

# White paper

Consolidation policy and business activities

at Danica Pension

Unaudited



February 2009

**Danica Pension**

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Profit policy and business activities  
at Danica Pension

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## Management summary

The Danica Group offers life insurance and pension products in Denmark, Sweden, Norway, and the Republic of Ireland. In Denmark, Danica offers conventional policies (*Danica Traditionel*), unit-linked products and health and accident products, while the product portfolio in Sweden and Norway covers unit-linked products and health and accident products. In the Republic of Ireland, Danica offers unit-linked products and mortgage protection. In 2008, the Danish activities accounted for 86% of total sales, and with a market share of 30%, Danica is the largest pension company in Denmark. During the past five years, the Danica Group has seen a rise in gross premiums, including premiums on investment contracts, of 10.4% per annum. The main growth driver is sales of the unit-linked products *Danica Balance* and *Danica Link*, which allow customers to choose their own risk profile.

Earnings contributed by the Danica Group to the Danske Bank Group consist of risk allowance, insurance results from unit-linked products and health and accident products, as well as the investment return on assets allocated to the shareholders. The accounts presented by the Danske Bank Group's business areas include a financing result that consists of interest paid for shareholders' equity and interest received on allocated capital.

The company Danica Pension contributes to the Danske Bank Group's profit for the Danica Group primarily via the risk allowance and the investment return on shareholders' equity. The risk allowance which is a share of the technical provisions from the traditional business, etc., can be booked as income only if it does not exceed the technical basis for risk allowance. The risk allowance is calculated mainly as the investment return on customer funds less the technical rate of interest and value adjustments of provisions. In 2008, the Danske Bank Group was not able to book the risk allowance as the technical basis for risk allowance was negative.

The company Danica Pension I contributes to the Danske Bank Group's profit from the Danica Group primarily through the insurance result on unit-linked products. The results and equity of Danica Pension I are based on IFRS and Danish accounting standards, under which the present value of insurance contracts can be no less than the surrender value of the contracts. The statutory accounts tend to underestimate the value of unit-linked products, and the fact that unit-linked products account for an increasing share of total premiums (unit-linked products account for more than 40% of gross premiums) has highlighted the need for more value-based methods as a supplement to conventional accounting methods. Danica Pension uses the European Embedded Value (EEV) for the Danish unit-linked business.

The European Embedded Value of *Danica Link* and *Danica Balance* is Dkr2,079m as of December 31, 2008. This is an increase of Dkr100m compared to the EEV as of December 31, 2007. The increase in the EEV is due mainly to the value of New Business (VNB). At the same time, the EEV of the in-force business decreased because of the turbulence in the financial markets during 2008. The turbulence resulted in negative return on equities, hence the lower results in 2008 and lower value of future fund charges and other income related to customers' savings.

## 1. Introduction

The purpose of this White paper is to inform investors, analysts and other stakeholders of Danica Group's activities and profit policy.

This White paper is intended to give an overview of the main factors that affect the Danica Group's annual accounts and not least to describe their relation to the annual accounts of the Danske Bank Group. The rules on preparing the income statement and balance sheet of a life insurance company are highly complex and sometimes very technical. This White paper is therefore not intended to give a comprehensive description of every aspect of the Danica Group's accounts.

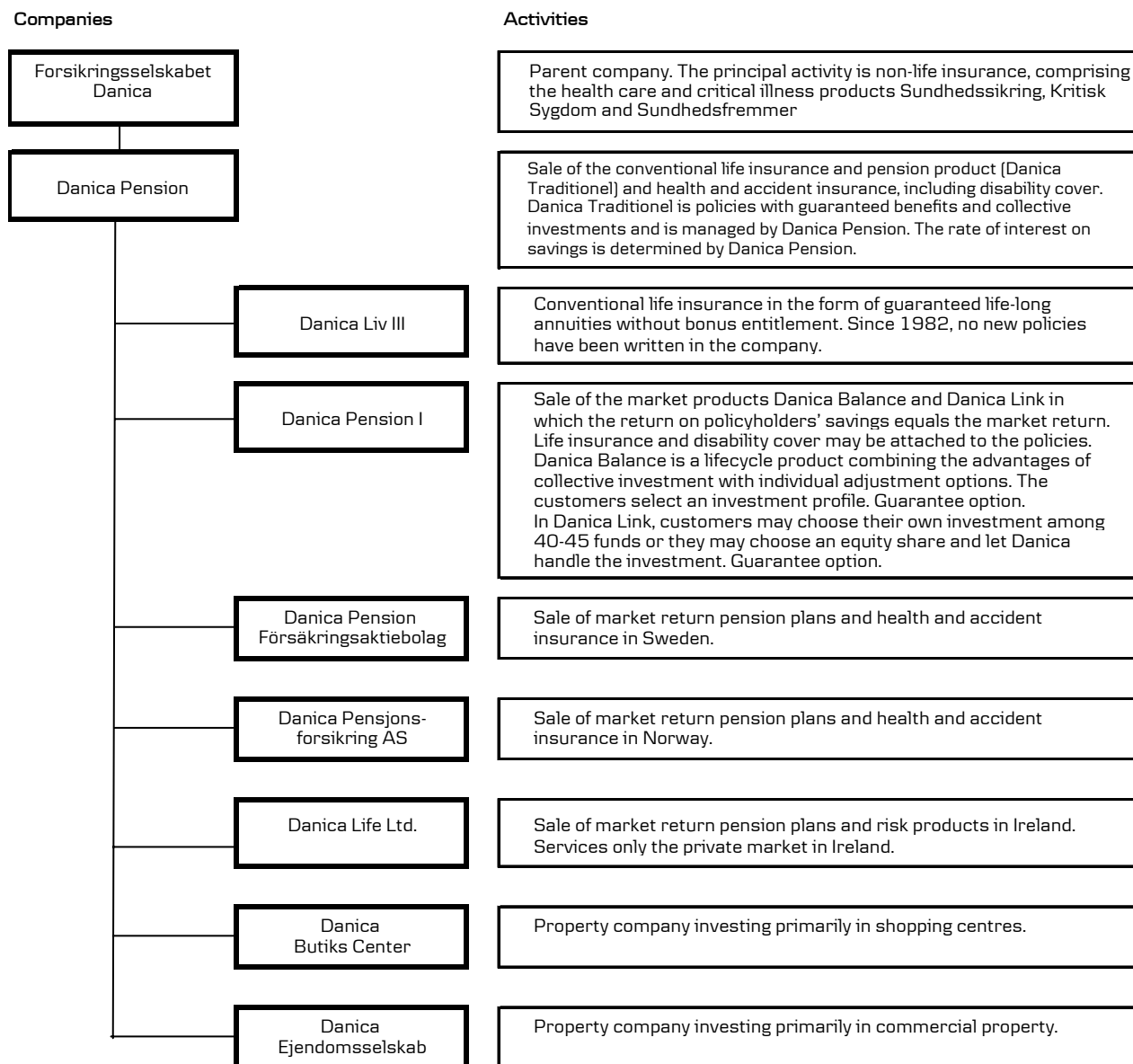
It is important to understand which parts of the Danica Group these issues concern. Section 2 gives an overview of the group and describes which parts of the Danica Group the subsequent analysis refers to.

In section 3, we present a business profile of the Danica Group, focusing on products, markets and distribution channels. In section 4, we describe the Danica Group's performance based on an explanation of how the results of the Danica Group affect the accounts of the Danske Bank Group. This is followed in section 5 by a description of the financial and insurance guarantees employed by Danica. In section 6, we review Danica Pension's earnings, including the relationship between the size of the investment return and when Danske Bank can book the life insurance risk allowance to its income statement. Finally, in section 7, we describe the value creation from the unit-linked business in addition to the conventional statutory accounts captured when calculating the European Embedded Value in Danica Pension I, Denmark.

## 2. Danica Group overview

The corporate structure of the Danica Group is described in Figure 1 below.

FIGURE 1: THE DANICA GROUP



It is particularly the activities of Danica Pension that are relevant to the profit policy.

Danica Pension I, Danica Pension Försäkringsaktiebolag, Danica Pensjonforsikring AS and Danica Life Ltd. are owned by Danica Pension, and their results are recognised directly in the results of the Danica Group. The earnings of Danica Pension I are described in section 7.

### 3. Danica's business profile

The Danica Group offers life insurance and pension-based insurance schemes. In addition to activities in its primary market, Denmark, the Danica Group has activities in Sweden, Norway and the Republic of Ireland.

In 2008, the Danica Group's gross premium amounted to Dkr21.9bn, of which the Danish activities accounted for 86%.

Since 2004, the Danica Group has seen a rise in gross premiums including investment contracts of 10.4% p.a., driven by organic growth primarily in the corporate market and through the international subsidiaries. The unit-linked products *Danica Balance* and *Danica Link* were introduced in 2005 and 2001, respectively. These products' share of total premiums in Denmark totalled 41% in 2008. Gross premiums from the international business rose by 61% from 2007 to 2008 primarily driven by the Swedish market.

