interest rate risk was positive throughout 2020 as the Bank was primarily exposed to a drop in market interest rates, which entails positive earnings when interest rates fall.

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 1.0 percentage point decrease in interest rates. At the end of 2020, the Bank was exposed to interest rate falls in DKK and to a minor extent 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, futures and options.

As appears from figure 7.3, the net interest rate risk attaching to the trading book amounted to DKK 109 million at end-2020, which is a DKK 68 million increase compared with 2019. The Bank is mainly exposed to interest rate falls in DKK.

Figure 7.3

Interest rate risk in the trading book

2020 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	16	28	42	3	13	**102**
EUR	1	-2	-3	22	-15	**2**
Other	5	0	0	0	0	**6**
Total	**22**	**25**	**39**	**25**	**-2**	**109**

2019 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	-4	17	22	9	11	**54**
EUR	3	-10	-7	-2	-5	**-20**
Other	2	1	4	-1	0	**7**
Total	**2**	**8**	**19**	**6**	**7**	**41**

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, monetary policy loans, 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 1.0 percentage point decrease 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 7 million at end-2020, against a positive interest rate risk of DKK 11 million at end-2019.

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. At year-end 2020, NII was calculated at DKK 84 million, against DKK 76 million at the end of 2019. EVE was calculated at DKK 16 million at end-2020, which was DKK 3 million lower than at the end of 2019.

Figure 7.4

Interest rate risk in the banking book

2020 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	-1	0	3	0	1	**4**
EUR	0	0	2	4	0	**6**
Other	-4	0	0	0	0	**-3**
Total	**-4**	**0**	**5**	**4**	**1**	**7**

2019 DKKm	Less than 3 months	3 months - 1 year	1 year - 3 years	3 years - 7 years	More than 7 years	Total
DKK	-2	2	2	3	0	**5**
EUR	0	0	2	3	0	**5**
Other	0	0	0	0	0	**1**
Total	**-2**	**2**	**4**	**6**	**1**	**11**

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.

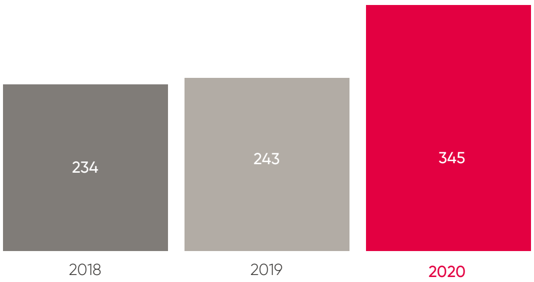
Credit spread risk is the risk that credit spreads on issuers on the bond portfolio should change. Losses may arise because of an increase in the credit risk (credit spread) on mortgage bonds relative to government bonds. The risk is also relevant for bonds for which the overall interest rate risk has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

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 with a possibility of back-testing the calculated results.

Credit spread risk rose by DKK 102 million to DKK 345 million at end-2020, driven by an increase in the bond portfolio of DKK 5 billion owing to an improved liquidity situation.

Developments in credit spread risk are illustrated in figure 7.5.

Figure 7.5
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. The Bank 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 yield curve, while convexity expresses the curvature of the yield curve.

7.3.6 Bond portfolio

As shown in figure 7.6, the bond portfolio is composed of 91.1% mortgage bonds, 4.7% bonds from financial issuers, 1.6% corporate bonds and 2.5% government bonds.

The combined bond portfolio rose by DKK 5 billion compared with end-2019. The change covers a modest shift in the composition, as the holding of mortgage bonds was increased by 3.4%, while bonds from financial issuers and government bonds combined was reduced by a corresponding percentage.

As shown in figure 7.7, 91.5% of the Bank's bond portfolio had an AA rating or better at end-2020.

Figure 7.6
Bond portfolio by issuer type*

DKKm/%	2020	2019	2020	2019
Mortgage bonds	19,041	14,026	91.1	87.7
Financial issuers	986	1,077	4.7	6.7
Credit bonds	335	277	1.6	1.7
Government bonds	532	604	2.5	3.8
Total bonds	**20,895**	**15,985**	**100.0**	**100.0**

*) Bond portfolio plus spot and forward purchases and sales

Figure 7.7
Bond portfolio by rating*

DKKm/%	2020	2019	2020	2019
AAA	18,571	13,080	88.9	81.8
AA	546	425	2.6	2.7
A	1,059	1,551	5.1	9.7
BBB	394	590	1.9	3.7
BB	110	80	0.5	0.5
B	17	6	0.1	0.0
CCC	2	0	0.0	0.0
CC	0	0	0.0	0.0
C	0	0	0.0	0.0
Not rated	196	254	0.9	1.6
Unallocated	0	0	0.0	0.0
Total bonds	**20,895**	**15,985**	**100.0**	**100.0**

*) Bond portfolio plus spot and forward purchases and sales

Market risk

Figure 7.8 shows a more detailed breakdown of the bond portfolio.

