

# Risk and Capital Management 2010

**Alm. Brand A/S**

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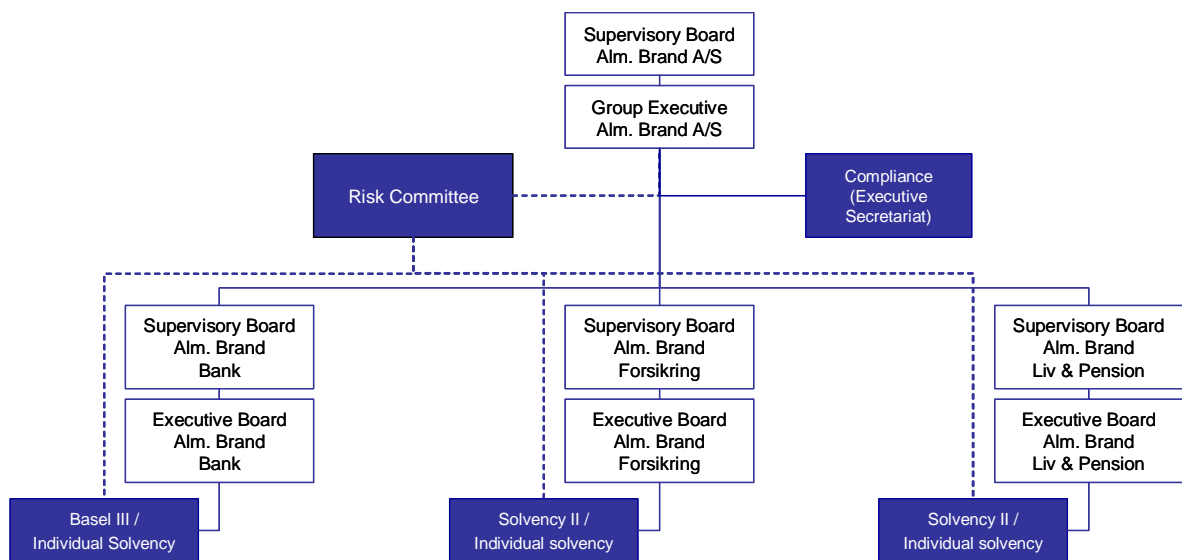
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# 1 Organisation

In compliance with Danish legislation, Alm. Brand A/S and all of the group's subsidiaries have a two-tier management system with a board of directors and a management board. The responsibilities and tasks of the Board of Directors and the Management Board are defined in the rules of procedure for the Board of Directors, which have been adopted by the Management Board. Managing the group's risk exposure is a key executive focal area, because non-controlled developments of the various risks may have a substantial impact on the group's financial performance and solvency and, by extension, its future business opportunities.

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



Alm. Brand has set up an intra-group risk management committee to ensure coordination and uniformity in the group companies with respect to assuming, calculating and reporting risk across individual business areas. Members of the risk management committee are the chief executives of Alm. Brand A/S, Alm. Brand Forsikring A/S, Alm. Brand Liv og Pension A/S and Alm. Brand Bank A/S, the chief financial officer and the marketing manager. Other members include heads of the credit secretariat, the actuarial department and the capital management section of the risk management department.

In addition, an approval committee for financial products has been set up. This committee is responsible for ensuring that business procedures, processing routines, etc. are in place before new products or activities are implemented, thereby helping to mitigate operational risk. Members of the product approval committee are heads and employees from the cross-functional risk management department and from Markets.

The handling of business risks is managed in each individual business area. The managements of each business area are thus responsible for identifying, quantifying and monitoring all risks relevant to the individual business areas and for defining and implementing relevant risk-management controls and strategies.

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

In addition, Alm. Brand has set up an investment committee, the purpose of which is to handle the strategic allocation of assets in the group. The investment committee is responsible for the group's investment activities and determines them on the basis of limits and policies adopted by the boards of directors of the individual companies. The members of the investment committee are coincident with the members of the risk management committee. Furthermore, the head of Market Risk Management of the risk management department and the heads of Financial Markets attend the meetings.

Independently of management-implemented controls, the internal auditors conduct regular independent reviews of the group's control procedures and verify compliance with management's guidelines.

## 1.1 Audit committee

The boards of directors of Alm. Brand A/S, Alm. Brand Forsikring, Alm. Brand Liv og Pension and Alm. Brand Bank have each set up an audit committee. Alm. Brand Bank's audit committee also performs this task for the subsidiary Alm. Brand Formue A/S.

The audit committees of all these companies consist of three board members:

- Jørgen H. Mikkelsen (chairman)
- Boris N. Kjeldsen
- Arne Nielsen

Arne Nielsen contributes special competencies within auditing and accounting. Arne Nielsen is a state-authorized public accountant with a deposited licence and an independent member of the Board of Directors.

