Translation from Danish by Danske Bank of a statement dated 23 August 2018 from the Danish Financial Supervisory Authority (*Finanstilsynet*). In case of discrepancies, the Danish version prevails.

M E M O R A N D U M

The Danish Financial Supervisory Authority
23 August 2018

Statement on inspection at Danske Bank A/S (Norwegian business loans)

In November 2017, the Danish Financial Supervisory Authority (the FSA) conducted an inspection at Danske Bank. The purpose was to assess the bank's risk appetite and practices in relation to granting loans to new or existing customers and, in general, to assess the credit management of business loans in Norway.

Summary and risk assessment

The FSA reviewed 99 loans granted primarily to customers whose loans had been substantially increased in 2016/2017 or which were subject to special or increased risks.

The inspection was carried out on the basis of the bank's growth strategy in Sweden and Norway. The bank's lending in Norway is concentrated in particular on cyclical activities such as oil and gas, ships and the Norwegian property market, and the economic development may lead to increased risks. Consequently, the inspection focused on these industries.

In October 2015, the FSA conducted a similar inspection of loans to new or existing Norwegian business customers. Subsequently, the Norwegian economy has seen large fluctuations in oil prices, and this has required changes at a number of companies. The considerable declines in the companies' income in 2016 and 2017 have increased the bank's risk substantially.

The Norwegian property market is characterised by uncertainty following many years of sharply increasing property prices and high rent levels. Especially the levels in the Oslo region were historically high in 2017. The following period has seen prices drop markedly in the private housing segment. A persistently negative trend may also affect the business property market.

Several customers with activities in oil and shipping etc. suffer losses and have weak liquidity positions. So far, capital injections from investors have been able to offset customers' capital losses and ensure that they will meet loan agreement obligations, but the bank has introduced lenient lending terms in a number of cases. The customers' future financial situation is uncertain.

At the inspection, the FSA found that the bank generally had an acceptable risk appetite. However, other units at the bank have better risk analyses than its Norwegian unit, so the Norwegian risk analysis work has room for improvement. In a few large and many small cases, there was a need for a more thorough analysis of risks identified by the bank or for the bank to identify other relevant risks.

The impairment charges made by the bank were adequate only because the individual charges were supplemented by a collective charge of DKK 1.1 billion based on a management estimate.

In most cases, the bank's risk classification of customers was prudent at the time of the inspection, but, in some of the cases, the bank had taken too long to downgrade the classification of customers with poor financial performance. In a few cases, the bank had also underestimated the risk when granting a loan or had assigned a risk classification to a customer on the basis of other customers even though there was no group affiliation. Because of the large number of cases with an inaccurate classification, the FSA believes that the bank's controls should have identified the problems.

As a consequence, the inspection gave rise to an order stipulating that the bank must ensure that customers are classified correctly. This includes updating records on customers' financial position etc. on an ongoing basis and making correct classifications for group affiliations.

In general, the bank's records contained many errors and its data quality was inadequate. The FSA pointed out that the bank must have a managerial focus on ensuring proper data quality.

The bank had calculated its solvency need at 10.5% at the consolidated level at 30 September 2017. The bank's total capital ratio was 21.6% at the consolidated level at 30 September 2017. The inspection did not give rise to a change in the FSA's assessment of the bank's solvency need.