Figure 7.8

Bond portfolio

2020

DKKm/%	Origin	Rating category		
Mortgage bonds	Denmark	AAA	17,562	84.1
		A	590	2.8
		Unrated	-29	-0.1
	Norway	AAA	903	4.3
	Sweden	AA	15	0.1
			19,041	**91.1**
Financial issuers	Denmark	A	77	0.4
		BBB-Unrated	392	1.9
	Norway	AA-BBB	266	1.3
	Sweden	A	75	0.4
	Finland	A	90	0.4
	Rest of Europe	AAA-Unrated	87	0.4
			986	**4.7**
Credit bonds	Denmark	BBB-Unrated	58	0.3
	Other	AA-Unrated	277	1.3
			335	**1.6**
Government bonds	Denmark	AAA-AA	506	2.4
	Europe	AAA	26	0.1
	Outside Europe	AAA	0	0.0
			532	**2.5**
Total			**20,895**	**100.0**
Own bonds	Denmark	Unrated	11	

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
			14,026	**87.7**
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
			1,077	**6.7**
Credit bonds	Denmark	BBB-Unrated	63	0.4
	Other	AA-Unrated	214	1.3
			277	**1.7**
Government bonds	Denmark	AAA-AA	518	3.2
	Europe	AAA	84	0.5
	Outside Europe	AAA	3	0.0
			604	**3.8**
Total			**15,985**	**100.0**
Own bonds	Denmark	Unrated	10	

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 7.9. The calculation is based on the assumption that all exchange rates change by 2% which will result in a loss of DKK 1.3 million.

Figure 7.9 shows an unchanged foreign exchange risk with minor shifts between the various currencies. Foreign exchange risk generally remains at a low level.

Figure 7.9

Currency

	Foreign exchange position		Foreign exchange risk	
DKKm	**2020**	**2019**	**2020**	**2019**
EUR	51	53	1.0	1.1
SEK	0	1	0.0	0.0
USD	1	3	0.0	0.1
GBP	1	1	0.0	0.0
CHF	1	0	0.0	0.0
NOK	0	6	0.0	0.1
JPY	4	0	0.1	0.0
Other currencies	6	1	0.1	0.0
Total	**64**	**64**	**1.3**	**1.3**

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 increased from DKK 132 million at end-2019 to DKK 144 million at end-2020, especially due to an increase in the portfolio of listed shares.

Figure 7.10

Equity risk in the trading book

DKKm	2020	2019
Listed shares in the trading book	134	106
Unlisted shares in the trading book	10	26
Total	**144**	**132**

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, a distinction is made 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 the Bank'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 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 shows a calculation of equity risk in the banking book. The total holding of shares in the banking book increased by DKK 92 million to DKK 2,169 million at end-2020.

Figure 7.11

Equity risk in the banking book

DKKm	2020	2019
Shares in credit and financing institutions	1,276	1,245
Shares in unit trust man. companies	214	193
Shares in pension institutions	2	2
Shares in data supplier	0	0
Shares in payment services business	5	8
Other equities	53	67
Total shares in strategic business partners	**1,550**	**1,514**
Realised gain	12	21
Unrealised gain	83	69
Associates	529	470
Other shares in the banking book	91	93
Total	**2,169**	**2,078**

Shares in strategic partners rose by DKK 31 million relative to 2019, driven by a sale of shares in VP Securities A/S and a sale of DLR shares, partly offset by a purchase of shares in BI-Holding. To this should be added price appreciation in connection with value adjustments of the portfolio.

The DKK 58 million increase in the value of associates was mainly due to market value adjustments of Spar Nord's ownership interest in Danske Andelskassers Bank of DKK 53 million and DKK 5 million from two private equity companies.

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

Derivatives are used to hedge and manage Spar Nord's risks. These include options and products that contain an embedded option. 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 0.9% 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 2.2% of shareholders' equity.

Figure 7.12

Sensitivity analysis*

	Impact on operating profit		Impact on equity	
DKKm/%	2020	2019	2020	2019
Interest rate increase of 1 %-point	-85	-32	-0.9	-0.4
Interest rate decrease of 1 %-point	85	32	0.9	0.4
Share price decrease of 10% in the trading book	-11	-10	-0.1	-0.1
A fair value decrease of 10% for shares in the banking book	-206	-197	-2.1	-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 2020, positive value adjustments totalling DKK 7 million were made on domicile properties, such adjustments being recognised directly in equity under other comprehensive income. Reversed impairment losses totalling DKK 1 million (net) have been recognised under depreciation and impairment in the income statement. Reference is made to Spar Nord's Annual Report for 2020 for a more detailed description of the accounting treatment of properties.

