

# Risk and Capital Management 2009

**Alm. Brand A/S**

# Contents

<b>1 Organisation</b> .....	<b>4</b>
1.1 Risk management.....	4
1.1.1 Embeddedness.....	5
1.2 Risk appetite.....	5
1.3 Organisation.....	8
1.3.1 Board of Directors.....	9
1.3.2 Group Management Board.....	9
1.3.3 Risk committee.....	9
1.3.4 Business areas.....	10
1.3.5 Allocation of responsibilities.....	11
1.4 Reporting.....	11
1.5 Consolidation.....	12
<b>2 Capital management</b> .....	<b>13</b>
2.1 Use of in-house models.....	13
2.2 Statutory capital requirements.....	14
2.2.1 Calculation of individual solvency need.....	15
2.3 Capital management in the Alm. Brand Group.....	18
2.4 Internal capital target.....	18
2.4.1 Future compliance with the capital requirement.....	19
2.5 Composition of capital in Alm. Brand Bank.....	20
<b>3 Credit risks</b> .....	<b>21</b>
3.1 Policy and responsibility.....	21
3.2 Use of models.....	23
3.3 Calculation.....	23
3.3.1 Derivatives.....	24
3.3.2 Default.....	24
3.3.3 Classification.....	25
3.3.4 Rating.....	25
3.4 Approval.....	26
3.5 Model validation.....	26
3.6 Risk reduction.....	27
3.7 Impairment losses.....	28
3.8 Monitoring.....	30
3.9 Portfolio management.....	31
3.9.1 Aggregation of credit exposure.....	31
3.9.2 Monitoring of the loan portfolio.....	31
3.9.3 Risk concentration.....	32
<b>4 Market risks</b> .....	<b>33</b>
4.1 Policy and responsibility (objectives).....	34

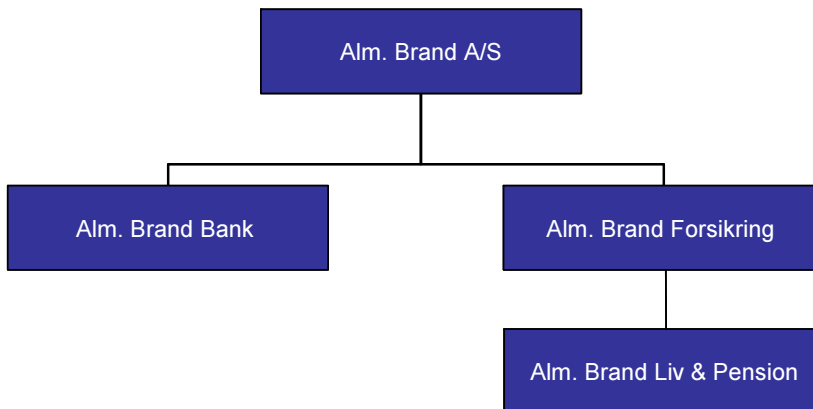
4.2	Use of models .....	34
4.3	Model validation.....	35
4.4	Monitoring.....	36
4.5	Asset allocation in Alm. Brand.....	36
4.6	Interest rate risks.....	37
4.7	Currency risks.....	39
4.8	Share price risk .....	41
4.9	Other market risks.....	42
<b>5</b>	<b>Liquidity risk .....</b>	<b>43</b>
5.1	Short-term liquidity management .....	44
5.2	Long-term liquidity management .....	45
5.3	Liquidity developments in 2010 .....	45
5.4	Cash resources .....	45
<b>6</b>	<b>Insurance risks.....</b>	<b>47</b>
6.1	Non-life insurance risks .....	47
6.2	Biometric risks.....	48
6.3	Default risks.....	48
6.4	Policy and responsibility.....	49
6.5	Monitoring.....	51
<b>7</b>	<b>Other risks .....</b>	<b>52</b>
7.1	Operational risks and control environment.....	52
7.2	Other business risks .....	54
7.3	Other issues.....	56

# 1 Organisation

Managing the Alm. Brand Group's risks is a significant focus area for management, as an uncontrolled development in various risks may affect the group's performance and solvency and thereby materially impact its future business potential.

The Alm. Brand Group accepts a range of risks, which are the various business risks related to operating the different business areas as well as the more uniform financial risks related to handling the group's cash flow and investment strategy.

The Alm. Brand Group's overall group structure is shown below.



## 1.1 Risk management

The Board of Directors of Alm. Brand A/S lays down and approves the overall policy for the group's acceptance of risks, just as the Board of Directors defines the overall framework and the necessary reporting. The Management Board of each subsidiary defines the operational risk management on this basis.

A cross-firm risk committee has been established at group level, the object of which is to ensure coordination and uniformity in accepting, calculating and reporting risks across the different business areas.

The handling of business risks as well as financial risks is administered in each of the business areas. Management is responsible for managing business risks and financial risks as well as for continuous control thereof.

The internal audit department independently reviews control procedures on an ongoing basis and looks into whether the directions set out are observed. The internal audit department estimates the

efficiency of the initiated risk management and assesses whether the risk management involves sufficient quality assurance and control.

### **1.1.1 Embeddedness**

To be able to currently manage and assess the risks that the Alm. Brand Group accepts, the group has drawn up acceptance policies (for non-life and life insurance) and a credit policy (for the bank). The object of these acceptance and credit policies is to ensure that only agreements that lie within the framework of the Alm. Brand Group's overall risk policy are concluded. The policies are determined and approved by the boards of directors at least once a year. Executive directions are prepared for the management boards on the basis of the approved policies. It is then the responsibility of the respective companies to comply with them.

Embeddedness of and compliance with risk management are ensured in that the credit policy, for instance, is reflected in credit instructions to the respective product areas of Alm. Brand Bank. In addition, business processes have been developed which support the group's staff in ongoing risk management, ensuring organisational embeddedness.

Policy and responsibility in respect of the group's material risks have been described in further detail under each risk type in this document.

## **1.2 Risk appetite**

The Alm. Brand Group's risk appetite reflects the active selection and rejection of different forms of risks.

On a quarterly basis, the risk committee follows up on the risk appetite defined.

### **Risks in Alm. Brand Bank**

The bank's business foundation is to accept calculated risks. The calculated earnings-generating risks are primarily taken on as credit risks (in connection with lending or leasing), liquidity risks (deposits and funding, etc) as well as market risks. For all material areas, the group has considered the desired risk profiles, what customer exposures are important and which ones to reject from the beginning.

#### Credit risks

A strategy for the types of customers that the bank accepts to have and the type of risk profile accepted has been prepared for all material types of exposures. A credit policy has been drawn up with related business processes. The credit secretariat assesses all substantial loan arrangements in accordance with established business processes and defined lending authority.

Reporting is prepared for management and the Management Board and Board of Directors on the loan portfolio broken down by types of exposures. Also, each area of the loan portfolio is currently reconsidered. Similarly, a half-yearly review of exposures is made with reporting on realised losses as well as impairment losses on loans and advances as well as receivables.

### Liquidity risk

Alm. Brand Bank manages and monitors liquidity every day based on short-term as well as long-term liquidity requirements. The liquidity management is aimed at preventing Alm. Brand Bank from incurring disproportionately large costs in connection with funding its operations. This is ensured through an internally defined framework for funding sources and their maturity structure.

The activities of daily monitoring of liquidity and ensuring external funding are placed with the bank's treasury department. The price and product policy on deposits is placed in the individual business areas. If necessary, the Management Board holds liquidity meetings every two weeks or more frequently.

The bank aims for an excess cover of at least 50% compared with the statutory requirement. The bank has drawn up a detailed policy for its liquidity risks and a contingency plan in the event that liquidity drops below the aim of having an excess cover of 50%. The excess cover is detailed in the monthly financial reporting.

### **Risks in Alm. Brand Liv & Pension**

The primary sources of risks are biometric risks, market risks as well as operational risks. Alm. Brand Liv & Pension has actively selected and rejected customer segments.

In provisions, expected future income is offset against expected future liabilities. The calculated premiums in these provisions include a number of risks, including risks on guarantees. Interest rate risks on the guaranteed benefits are included under market risks.

### Guaranteed benefits

On new policies, at least the guaranteed benefit surrender value should be provided for, so a new policy will have a provision of about zero. It is generally expected that future premiums will generate a profit as they are fixed on the safe side

### **Risks in the non-life insurance business area**

The primary business-related risk sources are premium risks, reserve risks and catastrophe risks. The Board of Directors has determined a considerable number of acceptance and writing rules at customer and product level for non-life insurance. Catastrophe risks are covered through reinsurance.

### **Risks across the Alm. Brand Group**

A number of risk sources exist across the group. The material ones are market risks, default risks as well as operational risks.

### Market risks

The financial risk management consists in achieving the desired balance between return and risk. The investment and risk management policy for each company has been adjusted to the conditions, under which the companies operate. The portfolio of investment assets is subject to market risks in

the form of interest rate risks, currency risks, volatility risks, inflation risks as well as price risks for example as a result of changes in share prices or real property prices.

At least once a year, the Board of Directors considers the market risk limits. Business processes and procedures are implemented to monitor compliance with these limits, and reports on this matter are submitted to the Management Board and the Board of Directors on a regular basis.

Attempts will be made to limit credit and counterparty risks for assets (shares, bonds, etc.) by minimising the exposure to single counterparties as well as groups of counterparties with the same characteristics.

#### Default risks

Default risks are primarily the risk of the company's reinsurers going into liquidation. The reinsurance strategy defines rules for spreading risks on all reinsurers and for the minimum rating required for reinsurers. To minimise the risk relating to each reinsurer, the reinsurer should as a general rule at least be rated as A- with Standard & Poors, Moody's and/or A.M. Best.

#### Operational risks

Operational risks comprise human errors, IT breakdowns, fire at the head office, etc.

Emergency and contingency plans have been established to counter external occurrences. Attempts are made to minimise risks of human errors by drawing up written business processes for all material areas and through considerable training efforts.

#### Other risks

Procedures and business processes ensuring that other risks are known and assessed have been implemented in all other material areas. The management boards of the companies assess the level of other risks on a regular basis.

### **Internal audit department**

The internal audit department regularly follows up on the most significant risks in the Alm. Brand Group and reports on them in accordance with the annual audit plan adopted by the boards of directors of the individual companies.

Separate from the implemented controls, the internal audit department regularly performs an independent review of control procedures and evaluates whether the directions set out are observed.

### **Subsidiaries not subject to FSA supervision**

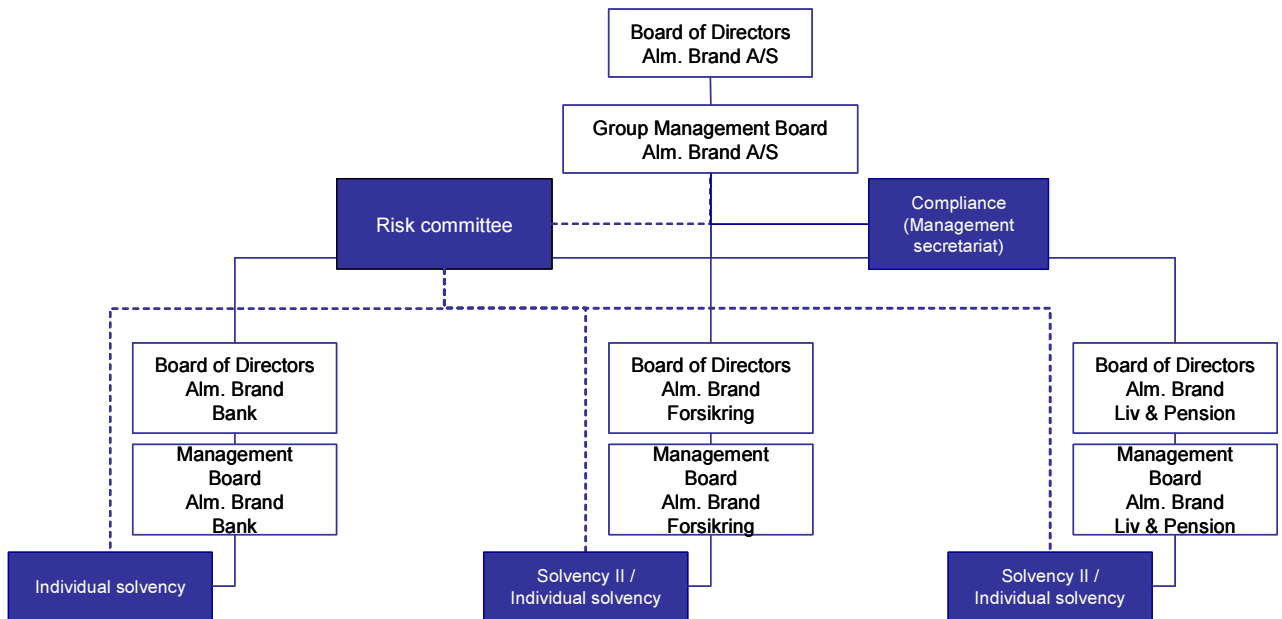
Risks of the Alm. Brand Group's subsidiaries that are not subject to supervision by the Danish Financial Supervisory Authority (the FSA) are analysed and included in the overall risk assessment for the Alm. Brand Group.

### 1.3 Organisation

The Board of Directors of Alm. Brand A/S is the ultimate body in charge of risk and capital management in the Alm. Brand Group. In relation to defining, managing and monitoring risks, the Board of Directors delegates certain tasks to the Group Management Board as well as to each of the business areas.

To ensure uniformity in the handling of risks across group companies and business areas, a cross-firm risk committee has been established at group level.

The figure below shows the group's organisation of risk management and compliance.



The figure does not reflect the legal structure of Alm. Brand A/S.

### **1.3.1 Board of Directors**

The Board of Directors of Alm. Brand A/S is responsible for ensuring a sound organisation of risk management and for Alm. Brand group companies having sufficient capital bases and internal procedures for assessing risks.

The Board of Directors determines Alm. Brand's overall risk appetite and decides upon the general principles for managing and monitoring risks.

Through current reporting, the Board of Directors follows up on whether risk policies and risk management systems are observed and match the group's requirements and objectives.

The Board of Directors has set up an audit committee. The annual report contains a detailed description of the audit committee's work.

### **1.3.2 Group Management Board**

The Group Management Board is responsible for compliance with the framework set out by the Board of Directors and operates within the specific framework defined in the rules of procedure of the group's Board of Directors and Management Board.

