

The FIH Group's Individual Solvency Need
31 march 2010

FIH | ERHVERVS BANK



Contents

1	Capital target	3
1.1	Applied regulatory methods	3
1.2	Base capital.....	3
1.3	Adequate capital base	4
1.4	Methodology.....	7
1.4.1	Stress test of the credit portfolio.....	7
1.4.2	Stress testing of market risk	8
2	Specification of adequate capital.....	10

FIH Groups individual solvency need March 2010

1 Capital target

FIHs capital target is based on a solvency position that is sufficient for the Bank to continue its lending activities even during negative business cycles. The capital must be sufficient to ensure that regulatory capital requirements can be met in such situations, and it must be able to withstand large unexpected losses. This is ensured by holding more capital than is legally required.

The Bank's capital planning and objectives are adapted to the current economic situation and legislation.

FIHs focus is directed towards the following:

- Maximum consolidation
- Optimisation of the risk-weighted items, taking into account the business strategy, risk measures and the cyclical situation

The level of the individually calculated solvency requirement (adequate capital base) is lower than the strategic target, but the strategic target should be seen in light of FIHs wish to present itself at all times as a well-consolidated company.

For the purpose of building up an additional solvency buffer to absorb any coming losses in the current poor economic climate, FIH, during 2009, admitted hybrid capital of DKK 1.9 billion from the Danish government through Bank Package II. At the end of Q1 2010, FIH Group solvency is 14.4 %.

Unless other specified the term FIH will cover the following entities; FIH Group, FIH Erhvervsbank A/S, FIH Kapital Bank A/S and FIH Realkredit A/S, in the proceeding sections.

Risk Weighted Assets ('000)	FIH Group	FIH Erhvervsbank A/S	FIH Kapital Bank A/S	FIH Realkredit A/S
Credit risk	70,233,215	61,763,037	11,616,291	440,612
Market risk	8,622,490	7,453,012	305,051	22,608
Operational risk	2,861,781	2,412,501	384,912	53,909
Solvency	14.4 %	16.8 %	15.9 %	22.1 %

1.1 Applied regulatory methods

In 2010, FIH will use the standard method to calculate capital requirements for credit and market risk, respectively, and the standard indicator method to calculate capital requirements for operational risk. The choice of method is expected to remain unchanged throughout 2010.

1.2 Base capital

FIHs capital base is calculated in accordance with Part 10 of the Danish financial business act. The composition of the capital base is set out in the table below.

Capital target

Capital base – (DKK million)	FIH Group	FIH Erhvervsbank A/S	FIH Kapital Bank A/S	FIH Realkredit A/S
Share capital	514	514	900	100
Reserves	9	681	900	0
Retained earnings	7,294	6,825	133	12
Net profit for the year	201	202	16	2
Total core capital	8,018	8,223	1,949	114
Primary deductions from core capital				
Intangible assets	-31	-31	0	0
Core capital after primary deductions	7,987	8,192	0	0
Hybrid core capital	1,900	1,900	0	0
Core capital, including hybrid core capital after primary deductions	9,887	10,092	1,949	114
Other deductions from core capital				
Half the amount of equity investments > 10%	0	0	0	0
Core capital, including hybrid core capital after deductions	9,887	10,092	1,949	114
Supplementary capital				
Subordinated loan capital	2,326	2,326	0	0
Deductions, maturities	-433	-433	0	0
Revaluation reserve transferred to supplementary capital	1	1	0	0
Total supplementary capital	1,893	1,893	0	0
Deductions from the capital base				
Half the amount of equity investments > 10%			0	0
Capital base after deductions	11,782	11,986	1,949	114

Table 1

Holdings	Debt outstanding, (DKK 1000)	Maturity
Var. % EUR	990	26-03-2013
4.80% JPY	591	31-03-2032
Var. % EUR	744	22-09-2012
Total	2,326	

Table 2

1.3 Adequate capital base

Under pillar 2 of Basel II's three-pillar model, financial institutions are required to implement a process for assessing their adequate capital base in relation to their risk profile, on the one hand, and a strategy for maintaining the capital level, on the other. This is normally known as an analysis of the adequate capital base.

While the minimum capital adequacy requirement (8 per cent of risk-weighted assets) only comprises calculation of capital to cover unforeseen losses as a result of credit, market and operational risks under pillar 1, pillar 2 – in addition to capital to cover credit, market and operational risks – also comprises capital to cover all other significant risks at FIH.

The analysis of the adequate capital base covers all processes and measures designed to ensure appropriate identification and measurement of risks and adequate internal capital in relation to the risk profile.

FIH Groups individual solvency need March 2010

The analysis of the adequate capital base is to ensure consistency between risk appetite, risk management and risk capital. It is particularly important to discern, as quickly as possible, trends that could compromise the financial institution, thereby enabling the institution to take the necessary measures. Thus the introduction of the analysis of the adequate capital base serves the interests of internal as well as external parties.