	2008	2007	2006	2005	2004
Danica Balance and Danica Link	7.7	7.1	6.0	3.2	1.8
Danica Traditionel	10.8	10.2	10.7	11.4	11.0
Internal transfers	-0.9	-1.4	-1.6	-0.6	-0.2
Health and accident etc.	1.3	1.2	1.1	1.1	1.0
International	3.0	1.8	2.0	1.8	1.1
<b>Total premiums</b>	<b>21.9</b>	<b>18.9</b>	<b>18.2</b>	<b>16.9</b>	<b>14.7</b>

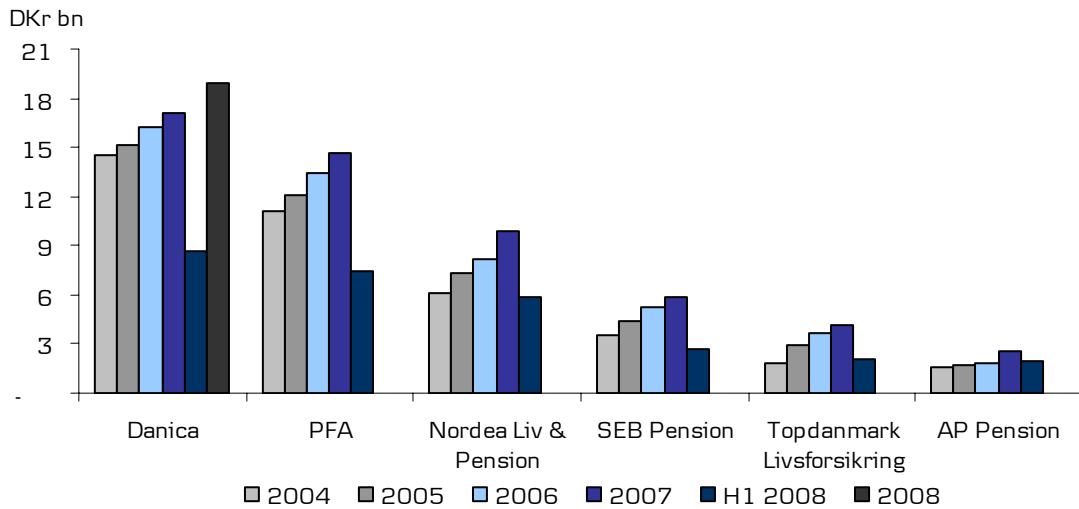
Danica has sustained a high degree of financial strength throughout the global financial turbulence and has an excess capital base of Dkr11.6bn. In October 2008, Standard & Poor's confirmed its AA- rating of Danica (the "Insurer financial strength" category), although it changed the outlook from stable to negative. Danica Pension remains one of the highest rated pension companies in the Nordic region.

#### 3.1 Activities in Denmark

In the Danish market, the Danica Group offers insurance-based pension schemes, life insurance and health care products through occupational pension plans and personal pension plans. These include both conventional policies (*Danica Traditionel*) based on a guaranteed benefit in terms of a technical interest rate and unit-linked products for which customers personally choose the risk profile including the option of a benefit guarantee.

Danica's business volume has risen in recent years, making Danica Denmark's largest pension company in terms of gross premiums with a market share of 30% (as of July 2008) of the market in which the company competes.

FIGURE 2: GROSS PREMIUMS IN DENMARK - GROUPS  
(including investment contracts and health and accident)



Danica uses several distribution channels. Danica has a large number of sales persons and advisers who primarily address the corporate segment. They are associated with a number of regional offices around Denmark. In addition, Danica works with many insurance agents who also operate in the market for corporate schemes.

Most sales of policies to individuals are handled through Danske Bank’s extensive branch networks.

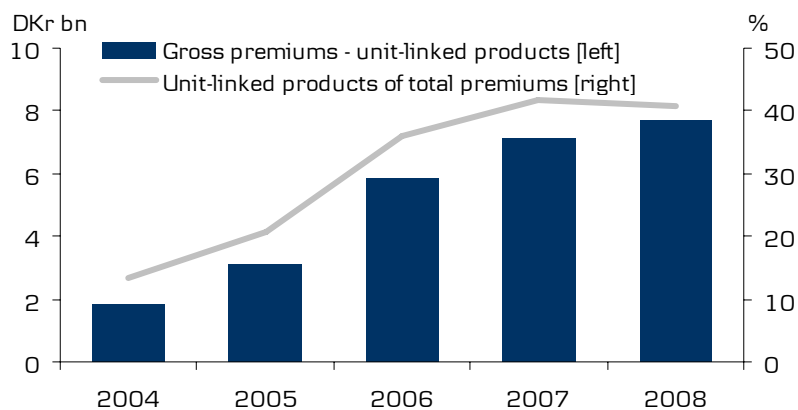
**Danica Traditionel**

*Danica Traditionel* customer funds are invested collectively. In return, *Danica Traditionel* offers a guaranteed benefit, calculated on the basis of technical interest rates of 4.5%, 2.5% or 1.5%, respectively. New business is written on the basis of 1.5% only and the average guarantee was 2.8% at the end of 2008.

**Danica Balance & Danica Link (unit-linked products)**

Figure 3 below shows the development in gross premiums from unit-linked products in Denmark.

FIGURE 3: GROSS PREMIUMS - UNIT-LINKED PRODUCTS, DANISH BUSINESS



Danica’s unit-linked products comprise *Danica Balance* and *Danica Link*. *Danica Balance* is a lifecycle product launched in 2005, which combines the advantages of collective investment with individual adjustment. The

result is a simple product, allowing the customer to choose a larger equity share than normally available in conventional products. In 2008, the range of investment profiles to choose from was broadened and an optional payment guarantee in the payout period was added.

*Danica Link* offers customers the opportunity to influence the way in which their pension savings are invested. This means that the returns accruing to the pension account are a direct reflection of the investments chosen. Customers can choose either to be active investors or to leave the investment decisions to Danica.

In Denmark, *Danica Link* customers can invest their pension savings in securities and at the same time insure themselves against capital loss, as *Danica Link* is available both with and without a payment guarantee. The payment guarantee ensures customers benefits equal to at least 95% of their contributions.

At the end of 2008, approximately 119,000 of Danica's customers had opted for unit-linked products, against some 97,000 at the beginning of the year.

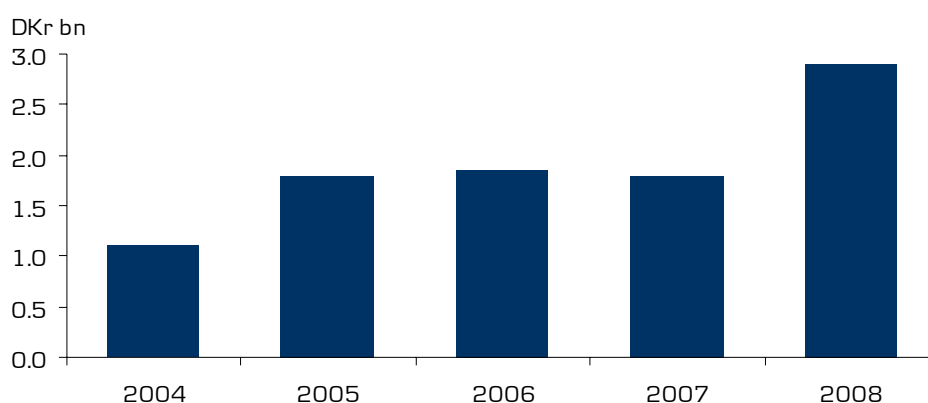
### Insurance cover

Customers are able to buy extra insurance cover against disability and death; these covers are mainly requested under corporate schemes. In addition, Danica offers cover against critical illness and healthcare insurance. In 2008, Danica Sundhedsfremmer (Danica Health Promoter) was introduced. Danica Sundhedsfremmer offers several tools to prevent health issues and is aimed at corporations and their employees.

### 3.2 International activities

Figure 4 below shows the development of gross premiums from unit-linked products from international subsidiaries.

FIGURE 4: GROSS PREMIUMS - UNIT-LINKED PRODUCTS, INTERNATIONAL BUSINESS



Gross premiums increased by DKr1.2bn from 2007 to 2008, which was mainly attributable to the Swedish market.

### Sweden

Danica set up its activities in Sweden in 1999 and offers pension products to the corporate market as well as to individuals. Danica also sells both unit-linked products and health and accident products in Sweden.

In Sweden, Danica's gross premiums increased by 82% to Dkr2,354m in 2008. The increase was mainly attributable to the success of the savings product Depåförsäkring launched at the end of 2007. The Depåförsäkring product was launched to replace the Kapitalförsäkring product, which accounted for 50% of the business' total premiums in 2006. Danica stopped selling Kapitalförsäkring in mid-2007 as a result of a change in the tax legislation.

Danica collaborates closely with Danske Bank Sweden and a number of the largest brokers in Sweden.

### **Norway**

In the Norwegian market, Danica offers pension products to the corporate market as well as individuals. Danica also sells both unit-linked products and health and accident products in Norway. The products are sold through Danica's own corporate sales force and in close collaboration with Fokus Bank.

In 2008, Danica's gross premium increased by 11% to Dkr614m, primarily from sales of unit-linked products.

On January 1, 2008, Danica transferred all the activities of the Norwegian branch from Danica Pension I to Danica Pensjonsforsikring.

### **Republic of Ireland**

Danica Pension established a life insurance company in the Republic of Ireland in 2007. Danica Life Ltd received a concession in 2008 and began sales in the second half of 2008.

Sales are conducted through National Irish Bank, which is part of the Danske Bank Group. Both unit-linked products and mortgage protection are offered to individuals only.

In 2008, sales were quite low because of the financial turbulence. Gross premiums totalled Dkr1.0m.

## 4. Danske Bank's profit from the Danica Group

The table below shows the earnings elements from Danica that are included in Danske Bank's annual accounts.

Ref. (DKr m)	2008	2007
1 Risk allowance	1,088	1,040
2 Insurance result, unit-linked business	-22	6
3 Insurance result, health and accident	-141	-112
4 Investment return	-961	710
5 Financing result	-609	-526
6 Deferred risk allowance	-1,088	0
7 Net income from insurance business	-1,733	1,118

Definitions of items in Table 2:

### 1. Risk allowance

The risk allowance is calculated as a share of average life insurance provisions and the collective bonus potential, excluding Forenede Gruppeliv, and totalled DKr1,088m in 2008.

### 2. Insurance result, unit-linked business

The insurance result from the unit-linked business consists of the technical result of unit-linked activities (*Danica Link* and *Danica Balance*) in Denmark, Sweden, Norway and the Republic of Ireland.

### 3. Insurance result, health and accident

The insurance result from health and accident is the technical result of Health and accident insurance and Health care products, excluding the investment return, in Denmark, Sweden and Norway.

A large part of Danica's life insurance and pension agreements includes disability cover. The customers pay for this cover, and the amount paid is a competitive parameter. The calculation includes a computed technical rate of interest (corresponding to the rate of interest on policyholders' savings) on the provisions, whereas the health and accident business' share of the company's remaining return on investment is included in the investment return. The health and accident result is specified in the notes of the financial statements of the Danica Group.

### 4. Investment return

The investment return comprises the return on assets allocated to the shareholders' equity of all the companies in the Danica Group that affect its profit as well as the portion of the investment return attributable to the health and accident business.