The Group Management Board lays down operating policies for and monitors the group's risk management. The Group Management Board reports on the group's risks to the Board of Directors, just as it approves material business transactions, including credit applications up to a specific limit.

The Group Management Board prepares recommendations for the Board of Directors as to how capital is allocated across the group as well as principles for how risks are managed and monitored in the group and in the respective enterprises.

### **Subsidiaries' boards of directors and management boards**

With respect to risk and capital management, the boards of directors and the management boards of each subsidiary under Alm. Brand A/S have roles comparable to those of the group's Board of Directors and Management Board in relation to the Alm. Brand Group.

### **1.3.3 Risk committee**

The object of the risk committee is to ensure coordination and uniformity across group companies in relation to accepting risks and calculating sufficient capital bases and individual solvency needs for the respective companies. Also, the risk committee's responsibility is to ensure that models and reporting forms for individual solvency needs are aligned throughout the group.

The risk committee's members include the Group Management Board, the management boards of Alm. Brand Bank, Alm. Brand Forsikring and Alm. Brand Liv & Pension as well as the Chief Marketing Officer, the Chief Financial Officer, the head of the actuarial department of the non-life division and the head of risk management of the Alm. Brand Group. In addition, the Group Chief Auditor participates as an observer in the risk committee.

The risk committee's work is supported by a secretariat anchored in risk management under the finance department.

Furthermore, risk management and compliance are currently coordinated at monthly meetings between all heads of the risk management and compliance departments, respectively, in the group.

	Board of Directors Alm. Brand A/S Alm. Brand Bank Alm. Brand Forsikring Alm. Brand Liv & Pension	Management Board Alm. Brand A/S Alm. Brand Bank Alm. Brand Forsikring Alm. Brand Liv & Pension	Risk committee	Business areas Alm. Brand A/S Alm. Brand Bank Alm. Brand Forsikring Alm. Brand Liv & Pension
<b>Risk areas</b>	<b>Risk policy, organisation and arrangement</b>			
	<b>Identification of risks</b>			
	<b>Assessing risks and individual solvency</b>			
	<b>Reporting, business processes and documentation</b>			
	<b>Risk monitoring, reporting and control</b>			
<b>Allocation of responsibilities</b>	<ul style="list-style-type: none"> <li>Approves the company's risk appetite and strategy, risk governance structure and management as well as risk-related policies</li> <li>Approves capital plan and contingency plan</li> <li>Approves recommendation on individual solvency needs of the respective companies</li> <li>Ensures sufficient resources for risk management in the organisation</li> </ul>	<ul style="list-style-type: none"> <li>Draws up recommendations for the company's overall risk appetite</li> <li>Determines operative policies for risk management</li> <li>Draws up recommendations for calculation of individual solvency needs of the respective companies</li> <li>Overall responsibility for the respective companies observing the regulations</li> <li>Ensures that the individual company has an adequate capital base and has internal procedures for risk measurement and reporting at its disposal</li> <li>Reports on the group's risks to the Board of Directors</li> </ul>	<ul style="list-style-type: none"> <li>Ensures uniform assessment of risks and solvency need across the group companies</li> <li>Ensures coordination across the group companies</li> <li>Considers the group's overall risk appetite, risk assessment and solvency need</li> <li>Draws up recommendations to the Board of Directors on risk appetite, strategy, governance as well as risk-related policies</li> </ul>	<ul style="list-style-type: none"> <li>Maintains overall view of requirements of the regulations for capital adequacy/solvency need and ensures compliance with regulations</li> <li>Evaluates the company's risk appetite and individual solvency need</li> <li>Appoints individuals for the work of assessing individual solvency and risks</li> <li>Draws up recommendations for assessing individual solvency</li> <li>Implements work processes, business procedures and documentation supporting risk policies and regulations</li> <li>Draws up reporting</li> </ul>

### 1.3.4 Business areas

The overall risk policies for the group are implemented in concrete risk policies and delegation of lending authority to the individual business areas, regions and branches. The business areas apply a number of tools and systems in their day-to-day work and loan application and claims handling. The business areas assume the day-to-day responsibility for ensuring that acceptance policies and lending authorities are observed and that all customer and product portfolios are in accordance with the group's risk policy. The business areas are also responsible for implementing work processes, business processes and documentation supporting risk policies and direction.

The business areas decide upon, and are responsible for the observance of, the company's risk appetite and relevant legislation as well as for compliance with the respective sets of regulations. The business areas are also responsible for risk management across the business area as well as reporting in this respect.

### **1.3.5 Allocation of responsibilities**

Risk management concerns five primary risk areas with responsibilities allocated between boards of directors, management boards, risk committee and business areas. This allocation of responsibilities is indicated in the figure below:

## **1.4 Reporting**

Alm. Brand has laid down processes for current reporting of risks and risk management to the management boards and boards of directors of the group and the relevant companies. Risk reporting is an integrated part of the current management reporting, ensuring that the management and boards of directors of Alm. Brand A/S and each of the group companies are currently informed about the development in lending, premiums and claims records, market risks, risk allocation, performance, etc.

### **Day-to-day reporting**

Some reporting takes place on a daily basis in the Alm. Brand Group, for instance on market risks and observance of investment limits as well as daily calculations of the bank's liquidity in accordance with section 152 of the Danish Financial Business Act.

### **Monthly reporting**

Monthly reporting is made on all material risks in each company, including reporting on the development in key risk ratios, observance of investment limits, credit and acceptance policies, etc. Monthly reports are also made on investment returns, market risks and performance. In addition to current reporting, reports are prepared for the Board of Directors and the Management Board in the event of major changes or overruns.

Also, current reports are drafted on whether the level for individual solvency has changed significantly. So, a new calculation is made and submitted to the Board of Directors for approval.

Quarterly reports on compliance with the group's risk appetite are prepared for the cross-organisational risk committee.

### **Annual reporting**

Annual reports are as a minimum submitted to the Board of Directors and the Management Board on the following matters in relation to risk management and capital adequacy for their approval:

- Overall capital requirements and policies
- Risk appetite and targets
- Risk management models and parameters
- Method for calculating individual solvency and the selected stress tests
- Capital and contingency plans

Furthermore, a number of reports are drawn up per business area, laying the grounds for the current risk management in the relevant companies and business areas.

## **1.5 Consolidation**

Risk data for the Alm. Brand Group are provided on the basis of the group definition applied in the financial statements. This definition corresponds to the one in the International Financial Reporting Standards. According to the International Financial Reporting Standards, subsidiaries are those enterprises in which Alm. Brand A/S directly or indirectly has controlling influence over financial and operating policy decisions.

The capital adequacy statement for the group, on the other hand, encompasses the Alm. Brand Group as defined in the Danish Financial Business Act.

The group does not consolidate its insurance companies in its capital adequacy statement. The capital base is reduced by their capital requirements less any difference between the capital base and the carrying amount of the equity interests.

Alm. Brand Liv & Pension and Alm. Brand Forsikring are consolidated in the annual report of Alm. Brand A/S, and they are described in separate sections of the risk assessments. Alm. Brand Liv & Pension's profit policy, which in accordance with the Danish executive order on the contribution principle has been notified to the FSA, implies that the policyholders receive return on allocated assets and take on associated risks. Assets are allocated to policyholders to ensure customers' guaranteed benefits. The various types of risks that Alm. Brand Liv & Pension has accepted as part of its business and that affect assets and liabilities allocated to the policyholders are presented in the following section.

### **Restrictions on dividend payments from subsidiaries**

The bank's and the insurance companies are through the national financial supervisory authorities subject to local statutory provisions on required capital base. These provisions restrict dividend distribution.

## 2 Capital management

The financial crisis continued in 2009 and evolved into an economic crisis. As a result, bank impairment charges have risen, and a number of banks in Denmark have been taken over by Finansielt Stabilitet A/S.

In a move to prevent the financial crisis from evolving into a credit squeeze, the Second Bank Package was adopted to ensure that healthy banks would have adequate capital resources to continue to grant loans and advances.

At 1 January 2009, Alm. Brand Bank had a capital target of 12% of its risk-weighted assets (RWA). During 2009, Alm. Brand Bank recognised substantial credit losses, which eroded its capital base. The bank's capital base has been restored and strengthened, partly due to a capital injection under the Second Bank Package and partly due to capital injection from the Alm. Brand A/S.

Alm. Brand Bank will retain its solvency target of 12% of RWA in 2010.

In Alm. Brand Forsikring, the financial crisis has entailed higher claims payments. In addition, European financial supervisory authorities have announced tougher capital base and risk management requirements for insurance companies.

Copenhagen Re was divested in 2009 and this served to strengthen Alm. Brand's capital base.

This chapter explains how the Alm. Brand Group calculates its capital needs and describes the elements included in the calculation of the individual solvency need of Alm. Brand Bank.

### 2.1 Use of in-house models

The EU Capital Requirement Directive was implemented with effect from 1 January 2007. This Directive applies to banks and, consequently, to the Alm. Brand Group.

Alm. Brand A/S is partially comprised by the rules relating to banks. Accordingly, the new solvency rules for Alm. Brand A/S became part of the Danish legislation for banks deriving from the EU Capital Requirement Directive for the implementation of the Basel II rules in the EU.

New Danish regulations governing solvency have also been introduced in the insurance area. They arise out of the forthcoming European Solvency II regulations for the insurance area. These regulations came into force on 1 July 2007.

The new rules that arise out of Basel II and Solvency II, respectively, have tightened the requirements for calculation of an adequate capital base and individual solvency need substantially.

## Implementation plan

In 2005, Alm. Brand Bank initiated a number of development activities to comply with the requirements in the new provisions for the determination of banks' capital adequacy (Basel II).

Based on the bank's new strategy, implying that all mortgage deed trading will cease and that, in future, loans and advances will be confined mostly to the retail area, a decision has been made to close down the Basel II project. Nevertheless, the data framework will be used to improve credit management.

As to market risk, the Alm. Brand Group has for the present decided to follow standard methods, but the Alm. Brand Group has developed an internal VaR model, which is used in the day-to-day monitoring of market risk.

In the insurance area, Alm. Brand Forsikring works towards introducing more advanced models for calculation of parts of the individual solvency need ensuring that the aggregate solvency model is based on a combination of internal models and standard models. Alm. Brand Forsikring has not yet decided whether to apply for approval of partial internal models under Solvency II.

Alm. Brand Forsikring participated in the latest test calculation/consequence analysis in 2008 (QIS 4) for Solvency II prompted and implemented by CEIOPS ("Committee of European Insurance and Occupational Pensions Supervisors") and will participate in QIS 5 in 2010.

## 2.2 Statutory capital requirements

As mentioned, the rules on calculation of capital requirements and solvency needs are specified in the new Danish Executive Order on Capital Adequacy for banks, which is based on the EU CRD.

According to these regulations, Alm. Brand A/S has to determine:

- **The adequate capital base**, which is the aggregate required capital calculated on the basis of a prospective risk assessment
- **The individual solvency need**, which is the adequate capital base's percentage share of the risk-weighted items

Aside from the existing capital requirements (collectively termed the capital requirement).

- **The solvency requirement**, which is calculated as 8% of the risk-weighted assets
- **The minimum capital requirement**, which is calculated as EUR 5m

The aggregate individual capital requirement for the group is calculated as the maximum of the adequate capital base, the solvency requirement and the minimum capital requirement.

The aggregate individual solvency requirement for the group is calculated (for companies complying with the minimum capital requirement) as the maximum of the percentage for the individual solvency need and 8%.

So, the aggregate individual capital requirement indicates the amount that is adequate to operate the company without experiencing difficulties, calculated on the basis of a retrospective accounting estimate as well as a prospective risk assessment.

Aside from the actual calculation of the adequate capital base and the individual solvency need, the new solvency rules affect a number of other areas, including:

- Selection of method and stress tests
- Internal processes
- Independent assessment
- Capital planning
- Supervisory authority
- Documentation and reporting
- Publication

## 2.2.1 Calculation of individual solvency need

In the model for calculating the adequate capital base and the individual solvency need of the Alm. Brand Group, a model based on stress tests has been selected. The model is designed so that it constitutes an extension of a prior model for the bank, enabling it to comply with the FSA's new, tougher requirements and at the same time comply with the QIS 4 methods in insurance.

### Model set-up

The Alm. Brand Bank Group applies a methodology based on the FSA's guidelines. The table below shows how the different risks are assessed in Alm. Brand.

Risks	The Alm. Brand Bank Group	Insurance Group	The Alm. Brand Group
	Methods described by the FSA	QIS 4 stress	Internal models/ Scenario analyses
<b>Pillar 1</b>			
Credit	X		X
Market	X	X	
Operational	X	X	
Insurance risks		X	
<b>Pillar 2</b>			
Liquidity risks	X		
Growth in business volume	X		
Control environment			X
Strategic risks			X
Reputational risks			X
Risks in relation to the company size			X
Settlement risks			X
Group risks			X
External risks			X
Earnings risks			X
Concentration risks			X

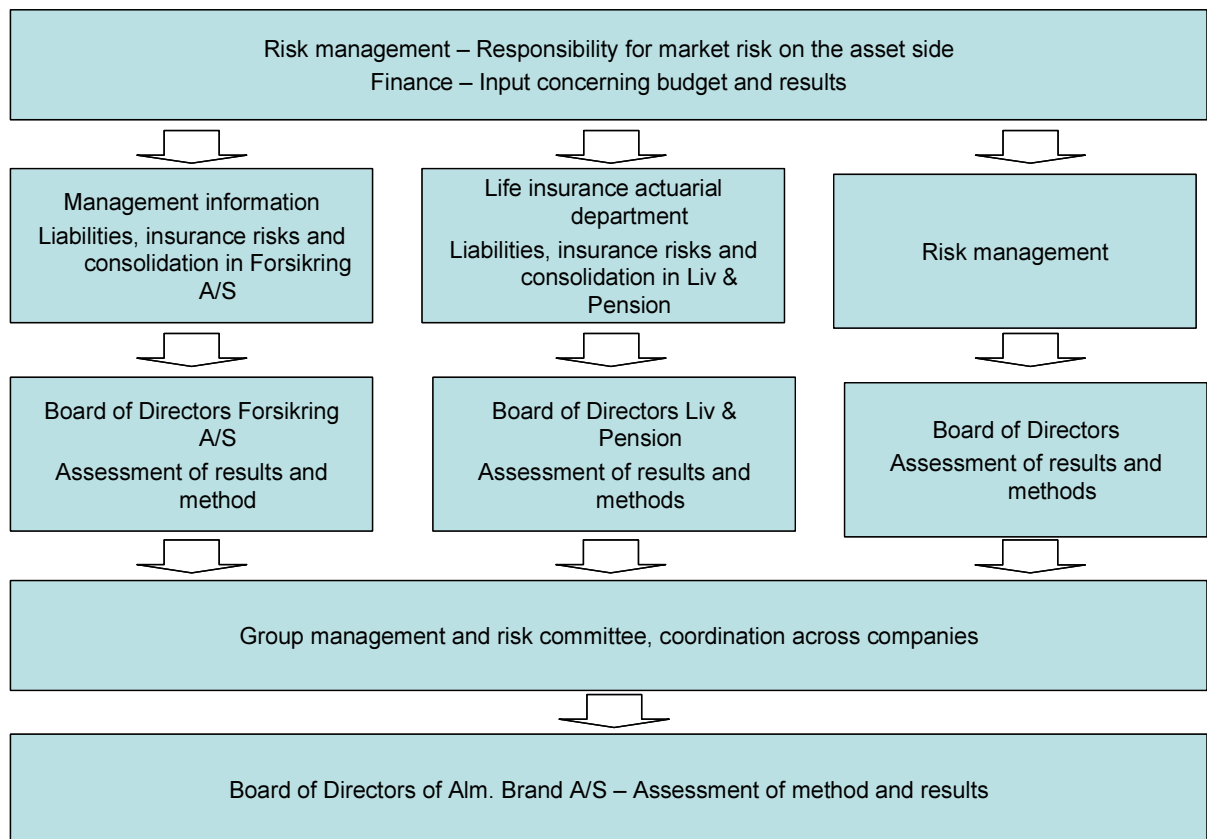
The aggregate capital requirement is, accordingly, calculated for all of the group's companies subject to supervision. For Alm. Brand Bank and the entire Alm. Brand Group, the total individual solvency need is calculated by comparing the aggregate required capital (the adequate capital base) with the risk-weighted assets.