FIH is required to determine its adequate capital base, based on FIHs special conditions and risk profile. The adequate capital base differs from the solvency requirement that is continuously calculated and submitted to the Danish financial supervisory authority (FSA) in that FIH defines its adequate capital base.

In order to determine its adequate capital base, FIH must take an active position on e.g. the Bank's earnings, growth and risk profile.

FIHs determination of adequate capital is based *inter alia* on models for economic capital, extensive stress testing of significant risk areas, a support model for internal ratings, a review of capital plans and cash resources.

FIH has been working explicitly with the determination of the adequate capital base since 2004. In 2008, the determination of adequate capital became even more extensive – not least in view of the tightening of requirements resulting from the introduction of Basel II.

Each quarter, an internal report is prepared with a presentation of the adequate capital base/solvency requirement based on current and future activities and in compliance with the general solvency requirements of the Danish financial business act.

The report is submitted to the Executive Board and approved by the Board of Directors quarterly. The approved solvency requirement is reported on a quarterly basis to the FSA.

Pursuant to the new rules issued by the FSA, FIH is under a duty to disclose its solvency requirement each quarter. The methodology of the ICAAP must be published once a year.

The responsibility for preparing the report rests with Risk Management, but each of the risks dealt with by the report has a risk owner assigned to it. Physical sign-off in the ICAAP report is provided by the heads of the departments that are risk owners.

FIH Groups individual solvency need March 2010

The following table provides an overview of risks and the associated risk owners:

Risk type	Department	Responsible for sign-off
Economic capital		
Credit risk	Risk Management/Credit Models	Head of Credit Models
Market risk	Risk Management/Market Risk	Head of Risk Management
Operational risk	Risk Management/Basel II	Head of Solvency
Model risk	Risk Management	Head of Credit Models
Other risks		
Concentration risk	Credit Models	Head of Credit Models
Control risk	Risk Management	Head of Risk Management
Earnings risk	Capital Markets and Banking	Heads of CM, Banking
Growth conditions	CM Treasury Funding	Head of CM Treasury Funding
Liquidity risk	CM Treasury Funding	Head of CM Treasury Funding
New business areas	Strategy	Head of Strategy
Group risk	Strategy	Head of Strategy
Reputational risk	Compliance/Marketing	Head of Compliance
Settlement risk	Capital Markets Operations	Head of CMO
Strategy risk	Strategy	Head of Strategy
Stress testing		
Credit risk stress	Risk Management/Credit Models	Head of Credit Models
Market risk stress	Risk Management/Market Risk	Head of Market Risk
Operational risk stress	Risk Management/Basel II	Head of Solvency
Earnings risk stress	Capital Markets and Banking	Head of CM, Banking
Overall sign-off	Risk & Legal, Management	Head of Risk & Legal Managing Director, CEO

Table 3

The report separately discusses the following topics:

- Business cycle movements
- Concentration risk, collateral
- Concentration risk, sector
- Concentration risk, single-name
- Control risk
- Credit risk
- Credit risk stress testing
- Dividend policy stress testing
- Earnings risk
- Earnings risk stress testing
- Economic capital model uncertainty
- Equity risk stress testing
- Foreign FX risk stress testing
- Growth conditions
- ICAAP support model stress testing
- Interest rate risk stress testing
- Internal processes
- Large exposures
- Liquidity risk
- Liquidity risk stress testing
- Market risk stress testing
- New business areas
- Operational risk
- Operational risk stress testing
- Overall group risk
- Reputational risk
- Risks associated with new business
- Settlement risk
- Strategic risk
- Unlisted shares – add on to general credit risk
- Value at Risk stress testing

1.4 Methodology

In the middle of January 2010 the Danish FSA issued a set of new guidelines and requirements to be followed when assessing the internal solvency requirement. In Q4 2009 FIH decided to place an additional add-on to the ICAAP result due to the new guidelines. Succeeding Q4 FIH has collected information on how other larger Danish financial institutions have interpreted the guidelines. The outcome is that group 1 institutions do not consider the guidelines relevant for their business. The primary reason is that the methods suggested in the guidelines by far are exceeded by in-house models regarding sophistication level and experience level. FIH regards its own models as having a higher sophistication and experience level thus FIH has chosen to follow the industry practice and remove the add-on.

FIH has been working explicitly with the determination of the adequate capital base since 2004. Each quarter, an internal report is prepared with a presentation of the adequate capital base/solvency requirement. The report is submitted to the Executive Board and the Board of Directors quarterly. The Board of Directors approves the ICAAP results. In this process, the Risk & Legal department challenges the quantification of risk by the risk owner.

Each risk has an appointed risk owner who signs off that the risk in question is adequately assessed and analysed. The risk owner is responsible for describing the risk and its implications for FIHs solvency, in cooperation with FIHs Risk & Legal department.