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

Figure 7.13

Yield/return

	2020		2019	
DKKm	**No. of properties**	**Value year-end**	**No. of properties**	**Value year-end**
-> 7%	11	203	11	204
7% - 8%	15	318	15	320
8% - 9%	13	124	14	131
Total	**39**	**645**	**40**	**656**

The most important assumptions when calculating the fair value of investment and domicile properties are the required rate of return and the 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 43 million at end-2020 against DKK 44 million at end-2019.

Other things being equal, an increase of the rent level of 5% will reduce the fair value by DKK 32 million at end-2020 against DKK 30 million at end-2019.

Section 8

Operational risk

Developments in 2020

In 2020, the Bank focused increasingly on the operational consequences of COVID-19.

Despite an increase in home working, more online meetings and mounting pressure on IT infrastructure, the business managed to adapt to the circumstances, and the changed work procedures thus did not cause any increase in the operational risk level.

Another area of enhanced focus in 2020 was the prevention of money laundering and terrorist financing.

RISK EXPOSURE, OPERATIONAL RISK

DKK 5.6 billion

2019: DKK 5.6 billion

Definition of operational risk

Operational risk is the risk of 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.

8.1 Operational risk policy

Spar Nord's Board of Directors defines the Group's operational risk policy. This includes determining risk tolerance in the area.

The purpose of the operational risk policy is to promote an open culture among its employees and thereby increase awareness of operational risk. The policy also describes how to ensure that the Board of Directors and the Executive Board are kept informed about significant risk areas.

Operational risks are assessed on the basis of the probability of the risk materialising in the form of an operational event, and the consequences this might entail. In the policy, operational risk tolerance has been determined as being low compared with the other types of risk the Bank is exposed to.

8.2 Addressing operational risks

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, with due consideration to continuing sound banking operations.

Operational risk is managed across the Bank through a comprehensive system of business procedures and control measures developed to ensure an adequate control environment.

Follow-up and reporting with respect to operational risk is anchored with the risk management function, while responsibility for addressing risks lies with the first line of defence in the unit responsible for the relevant business activity. This helps ensure segregation of controlling and operational functions.

Operational risk

In addition to identifying operational risk, all operational events resulting in a loss of more than DKK 10,000 are systematically recorded, categorised and reported. The Bank also registers operational events resulting in a gain and events that could potentially have resulted in a loss/gain, but did not do so (near-miss events). To enhance awareness and promote an open culture in the organisation, awareness activities are regularly undertaken aimed at operational risk management.

Figure 8.1
Number of operational loss events broken down by risk type
%

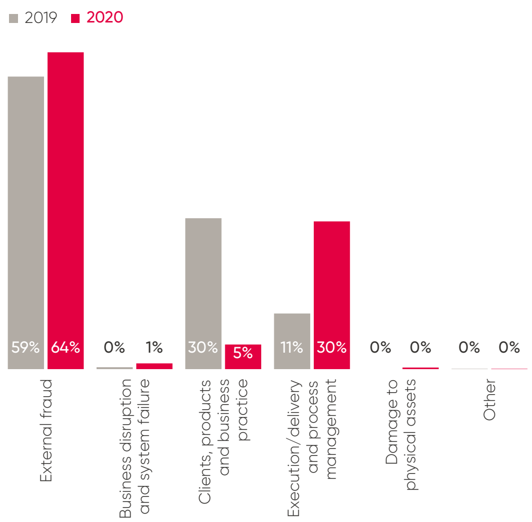
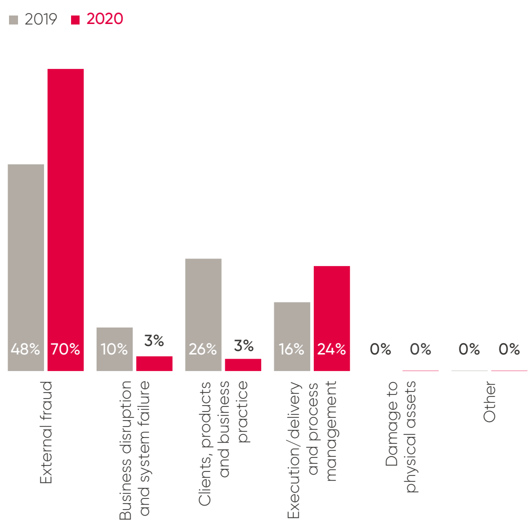


Figure 8.2
Operational loss amounts broken down by risk type
%



8.3 Reporting operational risks

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 during the period under review and about changes to the risk patterns of the area. The Board of Directors and Executive Board receive a summary of significant changes to the risk patterns and 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 operational losses are illustrated as a percentage distribution on risk types measured by number of events and loss amounts, respectively, in figures 8.1 and 8.2.