## Internal process

The managements of Alm. Brand's subsidiaries are responsible for assessing and approving results and methods at company level. This provides consistency between the applied methods and results and management's assessment of the risks.

The responsibility for methods and the calculation of the capital need per subsidiary rests with the individual subsidiaries. This approach ensures that risks are assessed where the relevant expertise is available.

Risk management supports this process in all subsidiaries by calculating the market risk of the assets. The process is illustrated in the figure below.



The internal audit department is responsible for conducting the independent evaluation of the calculation of the individual solvency need.

## Alm. Brand Bank

Alm. Brand Bank has identified three portfolios subject to increased credit risk:

- Agriculture
- Property development projects
- Loans to finance mortgage deed commitments

The capital requirement for lines subject to increased credit risk is calculated on the basis of the models used in the impairment testing process for calculating the present value of the commitment.

The assessment of the solvency need is based on stress tests and present value calculations combined with management assessment. However, work continues towards developing more advanced models, which can support the management assessment process.

The most important stress factors in the calculation of credit risk are:

- Property prices decline by 20%
- Funding rates for three-year interest rates increase by 69%, while 12-month interest rates increase by 136%
- Mortgage deeds in arrears are realised at 20% below the expected value

Applying the current models, the capital supplement amounts to DKK 100m for the agricultural portfolio, DKK 125m for the property development portfolio and DKK 155m for mortgage deed commitment funding.

The credit risk for the remaining portfolios is calculated at 8% of risk-weighted assets.

Market risk is calculated on the basis of the stress levels of 45% for equities and 135 basis points for interest rates specified by the FSA. The calculation of currency risk is based on exchange rate indicator 2 as described by the FSA.

The calculation of operational risk is based on the basis indicator method, which specifies 15% of the average net interest income and non-interest-related net income for the past three years.

The remaining risks are calculated on the basis of sensitivity and scenario analyses.

The most important results of Alm. Brand Bank A/S's individual solvency need are illustrated in the figure below.

RISK TYPE	REQUIRED CAPITAL (DKKm)	% OF RISK-WEIGHTED ASSETS
Credit risk	1,550	9.2%
Market risk	79	0.5%
Operational risk	72	0.4%
Other risks	36	0.2%
Total	1,737	10.3%

## Alm. Brand Forsikring A/S

Alm. Brand Forsikring A/S calculates insurance risk and market risk on the basis of the QIS 4 model as specified by CEIOPS.

Alm. Brand monitors developments in CEIOPS's recommendations for updating the parameters used in the standard model. During 2009, CEIOPS suggested a significant tightening of the parameters used in the standard model.

Alm. Brand closely monitors these developments and will in this connection assess whether it is necessary to adjust the models applied in calculating the individual solvency need.

## 2.3 Capital management in the Alm. Brand Group

A cross-firm risk committee has been established at group level, the object of which is to ensure coordination and uniformity in accepting, calculating and reporting risks across the different business areas.

## 2.4 Internal capital target

Alm. Brand has defined a dividend policy based on a capital model that meets the statutory capital requirements and provides financial latitude to cope with unforeseen events. The capital calculation model reflects management's defined capital needs.

The overall capital objectives for 2009 are retained in 2010.

DKKm	Times the solvency requirement	31-dec 2009
Non-life insurance	2,4	1.865
Banking excl partly owned listed subsidiaries	1,5	1.765
Banking, equity in partly owned listed subsidiaries		363
Life insurance	2,0	1.006
<b>Capital target</b>		<b>4.999</b>
Consolidated equity		3.694
Tax asset		-521
Intangible assets		-118
<b>Adjusted consolidated equity excl subordinate capital</b>		<b>3.055</b>
<b>Excess-of-capital target excl subordinate capital</b>		<b>-1.944</b>
Subordinate capital		1.834
<b>Excess-of-capital target incl subordinate capital</b>		<b>-110</b>

## 2.4.1 Future compliance with the capital requirement

In connection with the adoption of the budget, the group's management considers whether the current capital base is sufficient to ensure the desired strategic flexibility. This is done on the basis of sensitivity and scenario analyses.

### Sensitivity analysis

The Alm. Brand Group conducts a number of sensitivity analyses to illustrate how much the capital requirement may fluctuate. The elements investigated are:

- Parameter changes
- Changes in interest rate levels

### Scenario analyses

The Alm. Brand Group applies a number of different scenarios in its internal assessment of the capital objectives. The scenarios estimate the effect on earnings and on the individual solvency need and the capital requirement.

Scenarios applied and the negative factor in the scenarios

<b>Scenarios applied in 2009</b>	
<b>Claims scenarios</b>	
Rising claims	Worst thinkable result one would expect every 20 years. Calculated on the basis of the QIS 4 model's 95% quantile.
Windstorm scenario	A 20-year windstorm. The difference between the 95% quantile for weather and the expected weather-related expenses.
<b>Market risk</b>	
Red scenario	Adverse developments in the financial markets affect the group's capital and capital needs
<b>Banking</b>	
Central bank scenario	Long, deep chok as described by the central bank
3 largest counterparties default	50% loss on the three largest exposures
<b>Group</b>	
All at once	All of the above events occur at the same time

The scenarios are calculated on a quarterly basis and submitted to the risk committee each quarter in connection with the monitoring of Alm. Brand's risk appetite. The Alm. Brand Group remains solvent in most scenarios, but in some of the scenarios it will be necessary to transfer capital to the bank in order to maintain the bank's equity objectives.

## 2.5 Composition of capital in Alm. Brand Bank

### The capital base of Alm. Brand Bank and the Alm. Brand Group

DKKm	Alm. Brand Bank	The Alm. Brand Group
Shareholders' equity / Core capital	1,362	3,694
Proposed dividends	0	0
Intangible assets	0	0
Deferred tax assets	-317	-421
<b>Core capital net of statutory deductions</b>	<b>1,045</b>	<b>3,273</b>
Hybrid Tier 1 capital	1,036	1,036
<b>Core capital incl. hybrid Tier 1 capital net of statutory deductions</b>	<b>2,081</b>	<b>4,309</b>
Other deductions (half the deduction in subsidiaries)	0	-640
<b>Core capital incl. hybrid Tier 1 capital net of deductions</b>	<b>2,081</b>	<b>3,669</b>
Supplementary capital	400	650
<b>Capital base (before deductions)</b>	<b>2,481</b>	<b>4,319</b>
Deductions in capital base (half the deduction in subsidiaries)	0	-640
<b>Capital base (after deductions)</b>	<b>2,481</b>	<b>3,679</b>

## 3 Credit risks

Credit risks are risks of losses because one or more counterparties fail to meet all or part of their payment obligations with the group.

Credit risks also include

- Loss/writedowns for impairment on loans, guarantees, derivatives, etc.
- Concentration risks on types of customers, types of exposures, types of collateral, etc.
- General change in credit quality as a result of legal changes, financial market trends, market practices and conditions, etc.

For Alm. Brand Forsikring, credit risks are only relevant for the financial instruments described under "Spread" in the market risks section. Therefore, this section on credit risks only concerns Alm. Brand Bank.

### 3.1 Policy and responsibility

Alm. Brand Bank emphasises the identification, measurement and management of credit risks. For this purpose, directions are drawn up for the bank's lending operations which are described in a credit policy.

Alm. Brand Bank's overall credit policy is drafted by the bank's credit secretariat based on the development in the bank's credit exposures, market conditions, legislation, etc. Material changes are discussed by the bank's Board of Directors, and it reviews the overall credit policy once a year.

As a result of the significantly changed market conditions and the decline in collateral values, the bank has changed its forward-looking strategy. One of the effects of the new, revised strategy is that the bank has chosen to close down a number of business areas, and this is reflected in the credit policy.

The credit policy is obviously affected by the changed external setting, and this has led to a general reassessment and tightening of the risks accepted.

There are also a number of product-specific or business area-specific credit rules which define concepts and terms for establishing facilities in greater detail, but which are all subject to the overall credit policy.

#### **Credit policy**

The credit policy describes the positions and directions applicable for the bank's granting of loans, guarantees and other credit-related risks.

The directions for granting credits should ensure that the bank operates as a competent and bona fide bank with all customers, cooperating partners, public authorities and competitors.

Alm. Brand Bank's credit secretariat has the overall responsibility for assessing and following up on credit risks, both on the individual customer and on portfolios.

The credit policy is partly defined on the basis of the individual products offered by the bank and partly on the basis of the customer segments buying the bank's loan products. The bank aims to achieve earnings on the individual products and customer segments at a level that reflects the risks and required return on capital.

Alm. Brand Bank grants loans to both private and commercial customers.

The bank's loans to private customers are to a great extent based on the application of credit scoring models, which have been developed throughout a number of years. The models are still being developed and improved on the basis of experience and changes in market trends. Credit scoring models are applied to hedged as well as unhedged loans.

In the commercial customer segment, loans are concentrated on particular types of assets or particular industries. A satisfactory credit scoring of the business in combination with an assessment of any collateral offered serve as the main criteria for granting credit facilities.

The value of mortgaged assets is assessed on a regular basis and, moreover, the collateral value of mortgaged assets is monitored. If the values are not in compliance with the bank's requirements, the bank will seek to reduce the facility or obtain supplementary collateral.

The following overall conditions apply to Alm. Brand Bank's lending activities:

- The group aims to build long-term relationships with its customers.
- For the vast majority of products, credits are granted on the basis of insight into the customer's circumstances and/or specific insight into financial assets and on the basis of specific assessments that provide a context for such credits.
- Ongoing follow-up on developments in the customer's financial situation or status of funded assets is required in order to assess whether the basis for the group's granting of a credit has changed.
- The facilities should match the customer's creditworthiness, capital position or assets, and the customer should be able to substantiate his or her repayment ability.
- Alm. Brand Bank may only assume risks within the limits of applicable legislation and other rules, including the rules on best practices for financial businesses.
- When loans and credits are granted, it is of great importance that the group considers requiring collateral to the extent that the borrower is very likely to be able to repay the unsecured part of the exposure within a five-year period.
- Recourse guarantees from private individuals should be avoided if possible as great importance is attached to the assessment of debtor's ability to comply with his/her obligations.

- Alm. Brand Bank exercises caution before granting credit facilities to businesses or individuals if it is obvious that there will be practical difficulties in maintaining contact with the customer.
- Alm. Brand Bank intensifies attention towards enterprises operating in industries where the risk of liquidation is estimated to be far greater than usual.

When processing customers' and own orders in the liquidity, foreign currency and securities markets, the bank maintains a comprehensive cooperation with other financial businesses that also need to trade in these areas.

Alm. Brand Bank does not wish to have business relations with individuals or businesses that are known in the group or in public records as having a tarnished credit history, or customers whose past or reputation may be harmful to the bank's reputation, as the bank obviously complies with current legislation.

Alm. Brand Bank will not contribute to or encourage conclusions of agreements, etc which are incompatible with or constitute a deliberate attempt to circumvent statutory regulations or general recommendations to the bank provided by authorities.

## 3.2 Use of models

As a consequence of the revised strategy, Alm. Brand Bank has decided not to implement the IRB-F method under Basel II. The standard method, which the company has previously used to estimate risk, will be applied instead.

Alm. Brand Bank operates with two models: application scoring in connection with new customer relationships and behaviour scoring in connection with existing customer relationships. The models form part of the overall credit assessment foundation and are supplemented by other customer-specific information and inclusion of other information, including geographical, economic and industry conditions.

For the calculation of collective impairment losses, a restated model was used in 2009, which is based on a model developed by the Association of Local Banks in Denmark. Bankdata is in the process of developing a new model, which is expected to be implemented at year-end 2010.

## 3.3 Calculation

In the day-to-day credit management, the existing credit facilities for individual customers are calculated as the sum of all:

- loans including offers and commitments,
- the maximum for credits, including unutilised parts of committed facilities,
- any unauthorised excesses,
- guarantees,
- the bank's own portfolio of securities issued by the customer,
- calculated counterparty risks from derivatives, and

- other contingent liabilities, including effective recourse guarantees.

The counterparty risk from derivatives is offset by a risk weight of the individual contracts, calculated in relation to the estimated risk from investing in the underlying assets. When determining the counterparty risk, a full or partial set-off is made to the extent that the risks of the individual contracts are considered to cover each other.

### **3.3.1 Derivatives**

For derivatives, risks are calculated on the basis of a risk weighting of the individual contracts which are composed of position risks, term risks and risks concerning unsettled losses on concluded contracts, if any.