The return on customer funds in Danica Pension is distributed proportionally between Life insurance and Health and accident insurance based on the size of the technical provisions (investment community). However, the return on the derivative financial instruments used to hedge guaranteed benefits is not distributed on Health and accident insurance. The return on assets allocated to shareholders' equity corresponds proportionally to the return on customer funds as far as equities are concerned, while other investments of shareholders' equity are made independently.

## 5. Financing result

Danske Bank's business area accounts are based on the principle that capital is allocated to the individual business areas in relation to their activities. For the other business areas, the required capital is fixed at 5.5% of risk-weighted assets. For Danica, the allocated capital is defined as the charge on the Danske Bank Group's capital equal to its ownership of Danica, i.e. the portion deducted from the Danske Bank Group's capital base. This largely corresponds to the solvency requirement for Danica minus external subordinated loan capital and plus capital tied up in assets allocated to shareholders' equity. For Danica, this results in the following funding transactions:

(DKr m)	2008	2007
Interest of Danica's shareholders' equity	-851	-730
Interest on allocated capital	242	205
Financing result	-609	-526

It is important to note that this item is not included in Danica's group accounts, but only in Danske Bank's business area accounts. As shareholders' equity exceeds the allocation of capital, overall net funding is negative.

## 6. Deferred risk allowance (Change in the shadow account balance)

In 2008, the Danske Bank Group was not able to book the risk allowance of DKr1,088m. The shadow account consists of risk allowances which could not be taken to income in previous accounting periods, see section 6.2. A change in the shadow account balance constitutes recognition in the P&L statement of the shadow account balance. The balance of the shadow account was 0 (zero) at the beginning of 2008 and stood at DKr1,088m at the end of 2008.

## 7. Net income from insurance business

The net income is equal to the profit from the Danica Group included in Danske Bank's Net income from insurance business. The profit deviates from, but is consistent with, the official profit of the Danica Pension group.

### 4.1 Risk allowance

Danica Pension's traditional products are subject to the Executive Order on the Contribution Principle, which prescribes that earnings are to be distributed between customers and owners. Danica Pension prepares and notifies the authorities of the company's profit policy in accordance with these rules.

The major component of the profit from Danica Pension is typically the investment return on shareholders' equity and the risk allowance, which consists of a share of technical provisions etc. As shown in table 2, the risk allowance amounted to DKr1,088m in 2008. Overall, this risk allowance may be booked only if the technical basis for risk allowance permits. See section 6 for a description of the technical basis for risk allowance.

## 5. Importance of financial guarantees and insurance guarantees

The majority of customer funds relates to schemes to which financial or insurance guarantees are attached. To the extent that the customer funds are insufficient to cover the guarantees, a loss is posted on shareholders' equity, reducing Danske Bank's profit from the Danica Group.

### 5.1 Insurance guarantees

Insurance risks are linked to trends in life expectancy and disability. For example, the increase in life expectancy affects the time during which benefits are payable under certain pension schemes, whereas the trends in mortality, sickness and recoveries affect the benefits of life insurance and disability insurance.

In order to reduce insurance risks, Danica takes out reinsurance to cover a minor part of the risk relating to deaths and disability. Disaster risk is also covered by reinsurance for the entire portfolio.

### 5.2 Financial guarantees in unit-linked products

Unit-linked products (*Danica Balance* and *Danica Link*) are individual schemes in which the results of interest rate and market value fluctuations directly affect the value of policyholders' funds. Financial guarantees can be attached to these products. These guarantees are hedged in the financial markets in order to reduce the risk of their affecting shareholders' equity.

### 5.3 Financial guarantees in Danica Traditionel

*Danica Traditionel* is a collective scheme in which the financial guarantees are expressed through the technical rate of interest (see 2. in section 6.1). If the technical basis for risk allowance is insufficient to cover the risk allowance, tax on pension returns and bonuses, the excess is initially deducted from the collective bonus potential and then, to some extent, from the bonus potential of paid-up policies. The amount that can be deducted from the bonus potential of paid-up policies depends on whether Danica has implemented a temporary charge on transfer and surrender and the size of this charge. The change in collective bonus potential is calculated as follows:

(DKr m)	2008	2007
Technical basis for risk allowance	-11,570	2,120
- Share of technical provisions etc.	-28	-1,068
- Tax on pension returns	358	-44
- Bonus etc.	-3,470	-1,410
- Reduced bonus potential on paid-up policies	2,800	-
Change in collective bonus potential	-11,910	-402

If this calculation results in a loss exceeding the current collective bonus potential, the excess may to some extent be deducted from the bonus on paid-up policies. Any losses in excess of the collective bonus potential and the amount that can be deducted from the bonus potential on paid-up policies are set off against shareholders' equity. As shown in Table 4, the bonus potential on paid-up policies was reduced by DKr2.8bn. The Danske Bank Group cannot book a risk allowance before the bonus potential on paid-up policies has been restored.

The financial guarantees linked to Danica Traditionel typically have very long durations and a large proportion is related to a technical interest rate of 4.5%.

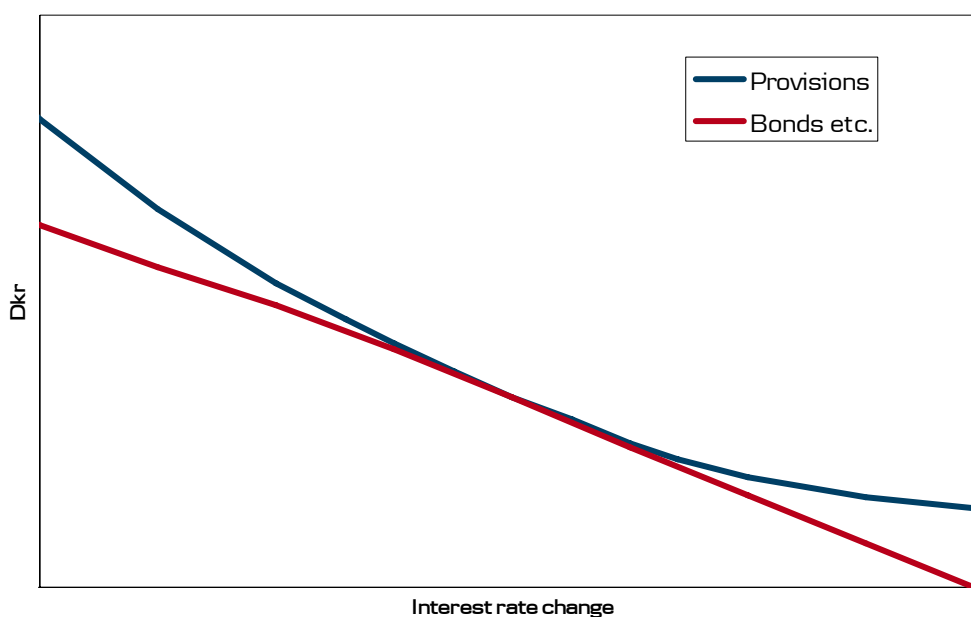
Danica uses its own risk management framework and hedging. The intention is that the company is able at any given time to withstand a 30% drop in share prices and a 50% drop or a 2.5 percentage point increase in interest rates.

Danica Pension's liabilities mainly comprise life insurance provisions, which are stated at market value by discounting the expected future cash flows.

The value of the bond portfolio increases when the level of interest rates drops. The market value of the life insurance provisions also increases, but due to the greater interest rate sensitivity of these provisions, the value adjustment of the provisions is greater than the corresponding value adjustment of the bond portfolio. Overall, this means that Danica Pension experiences a negative value adjustment when the level of interest rates falls. Therefore, Danica Pension has purchased derivative financial instruments.

The value of the bond portfolio is reduced by a greater amount than the value of life insurance provisions if interest rates rise, because provisions must equal, as a minimum, policyholders' savings. Figure 5 illustrates the relationship between assets and liabilities. Please note that the figure is for illustrative purposes only.

FIGURE 5: ILLUSTRATION OF MARKET VALUE ADJUSTMENT OF ASSETS AND LIABILITIES



Financial instruments are used to hedge the difference between the two curves.

In addition, funds are invested in assets with a view to maximising the return on investment, taking into account credit, currency and liquidity risks.

## 6. Earnings of Danica Pension

The company Danica Pension (see Figure 1) primarily contributes to Danske Bank's profit from the Danica Group through its investment return on shareholders' equity and the risk allowance. For 2008, the contribution from the risk allowance was DKr1,088m, while the investment return was DKr-961m. The risk allowance typically accounts for the main income from the Danica Group although it could not be booked in 2008. The calculation of the risk allowance and its sensitivity to various risks are described in the following. This is followed by a description of the investment return on shareholders' equity.

### 6.1 Risk allowance

The risk allowance for 2008 is DKr1,088m, which is in line with 2007. Danske Bank is permitted to book the risk allowance as income only to the extent that it does not exceed the technical basis for risk allowance. If the bonus potential on paid-up policies has been reduced, Danske Bank cannot book the risk allowance before the bonus potential on paid-up policies has been restored. The technical basis for risk allowance is calculated mainly as the investment return on customer funds less the technical rate of interest (see 2. below) and the value adjustment of provisions. The calculation of the technical basis for risk allowance is illustrated in Table 5. As shown in Table 5, Danske Bank was able to book the 2007 risk allowance of DKr1,040m but not the 2008 risk allowance of DKr1,088m.

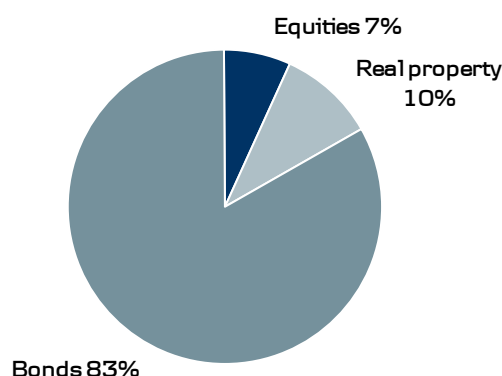
Item (DKr m)	2008	2007
1 Return on investment securities	-2,229	1,662
2 Average technical interest rate	-5,131	-5,231
3 Return on health and accident result	245	-123
4 Cost and risk result before bonuses	276	243
5 Profit/loss on reinsurance	265	-96
6 Value adjustment of provisions	-4,996	5,665
7 Technical basis for risk allowance	-11,570	2,120

Definitions of items in Table 5:

#### 1. Return on investment securities

The return on investment securities is the total gross investment return on assets allocated to customers. Customers' investment securities comprise bonds, equities and properties as illustrated in Figure 6.