FIH has developed an economic capital model. Within this model credit risk, market risk and operational risk have been measured since 2005, at a confidence level of 99.97%.

The Internal Capital Adequacy Assessment Process (ICAAP) uses several building blocks to determine the adequate capital for FIH. The basis for the calculation of adequate capital is FIHs economic capital model. The advanced models make it possible to calculate a unified measure of risk across credit risk, market risk and operational risk. The determination of economic capital is made in strict accordance with the fundamental principles of the most advanced methods in the Capital Requirements Directive (CRD). The economic capital models do not incorporate any diversification benefits or correlation structures other than those present in the CRD.

Some risk types are poorly captured in quantitative models and therefore expert opinions are used to manage those risks. The overall level of confidence corresponds to 99.97%.

In order to capture future risk elements, extensive stress testing is performed on a regular basis. Stress tests are divided into the 3 major contributors to the overall risk: credit risk, market risk and operational risk.

The methodology, as described in this section, is not applicable for FIH Realkredit A/S. FIH Realkredit A/S consists of a run-off portfolio with limited maturity and minimal risks. The methodology used for FIH Realkredit A/S is an add-on method which starts out with the minimum capital requirement of 8% and adds on capital charges following the guidelines from the Danish FSA.

1.4.1 Stress test of the credit portfolio

Stress tests of the credit portfolio are conducted quarterly. The objective of the stress test is to assess the effect of different possible scenarios on the probability of default for every customer and the derived effect on the capital requirement. The horizon for the stress test is the next three years.

The stress test does not predict what will happen in the near future but shows the effect of different possible scenarios. To obtain the effects, the models calculate the expected impact the scenarios will have on each customer's annual accounts. Using these stressed accounts the stress model estimates the stressed PDs and the stressed capital.

The scenarios used are all evaluated at least once a year and new scenarios are added if deemed necessary.

The results from the stress model are used in the Internal Capital Adequacy Assessment Process (ICAAP).

FIH Groups individual solvency need March 2010

The scenarios used are

- Scenario 1: Increasing interest rates
- Scenario 2: Decreasing stock prices
- Scenario 3: Decreasing real property prices
- Scenario 4: DKK appreciates to all currencies except EUR
- Scenario 5: Increasing oil prices
- Scenario 6: All customers are downgraded
- Scenario 7: Multi-factor stress test using combinations of the above-mentioned scenarios

The macro variables behind the scenarios are derived from Danmarks Nationalbank, EcoWin, Statistics Denmark and Bloomberg.

In none of the scenarios, the stressed capital is near or falls below the required capital.

In the autumn FIH participated in a large stress test facilitated by Danmarks Nationalbank. The 3-year scenarios covered the anticipated projection of the Danish economy through an intensified financial and confidence crises in Denmark to a lengthy recession in both Denmark and abroad. The results from this stress test showed that FIH will experience negative pre-tax profits in some years with a credit loss of 2.31 pct of loans and guarantees in the worst case. In no cases the capital adequacy ratio was near or fell below the required level. Experiences from the exercise will be integrated in the stress tests made by FIH.

1.4.2 Stress testing of market risk

The Risk Committee has set up stress-test limits at Group level and for different business and product levels in Capital Markets. The Risk Management department conducts and reports stress tests for market risk on a daily basis.

Risk Management conducts stress testing based on historical events for interest rates, exchange rates and equities to show the implications of changes in interest rates, exchange rates or equity prices, equivalent to the largest observed change for a given number of years on the current market risk positions.

Risk Management also uses standard stress-test scenarios for selected areas. Under these scenarios, interest rates are changed by 0.1 percentage points, 0.5 percentage points, 1 percent point and 4 percentage points in each direction, while exchange rates are changed by 1 percentage point, 2.5 percentage points, 5 percentage points, 10 percentage points and 15 percentage points in an unfavourable direction.

Stress testing provides an important contribution to underpinning FIHs overall risk assessment and risk management. Therefore, the scenarios are reviewed regularly and modified to reflect changes in the risk profile and developments in the financial markets.

The graph below is an example of a daily stress test off FIHs interest rate risk. In the case where FIH uses data from March 2001 until presents, and identify the largest single day increase in the 1-year Danish interest rate. On the day this occurs the interest rate change for all currencies will be fixed. For each FX and each maturity on the term structure a volatility factor is calculated as the ratio between the volatility on the interest rate for any given maturity and the 1-year interest rate. For each FX and maturity the term structure is stressed with the volatility factor compounded with the historic changes in the 1-year interest rates.