Most of the loss events are events involving a limited financial effect. As shown in figures 8.1 and 8.2, most of the loss events relate to external fraud, including payment card abuse and online banking fraud. The rest of the loss events relate to traditional banking operations.

8.4 IT security

As Spar Nord is a digital business, data and IT systems security are paramount to its credibility and existence and involve the Bank managing a number of business-critical IT risks.

The Bank's central IT security function teams up with the business and IT to ensure that the threat picture is kept up to date, that IT risks are identified and analysed and that these risks are adequately mitigated through appropriate controls and risk-mitigating measures. The end-goal of the IT security function is thus for the current risk level to reflect the risk tolerance for IT security accepted by the Board of Directors.

The IT security function is responsible for ensuring compliance with the adopted IT security risk tolerance, as defined in the IT security policy, and for Spar Nord's IT contingency plan. The Bank's IT security efforts also include the preparation of contingency plans and recovery procedures and the periodic testing of such measures. The aim is to ensure continued operation of the Bank at a satisfactory level in the case of extraordinary events. The IT security function is also 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.

The IT security function, Executive Board and Board of Directors regularly review the Bank's IT security. The IT risk patterns are regularly addressed in the IT security committee which has representatives with decision-making powers that enable the committee to handle the Bank's IT risks.

Section 8

Operational risk

In order to protect the Bank against the growing threat in the area of cyber security, the IT security function has regularly carried out awareness activities for employees. The function has also participated in sector-specific collaborative initiatives to build internal knowledge about information security.

8.5 Compliance risk
Operational risk 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 2020, the function focused on areas such as compliance with anti-money laundering (AML) measures, governance rules, payment services, liquidity, capital, product approval the Market Abuse Regulation 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 anti-money-laundering (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 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. The AML function supports the Bank's business development in connection with ongoing implementation of the rules. In addition, the AML function carries out regular controls to ensure compliance.

In 2020, the AML function continued to focus on enhancing and optimising existing processes and systems. The Bank has opted to centralise parts of its anti-money laundering procedures, as a result of which 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 2020, Spar Nord had 2,048 filings with SØIK as compared with 1,750 cases in 2019.

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

8.7 GDPR
2020 was characterised by a focus on systems compliance along with controls in the data protection area to reduce operational risk.

As with the rest of the Bank's compliance function, the Bank's data protection adviser applies a risk-based approach to identify areas for review.

In 2020, the adviser focused on areas such as compliance with security of processing requirements and the actual handling of confidential information and material – both on and off the Bank's premises.

The data protection adviser 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 the Board of Directors.

Risk analyses 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.

Products which have been subjected to the internal approval procedures are regularly monitored and revisited at least every other year. If it turns out that a previous analysis of the Bank's and customers' risks is no longer accurate, the product will again be subjected to the internal approval procedure with a view to ensuring an accurate description of the Bank's and the customers' risks.

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

Section 9

Risk statement

Spar Nord's Board of Directors approved Spar Nord's 2020 Risk Report on 11 February 2021.

The Board of Directors believes Spar Nord's risk management complies with applicable rules and standards, is appropriate and effective, and is consistent with the Bank's business model. In addition, in the opinion of the Board of Directors, the 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 the Bank's risk management, including of the adopted risk profile and risk appetite. Selected financial ratios are shown in figures 9.1 and 9.2.

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.

Figure 9.1

Key figures

Capital	**2020**	**2019**
Common equity tier 1 capital ratio	17.2	14.6
Own funds ratio	21.0	18.5
Individual solvency need	9.9	9.5
Excess capital coverage in percentage points	7.6	5.0
Leverage ratio	8.6	8.3
Liquidity		
LCR (%)	241	195
Asset Encumbrance (%)	4.3	5.0
Bank deposit rating and outlook (Moodys)	A1/Stable	A1/Stable
Credit		
Impairment account (DKKm)	1,717	1,503
Impairment ratio	0.44	0.03
NPL ratio	3.4	3.7
Total assets (DKKm)	102,077	93,113

The core of the Bank'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 the Bank 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.

Figure 9.2

The Supervisory Diamond

%	**Threshold values**	**2020**	**2019**
Sum of large exposures	<175	78.1	83.6
Growth in lending	<20	-1.5	9.1
Property exposure	<25	10.5	11.5
Funding ratio	<1	0.5	0.5
Liquidity benchmark	>100	251.0	204.0

Section 9

Risk statement

Executive Board

Lasse Nyby
Chief Executive Officer

John Lundsgaard
Managing Director

Lars Møller
Managing Director

Martin Kudsk Rasmussen
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

Henrik Sjøgreen

Jannie Skovsen

John Sørensen

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