FIGURE 6: DISTRIBUTION OF INVESTMENT SECURITIES AT 31.12.2008  
ALLOCATED TO DANICA PENSION CUSTOMERS



## 2. Average technical interest rate

Contracts with customers are based on a technical interest rate, on which the guaranteed benefits offered to customers are based. During the last 15 years, the technical interest rate has dropped sharply owing to the general fall in interest rates. Until 1994, the technical rate was 4.5%. From 1994 to 1999, the rate was 2.5%. At present, new policies are written with a maximum rate of 1.5%. Table 6 shows the distribution of provisions according to the various technical rates at the end of 2008, compared with the distribution at the end of 2007.

(DKr m)	End 2008	End 2008 [%]	End 2007 [%]
Technical interest rate in %			
0.0	1,082	1	1
1.5	54,834	35	29
2.5	26,962	17	19
4.5	74,433	47	51
16	168	0	0
Life insurance provisions	157,479	100	100
Without guarantee	14,037		
Total life insurance provisions	171,516		

As the table shows, the technical interest rates have generally become lower.

## 3. Return on health and accident result

The health and accident business consists of disability insurance, for which reserves have been provided. Part of the total investment return is therefore attributable to the health and accident result.

## 4. Danske Bank Group before bonuses

The calculation of guaranteed benefits is based on assumptions of future investment returns, costs and insurance risks (death and disability). These assumptions are conservative, and the difference between assumed and actual investment returns, costs and insurance risks are distributed to customers over time in the form of bonuses.

The cost result before bonuses represents the difference between actual costs incurred and the costs assumed in the calculation of guaranteed benefits.

The risk result before bonuses represents the difference between actual risk cover and the risk premium assumed in the calculation of guaranteed benefits.

## 5. Profit on reinsurance

The profit on reinsurance is calculated as the reinsurance cover received less reinsurance premiums.

## 6. Value adjustment of provisions

Value adjustment of the provisions constitutes the part of life insurance provisions exceeding the value of policyholders' savings. Life insurance provisions are stated at present value by discounting expected future cash flows using the swap yield curve prescribed by the Danish FSA. As a consequence of the global financial crisis, the Danish Government made an agreement with the Danish Association of Insurance and Pension Providers to ensure financial stability. The agreement implied that a Danish

mortgage bond spread was added to the yield curve used for discounting the expected future cash flows. This initiative is a temporary measure applying until the end of 2009.

### 7. Technical basis for risk allowance

If the technical basis for risk allowance is positive, Danica Pension can book the risk allowance to its income statement to the extent that it does not exceed the technical basis for risk allowance. If the risk allowance cannot be booked, in whole or in part, it can be deferred and booked in a year when the technical basis for risk allowance permits.

### 6.2 The shadow account

The portion of the risk allowance for the period exceeding the technical basis for risk allowance is transferred to the shadow account. From this account, recognition in the profit of Danske Bank may be made at a later date when the technical basis for risk allowance permits. However, The Danske Bank Group cannot book a risk allowance until the bonus potential on paid-up policies has been restored. The shadow account accrues interest at the rate that applies to the bond portfolio allocated to shareholders' equity.

At the end of 2008, there was a deferred risk allowance of Dkr1,088m on the shadow account, attributable only to 2008.

### 6.3 Relationship between risk allowance, investment return and provisions

If the investment return exceeds the technical interest rate and the value adjustment of provisions, the company may (other things being equal) book all or part of the risk allowance to the income statement as shown in the example in table 7 below.

TABLE 7: RELATIONSHIP BETWEEN RETURN ON INVESTMENT AND RISK ALLOWANCE

Scenario (in % of provisions)	A	B	C	D
Return on investment securities	3.0	4.5	6.0	6.0
Technical interest rate	-2.8	-2.8	-2.8	-2.8
Cost and risk results and return on H&A	-0.2	-0.2	-0.2	-0.2
Profit on reinsurance	0.0	0.0	0.0	0.0
Value adjustment of provisions	0.0	0.0	0.0	-3.0
<b>Technical basis for risk allowance</b>	<b>0.0</b>	<b>1.5</b>	<b>3.0</b>	<b>0.0</b>
<b>Risk allowance may be recognised as income in whole or in part</b>	<b>No</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>
Risk allowance of provisions	0.0	-0.6	-0.6	0.0
Tax on pension returns (PAL)	-0.5	-0.7	-0.9	-0.9
Bonuses (difference between technical interest rate and interest on policyholders' savings)	-1.0	-1.0	-1.0	-1.0
<b>Change in collective bonus potential</b>	<b>-1.5</b>	<b>-0.8</b>	<b>0.5</b>	<b>-1.9</b>

In principle, the technical basis for risk allowance can be used to book all or part of the risk allowance for the period and the potential shadow account balance, as tax on pension returns and bonuses are covered by the collective bonus potential. The option of using this practice does, however, depend on the trend in the collective bonus potential.

#### Scenario A

The investment return is just large enough to cover the technical interest and the return on health and accident. Consequently, the risk allowance cannot be booked. The collective bonus potential is reduced by 1.5% of the provisions to cover obligations toward customers.

**Scenario B**

The investment return is larger than the technical interest etc., there is no value adjustment of provisions and the technical basis for risk allowance is positive. This means that the risk allowance may be booked in whole or in part. However, the technical basis for risk allowance does not cover the tax on pension returns or the difference between the technical interest rate and the rate on policyholders' savings. To cover these payments, the collective bonus potential will be reduced by 0.2% of the provisions. For the full risk allowance to be booked as income, an additional 0.6% reduction of the collective bonus potential is required.

**Scenario C**

The technical basis for risk allowance covers all customer obligations and leaves 3.0% of the provisions for additional profit allocation. This return also covers the tax on pension returns, bonuses and the risk allowance to Danske Bank with no reduction of the collective bonus potential.

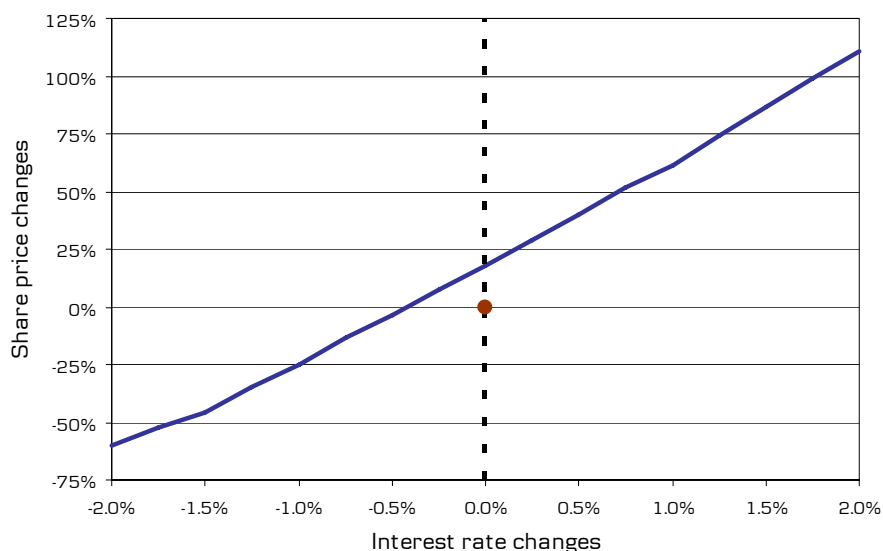
In scenarios B and C, it is possible to book the risk allowance for the year. In both scenarios it is also possible to book from the shadow account; this will, however, cause a (further) reduction of the bonus potential at a one-to-one ratio.

**Scenario D**

Scenario D is based on the same assumptions as C, but with a 3.0% value adjustment of provisions as a result of a reduction of interest rates. The technical basis for risk allowance is 0. Consequently, no risk allowance can be booked in the income statement.

The relationship between risk allowance and investment return is illustrated further in Figure 7. The figure shows the equity returns and interest rate changes necessary for Danica Pension to be able to book the full risk allowance for 2009. The full risk allowance can be booked at combinations of equity returns and interest rate changes that result in data points above the curve shown. In 2008, DKr2.8bn has been drawn from the bonus potential of paid-up policies. This must be restored before any risk allowance can be booked. At an unchanged level of interest rates, a return on real property of 8% and an 18% return on equities, it will be possible to book a full risk allowance of approximately DKr1.1bn for 2009.

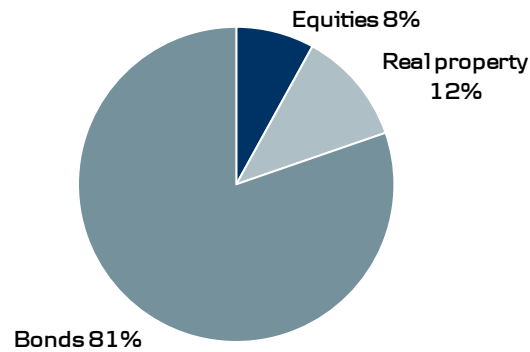
FIGURE 7: LIMIT OF FULL RISK ALLOWANCE ONE YEAR AHEAD (31.12.2008)



#### 6.4 Investment return on shareholders' equity

Assets allocated to shareholders' equity in Danica Pension are primarily invested in short-term bonds, equities and properties, as shown in Figure 8. In addition, a minor portion of shareholders' equity is invested in Danica Pension I, from which Danica's unit-linked products are sold. The profit generated by Danica Pension I is described in section 7.

FIGURE 8: DISTRIBUTION OF DANICA PENSION'S ASSETS ALLOCATED TO SHAREHOLDERS' EQUITY



## 7. European Embedded Value in Danica Pension I, Denmark

### 7.1 Management summary

The successful sale of unit-linked products (*Danica Link* and *Danica Balance*) by Danica Pension has significantly increased the demand for more value-based accounting methods as a supplement to conventional accounting methods. The unit-linked products now account for more than 40% of the gross premiums in Danica Pension, Denmark.

In this light, Danica Pension decided to introduce European Embedded Value (EEV) in Danica Pension I, Denmark last year. The EEV methodology adopted by Danica Pension is a “bottom-up” market-consistent approach, and it covers the Danish unit-linked life business. Hence, neither Health and accident insurance, nor the foreign activities are included.