For position risks, the risk calculation is based on the estimated risk of the underlying asset. The risk weighting has been determined on the basis of estimated and observed volatilities of individual assets, and accordingly expresses the calculated, but not the maximum risk relating to the position. When determining the position risk, full or partial netting may take place, either through offsetting transactions with the same underlying asset or where the underlying assets in the offsetting transactions are considered to have almost identical risk profiles.

For term risks, the calculated risk implies that if Alm. Brand Bank or the customer at a future point in time wants to close a position by concluding an offsetting transaction, a risk exists that the interest rate on the placement and/or financing asset has changed resulting in a change of the arbitrage premium/price of the offsetting transaction.

Unsettled losses on concluded transactions are a direct debtor risk as they concern the customer's ability to cover calculated losses on concluded transactions. Losses and gains on concluded transactions are calculated by comparing the price on concluded transactions with a calculated market value of comparable offsetting transactions.

When calculating unsettled losses that are to be included in the credit exposure, gains may be offset against offsetting transactions (net calculation) to the extent that a written agreement has been concluded to this effect.

The applied risk weights are currently reassessed in relation to the development in the volatility of the value of the underlying assets, but will never be lower than the risk weights laid down by the FSA.

### **3.3.2 Default**

For each loan segment, Alm. Brand Bank has defined a number of criteria that decide when exposures are considered in default. The definition of default used by the bank is consistent with the requirements of the EU Capital Requirement Directive (CRD).

The group records a receivable as being in default when it is considered unlikely that the customer will fully meet all obligations to Alm. Brand Bank or its subsidiaries.

The rules on disclosure of information between the companies of a financial group do not permit the dissemination of sensitive information about private customers. This applies, for example, to

information that may lead to the recording of a default status, for which reason a private customer default in one of the bank's companies will not necessarily lead to a default marking in other companies of the bank.

This stipulation does not apply to commercial customers, so for these customers a default status may in certain circumstances lead to default on all receivables to the bank from the customer in question.

A default situation in a group of related customers requires a specific assessment as to whether default should be recorded for all customers in such group. In this context, it is considered unlikely that the customer will fully meet all obligations to the bank if the customer or the customer's creditors have filed for bankruptcy, or if the customer has notified the court of suspension of payments, initiated negotiations for financial restructuring or taken similar steps.

Alm. Brand Bank operates in almost all lending areas with concepts that more or less define whether a customer is in default or not. The bank has therefore in several lending areas extended the above default criteria to also include criteria in connection with non-observance of conceptual terms. The bank assesses whether non-observance of the conceptual terms is very likely to lead to breach which must be expected to lead to actual default.

### **3.3.3 Classification**

Alm. Brand Bank's lending can be divided into a number of sub-segments for which a so-called lending concept has been developed, which defines the conditions under which the credit facilities should be established. This concept determines what products to offer the relevant type of customer, how to handle the current credit management and what security requirements to assume. If the bank wishes to depart from the effective lending concept due to specific customer circumstances, credit approval must be performed.

### **3.3.4 Rating**

Rating is determined by using a rating model. The model receives a range of information which has been scrutinised and assessed to be significant in terms of determining the credit risk on the customers comprised by the model.

As mentioned above, Alm. Brand Bank operates with application scoring in connection with new customer relationships and behaviour scoring in connection with existing customer relationships.

The rating values are used in the current portfolio assessment of the bank's lending activities as well as in connection with approval processes of customers where they are included in the customer adviser's basis of decision together with other information.

The main objectives of the classification are to rank Alm. Brand Bank's customer base according to risk and to estimate the probability of default of each customer. The classifications used in the day-to-day credit process are private customers and commercial customers.

Customers are rated through a process managed by the bank's credit organisation. Customer advisers can provide factual information for the process, but have no influence on the outcome of

the scoring. The process is structured in such a way that the decision on the scoring is independent of the individual adviser.

### **3.4 Approval**

Any credit facility with Alm. Brand Bank is approved by persons, who in writing hold a lending authority describing the extent of the credit exposures that may be approved and the estimated accompanying risk on the basis of the bank's rules.

In most cases, the lending authority will be limited to specific customer segments and types of exposures.

Credit management in Alm. Brand Bank relies on a proven credit process, which ensures a proper correlation between customer creditworthiness and employee and lending authorities.

Alm. Brand Bank uses an automatic authorisation control system on private customers. In combination with the bank's credit application and approval system, this system ensures that the approvals made by individual managers and employees are within their authorisations. The system also supports collection of information on the customer. This information is included in the overall basis of decision for credit segmentation of the customer and measurement of the maximum exposures and risks, including already established facilities.

For every application of commercial segment credit facilities, information is gathered which is included in the overall basis of decision, including

- overview of the facility and collateral,
- financial analysis data or financial data from the owner,
- supplementary comments on the application,
- company profile, and
- overview of Alm. Brand Bank's total exposure to the individual customer after approval.

In future, Alm. Brand Bank will offer a limited number of lending products, where the credit approval is more about observing a number of product-specific requirements, in relation to i.a. collaterals that exceed the value of the credit exposure. Collection of the above information may be reduced for these types of exposures.

### **3.5 Model validation**

The model in the credit risk area is in principle subject to the same follow-up and validation as the models in other risk areas. After development and implementation, a continuous follow-up process is initiated as to how the model works as well as a periodical reassessment of the applied parameters. Both validations are normally made once a year, but may be accelerated if issues found when monitoring the models stipulate so.

If the models do not function appropriately, they will be adjusted. This change may either consist in a minor or partial adjustment or in a more basic new development, depending on the need.

Validation of classification models is the responsibility of the bank's credit control unit and follows a precisely determined procedure in accordance with the recommendations from the Committee of European Banking Supervisors (CEBS).

### **3.6 Risk reduction**

A key component of Alm. Brand Bank's business strategy is to reduce risks in its lending portfolio, etc. by seeking to enter into risk-reducing agreements.

For a number of loan products, collateral is required by market practice, for example in the property, mortgage, investment and car financing commitments. The most important risk-mitigating means are pledges, recourse guarantees and netting arrangements. The most frequently used pledges are mortgages on real property, pledges on vehicles, financial assets in the form of mortgage deeds, shares and bonds.

Alm. Brand Bank has defined specific rules for the extent to which collaterals may be applied to reduce the calculated risks. Determination of the risk-reducing value of the collateral in relation to the current market value depends on the type of collateral. When determining these collateral values, the bank has taken into consideration the volatility of the collateral's market value and the estimated realisable liquidity. So, the risk reduction reflects to what extent the collateral, based on a conservative estimate, must be expected to be able to reduce the estimated risk at a market-conforming realisation of the collateral. The size of the applied collateral values is currently reassessed by measuring the volatility of the market value of the individual types of collaterals.

Alm. Brand Bank maintains information about pledges and recourse guarantees received, etc. to be able to estimate their values on an ongoing basis. The value is calculated as the amount that would be received from a forced sale minus costs of realisation, including costs for days on the market.

The bank's basis of agreement when concluding financial derivatives enables netting of transactions made with the same counterparty, making it possible to offset the bank's receivables, if any. This could be netting of a receivable from concluded agreements against the counterparty's receivables on other agreements before payment of any profit to the counterparty or its other creditors.

#### **Models for reducing credit risks**

Alm. Brand Bank applies financial collateral and mortgages on real property to cover its credit risks in accordance with the rules of the Executive Order on Capital Adequacy.

The table below shows the cover of the collateral for each exposure category, i.e. the fully adjusted size of the collateral within each exposure category. These figures have been compiled at 31 December 2009.

**The cover of the collateral per exposure category for Alm. Brand Bank**

<b>Exposure category</b>	<b>Collateral cover (DKKm)</b>
Exposure to central governments or central banks	<b>0</b>
Exposure to regional and local governments	<b>0</b>
Exposure to public entities	<b>0</b>
Exposure to multilateral development banks	<b>0</b>
Exposures to international organisations	<b>0</b>
Exposures to institutions	<b>1,887</b>
Exposures to business entities, etc.	<b>808</b>
Exposures to private customers	<b>104</b>
Exposures secured by mortgage on real property	<b>2,082</b>
Exposures subject to accounts overdrawn or in arrears	<b>282</b>
Securitisation positions	<b>0</b>
Short-term exposures to institutions and commercial customers, etc.	<b>0</b>
Exposures to collective investment undertakings	<b>0</b>

The collaterals shown for mortgages on real property are within 80% of the value of private properties and 50% of the value of commercial properties.

In addition to the collaterals shown, Alm. Brand Bank has granted loans to Alm. Brand Pantebreve and Alm. Brand Finans, which are backed by collateral. Moreover, Alm. Brand Bank's loans to PFI commitments are secured against collateral.

### **3.7 Impairment losses**

Receivables are written down for impairment in accordance with International Financial Reporting Standard 7 when objective evidence of impairment occurs. The extent of the writedown for impairment is found by calculating the present value of the expected future cash flows.

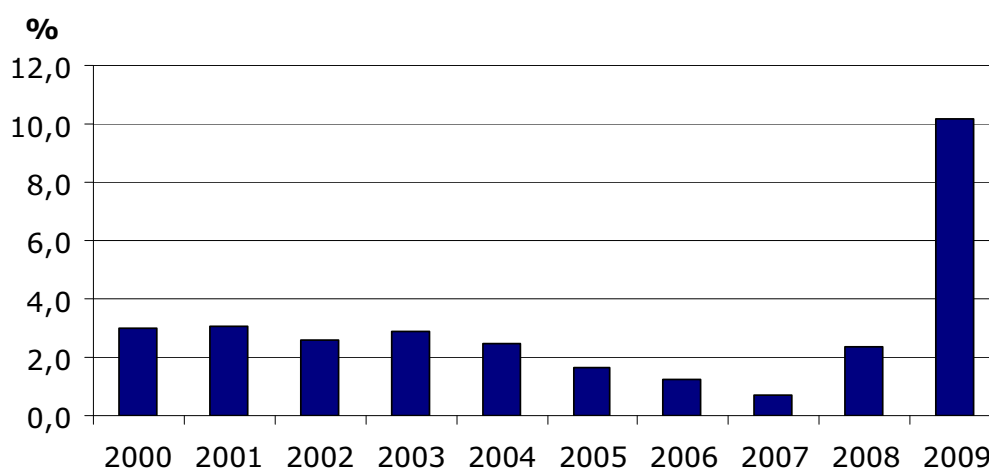
The indication of impairment is assessed on an ongoing basis via a process managed by Alm. Brand Bank's Credit Secretariat. Also, collective impairment writedowns are made under the special rules in International Financial Reporting Standard 7 and the so-called "Christmas letter" sent by the FSA in this respect.

Financial assets, for which objective evidence of impairment has occurred, will be written down for impairment equal to the difference between the carrying amount and present value of the expected future cash flows.

A collective assessment is made in addition to an assessment of objective evidence of impairment for individual exposures in accordance with the rules of International Financial Reporting Standard 7. Objective evidence of impairment of private customers normally occurs in connection with filing debt recovery proceedings against the customer, while for commercial customers, this is usually after liquidation, suspension of payments or in connection with a financial restructure of the counterparty. Moreover, other parameters, such as long-term unauthorised, uncovered overdrafts or adverse developments in the customer's operations, may trigger objective evidence of impairment-marking and result in impairment writedown.

Below, a more detailed description of impairment losses in Alm. Brand Bank is provided in graphs and tables, respectively.

#### Impairment ratio for Alm. Brand Bank in the period 2000-2009



For information on the significant impairment ratio increase, see the management's review in Alm. Brand Bank's annual report.

#### Individual and collective impairment losses for Alm. Brand Bank in 2008 and 2009.

Individual og collective impairment losses for Alm. Brand Bank in 2008 and 2009 (DKK)	Accumulated individual impairment losses 2009	Collective impairment losses 2009	Total impairment losses 2009	Total impairment losses 2008
Impairment losses at beginning of year	395	21	416	130
Impairment losses for the year	1,382	46	1,428	393
Reversed impairment losses	15	5	20	64
Impairment losses considered lost	6	0	6	10
<b>Impairment losses at year-end</b>	<b>1,756</b>	<b>62</b>	<b>1,818</b>	<b>450</b>

**Loans and advances before and after impairment losses for Alm. Brand Bank in 2008 and 2009.**

DKKm	Individual impairment losses 2009	Collective impairment losses 2009	Total impairment losses 2009	Total impairment losses 2008
<b>Loans and advances written down for impairment</b>	<b>3,652</b>	<b>7,644</b>	<b>11,296</b>	<b>12,628</b>
Impairment losses	1,756	62	1,818	450
<b>Loans and advances after impairment losses</b>	<b>1,897</b>	<b>7,582</b>	<b>9,479</b>	<b>12,178</b>

**Impairment losses on loans, advances and receivables for Alm. Brand Bank in 2009**

DKKm	Individual impairment losses	Collective impairment losses	Total impairment losses	Claims in default
<b>Exposure in private customer area, of these</b>				
Secured against real property	11	9	20	48
Secured against cars	20	17	37	183
Other exposure in the private customer area	42	1	43	450
Exposure in commercial customer area	1,683	35	1,718	2,907
Exposure from institutions	0	0	0	0
Government exposures	0	0	0	0
<b>Total</b>	<b>1,756</b>	<b>62</b>	<b>1,818</b>	<b>3,588</b>

**Losses and impairment writedowns for Alm. Brand Bank in the period 2007-2009**

DKKm	2009	2008	2007
Exposure in the private customer area from financing of real property	17	4	10
Exposure in the private customer area from financing of cars	-9	-2	-4
Other exposure in the private customer area	108	26	-14
Exposure in commercial customer area	1,277	308	-42
Exposure from institutions	17	4	0
Government exposures	0	0	0
<b>Total</b>	<b>1,410</b>	<b>340</b>	<b>-50</b>

Impairment losses for Alm. Brand Bank totalled DKK 1,451m in 2009 on a pro rata basis.

### Write-off procedures

Loans and advances are written off when the usual dunning procedures have been performed and the loss may be estimated based on an individual assessment. The write-off is deducted from the allowance account. The losses form the basis of the calculation of credit parameters, which are taken into account when calculating i.a. economic capital.

## 3.8 Monitoring

To ensure compliance with the credit policy, the bank has established a number of routines to currently assess Alm. Brand Bank's credit assumptions as well as to monitor the development in

facilities. One aspect of this monitoring is to currently assess whether credit limits are violated or security requirements are complied with. Monitoring compliance with the credit policy is to ensure that the bank reduces the risk of losses and that the general credit policy is observed.