The audit committees support the boards of directors in their work with and supervision of

- The annual reports, including checking the accuracy of financial information disclosed in the annual report, and ensuring that accounting policies are relevant and have been consistently applied,
- Internal control and risk management, including reviewing and assessing management's guidelines with a view to identifying, monitoring and managing the most important risks at least once a year. The audit committees also assess and review internal control and risk management systems, and

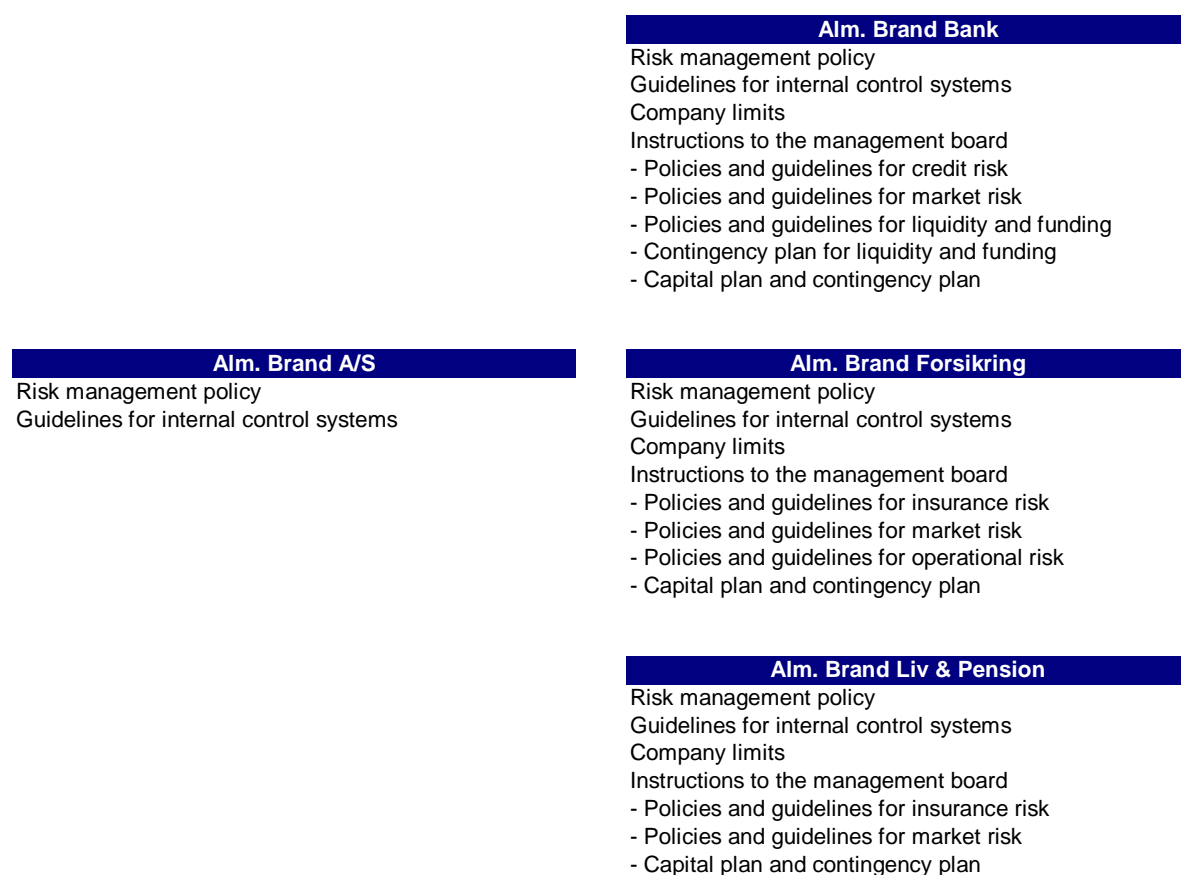
- Internal and external audit, including reviewing and discussing the results of the work of the internal and external auditors and the auditors' observations and conclusions. The committees supervise management's follow-up on the recommendations to management reported by the internal and external auditors.

The audit committee held four meetings in 2010. The audit committees are generally not involved in forward-looking events such as outlook and budgets.

## 1.2 Responsibility

To be able to currently manage and assess the risks that the Alm. Brand Group accepts, the group has drawn up and adopted policies and guidelines for the boards of directors of all subsidiaries which define the risk tolerance of the company and how the Board of Directors wishes to manage the individual risks.

The figure below shows the structure of Alm. Brand A/S' guidelines and policies at board level in relation to risk management.



The guidelines and policies are determined and approved by the boards of directors at least once a year. Guidelines for the management boards are prepared on the basis of the approved policies. It is then the responsibility of the respective companies to comply with these policies and guidelines.

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

Policies and responsibilities in respect of the group's material risks are described in further detail under each risk type in this document.

## **1.3 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 integral 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 regularly informed about developments 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 developments 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.

### **Quarterly reporting**

The individual solvency need is recalculated each quarter and the Board of Directors is informed in the event of significant changes.

Quarterly reports on compliance with the group's risk appetite are prepared for the cross-organisational risk management 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 basis for the current risk management in the relevant companies and business areas.

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

The bank and the insurance companies are subject to the provisions on required capital base, which limits the scope for the distribution of dividends. In addition, the bank packages limit Alm. Brand Bank's scope for distributing dividends.