On December 31, 2008, the European Embedded Value of *Danica Link* and *Danica Balance* was DKr2,079m. This is an increase of DKr100m compared with the EEV as of December 31, 2007.

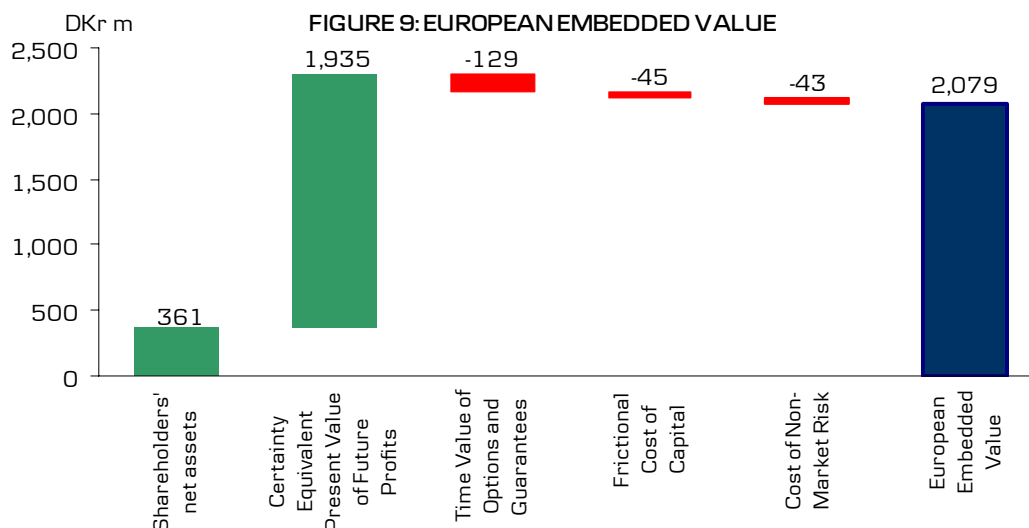
TABLE 8: EUROPEAN EMBEDDED VALUE

(DKrm)	2007	Growth	Movements in shareholders' net assets	2008
Shareholders' net assets	349	-28	40	361
Value of Business In force	1,630	88		1,718
<b>European Embedded Value</b>	<b>1,979</b>	<b>60</b>	<b>40</b>	<b>2,079</b>
- hereof Value of New Business				272
Return on EEV (excl. movements in shareholders' net assets)				2%
Return on EEV (excl. financial variance and movements in shareholders' net assets)				21%

The increase in the EEV is due mainly to the value of New Business (VNB). At the same time, the EEV of the in-force business decreased because of the turbulence in the financial markets in 2008. The turbulence resulted in negative return on equities, lower results in 2008 and lower values of future fund charges and other income related to customers' savings.

Shareholders' net assets are defined as 125% of statutory solvency requirements, which is in accordance with Danica Pension Management's view on the capital requirements of the business. The solvency requirements are based on the consolidated accounts, which are presented in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU. In the annual report for Forsikringselskabet Danica, the result for the covered business and shareholders' net assets is shown in the segmental accounts.

The Value of Business in force is the present value of future distributable earnings from the covered business. The components are represented as Certainty Equivalent Present Value of the Future Profits less Time Value of Options and Guarantees, Frictional Cost of Capital and Cost of Non-Market Risk. In the Figure 9 below, the value of each of the components that constitute the total EEV as of December 31, 2008 is shown (a more thorough review of the components is made in section 7.6.4)



In the following sections, the key assumptions used in the EEV calculations and the EEV results as of year-end 2008 will be examined. The methodology and definitions, which are the foundation of the EEV reporting, will be outlined in section 7.6-7.7.

## 7.2 Key Assumptions for EEV

The 2007 figures are based on the assumptions prevailing as of December 31, 2007. This means that any changes (i.e. changes in prices, expenses etc.), which occurred during 2008, are only accounted for in the 2007 figures if these changes were already known at year end 2007.

### 7.2.1 Economic assumptions

The economic assumptions used are based on the information available at December 31, 2007 and December 31, 2008, respectively.

**TABLE 9: RISK-FREE INTEREST RATE**

(forward rate)	Year 1	Year 2	Year 5	Year 10	Year 20	Year 40
As of December 31, 2007	5.11%	4.78%	4.68%	5.49%	5.37%	5.06%
As of December 31, 2008	4.64%	3.46%	4.62%	5.38%	4.06%	2.48%

The risk-free rate used in the EEV reporting is defined on the basis of a Euro swap market with the addition of the spread between Danish and German government bonds. This is the same definition as the one used in prior EEV reporting.

Since the risk-free rate used by Danica Pension for reporting under IFRS standards has been changed as a result of an agreement between the Danish Ministry of Economic and Business Affairs and the Danish Insurance Association (DIA) at the end of 2008, the risk-free rates used in the EEV calculations and in the IFRS reporting are not consistent. The risk-free rate used for calculating technical reserves in the IFRS reporting has been temporarily adjusted by the spread between the mortgage rate and the current discount rate. Since this is a temporary solution, it has been decided that this new rate is not appropriate for calculating EEV.

TABLE 10: INFLATION

	Year 1	Year 2	Year 5	Year 10	Year 20	Year 40
As of December 31, 2007	2.64%	2.61%	2.44%	2.57%	2.67%	2.73%
As of December 31, 2008	1.91%	1.42%	1.74%	2.20%	2.19%	2.19%

The inflation rate used reflects market implied inflation rates from traded Euro instruments adjusted by the difference between Euro and DKK interest rates (1-year forward rates). The inflation rate is used to project nominal charges and expenses in addition to premiums on the corporate pension plans (i.e. projection of salaries).

### Volatilities

The volatility of interest rates reflects the implied volatility of at-the-money Danish swaptions and was set at 0.71% as of December 31, 2007, and at 1.18% as of December 31, 2008. The volatility of shares was set at 22.06% as of December 31, 2007. As of December 31, 2008 the volatility was 36.65%, which reflects the two year S&P 500 at-the-money implied volatility. The volatilities are used when calculating the Time Value of Options and Guarantees.

### Taxation

In accordance with Danish tax legislation, the corporate tax rate is set at 25% and the tax on pension returns is set at 15% both as of year end 2007 and as of year-end 2008. These assumptions are also used as assumptions for the projections.

### 7.2.2 Operating assumptions

The operating assumptions are made on the basis of the current price lists, analysis of historical data and expectations for the future.

### Income assumptions

The income assumptions used in the EEV calculations are based on the price lists, which are adjusted for any discounts and price reductions made. Income covers fees and charges from policyholders and commissions received from the fund managers who invest policyholders' savings.

### Expense assumptions

The expenses used in the EEV calculations are based on the financial reporting of the covered business, expenses having been divided into:

- Acquisition costs
- Administrative expenses

Acquisition costs consist of up-front commissions and other costs related to sales of new business. Administrative expenses consist of premium and fund commissions to Danske Bank, brokers and Danica Pension's own sales force in addition to expenses related to administration and overhead.

Any future productivity improvements or any future one-off expenses have not been included in the assumptions.

### Decrement and policyholder behaviour assumptions

The decrement and policyholder behaviour assumptions include lapse assumptions, mortality and disability assumptions. These are all based on analyses of historical statistics for the customers in the covered business

and on expectations for the future. The lapse rate assumptions depend on the value of the guarantees, which depends on the investment conditions.

### Mortality and disability result

The mortality and disability results tend to fluctuate from year to year. In the long run, this business is expected to carry an average result close to zero and, therefore, a zero result from that part of covered business is assumed.

### 7.3 Analysis of change

In Table 11 below the results of Danica Pension's EEV for 2008 is shown. The value of PVFP, TVOG and FCOC are summarised under the value of Business in force. The value of new business is presented in a separate line after the main components.

TABLE 11: EEV ACCOUNTING (DKrm)	Shareholders' net assets	Value of Business in-force	European Embedded Value
<b>Reported EEV as of December 31 2007</b>	349	1,630	1,979
<b>Initial adjustments</b>	0	13	13
<b>Starting EEV as of December 31 2007</b>	349	1,643	1,992
Expected return	140	-40	100
Assumption changes	0	71	71
Experience variance	-39	7	-32
Financial variance	-11	-353	-364
Contribution from new business	-118	390	272
Movements in shareholders' net assets	40	0	40
<b>Ending EEV as of December 31 2008</b>	<b>361</b>	<b>1,718</b>	<b>2,079</b>

"Initial adjustments" are adjustments made to the EEV calculations at the beginning of the year. These adjustments consist of technical adjustments in the EEV model that cannot be characterised as for example assumption changes, that is, changes in the way that the business is defined or managed.

"Expected return" shows the results that would have been realised for the period, if everything regarding the existing business (that is, excluding new business) had evolved as expected under the Certainty Equivalent scenario at the beginning of the period.

"Assumption changes" consists of changes in the price lists carried out in 2008, changes to expense assumptions and changes regarding the mortality assumptions. The changes to expense assumptions account for more than half of all the changes.

"Experience variance" covers the fact that reality does not always turn out as expected when assumptions were made. This can comprise the size of the business volume at the end of the period (number of policies, premiums, reserves etc.) as well as the realised revenues and expenses.

The primary reason for the experience variance in 2008 is that the realised result in 2008 was lower than expected, affecting Shareholders' net assets negatively. This can primarily be explained by a one-off increase in life insurance provisions. At the same time, the net present value of future results was higher than expected, affecting the Value of Business in force positively.

“Financial variance” covers differences between the actual investment return and the risk-free discount rate and all effects arising from changes in capital market assumptions. The financial variance in 2008 was primarily due to the turbulence in the financial markets. The realised investment returns on assets allocated to the equity in DPI and on policyholders’ savings were far below the expected investment returns (i.e. the risk-free rate, which was expected to be 5.11% in 2008). The realised return for *Danica Balance* customers with 30 years to retirement and a medium-risk option illustrated this with a negative 36.2% before tax. The return for *Danica Link* customers with a medium-risk option and with 30 years to retirement was a negative 24.4% before tax.

Because of the negative investment returns on policyholders’ savings during 2008, the value of future fund charges and commissions received from the fund managers investing policyholders’ savings etc. are reduced, which ultimately reduces the EEV result.