Central monitoring is the responsibility of the bank's credit secretariat and includes data on the size and utilisation of all types of credit facilities and information on the estimated realisable value of collateral after deduction of the estimated costs of realisation.

Recommended limits have been set for customer facilities, and these limits are graduated according to the ratings assigned and the collateral provided. Facilities are currently evaluated for all exposures, by i.a. taking new financial data into account.

If customer exposures show a weak financial performance, they will be marked in the bank's credit system. The purpose is to ensure closer follow-up on the customer relationship in order to reduce the risk of losses. For example, if there are signs of a decline in a customer's creditworthiness, the group prepares an action plan for minimising the risk on the customer. Also, the extent of the approval related to the customer is reduced.

The ongoing monitoring of credit quality in the individual business areas is based on a quarterly review of and report on various credit portfolio characteristics. Steps may be taken to counter negative developments in the portfolio. Reporting hereof is made to the bank's management and the management bodies of the business areas.

Unauthorised excesses on current accounts and lines are automatically referred to a centralised unit, which together with the customer's adviser, decides whether or not to accept the excess. If the excess is not accepted, a dunning procedure is initiated, which, if the excess has not already been settled, may result in debt recovery proceedings within a period up to 30 to 60 days.

Claims submitted for debt recovery are transferred to a centralised debt collection department.

## **3.9 Portfolio management**

In addition to credit management at the individual customer level, Alm. Brand Bank has set up additional management levels as to credit risks at the portfolio level. Alm. Brand Bank has built a data warehouse which gathers commitment data for all the bank's customers.

### **3.9.1 Aggregation of credit exposure**

Besides serving the day-to-day credit management process, the bank's credit system aggregates credit risks on credit segments, thereby allowing the bank to monitor the development in credit risk in the various customer segments.

### **3.9.2 Monitoring of the loan portfolio**

Alm. Brand Bank has established a central concept monitoring the development in the loan portfolio. Focus is on the development in central measuring points within credit quality, including overdraft, outstanding amounts, credit granting to weak customers and assessment of compliance

with credit policies and quality in the credit process. The results of the periodical monitoring are submitted to the individual business areas so they can compare the development in various branches.

### 3.9.3 Risk concentration

Alm. Brand Bank's identification of risk concentrations in the credit portfolio serves as a parameter for credit risk management. The risk concentration may be based on volume of credit exposures, single assets or types of commitment.

The Alm. Brand Group has a broad access to the Danish property market across the group's business areas. Alm. Brand Bank's commitment primarily relates to guarantees and loans and advances to private homes, commercial and investment properties as well as mortgage deeds and financing of investments in mortgage deeds.

Alm. Brand Bank operates with a number of credit rules to limit and spread the property exposure. In addition, the bank has implemented credit systems and risk models to separately monitor the risk development in these portfolios, just as the bank prepares special accompanying risk analyses.

To limit the credit sensitivity to single risks, Alm. Brand Bank's credit policy specifies limits as to the extent of the bank's maximum exposure as well as requirements for spreading the credit risk on several debtors and/or single assets.

The sum of large exposures, calculated in accordance with the FSA's requirements for quarterly reporting, is 174% of the bank's capital base, distributed on eight exposures at year-end 2009. The exposures are characterised by the credit risks actually being allocated on financing of a number of properties or mortgage deeds, in order not to reduce the quality of the relevant exposure significantly from default of a single financed asset.

#### Application of the 800 per cent rule for Alm. Brand Bank in the period 2007-2009

Year-end	2009	2008	2007
Large exposures – number	8	13	14

Credit risks are risks of losses because one or more counterparties fail to meet all or part of their payment obligations with the group.

Credit risks also include

- Loss/writedowns for impairment on loans, guarantees, derivatives, etc.
- Concentration risks on types of customers, types of exposures, types of collateral, etc.
- General change in credit quality as a result of legal changes, financial market trends, market practices and conditions, etc.

For Alm. Brand Forsikring, credit risks are only relevant for the financial instruments described under "Spread" in the market risks section. Therefore, this section on credit risks only concerns Alm. Brand Bank.

## 4 Market risks

Market risks entail a risk of loss because the fair value of assets and liabilities varies with changes in market conditions. Market risks relate to interest rates, exchange rates and equity markets and are impacted by both general and specific market trends.

Market risks are cross-functional financial risks and are therefore relevant to the entire Alm. Brand Group.

The CRD rules distinguish between market risk on items inside and outside the trading book, and between general and specific risk. A similar breakdown is not presently considered relevant for the insurance area.

Market risks outside the trading portfolio will therefore only be further specified for Alm. Brand Bank.

The market risk is mainly calculated according to conventional risk measures.

### Definition

Market risk consists of the following components:

- Interest rate risk is the risk of loss because of changes in the market rate
- Exchange rate risk is the risk of loss on the group's foreign currency positions because of changes in exchange rates
- Share price exposure is the risk of losses because of changes in share prices
- Other market risks include:
  - Property risks are the risk of a decline in property values of the group's properties
  - Credit and counterparty risk is the risk (reflecting a spread element but cannot be designated spread risk) of
    - the company incurring losses because a position's market value is changed as a result of conditions related to the individual issuer of the debt instrument, and
    - the company incurring losses because a counterparty in a contract on a derivative financial instrument is incapable of honouring his obligation to the company
  - Concentration risks on assets (shares, bonds, etc) are risks of having too large a concentration of certain assets as to large or weak commitments, geography, customers, etc.

However, please note that counterparty risks are recognised under credit risks in the annual report of Alm. Brand Bank.

## **4.1 Policy and responsibility (objectives)**

The purpose of managing market risks is to balance the aggregate financial risk on assets and liabilities in order to obtain a satisfactory weighting of yield and risk. The risk management target is achieved through risk management policies that lay down directions for exposure to different types of financial risks. The investment and risk management policy for the individual companies of the group has been adjusted to the conditions, under which the companies operate.

The Board of Directors lays down and approves the overall policy for the group's acceptance of market risks, just as it determines the overall framework in this respect and the required reporting.

Alm. Brand has set-up an investment committee, the purpose of which is to handle the strategic allocation of capital in the Alm. Brand Group. The investment committee is responsible for the group's investment activities and determines them on the basis of scopes and policies adopted by the boards of directors of the individual companies. The investment committee is responsible for monitoring the strategic allocation of assets in the Alm. Brand Group.

In addition, Alm. Brand has set up a product approval committee for financial products. This committee is responsible for ensuring that business procedures, processing routines, etc. are in place before new products or activities are implemented. In this way, the product approval committee helps ensure that new products/activities are handled for administrative purposes before they are brought into use, thereby helping to mitigate the operational risk.

The current identification and monitoring of market risks takes place in interaction with the individual business areas and the cross-sectoral risk management department, which has a coordinating responsibility for the risk management of market risks at group level. The risk management department performs daily calculations and controls of market risks for the business areas.

## **4.2 Use of models**

Conventional risk measures are primarily used to determine market risks. In addition, the insurance companies use internal asset-liability models and stress tests in the form of the FSA's risk and capital assessments. A few derivative financial products, whose value depends on both the share and interest rate market, are assessed by internal models that use a Monte Carlo simulation to estimate the share price risk and interest rate risk for the product.

The conventional risk measures are used in the daily assessment of market risk. Interest-bearing assets are assessed by the interest rate risk made up by the value change upon a general interest rate change of 1 percentage point.

Alm. Brand uses Value-at-Risk to measure and monitor risk in the group. In 2010, VaR will be implemented in the group's limit monitoring system together with the risk measures already used. In

Alm. Brand's use of VaR, the measure indicates the maximum loss that may occur within one day with a probability of 99.5%.

In Alm. Brand Liv & Pension, derivative instruments are used to ensure that interest rate exposure on assets and liabilities is at a similar level. The company has developed a simple ALM model to manage the correlation between assets and liabilities. Run every week, the model provides an analysis of the consequences of changes of up to +/- 2 percentage points in discount rates after PAL. The ALM model builds on a number of assumptions relating to prepayment probabilities, parallel shifts in yield levels, etc. Being a statistical model, it calculates the effect of an interest change here and now. Equity, property and investments are not included in the calculation. Monthly follow-ups are made to see whether the model predictions correspond to actual results. Generally, the model provides a good indication of the effect of interest rate changes.

The ALM model includes limits for the company's risk tolerance. The limit is set at a maximum loss of DKK 600m at an interest rate movement of 2 percentage points. However, if the discount rate is between 2.5% and 3.5%, a drop in interest rates down to 1.5% is used, and if the discount rate is below 2.5%, a drop in interest rates of 1 percentage point is applied. In this connection, the company's fund manager has been assigned with the task of providing hedging so that the net effect on the balance sheet at the specified change in interest rates is capped at a loss of DKK 600m.

A share market exposure is calculated for shares which includes the sensitivities to changes in the share market for shares, financial instruments such as futures and options and other derivative financial instruments whose value hinge on the share market.

The aggregate net exposure to single currencies is used for currency risks. Exchange rate indicator 2 is also used. This is a Value-at-Risk measure for a maximum loss with a 99% probability assuming unchanged currency positions in the subsequent 10 days. The definition of exchange rate indicator 2 corresponds to the official definition of the FSA.

The FSA's risk and capital assessments are prepared for the insurance companies and constitute a stress test of assets' and liabilities' sensitivity to market risk scenarios which include interest rate changes, share market declines etc.

### **4.3 Model validation**

The in-house asset-liability models that estimate assets' and liabilities' sensitivity to interest rate changes are assessed currently by means of back tests. In this assessment, realised net results for assets and liabilities are compared with the model's estimate of the realised interest rate change, assuming unchanged positions.

The validity of models estimating market sensitivity of financial products that are conditional on both interest rate developments and share market developments is tested on a regular basis by comparing the model's market value output with quotations. Also, routines and procedures have been established to monitor the rates and other market data used in the current determination of market risks.

## 4.4 Monitoring

The cross-functional risk management department which has the coordinating responsibility for risk management at group level monitors market risks on a daily basis. The risk management department checks compliance with the investment limits laid down for each company of the group.

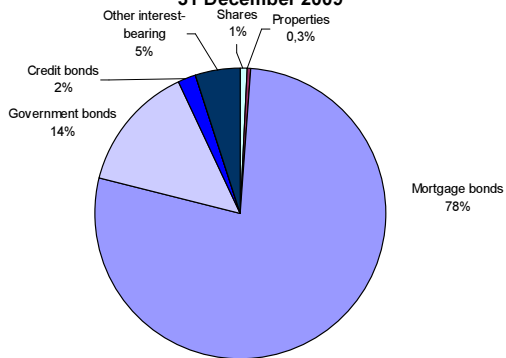
The calculation of market risks and compliance with the investment limits laid down for each company of the group are reported to the boards of directors and management boards of the relevant companies.

## 4.5 Asset allocation in Alm. Brand

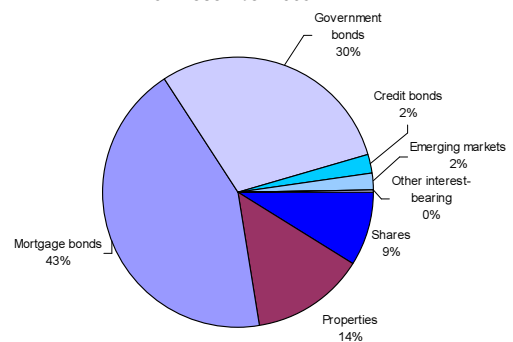
### Asset allocation in general

Alm. Brand traditionally takes a prudent approach to allocation of own and customer investment funds. Both for the bank and for the insurance companies, this implies limited holdings of shares and a ban on investments in exotic products.

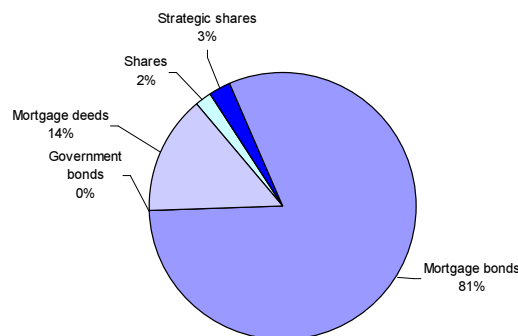
**Non-life insurance, allocation of investment assets  
31 December 2009**



**Alm. Brand Liv & Pension, allocation of investment assets  
31 December 2009**



**Alm. Brand Bank, allocation of investment assets  
31 December 2009**



## 4.6 Interest rate risks

Interest rate risk is calculated as the risk of a gain/loss as a result of an interest rate increase or decline. Interest rate risk is usually measured as the expected changes on interest rate positions that would result from an immediate upwards or downwards change in all interest rates by 1 percentage point. Interest rate risk is measured across the group for all business areas exposed to interest rate risks. For departments trading in interest rate options, the maximum percentage loss in case of a given interest change is also measured.

Selected elements of interest rate risks have been further specified below.

### **Interest rate risk in the bank**

Alm. Brand Bank holds significant interests in Alm. Brand Pantebreve and Alm. Brand Formue. In order to give a more true and fair view of the banking group's interest rate risk, risks are measured and managed including ownership interests in these subsidiaries.

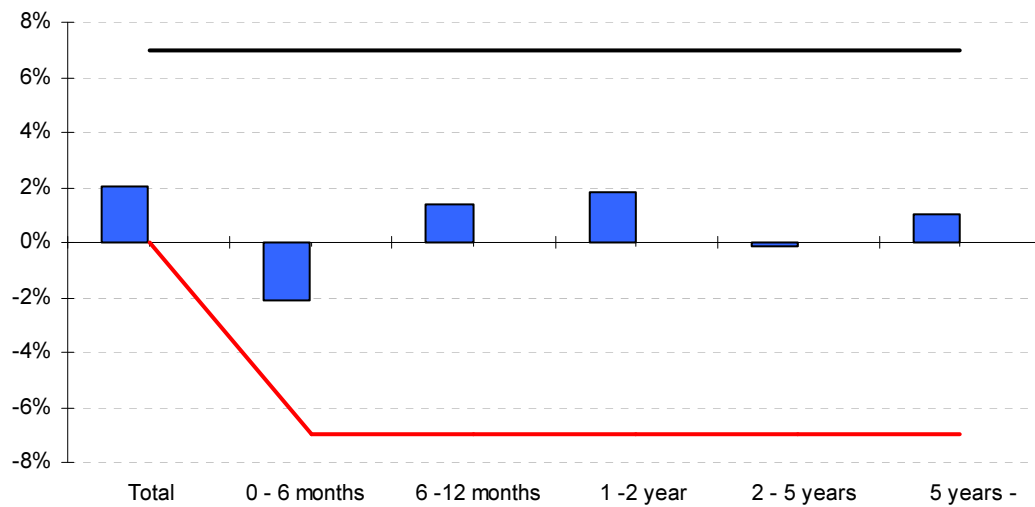
Interest rate risk in Alm. Brand Bank may be divided into interest rate risk on the investment portfolio and interest rate risk on the trading portfolio. At 31 December 2009, the bank's overall interest rate risk amounted to DKK 33m, including interest rate risk outside the trading portfolio in a positive amount of DKK 35m and interest rate risk in the trading portfolio in a negative amount of DKK 3m.