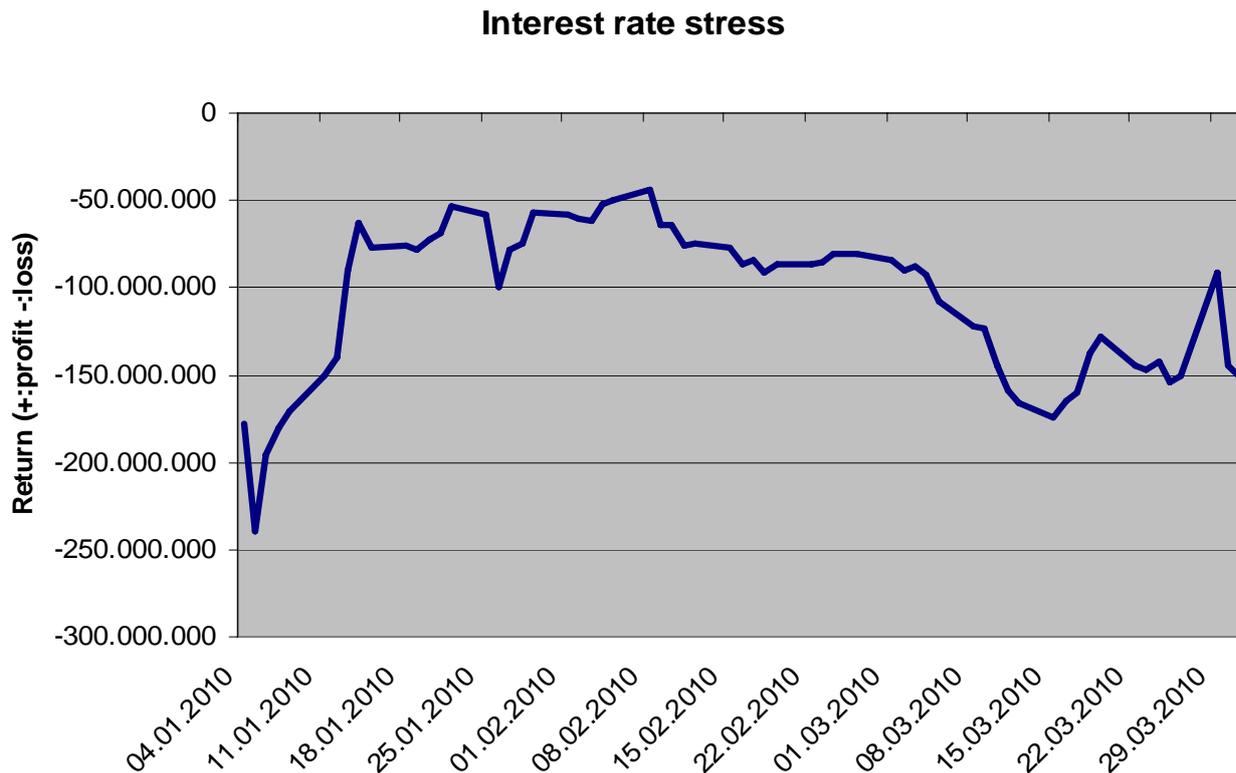


Figure 1 Interest rate risk stress

The increased interest rate stress end of 2009 is primarily caused by an increased position in mortgage bonds. This position has partly been sold off in the beginning of 2010.

Furthermore, a single probability distribution of extreme events is calculated to assess the expected total loss FIH would occur if the VaR limit was exceeded. Additional stress tests for liquidity, earnings and business cycle movements are performed.

2 Specification of solvency need

The adequate capital of each financial entity is specified in table 4. The solvency requirement, for FIH Group, FIH Erhvervsbank A/S and FIH Kapital Bank A/S, is determined by the ICAAP methodology. Due to the special circumstances in FIH Realkredit A/S the adequate capital level is determined by the minimum capital requirements.

Risk Type (DKK million)	FIH Group	FIH Erhvervsbank A/S	FIH Kapital Bank A/S	FIH Realkredit A/S
Credit risk	6,506	5584	975	35
Market risk	439	424	15	2
Operational risk	365	364	31	4
Other risk contributors	552	546	49	0
Total	7,862	6,918	1,070	41
ICAAP result	9.6 %	9.7 %	8.7 %	8 %

Table 4

The specification of the adequate capital is broken down by key areas. The credit risk segment contains the following items:

- Add on for unlisted shares to general credit risk
- Business cycle movements
- Collateral risk
- Concentration risk
- Credit risk stress
- Economic capital for credit risk
- Economic capital uncertainty
- Unreserved probable impairments

The other risk contributors contains the following:

- Earnings risk
- Growth conditions
- Liquidity risk
- Reputation risk
- Settlement risk

Capital allocated for market risk is calculated by FIHs value at risk model. Capital allocated for operational risk is calculated by FIHs value at risk model for operational risk.

The Executive Management assesses the level of the solvency requirement to the institution's risk profile. During this assessment non-model driven add-ons might be included in the solvency requirement.