The financial variance is also negatively affected by the changed volatility of shares, which has increased by more than 60% since December 31, 2007. The volatility assumption is based on the market volatilities as of December 31, 2008, which was heavily influenced by the exceptional situation in the financial markets. The calculated value of the guarantees is based on constant volatilities throughout the projection period, even though a continuation of such high volatilities seems highly unlikely. If the current volatility level actually was to remain unchanged in the future, Danica Pension would carry out price increases to the guarantee premiums in accordance with the volatility level. Neither 'normalised' volatility levels, nor price increases have been incorporated. In section 7.4, a sensitivity concerning changes in the market volatilities is shown.

“Contribution from new business” is defined as the value arising from the sale of new contracts during the reporting period at year-end using end-of-year assumptions. New business includes all new policies, all additional single premiums on existing policies, all increases on private policies and all increases on corporate policies that are different from expected increases.

The table below presents the net profit from new business. The acquisition costs are shown separately to illustrate the initial high costs of new business.

TABLE 12: NEW BUSINESS		
(DKrm)	2007	2008
Acquisition costs (after tax)	-143	-126
Present value of new business	468	398
<b>Net profit from new business</b>	<b>325</b>	<b>272</b>

The value of new business was Dkr53m lower than in 2007 owing to a minor decrease in sales and the negative investment return, which also resulted in lower margins as shown below.

As a supplement to the Value of New Business (VNB), a few key figures have been calculated. In the following table, the value of new business is calculated in relation to net present value of future premiums from new business in percent (PVNBP). The new business premiums are calculated consistently with VNB, and the regular premiums paid in the year concerned are included. The other key figure shows the VNB in relation to the annual premium equivalent (APE); that is, sales of new premiums including 10% of single premiums.

TABLE 13: KEY FIGURES - VALUE OF NEW BUSINESS

(DKrm)	2007	2008
Present value, new regular premiums	6,046	5,364
Single premiums	3,508	3,491
Present value of new business premiums (PVNBP)	9,554	8,855
<b>New business margin - % of PVNBP</b>	<b>3.4%</b>	<b>3.1%</b>
New regular premiums (year to date)	1,569	1,372
Single premiums	3,508	3,491
Annual Premium Equivalent (APE) <sup>1)</sup>	1,920	1,721
<b>New business margin - % of APE</b>	<b>16.9%</b>	<b>15.8%</b>

<sup>1)</sup> Weighting of single premiums: 10%

“Movements in shareholders’ net assets” arise because of increased business volume, which results in higher solvency requirements.

Table 14 lists two key figures calculated to expand the analysis of the return on the EEV result. Generally, the calculations of the return on the EEV do not include any movements in shareholders’ net assets.

TABLE 14: KEY FIGURES - RETURN ON EEV

	Dec. 31, 2007	Dec. 31, 2008
Return on EEV	24%	2%
Return on EEV (excl. financial variance)	26%	21%

#### 7.4 Sensitivity analysis

In accordance with the CFO Forum’s Additional Guidance on European Embedded Value Disclosures, a number of sensitivities have been produced. The table below lists a summary of the sensitivities.

TABLE 15: SENSITIVITY ANALYSIS

(DKrm)		Change in EEV	Change in new business value
European Embedded Value, year end 2008	2,079		
Value of New Business, year end 2008	272		
Increase in RDR (risk discount rate)	+ 100bps	-85	-33
Decrease in RDR (risk-discount rate)	- 100bps	75	37
Increase (parallel) in the risk-free rate, with a corresponding decrease in fixed interest asset value	+ 100bps	-29	-14
Decrease (parallel) in the risk-free rate, with a corresponding increase in fixed interest asset value	- 100bps	13	14
Decrease in equity and property market values	- 10%	-79	-12
Increase in the level of implied market volatilities	+ 100bps	-3	0
Decrease in administrative expenses	- 10%	91	24
Increase in lapse rates	+ 10%	-129	-36
Decrease in lapse rates	- 10%	150	42
Decrease in base mortality rates	- 5%	1	0
Decrease in base disability rates	- 5%	0	0
Impact of assuming only statutory minimum capital requirements		18	3
Decrease in revenues (all charges and fees from customers)	-10%	-245	-54

In each of the calculations, all other assumptions are unchanged unless they are directly affected by the changed assumption. The sensitivities have been calculated in a single direction only, if the impact of a change in factors in the opposite direction does not give a significantly different movement.

### 7.5 Executive Board' attestation

The Executive Board of Danica Pension acknowledges its responsibility for the preparation of the EEV report disclosed in Danica Pension's White Paper. The Board also acknowledges that the disclosure and preparation have been conducted in accordance with the EEV principles developed by the CFO Forum. The Market-Consistent Embedded Value (MCEV) principles, which were introduced in June 2008, have not been applied in all aspects ([www.cfoforum.nl](http://www.cfoforum.nl)). The assumptions underlying this report have been 'signed off' by Danica Pension's Management.

### 7.6 METHODOLOGY AND DEFINITIONS

Embedded Value is a measure used to estimate the shareholders' interest in the covered business and is determined by calculating the present value of expected future distributable earnings. Danica Pension discloses the EEV of its unit-linked products in Danica Pension I, Denmark, in accordance with the requirements of the CFO Forum.

The primary purpose of reporting EEV is to give analysts, investors and other stakeholders a more comprehensive view of the value creation of Danica Pension's unit-linked products. It is important in this context to stress that the EEV results must be seen not as the actual value to investors of the unit-linked product business but as a supplement to the existing accounting. Policies that the company expects to sell in the future are not part of the EEV calculations and constitute an important difference between EEV and the actual value of the business to investors.

The reason for focusing on unit-linked products only and leaving out the conventional life and pension business (*Danica Traditionel*) is that the difference between the statutory profit and estimated value creation is highest for these products. Hence, the results of the unit-linked products have been negative due to high growth rates and thus high acquisition costs. In the statutory accounts concerning the conventional business, the result primarily consists of risk allowance and investment return, while it is not directly influenced by acquisition costs. Thus, the accounting for the conventional business creates more transparent results compared with those of the unit-linked product business.

The approach that Danica Pension has adopted for the EEV calculation is a bottom-up market-consistent approach, where asset and liability cash flows are valued consistently with similar cash flows in the capital markets. The time value of options and guarantees are valued using market-consistent valuation approaches calibrated to observable market prices.

The Present Value of Future Profits (PVFP) is calculated using a certainty equivalent technique, which is a deterministic method. The certainty equivalent value of in-force business is the present value of best-estimate distributable earnings discounted by the risk-free rate consistent with the current yield curve. The best-estimate distributable earnings are determined under the assumption that the future investment returns on all asset classes will be equal to the forward rates implied by the risk-free interest rates.

In theory, when valuing cash flows depending on volatile assets, such as charges depending on fund value, these assets need to be projected at returns reflecting these volatile assets. But as the resulting cash flows are volatile they should also be discounted taking the risk into account. These two effects cancel out each other and it is therefore sufficient to project volatile cash flows at the risk-free rate and discount using the same risk-free rate.

As many customers have a maturity guarantee attached to their unit-linked product, these guarantees need to be valued as well. The value of the guarantees has been divided into two parts: intrinsic and time value. The intrinsic value is the value of the guarantee if there were no volatility in the capital markets, and is included in PVFP. As of December 31, 2008, this value is insignificant. The remainder, Time Value of Options and Guarantees (TVOG), depends on the exposure to volatile cash flows, and therefore a market-consistent stochastic model has been applied to determine the TVOG. This value is calculated using an advanced option pricing approach calibrated to be consistent with the prices of quoted options with similar characteristics.

While the financial cash flows are adjusted for any financial risks, adjustment for other risks such as operational and insurance risks is made by including a Cost of Non-Market Risk. This is described in section 7.7.4.

Total EEV is calculated as the sum of shareholders' net assets and PVFP less TVOG and Cost of Capital (CoC), where CoC covers Frictional Cost of Capital (FCOC) and Cost of Non-Market Risk (CNMR). These elements will all be described in section 7.7.4.

### 7.6.1 Covered business

The covered business in Danica Pension's EEV calculation comprises the unit-linked products sold in Denmark (*Danica Balance* and *Danica Link*), also referred to as Danica Pension I, Denmark, excluding Health and accident insurance. Conventional life and pension business (*Danica Traditionel*) and unit-linked products sold outside Denmark and the result of Health and accident insurance, are not covered. In the tables below, the gross premiums, the annual premiums and provisions concerning covered business are shown to illustrate the size.

**TABLE 16: COVERED BUSINESS**  
(DKrm)

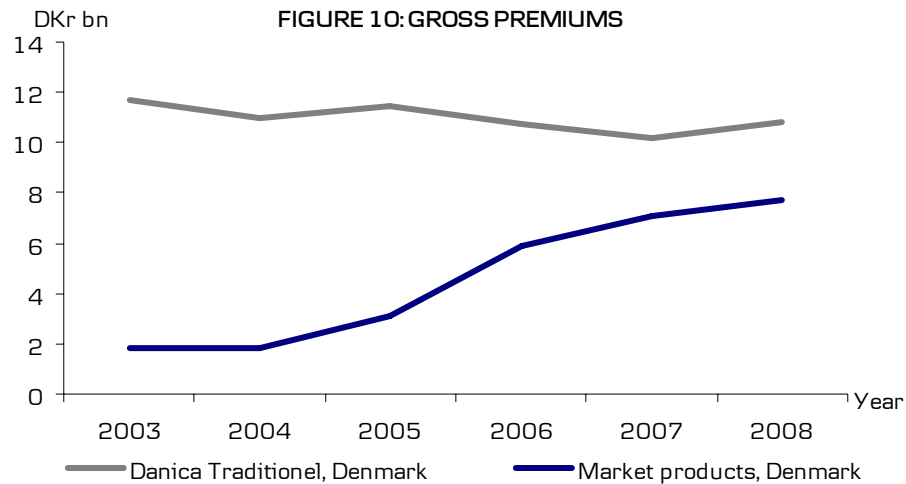
	2007	2008	Change
<i>Gross premiums</i>			
Regular premiums	3,597	4,245	18%
Single premiums	3,509	3,492	0%
<b>Total gross premiums</b>	<b>7,106</b>	<b>7,737</b>	<b>9%</b>

**TABLE 17: COVERED BUSINESS**  
(DKrm)

	Dec. 31, 2007	Dec. 31, 2008	Change
<i>Annual premiums</i>			
- with guarantee	606	721	19%
- without guarantee	3,302	3,863	17%
<b>Total annual premiums</b>	<b>3,908</b>	<b>4,584</b>	<b>17%</b>
<i>Provisions</i>			
- with guarantee	5,723	5,922	3%
- without guarantee	16,028	17,224	7%
<b>Total provisions</b>	<b>21,751</b>	<b>23,146</b>	<b>6%</b>
<b>Statutory profit before tax</b>	<b>7</b>	<b>39</b>	<b>457%</b>

In comparison, provisions at the Danica Pension group totalled Dkr218,139m as of year-end 2008, which means that covered business accounts for approximately 11% of the total business of the Danica Pension group.