The bank's interest rate risk in the trading portfolio is primarily derived from trading on behalf of customers. The bank only engages in own-account trading to a limited extent. Most of the bank's interest rate risk outside the trading portfolio is derived from the bank's portfolio of bonds and direct and indirect mortgage deed holdings.

The bank's total interest rate risk amounted to DKK 33m at 31 December 2009, corresponding to 2% of the bank's equity.

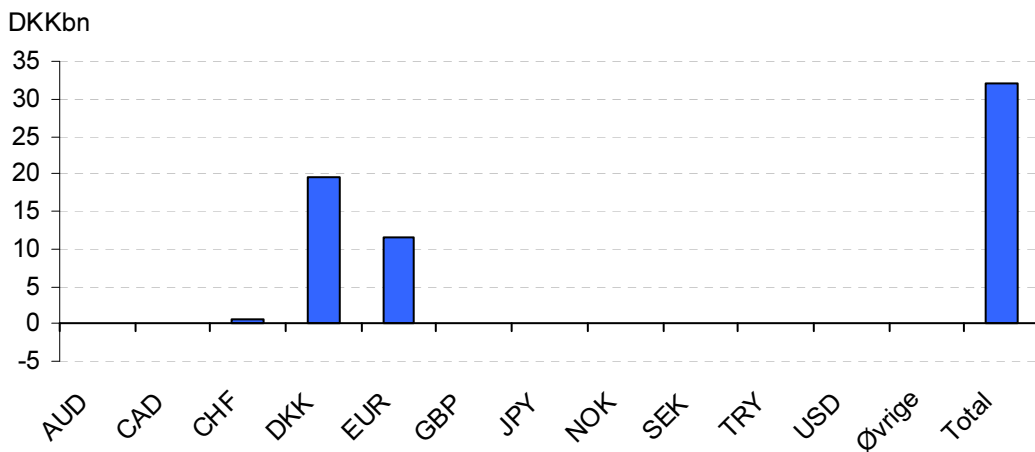
As part of Alm. Brand Bank's management of interest rate risk, the bank also calculates the interest rate structure risk, which expresses losses attributable to non-parallel shifts in the yield curve. The risk of changes in the yield curve is calculated for the intervals 0–6 months, 6–12 months, 1–2 years, 2–5 years and 5 years or more. Alm. Brand Bank's risk policy in this respect permits a total interest rate risk in the interval [0 ; 7%] of equity, while an interest rate risk in the interval [-7% ; 7%] is permitted for the individual curve intervals.

### Interest rate risk as a percentage of equity



Most of the bank's interest rate risk is exposed to Danish kroner. The bank strives to keep interest rate risk in currencies other than DKK and EUR at a minimum. As a result, interest rate risk in other currencies is swapped to DKK.

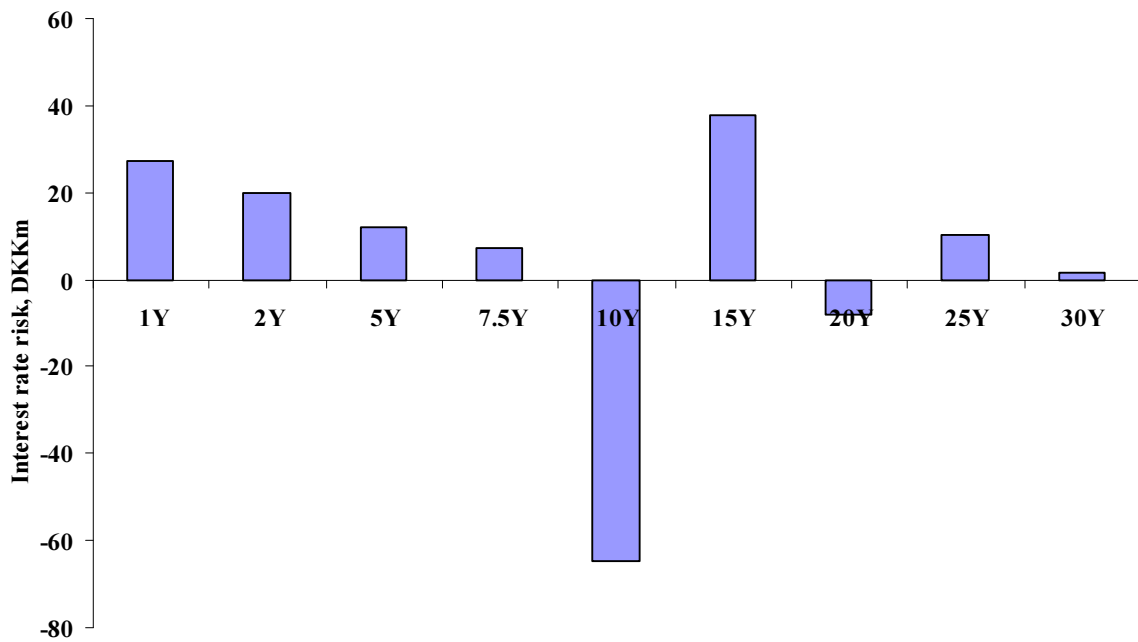
### Total interest rate risk per currency



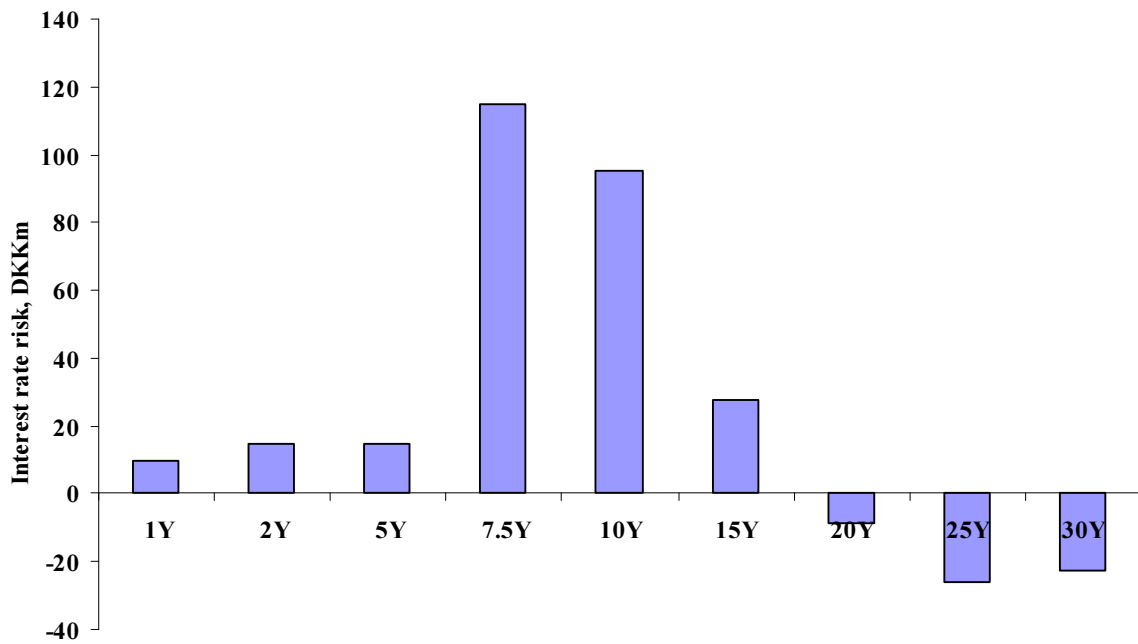
### Interest rate risk in the non-life and life insurance companies

Interest rate risk in the non-life and life insurance companies is managed on the basis of the net interest rate risk, i.e. after the interest rate risk on assets and liabilities has been aggregated. The net interest rate risk distributed on maturity is set out for the two companies in the figures below (seen relative to an interest rate decline of 100 basis points).

**Distribution of net interest rate risk in the non-life insurance company, 31 Dec 2009**



**Distribution of net interest rate risk in the life insurance company, 31 Dec 2009**



## 4.7 Currency risks

Currency risk is the risk of losses on the group's positions in foreign currency when the exchange rates change.

The risk is calculated as the largest sum of positions in currency where the group has a net receivable and the sum of positions in a currency where the group has a net debt. Foreign currency is calculated as positions in each currency, and a risk limit has been defined for three currency categories, from which calculation, management and monitoring are made.

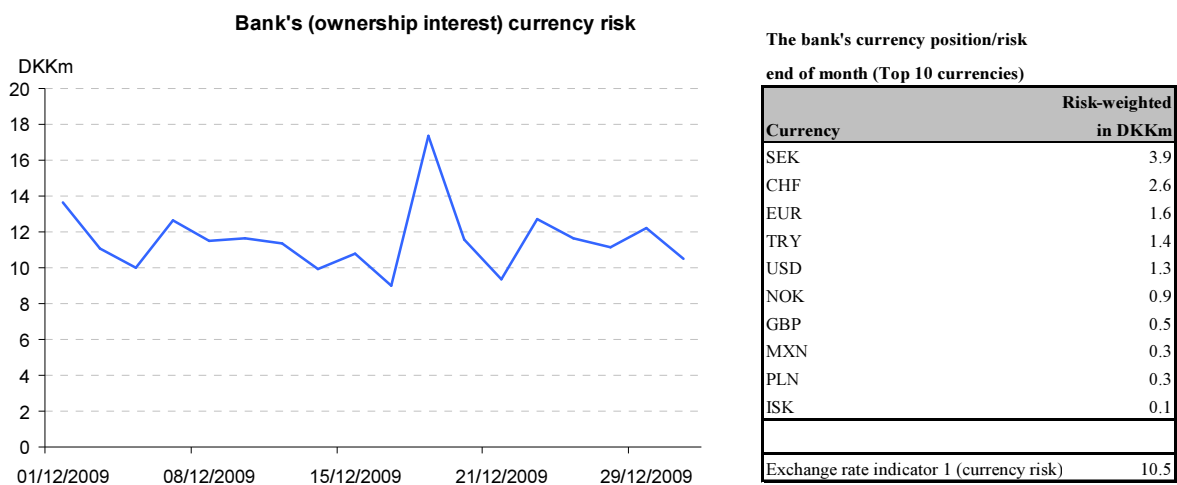
Foreign currency is calculated and managed on a day-to-day basis across the banking group.

The currency risks of Alm. Brand are primarily limited to the activities of the listed subsidiaries, Alm. Brand Formue A/S and Alm. Brand Pantebreve A/S. The bank only engages in own-account trading to a limited extent.

Currency risk is basically measured in Danish kroner.

At 31 December 2009, the overall currency risk of the Alm. Brand Bank parent company made up on the basis of unweighted exchange rate indicator 1 amounted to DKK 21m, while the corresponding figure for the banking group was DKK 64m.

At 31 December 2009, the overall currency risk of the Alm. Brand Bank parent company made up on the basis of risk-weighted exchange rate indicator 1 amounted to DKK 5m, while it was DKK 11m including the ownership interests in the subsidiaries.



Made up on the basis of the FSA's exchange rate indicator 2, the currency risk for the yellow scenario totalled DKK 0.4m in the Alm. Brand Bank parent company at 31 December 2009. The similar calculation for Alm. Brand Bank (pro rata) was DKK 2.4m at 31 December 2009. The yellow scenario of the FSA's exchange rate indicator 2 indicates the maximum loss within one day with a probability of 99.5%.

**Exchange rate indicator 2 (Value-At-Risk)**

	Alm. Brand Bank parent company	Alm. Brand Bank A/S (pro rata)	Alm. Brand Bank Group
Yellow risk scenario (10 days, 99.5%)	0.4	2.4	2.8

## 4.8 Share price risk

Share price risks are the risk of losses because of changes in share prices.

Share price risks are calculated as the net sum of the fair value of short and long positions in shares and share-related instruments. The management of share price risk distinguishes between listed and unlisted shares and the position in individual companies is calculated and monitored separately.

### Share price risk in the bank

#### Exposures in the trading portfolio

The bank's share price risk in the trading portfolio is primarily derived from trading on behalf of customers. The bank only engages in own-account trading to a limited extent.

#### Exposures outside the trading portfolio

Alm. Brand Bank has in cooperation with other banks acquired shares in a number of sector companies. The object of these sector companies is to support the banks' activities in mortgage financing, payment services, IT, investment funds, etc. Alm. Brand Bank does not plan to sell these shares as participation in these sector companies is considered necessary to operate Alm. Brand Bank. The shares are therefore considered to be held outside the trading portfolio and are categorised as strategic sector shares.

In several of the sector companies, the shares are reallocated so as to constantly reflect each bank's business volume with the sector company in the bank's ownership share.

The shares are typically reallocated on the basis of the sector company's equity value. Alm. Brand Bank accordingly adjusts the carrying amount of these shares on a quarterly, half-yearly or annual basis, or dependant on the frequency of new information from the individual company. The current adjustment is recognised in the income statement in accordance with the rules.

Other sector companies do not reallocate the shares, however typically perform valuation on the basis of the latest known transaction. Alternatively the value is calculated based on a recognised valuation method. Adjustments to the carrying amount of the shares in these companies are also recognised in the income statement.

Alm. Brand Bank owns a number of unlisted shares, acquired for strategic reasons, and which for this reason are considered to be outside the trading portfolio. The shares are typically valued on the basis of the latest known transaction. In the alternative, the value is calculated on the basis of a recognised valuation method.

On initial recognition and subsequently, the unlisted shares are measured at fair value. The adjustment of the shares to fair value is recognised in the income statement.

At 31 December 2009, Alm. Brand Bank's portfolio of sector shares and strategic shares totalled DKK 243m. The capital gains on the portfolio of sector and strategic shares totalled DKK 17m at 31 December 2009.

