FINANSTILSYNET

MEMORANDUM

Danish Financial Supervisory Authority

[Translation of memorandum from the Danish FSA (Finanstilsynet). In case of discrepancies, the Danish version prevails.]

24 September 2010

File No. 6252-0311
/mho

Statement on inspection of Danske Bank in Ireland

1. Introduction

In June and July 2010, the Danish Financial Supervisory Authority (FSA) inspected Danske Bank's branch in Ireland, National Irish Bank. We performed a function-based inspection, that is, an inspection of one or more selected areas. Following up on the inspections carried out in September 2008 and May 2009, we focused on the branch's credit activities.

This assessment is published in accordance with the Danish Executive Order on the Duty of Banks and Mortgage Credit Institutions to Publish the Danish FSA's Assessment of the Institution.

2. Summary and risk assessment

We inspected 115 exposures in the range from EUR 590,000 to EUR 305 million. The exposures were selected randomly and represented several different customer categories.

We did not find grounds for ordering an increase in National Irish Bank's impairment charges. We believe that, because of the considerable charges made in the first and second quarters of 2010, the level of impairment charges at National Irish Bank is adequate. Because of the difficult market conditions in Ireland, impairment charges are likely to remain higher than they would be under normal market conditions.

A contributory factor is that National Irish Bank has provided a considerable volume of property finance. The property market in Ireland suffers from uncertainty with regard to pricing, very few completed sales and lack of transparency of completed sales.

We assess that estimates of the value of land sold for development and small residential rental properties are subject to considerable uncertainty, and National Irish Bank uses a price index to estimate such value.

Most loans have been granted with interest rates based on market terms. In a number of cases, borrowers are able to service the loans only because short-term interest rates are currently historically low. Although impairment charges have been made against such loans, there is a considerable credit risk associated with future interest rate increases.

Following our inspection in September 2008, Danske Bank has taken many – necessary – steps to improve credit management at its Irish branch. Some of these measures were being implemented during our follow-up inspection in May 2009. On the basis of our most recent inspection, we believe that credit management has now been adjusted to the difficult market conditions. Because market conditions continue to be very difficult, credit management must remain tight with close follow-up for a long period of time in order to minimise losses.

In relation to loans based on real property, we are generally of the opinion that approval and follow-up procedures must be expanded and standardised to ensure that decisions are made on a more adequate and consistent basis. We have therefore ordered Danske Bank to prepare a plan for measures to improve the decision basis substantially.

In a few instances, we ordered Danske Bank to consolidate two or more loans because of interdependent risks. The fact that the loans in question were assessed separately does not, however, result in an increased risk for National Irish Bank.

The Danske Bank Group has calculated its ICAAP result (solvency need) at 31 March 2010 at 10.3%. Its actual solvency ratio at 31 March 2010 was 17.9%.

As a result of the considerable uncertainty surrounding the credit risk on the Irish loan portfolio, Danske Bank’s ICAAP calculations include substantial provisions to cover this risk. Our inspection did not reveal anything that causes us to question Danske Bank’s assessment of this risk.