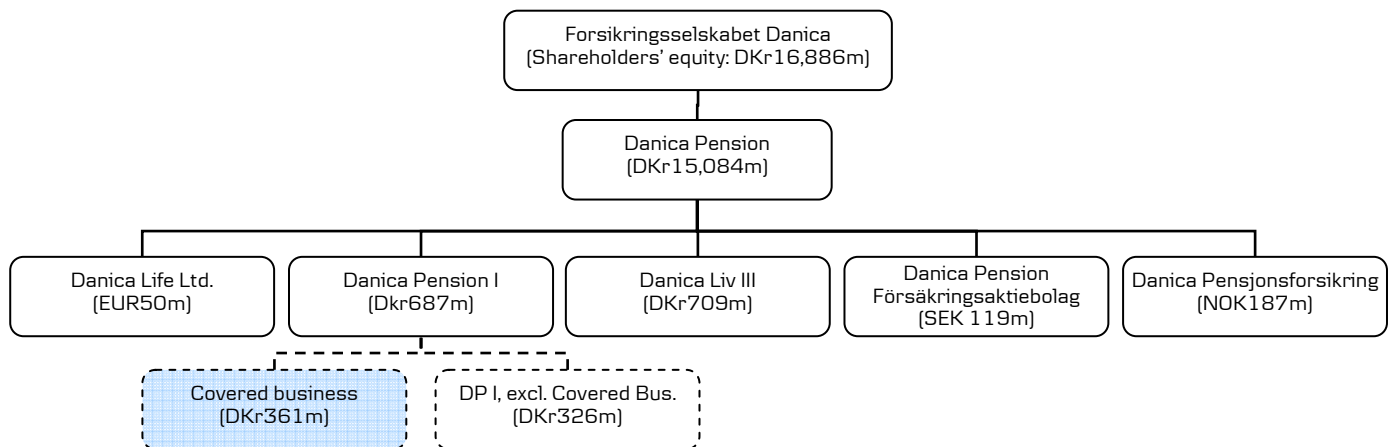
However, when looking at the gross premiums in Danica Pension, Denmark, the unit-linked products account for more than 40%, as the figure below illustrates.



Any revenues generated by covered business in other parts of the Danske Bank Group are not included in the EEV. This includes, for example, income generated in Danske Bank by selling Danica Pension’s unit-linked products and, likewise, income generated in Danske Capital by managing customers’ investments. Danica Pension has thus decided not to apply the “look-through” principle, which is part of the EEV principles. It should be noted that valuation of revenues in other units of the Danske Bank Group are included in the valuation of these business areas.

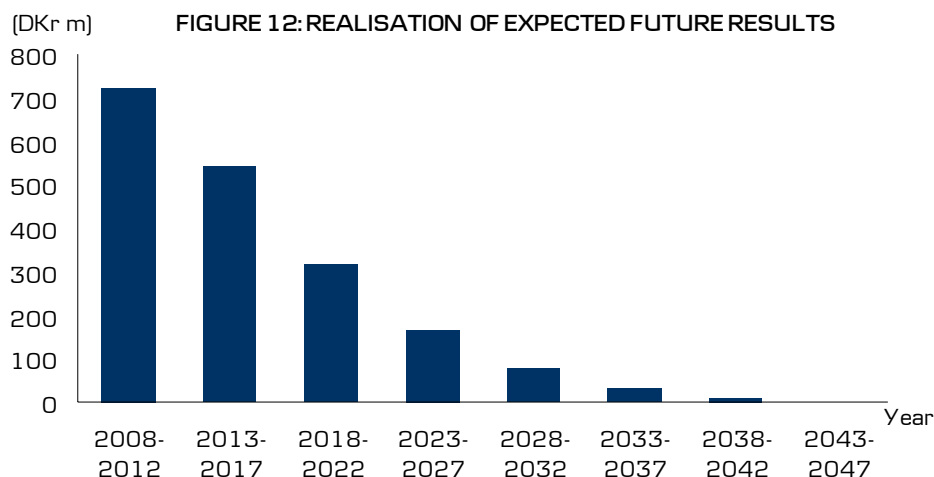
In the chart below, the corporate structure of the Danica group is shown together with the shareholders’ equity of the individual units. Danske Bank is the owner of Forsikringselskabet Danica.

**FIGURE 11: CORPORATE STRUCTURE OF THE DANICA GROUP**



**7.6.2 Calculation of value of future results**

The calculation of Danica Pension’s EEV is performed using a model developed to reflect the actual products and cash flows in the covered business. The cash flows are projected over 40 years using the risk-free interest rate as growth rate for all assets and subsequently discounted using the risk-free discount rate. The chart below shows how the expected future results are spread out over the 40-year period. On the basis of this chart, it is evident that a projection period of 40 years is sufficient - approximately 40% of the value is generated during the first five years.



The pre-tax profit of the covered business can be broken down into the following elements:

- Income consists primarily of the fees paid by policyholders and the commissions received by the company from the fund managers investing policyholders' savings.
- Expenses consist of acquisition costs and administrative expenses.
- The result from the risk cover sold in relation to pension savings and the profit from the financial guarantees that policyholders can opt to buy.
- Return on investment of the assets allocated to shareholders' equity.

The income is generated from the assets over the term of the agreements, whereas the costs are highest in the first year due to acquisition costs. In years with a sharp increase in business volume, the accounts are negatively affected by major acquisition costs. Thus, the profit does not reflect the value creation during such years, and this is one of the main reasons for disclosing EEV reporting.

### 7.6.3 Options and guarantees

Danica Pension I has two different types of product; *Danica Link* and *Danica Balance*, each with financial options and guarantees. The guarantee attached to *Danica Link* ensures customers at least 95% of the payments (after charges and payment of insurance coverage). The guarantee is raised once a year to 95% of the fund value if, and only if, this constitutes an increase. The guarantee linked to *Danica Balance* guarantees 0% return on premiums (after charges and payment of insurance coverage).

The options and guarantees connected to *Danica Link* products are partially hedged on an ongoing basis through the purchase of financial instruments, financed by guarantee premium payments from policyholders. In an EEV context, these options and guarantees are valued using a market-consistent stochastic pricing model. Furthermore, the value of the guarantees has been divided into intrinsic and time value.

The options and guarantees embedded in *Danica Balance* products are managed in Danica Pension I using a CPPI (Constant Proportion Portfolio Insurance) strategy. The CPPI strategy aims at ensuring that each portfolio is managed in such a way that its value at a certain point in time always exceeds the present value of guaranteed amounts. This is conducted by investing in a combination of risk-free and risky assets, so that following a low or negative return of the equity component, a reallocation into risk-free assets would be sufficient to make certain that the value of the embedded option is not substantial.

The amount invested in the risky assets depends on the difference between the value of the portfolio and the value of the guarantee. The smaller this difference, the smaller the proportion of risky assets becomes.

Because of this established strategy, Danica Pension can assume that the value of options and guarantees of the *Danica Balance* products is near zero and consequently does not affect the EEV. The premiums that the customers pay in relation to this guarantee cover the cost of holding extra capital due to a higher solvency requirement when a guarantee is attached.

#### 7.6.4 The components of EEV

Danica Pension's EEV reporting is disclosed in accordance with the EEV principles, and it is a measure of the estimated consolidated value of shareholders' interests in the covered business. This value can be broken down into the following components:

##### Shareholders' net assets

In Danica Pension's EEV calculations, shareholders' net assets equal the required capital of the covered business. In accordance with Danica Pension Management's view on the capital requirements of the business, required capital is defined as 125% of the solvency requirements.

##### Certainty Equivalent Present Value of Future Profits

The certainty equivalent value is the value of the distributable earnings calculated based on a specific scenario in which all financial assets earn the forward rate implied by the yield curve at valuation date and the distributable earnings are discounted using the yield curve. The PVFP covers all estimated future profits from existing business (including profits from New Business).

When calculating PVFP, the model takes into account all income and expense cash flows, which are projected over 40 years and discounted. Examples of such income cash flows are fees and fixed charges paid by policyholders, whilst expenses among other things consist of administrative expenses and overheads.

##### Time Value of Options and Guarantees

TVOG captures the time value of the options and guarantees, i.e. the part of the value which is due to volatility in the interest rates and the underlying asset. By definition, the time value will always represent an expense for Danica. In practice, Danica offers options and guarantees, predominantly to customers in connection with products with low volatility (unit-linked products with a high proportion of bonds in the portfolio), and this lowers the potential time value.

##### Frictional Cost of Capital

FCOC represents the economic cost of holding shareholders' equity. The FCOC represents investment management expenses and taxes on investment income on total required capital.

##### Cost of Non-Market Risk

CNMR reflects an allowance for the impact on shareholder value of operational risks and other non-diversifiable risks.

Currently, no best practice exists regarding how to calculate CNMR. The majority of European insurance companies recognise that EEV needs to be adjusted for CNMR, especially when calculating the PVFP on a market-consistent basis. Danica Pension will follow the EEV discussions in the coming years, but until a best practice has emerged, the cost of non-market risk is allowed for by applying an annual 1% charge of the

required capital. The level of CNMR implied by using this method reflects Management's view of an appropriate adjustment.

## 7.7 Glossary of terms

**Annual premium equivalent (APE):** Annual premium equivalent is defined as new annualized regular premiums plus 10% of single premiums.