## **4.9 Other market risks**

Other market risks include property risks, spread and concentration risks on assets (shares, bonds etc).

Property risks mainly concern Alm. Brand Liv & Pension and the subsidiary, Alm. Brand Ejendomsinvest, and relates to customer funds in this respect.

Spread concerns credit and counterparty risk on assets (shares, bonds etc). Alm. Brand Forsikring has a number of asset management agreements with Alm. Brand Bank. The Board of Directors has approved with which counterparties agreements may be concluded under the asset management agreement.

At 31 December 2009, Alm. Brand Bank has credit and counterparty risks on assets in the amount of DKK 25m. Most of these risks were credit risks derived from the group's portfolio of mortgage bonds.

## 5 Liquidity risk

Liquidity risk is defined as the risk of timing differences between cash inflows and cash outflows. These differences may give rise to losses as a result of:

- differences between premium payments and claims payments
- a disproportionate increase in the company's funding costs
- inability of the company to grant new loans due to lack of funding, or
- ultimate inability of the company to honour its commitments due to lack of funding.

### Policy and responsibility

Liquidity risk is limited in Alm. Brand Forsikring A/S and Alm. Brand Liv & Pension. Premium payments in the company are pre-paid. As a result, the liquidity risk involves the pre-paid premiums being insufficient to cover the claims and costs for the year.

Forsikring A/S and Liv & Pension typically have liquid funds in the hundreds of millions of Danish kroner.

The non-life insurance company's investment portfolio consists almost exclusively of bonds, the vast majority of which are mortgage bonds. Approximately half of Alm. Brand Liv & Pension's assets are invested in mortgage bonds.

The non-life insurance company's liquidity would be most severely squeezed by a windstorm. The portfolio of mortgage bonds could be realised without losses, as these bonds are short-term. The liquid funds and the bond portfolio provide overall liquidity of slightly more than DKK 6bn.

The greatest liquidity risk for Alm. Brand Liv og Pension is the risk of a large number of customers wanting to move their pension savings at the same time. However, the possibility of procuring liquidity by realising assets is very significant.

Alm. Brand Bank monitors liquidity closely on a regular basis. Alm. Brand Bank believes that liquidity risks are best handled through close management and strong resources. Alm. Brand Bank procures liquidity through three sources of funding:

- Money market
- Bond issues and the interbank market
- Customer deposits

In Alm. Brand Bank, liquidity management is based on a daily calculation of the bank's liquidity based on section 152 of the Danish Financial Business Act.

The bank's liquidity management has two objectives. The short-term liquidity management is intended to ensure that Alm. Brand at all times complies with the statutory requirements. The long-term liquidity management is intended to ensure that Alm. Brand does not find itself in a situation where the funding of the bank's operations generates disproportionately large expenses. Compliance with the long-term strategy is achieved through an internally defined framework for the composition of funding, including sources of funding and the maturity structure thereof.

## 5.1 Short-term liquidity management

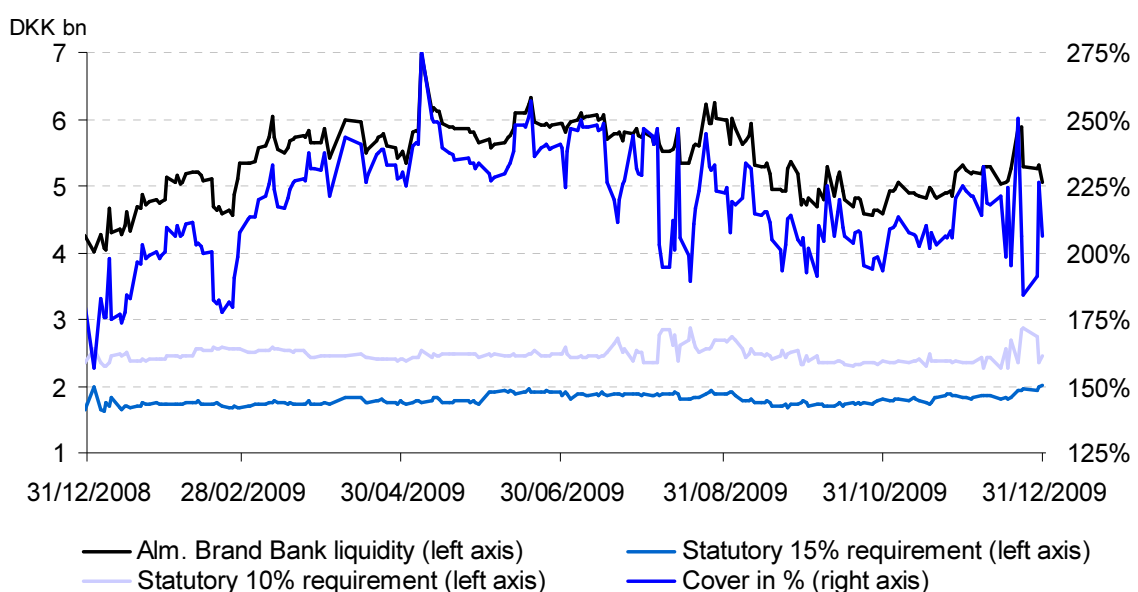
Alm. Brand Bank achieves its short-term liquidity management partly by neutralising imminent liquidity effects, thereby maintaining liquidity within the limits defined by the Board of Directors, and partly by securing financial resources in the form of certificates of deposit and undrawn money market lines with major market players.

Alm. Brand Bank's short-term liquidity management is based on the following guidelines:

- Liquidity is projected on a day-to-day basis for a period of seven business days
- Maturity of money market transactions with customers and banks are taken into consideration
- Next, known effects from the bank's currency and securities trading activities are included
- Finally, expected clearing and giro numbers are estimated on the basis of historical data and expected effects on overall sector liquidity as a result of government receipts and payments.

Alm. Brand Bank aims to have a liquidity cover of at least 150%. The bank's liquidity cover is measured on a day-to-day basis, and throughout 2009 it was in the interval [157;276], as can be seen in the figure below.

### Alm. Brand Bank - liquidity developments in 2009



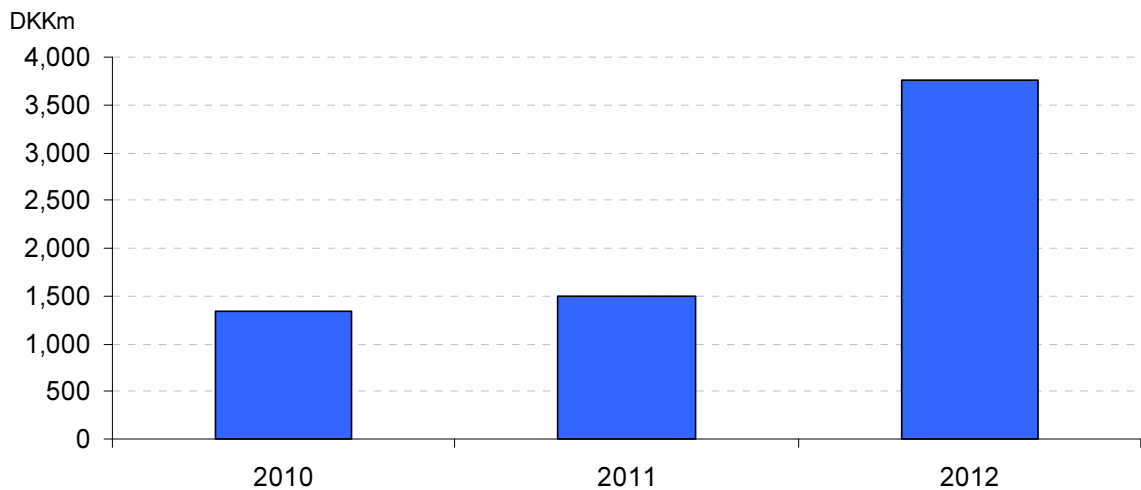
## 5.2 Long-term liquidity management

Alm. Brand Bank's policies for the long-term liquidity management are intended to ensure a diversified composition of funding (sources of funding, maturity structure and currency).

At 31 December 2009, deposits accounted for 54% of the funding, hybrid capital and equity accounted for 14%, whereas the remaining 32% was composed of interbank funding and other market instruments.

At 31 December 2009, Alm. Brand Bank's 12-month maturity structure of interbank funding and other market instruments accounted for 20%. The bank's five-year maturity structure appears from the figure below.

### Maturity structure of Alm. Brand Bank's loans



## 5.3 Liquidity developments in 2010

At 31 December 2009, Alm. Brand Bank excess liquidity cover of DKK 2.6bn relative to the statutory requirement, corresponding to a liquidity ratio of 206%. In March and April 2010, two schuldscheine and a revolving credit for a total amount of EUR 180m will be repaid. All other things being equal, this will reduce the bank's liquidity cover to around 160%.

In connection with the annual report, Alm. Brand Bank intends to apply for a government guarantee under the Second Bank Package under which the bank may conduct guaranteed issues in case the bank needs to strengthen its liquidity. Alm. Brand Bank will use the guarantee if necessary.

## 5.4 Cash resources

Alm. Brand Bank has a contingency plan for liquidity risks, which is intended to ensure that the bank is sufficiently prepared to take remedial action if an unfavourable liquidity situation should arise.

Due to the expiry of the government guarantee under the First Bank Package on 30 September, there is a risk that the money markets may come under pressure. Alm. Brand Bank has factored in such a situation in its contingency plan.

## 6 Insurance risks

Insurance risks for Alm. Brand relate to both non-life insurance risks, i.e. risks relating to non-life insurance products and biometric risks relating to life insurance and pension products.

### 6.1 Non-life insurance risks

The calculated, earnings-generating risks are primarily assumed as premium risks (upon acceptance of the policy), reserve risks (risk of provisions being too low in comparison to the cost of the loss) and emergency risks (extreme events costs). There are also primary risk sources such as market risks (changes in interest rates, share prices and exchange rates), credit risks, default risks and operational risks. Furthermore, there are a number of other derivative risks such as strategic risks, liquidity risks as well as reputational risks in carrying on non-life insurance business.

In all significant areas, it has been considered what the desired risk profile of non-life insurance is. Business processes and controls have been developed in this respect, and the Board of Directors and the Management Board of Alm. Brand Forsikring A/S receive reports on a regular basis.

#### Premium risks

This is the risk that expenses related to losses and costs exceed earned premiums. The risks are assessed for each type of business, for which reason there are several premium risks. The overall directions as to what classes of insurance may be written have been laid down by the Board of Directors, and this includes rules for the company's maximum own retention per risk and per loss event. Acceptance and writing rules exist at customer and product level. Written risks are assessed for policies that may possibly be affected by the same loss event. Directions have been laid down as to what risks each seller may accept.

Once or twice a year, the quality assurance department performs controls (Closed File Review) on a sample basis on all significant products written and sales channels. Findings and proposals for focus areas are reported to the Management Board, managers in charge as well as the internal audit department.

Pursuant to section 71 of the Danish Financial Business Act, the Board of Directors has defined rules for the introduction of new products. Before a new significant product is introduced, analyses of profitability, potential market, operational and credit risks need to be performed.

Products written and particularly large risks written are reported on a monthly basis. Writing of risks exceeding a specified limit has to be approved by the Management Board and subsequently by the Board of Directors. Developments in the individual lines are tracked on a monthly basis by means of reports to the Management Board and the Board of Directors.

## **Reserve risks**

Reserve risks mean that the provisions made are too low in comparison to the ultimate cost of losses. Adequate provisions are made by actuaries on the basis of recognised statistical methods. Provisions are based on extracts from the business systems.

The provisions committee holds quarterly meetings. The participants are representatives from the different non-life insurance departments. The committee was established to ensure quality in the calculations of provisions.

Changes in provisions are reported every month. The report includes any run-off profits or losses on prior years' claims as well as developments in the year under review.

## **Catastrophe risks**

Catastrophe risks are those related to extreme events. The largest single risks in non-life insurance are risks of windstorm/hurricane and terrorist attacks. In 2009, Alm. Brand Forsikring set up a model for the company's weather-related expenses. The model has been used on a regular basis to assess the size of risks associated with windstorm or cloudburst claims and it has also become an integral part of the process relating to renewal of Alm. Brand's reinsurance.

Catastrophe risks are covered through reinsurance. Once a year, the Board of Directors defines and approves the reinsurance strategy. This strategy outlines requirements for range of cover, self-retention, required rating of the reinsurance companies, etc. The reinsurance department is responsible for the tactical and operational handling of reinsurance.

## **6.2 Biometric risks**

Biometric risks primarily consist of mortality and disability. The risk premium of market value provisions covers any future fluctuations of up to 10% in relation to mortality and disability.

The risk of disability and death is restricted by directions as to how large a risk the company may assume. It is Alm. Brand Liv & Pension's policy not to write risk coverage without individual health statements having been submitted. Also, the risks are restrained through proportional reinsurance to the effect that anything exceeding a specific amount of capital at risk is reinsured.

Changes in mortality and disability are monitored on a current basis, and the market value parameters used to calculate market value provisions are assessed at least once a year.

## **6.3 Default risks**

Default risks are primarily the risk of Alm. Brand's reinsurers going into liquidation to the effect that part of the receivables may be lost and new coverage of the business will have to be purchased. Default risks can be divided into the following two elements:

- risks of reinsurers not being able to pay, and

- risks of reinsurers going into liquidation, for which reason Alm. Brand will have to purchase new coverage of Alm. Brand Forsikring's business.

To minimise the risk for each reinsurer, the reinsurer should as a main rule at least be rated as A- with Standard & Poors, Moody's and/or A.M. Best. Departures from the main rules need to be approved by the Board of Directors. The reinsurance department is responsible for currently following up on the reinsurers' ratings.

## 6.4 Policy and responsibility

### Non-life insurance

Alm. Brand writes insurance for individuals, agricultural establishments as well as for small and medium-sized business enterprises. The acceptance policy contains rules as to what type and size of risks may be written on a contract.

Written risks are estimated and assessed for insurance policies (accumulated) that may possibly be affected by the same loss event. A fixed procedure is observed when new products are introduced for purposes of ensuring correct risk assessment and pricing.

### Reinsurance

To reduce the risk of losses from insurance events, risks exceeding the determined maximum are reinsured.

The purpose of the reinsurance programme is to ensure that a single loss event or a random build-up of large losses cannot lead to an unacceptable loss of capital and also to reduce the size of fluctuations in technical results.