**Certainty equivalent value (CE):** The certainty equivalent value is the value of the best estimate distributable earnings projected based on one specific scenario in which all assets earn the forward rate implied by the risk-free yield curve at the valuation date and the distributable earnings are discounted using this yield curve.

**CFO Forum:** Group formed and attended by Chief Financial Officers of a number of listed and non-listed European insurance companies. The Forum was created in 2002, and its aim is to discuss new accounting regulations and create greater transparency for investors. ([www.cfoforum.nl](http://www.cfoforum.nl))

**Cost of Capital (CoC):** Is the sum of frictional cost of capital (FCOC) and cost of non-market risk (CNMR)

**Cost of Non-Market Risk (CNMR):** The cost of non-market risk is an explicit deduction from the value of business in force reflecting shareholders' costs from non-diversified operational risks and variability in insurance business. CNMR is allowed for by deducting 1% of the required capital each year.

**Covered business:** The covered business is Danica Pension's portfolio of unit-linked products in Denmark, excluding Health and accident insurance. The products are sold under the names *Danica Link* and *Danica Balance* and are accounted for under Danica Pension I, Denmark.

**European Embedded Value (EEV):** Standard principles for calculating embedded value in European insurance companies. The calculation methods are in accordance with the requirements set out by the CFO Forum ([www.cfoforum.nl](http://www.cfoforum.nl)).

**Frictional Cost of Capital (FCOC):** Economic cost of holding required capital. In a market-consistent environment, these frictional costs represent investment management expenses and taxes on the investment income of the total available capital.

**Market-Consistent Embedded Value (MCEV):** Value of the future distributable earnings from in-force business where assets and liabilities are valued consistently with market prices of similar cash flows in the financial markets.

**New Business (Value of New Business = VNB):** VNB is defined as the net present value of premiums sold in the current year. New Business includes all new policies, all additional single premiums on existing policies, all increases on private policies and all increases on corporate policies that exceed expected changes.

**Present Value of Future Profits (PVFP):** Net present value of best estimate distributable earnings from in-force business.

**Required capital:** Equals 125% of the solvency requirements.

**Risk-free rate (RFR):** The risk-free rate used is consistent with the risk-free rate that is used by Danica Pension for reporting under the IFRS standards. The risk-free rate is defined on the basis of the German swap-yield curve adjusted by the differential between Danish and German government bonds.

**Shareholders' net assets:** Shareholders' net assets for the Danish business in Danica Pension I, excluding Health and accident insurance. The shareholders' net assets equal the required capital for the covered business, which has been determined to be 125% of the solvency I requirements.

**Time Value of Options and Guarantees (TVOG):** The part of the market-consistent value of the options and guarantees which exists only due to the volatility of the capital markets.

## Appendix A. The Danica Group in the statutory accounts of Danske Bank

The Danica Group is consolidated in Danske Bank's statutory accounts according to the following principles:

- Danica's assets can be divided into assets related to insurance contracts (contracts subject to significant insurance risk or entitling the policyholder to a bonus), investment contracts (contracts subject to insignificant insurance risk) and assets allocated to shareholders' equity. At the end of 2008, 90% of Danica's assets consisted of insurance contracts, 4% of investment contracts and 6% of assets allocated to shareholders' equity.
- Assets relating to insurance contracts are consolidated under Assets under insurance contracts. These assets consist of financial assets, investment properties, domicile properties, other tangible assets, etc.
- Liabilities relating to insurance contracts are consolidated under Liabilities under insurance contracts. The liabilities consist of life insurance provisions, provisions for unit-linked contracts, collective bonus potential, other technical provisions and other liabilities.
- Payments received on insurance contracts are recognised under Net premiums. The return on the allocated assets is recognised under the respective income statement items. Changes in insurance obligations due to additional provisions for benefit guarantees and the accrual of the return for the year on assets relating to insurance contracts and the related tax on pension returns are recognised under Net trading income. Other changes in insurance obligations are recognised under Net insurance benefits.
- Investment contracts are recognised as financial instruments. The assets relating to unit-linked investment contracts are included under Assets under pooled schemes and unit-linked investment contracts. Deposits are included in the balance sheet under Deposits under pooled schemes and unit-linked investment contracts.
- Deposits/payments under investment contracts are recognised directly as a change to the liability in the balance sheet. The return on the assets and its accrual to policyholders' accounts are recognised under Net trading income.
- The assets allocated to shareholders' equity are consolidated on a line-by-line basis with the group's other assets. The allocated assets consist of Bonds, Investment properties and Equities.

In the financial highlights, Danica is presented in a single line under Net income from insurance business. In the Segment note, Danica is presented according to the above principles in the statutory format. The differences between the presentation of Danica in the group's income statement and the financial highlights are included as part of reclassification in the Segment note.

## Appendix B. Changes in 2008

### Government initiative for the financial sector

As a consequence of the global financial crisis the Danish Government has made an agreement with the Danish Association of Insurance and Pension Providers to ensure financial stability. The main components of the agreement are:

- A Danish mortgage bond spread has been added to the yield curve which is used for discounting liabilities
- Bonus payments to policyholders has been limited
- The yellow traffic light stress test has been abandoned
- All life insurance and pension companies must submit their financial statements and individual solvency to the Danish FSA on a quarterly basis

The additions of the mortgage spread to the yield curve which is used for discounting liabilities and the limit on bonus payments are temporary measures which will cease to apply by the end of 2009.

In response to the agreement Danica lowered the interest on policyholders' savings to 1.5% after tax.

### Charge on transfers and surrenders for policyholders with Danica Traditionel

The bonus potential has been severely reduced due to the global financial crisis in the fall of 2008. As a consequence Danica and several of our competitors have imposed a temporary charge on transfers and surrenders for policyholders with *Danica Traditionel*. The charge was imposed on October 28 2008. The charge on transfers and surrenders was imposed to protect existing customers in *Danica Traditionel* against speculation from other customers. As a result customers who want to transfer or surrender funds from *Danica Traditionel* before the agreed-upon termination date will get a 5% deduction in their savings.

### SRI - Socially Responsible Investment

In 2008 Danica implemented SRI guidelines. The guidelines are fully implemented for *Danica Traditionel* and *Danica Balance* and to some extent *Danica Link*. Screening of companies is done by Ethix SRI Advisors. For more information please see the Annual Report or the Danica website [www.danicapension.dk](http://www.danicapension.dk).

## Appendix C. Frequently asked questions

### 1. Which assets has Danica Pension invested in?

At the end of 2008, 83% of the assets were invested in bonds, 7% were invested in Danish and foreign equities and 10% were invested in real property.

### 2. What is Danica Pension's capital base, and how large a capital base does the authorities require?

At the end of 2008, Danica's capital base stood at DKr17.2bn, and the minimum capital requirement/solvency margin is DKr7.4bn.

### 3. What is interest on policyholders' savings, and who determines the interest rate?

Interest on policyholders' savings is the return that is added to the individual policyholder's account for a given year. If the actual investment return is lower than the rate of interest on policyholders' savings, the difference is taken from the collective bonus potential.

From January 1, 2009, the rate of interest on policyholders' savings after tax on pension returns has been fixed at 1.5%, corresponding to 1.8% before tax.

### 4. Why is there a difference between the interest on policyholders' savings and the average technical interest rate?

Contracts with customers are designed as a payment guarantee based on a guaranteed minimum average technical interest rate. Since the investment return might exceed the technical interest rate it is possible to add additional interest to the savings during certain periods and this can lead to increased benefits. However, if the investment return falls below the technical interest rate, the interest on policyholders' savings can be set below the technical interest rate as long as the original payment guarantee is respected.

### 5. PAL tax - changes

In the spring of 2007, judgement was passed in a case brought by the European Commission against Denmark concerning the deductibility of pension contributions to foreign companies. Pursuant to the judgment, the tax liability on pension returns at a corporate level for schemes in life insurance companies and pension funds etc. cannot be maintained. In December the Danish parliament passed a new act transferring the tax liability on pension returns to individuals.

### 6. Why does Danica buy financial instruments?

Danica's benefit guarantees to life insurance policyholders pose a risk if the general level of interest rates declines. This is because the calculation rate and thus the market value of life insurance obligations rise. Danica has therefore bought a portfolio of financial instruments that provide protection against a decline in interest rates.

### 7. Who owns Danica?

Danica is 100% owned by Danske Bank.

### 8. Does Danica sell non-life insurance?

Danica has divested virtually all of its non-life insurance activities. Today Danica sells health insurance as a supplement to conventional life and pension products only.

The Danske Bank Group has an agreement with Topdanmark to sell that company's non-life insurance products through the group's sales channels.

**9. Where can I find information about Danica Pension's financial accounts?**

Danica publishes annual and semi-annual accounts. The accounts are available at [www.danskebank.com/DanicaPensionInEnglish](http://www.danskebank.com/DanicaPensionInEnglish).

**10. Where can I find information about the Danske Bank Group?**

Our website, [www.danskebank.com](http://www.danskebank.com), and the Investor Relations section in particular, provide comprehensive information about the Danske Bank Group.

## Appendix D. Contact persons

Danske Bank's Investor Relations department is responsible for all IR matters for the Group's subsidiaries. If you have any questions, please contact us. You can also find more information about the entire Danske Bank Group at [www.danskebank.com](http://www.danskebank.com).



Tonny Thierry Andersen  
Chief Financial Officer  
Tlf.: +45 45 14 07 07  
Fax: +45 45 14 97 87  
Mobil: +45 22 65 65 97  
E-mail: [tonan@danskebank.dk](mailto:tonan@danskebank.dk)



Martin Gottlob  
Head of Investor Relations  
Tlf.: +45 45 14 07 92  
Fax: +45 45 14 97 87  
Mobil: +45 25 27 25 41  
E-mail: [mgot@danskebank.dk](mailto:mgot@danskebank.dk)



Maria Hjorth  
Senior IR Officer  
Tlf: +45 45 14 06 02  
Fax: +45 45 14 97 87  
Mobil: +45 25 55 63 39  
E-mail: [marhj@danskebank.dk](mailto:marhj@danskebank.dk)



Seppo Rajpar  
Senior IR Officer  
Tlf: +45 45 14 06 04  
Fax: +45 45 14 97 87  
Mobil: +45 24 82 51 63  
E-mail: [sraj@danskebank.dk](mailto:sraj@danskebank.dk)

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