The reinsurance programme which i.a. contains determination of the Alm. Brand Forsikring's self-retention in various events is adopted annually by the Management Board and the Board of Directors.

The need for reinsurance is assessed currently based on experience from the programme's efficiency. Market experience, the company's capital resources and prices for reinsurance cover are also included in the assessment.

The reinsurance programme for 2010 has been prepared applying the same guidelines as in 2009. For 2010, Alm. Brand has purchased catastrophe reinsurance up to DKK 4.4bn with self-retention of DKK 150m.

Coverage is DKK 400m for property damage and up to DKK 700m for personal injury on personal accident and workers' compensation. The self-retention amounts to DKK 30m and DKK 20m, respectively, per event. In addition, frequency cover has been taken out on large property claims covering large fire claims between DKK 7.5m and DKK 30m. However, the cover will not take effect until Alm. Brand has incurred claims in the aggregate amount of DKK 125m for this type.

In order to ensure hedging of losses as a result of windstorm/hurricane, the group works with a number of windstorm scenarios based on the portfolio's exposure and on calculated probability. The total cost to Alm. Brand of a 100-year windstorm event is estimated at DKK 254m, partly as a result of self-retention, and partly for payment of reinstatement premiums on the windstorm insurance programme.

The risk to Alm. Brand from a terrorist attack is considered to be covered by the reinsurance programme or excepted in the ceded coverage.

If the company proposes changes to existing products' scope of coverage or wants to implement brand new products, these are presented to the reinsurance department for assessment. This is done to ensure that the Alm. Brand Group continuously complies with the company's reinsurance policy and reinsurance manual.

Faulty construction insurance is a new product in Alm. Brand's portfolio, and the company has therefore chosen a prudent risk strategy for this segment. Risk assessments are conducted on a regular basis, and the faulty construction insurance is covered proportionally to the effect that Alm. Brand cannot be made to pay more than DKK 30m.

## **Copenhagen Re**

Copenhagen Re was divested in the autumn of 2009 and will therefore no longer form part of Alm. Brand's risk reporting and monitoring.

## **Life insurance**

In Alm. Brand Liv & Pension, the policy is to not write any business without the customer disclosing personal health information. This requirement means that the company has deliberately opted not to write typical labour market pensions, as such pensions may be set up without personal health information.

The principal insurance risks are related to insurance with a guaranteed average benefit. Until 1994, the life group wrote policies with average guaranteed benefits of 4.5% after tax on pension investment returns. From 1994 to 1999, the benefit was 2.5% after tax on pension investment returns, and since 1999 it has been 1.5%. Alm. Brand Liv & Pension focuses on hedging the guaranteed benefits provided, applying derivative instruments to ensure that interest rate risks on assets and liabilities remain at a similar level.

Changes in the value of investment assets resulting from changes in interest rates are partly offset by corresponding changes in the value of the technical provisions and the collective bonus potential. As a result, shareholders' equity may, however, be affected if the average return generated over the life of the policies fails to cover guaranteed benefits.

Other material risks relating to Alm. Brand Liv & Pension mainly involve financial risks, which we seek to balance with the insurance liabilities as much as possible.

The investment assets that correspond to Alm. Brand Liv & Pension's shareholders' equity are held in a separate account. At 31 December 2008, this account had a relatively short duration, limiting the risks of price falls triggered by interest rate fluctuations.

## 6.5 Monitoring

Alm. Brand Forsikring has introduced a number of measures to ensure that the group's rules, including acceptance policies are complied with and kept up-to-date, and that current reporting takes place on all significant business risks.

### Compliance with acceptance policies

A large number of ad hoc random tests are performed on a regular basis in specific sub-areas, which are reported to the Management Board. Also, customer satisfaction surveys are performed annually for the customers that have taken out insurance in the previous year.

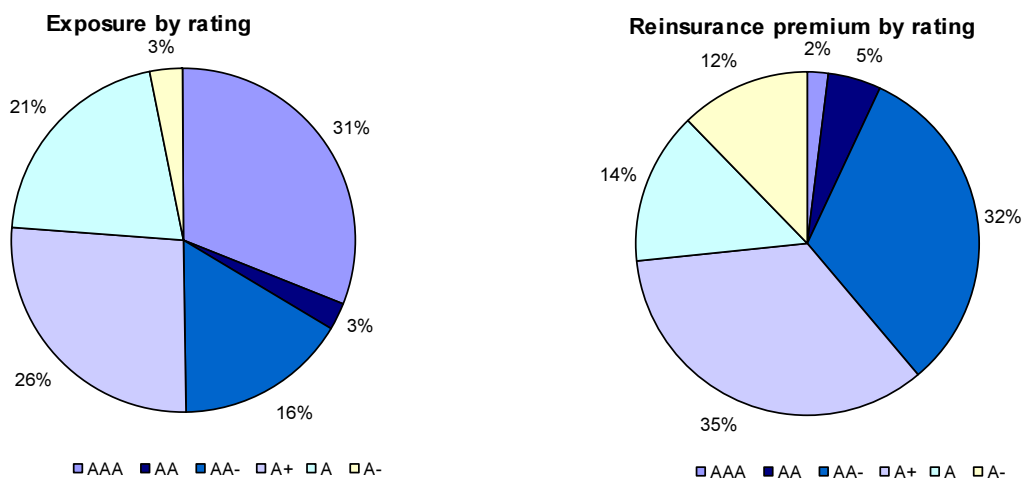
Based on the results of these random tests, it is determined whether the acceptance policy has been observed and on this basis, a number of proposals are prepared for implementation of improvements. This may i.a. imply updating of business processes, additional training of employees, restructuring of competencies for several employees and increased quality measurement.

### Reinsurers' ratings

Alm. Brand Forsikring aims to ensure that the minimum rating requirements set by the Board of Directors of Alm. Brand Forsikring are fulfilled by reinsurers, with whom Alm. Brand Forsikring A/S has placed or considers placing business.

This takes place via a current monitoring of relevant reinsurers, where a drop in ratings with Standard & Poors, Moody's and/or A.M. Best, respectively, to below A- will cause a review of contract to examine the reinsurer's solvency situation and the related risks for Alm. Brand. It will then be decided whether Alm. Brand wishes to continue the relevant contract and, if yes, under what terms.

The current distribution of Alm. Brand Forsikring's premium and exposure broken down by S&P rating is shown in the chart below.



## 7 Other risks

Aside from credit risks, market risks and business risks, there are a number of other areas where it is relevant to assess the potential risks.

The types of risk the Alm. Brand Group includes in its aggregate risk assessment comprise:

- Operational risks and control environment
- Other business risks, including
  - External risks
  - Reputational risks
  - Growth in business volume
  - Earnings
  - Risks in relation to the company size
  - Strategic risks
  - Settlement risks
- Other issues

### 7.1 Operational risks and control environment

Operational risks may include human errors, IT downtime or a head office destroyed by fire. The risk implies inability to maintain the daily operations and the daily activities.

Examples of risk sources for operational risk in a financial services company may include:

- Inadequate recording
  - Lacking recording of data relating to losses, payments, premiums, etc. and poorly running system with feeble interaction
  - Poor or no data discipline
  - Poor or no reporting data
- Inadequate or outdated training level
- Inadequate descriptions/business processes for operational tasks, etc.
- Access to systems not adapted to the individual employee's knowledge
- Key resource issue

Risks involved in control environments are those that the controls are implemented unsystematically or inadequately. Examples of risk sources for the control environment in a financial services company may include:

- Controls in preparing accounting figures
- Controls in writing business, damage processing, etc.

## Policy and responsibility

The Alm. Brand Group's operational risks and control environment are currently assessed with a view to ensuring the necessary safeguards, controls and contingency planning. The extent of these safeguards is balanced against the expenses related to the initiatives.

Safety measures are assessed in relation to the threats and the probability to which the group is considered exposed. The business consequences that may arise if the threats materialise are also assessed.

The continuous risk assessment helps to ensure that the operational risks are limited, implying that the group at an acceptable risk level that matches the requirements and expectations of internal and external stakeholders.

The Alm. Brand Group has a number of control procedures in the form of work routines, business processes and reconciliation processes that are embedded both locally and centrally in the organisation. These procedures, the organisational segregation of functions between the executing and controlling departments and training of staff help minimise the operational risks.

## IT

In the event of long-term physical or IT breakdown, Alm. Brand's most vital business functions must be continued and re-established. The Board of Directors has in that connection approved a number of objectives for the emergency preparedness of the group. The objectives have been implemented in the form of a centrally managed emergency organisation, evacuation plans, emergency manuals in the individual departments, a robust basic IT-technical set-up as well as a focus on standardisation of both processes and IT.

The Alm. Brand Group works continually on enhancing IT security. IT security of Alm. Brand is based on an IT security policy adopted by the Board of Directors. The policy lays down the general requirements for IT security to ensure that the Alm. Brand Group's aggregate IT application takes place in a safe and controlled way. The policy has been made operational in i.a. IT security guidelines, directions to users and through measures and business processes.

The physical IT security and operational security in the group is further enhanced by the central banking systems being operated by Bankdata, and the group's other central IT equipment and systems being located with the external IT cooperative partner, IBM SDC DK A/S. The operational risks in this area have, accordingly, been reduced substantially. Alm. Brand also continuously updates and manages the IT production based on three general initiatives: Management of all IT-related changes in Alm. Brand based on a number of pre-defined change procedures, management of all IT-related projects and management of all IT-related tasks.

A number of areas are also subject to IT support to reduce the risk of errors. All acceptance policies for life insurance are, for instance, to the extent possible sought integrated in the applied systems, including in the applied sales tool. Accordingly, a number of risk reducing measures such as validations, cross-check rules and similar system checks have been implemented in these systems.

### Audit

As part of the internal audit department's work, a current, comprehensive and independent audit is performed to ensure that defined work routines and business processes have been prepared satisfactorily and that they are observed by the personnel. As a supporting element to the internal audit, an external IT audit is performed on both own elements and the elements located at, for instance, Bankdata and IBM.

### Training

Training of personnel is handled by external providers and by the Alm. Brand Academy. A general training policy has been drawn up for Alm. Brand. The contents of this training policy are currently considered, including the competences required for each job. In accordance with this training policy, training plans are prepared for all employees and employee groups.

### Key staff

The key staff issue is addressed in a key staff policy which i.a. comprises a number of increased requirements for specific job descriptions. Specific resignation clauses have also been laid down for key staff.

### Compliance department

Alm. Brand has set up a compliance department. This cross-firm function has been established to ensure that Alm. Brand observes effective laws, rules, internally defined rules and guidelines and ethical standards.

Alm. Brand A/S assesses on an ongoing basis the necessary capital for the group's operational risk for both Alm. Brand Bank and Alm. Brand Forsikring. If this is deemed to exceed the allocated amounts, this will be taken into account in the calculation of the aggregate individual capital requirements.

## **7.2 Other business risks**

Aside from credit risks and business risks, business risks also comprise risks of losses as a result of changes in external circumstances or events that inflict damage on the group's image or earnings. Business risks also include growth, risk relating to reductions in earnings, risks relating to company size, risks as a result of strategic decisions and risks relating to settlements.

### **External risks**

External risks comprise risks that outside factors may affect the individual solvency need. These may be risks that arise as a result of changes in legislation or financial and business conditions.

The insurance area is subject to new legislation as insurance terms and coverage become out of date. Legislation has a direct consequence on the risk, a company is exposed to. As to workers' compensation insurance, the Danish supreme court may in its ruling on individual cases establish a precedent for certain types of injuries which may subsequently lead to the reopening of a large number of similar cases.

In recent years, several cases of occupational disability have been settled by the supreme court resulting in greater compensation. The Danish Act on Liability for Damages was subject to a major revision in 2002.

As a professional company, Alm. Brand aspires to participate in and contribute to the pre-legislative work phase (i.a. through the organisation Forsikring & Pension) in order to influence future legislation favourably.

The courts' interpretation of new legislation may, however, trigger latent claims which have escaped focus previously. In that case there is the possibility to let the price development reflect the legal practice - i.e. to perform a subsequent adjustment of premiums, however only with prospective effect.

Economic conditions affect Alm. Brand's calculation of the individual solvency need as the economic development will have an impact on credit portfolio quality and bonus potential in Liv & Pension. Also there is a tendency to a higher claims frequency during economic downturns.

Alm. Brand uses scenario and sensitivity analyses to illustrate the potential impact on the group's capital needs and capital base. Such analyses are included in the assessment of the individual solvency needs.

### **Reputational risks**

Reputational risks are risks resulting from a poor reputation.

Alm. Brand makes an active effort to reduce reputational risks through controls and business processes. Alm. Brand Forsikring also houses a quality department which applies consumer surveys and random testing, etc to assure quality in the business on an ongoing basis. The Alm. Brand Group has established business processes for press alert to handle any events that may lead to poor press coverage.

### **Growth in business volume**

When volume increases, more capital should be retained to accommodate more liabilities than required at present. It is therefore relevant to also consider risks in the event of a potential unfortunate future development. This is monitored on an ongoing basis.

### **Earnings**

It is relevant for a company to evaluate its earnings in relation to earnings capacity, stability, etc. Low or unstable earnings may suggest that the company will sustain increased difficulties in absorbing potential losses in the future. The Alm. Brand Group aspires to have a pricing policy implying that the relation of price to risk ensures earnings in all lines and business areas.

### **Risks in relation to the company size**

Various conditions may trigger risks in relation to the company size. These risks are closely related to operational risks and control environments, and for Alm. Brand they are considered covered by such operational risks and control environments.

## **Strategic risks**

Strategic risks are the risks involved in the group's strategic decisions.

The Alm. Brand Group's strategy is developed on the basis of a structured process by the senior management in cooperation with each board of directors, management board and managerial group in the group's subsidiaries. The group has also adopted a structured process to follow up on the implementation of the individual strategies.

## **Settlement risks**

Alm. Brand believes that settlement risks have been sufficiently covered by controls and business processes.

## **7.3 Other issues**

There are a number of other issues which do not fall directly within any specific risk type, but which nonetheless are considered as relevant to include in a risk assessment for the group as whole. For Alm. Brand, these issues are primarily:

### **Decline in operating income**

For Alm. Brand Bank, a potential decline in interest and fee income and other operating income is included in the aggregate risk assessment.

### **Forenede Gruppeliv**

For Alm. Brand Liv & Pension, the portfolio consisting of the holdings under Forenede Gruppeliv is closely monitored, and the premium is adjusted annually.