## 2 Capital management

Alm. Brand Bank remained affected by the financial and economic crisis in 2010, resulting in impairment writedowns of DKK 836 million in the Alm. Brand Bank A/S parent company. DKK 149 million of this amount was written down in the fourth quarter of 2010 including credit losses on mortgage deeds.

Alm. Brand Bank has estimated impairment writedowns for the period until 31 December 2012 at DKK 550 million provided the assumptions with respect to the economic situation hold.

The board of directors of Alm. Brand Bank increased the individual solvency need from 10.3% at 31 December 2009 to 14.9% at 31 December 2010, equivalent to an increase of the solvency need of approximately DKK 400 million.

In the beginning of 2010, Alm. Brand Forsikring recorded extraordinary winter-related claims of DKK 282 million, DKK 200 million of which was attributable to snow load claims. The third quarter of 2010 also saw an increase in weather-related expenses when Copenhagen and North Zealand were hit by a violent cloudburst.

In December 2010, Alm. Brand A/S completed a rights issue which produced net proceeds of approximately DKK 1.5 billion.

The requirements for the capital bases of Alm. Brand Bank and Alm. Brand Forsikring are expected to increase as a result of the Solvency II and Basel III rules. The Solvency II Directive is expected to be implemented in the Danish legislative framework with effect from 1 January 2013. Basel III will have to be implemented at EU and national level before they become applicable to Danish banks. The current plan is for the first elements of Basel III to be phased in from 1 January 2013.

In order to ensure that the capital base is adequate to comply with the new rules, the capital targets have been revised. The new capital targets, which are higher than the previous ones, are set out in section 2.2.

Below is a description of the capital management and the method for calculating the capital requirement of the Alm. Brand Group. In addition, the calculation of the adequate capital base of Alm. Brand Bank is shown.

### 2.1 Capital management in the Alm. Brand Group

An intra-group risk management committee has been set up to ensure coordination and uniformity with respect to assuming, calculating and reporting risk across the individual business areas.

## 2.2 Internal capital target

The capital targets for Non-life and Life Insurance are calculated on the basis of the expected level of Solvency Capital Requirements (SCR) under the Solvency II rules (expected QIS 5 levels) with the addition of a buffer calculated on the basis of a wish to ensure sufficient excess capital adequacy also after the occurrence of any external and not unthinkable events outside the group's control. In order to make these capital targets operational in day-to-day management and to make them transparent, the calculated capital target for Non-life Insurance has been translated into a fixed percentage of gross premiums.

As for Life Insurance, the capital target is translated into a fixed percentage of life insurance provisions.

The method is measured and assessed on an ongoing basis and the fixed percentages representing the capital targets will naturally be adjusted if the Solvency II requirements are changed significantly or if the scope of business or risk profile of the insurance companies change significantly.

Management's new capital target for Non-life Insurance results in an expected level of SCR plus a capital buffer of 30%, estimated to amount to an aggregate of 45% of gross premiums. With the capital buffer, Non-life Insurance – over and above the caution already inherent in the SCR rules – has calculated a sufficient excess capital adequacy to withstand the calculated total expense of DKK 350 million of two more major 100-year storms with a full retention and a brief period of negative earnings. If storms or other extreme weather conditions do not occur, the capital buffer allows Non-life Insurance to absorb almost two years with a combined ratio at a level of 105. It is assessed that this will enable management to implement the necessary managerial measures to overcome any further negative events.

The capital target for Life Insurance has been determined with due consideration for the fact that SCR in Life Insurance is highly volatile. The reason for this is that Life Insurance assets are volatile and sensitive to interest rate fluctuations and that the ability to set off collective bonus potential and borrow against paid-up policies varies according to interest rate levels etc. The capital target at 31 December 2010 was considerably greater than the capital requirement under the current rules, but has been determined to ensure the desired excess relative to the capital requirement under a number of specified stress scenarios, meaning that Life Insurance will be able to withstand interest rate fluctuations without customer returns being unduly reduced through forced sales or an overly cautious and expensive hedging strategy.

Management has decided to focus on risk in the form of the volatility of provisions rather than calculate the capital target based on premium levels. Against this background, management has defined the capital target for Life Insurance at 9% of life insurance provisions.

The capital target of the Alm. Brand Bank parent company has been calculated on the basis of the estimated effect of the Basel III rules and a wish always to maintain an excess capital adequacy relative to the individual solvency need. The capital target chosen has been calculated as a percentage of risk-weighted assets and is determined as the higher of 13% and the individual solvency need plus 3 percentage points. The capital target of the Alm. Brand Bank Group includes a supplement corresponding to the equity in subsidiaries which are not wholly owned.

It is considered unlikely that all three companies will be hit by extremely negative events simultaneously and, as a result, the capital target of the Alm. Brand Group is determined as the sum of the capital target of the three subsidiaries less a diversification effect of DKK 300 million.

The table below shows the capital base and capital targets of Alm. Brand A/S:

<b>Capital target</b>	<b>DKKm</b>	<b>Capital base</b>	<b>DKKm</b>
Non-life insurance (45% of gross premiums)	2.143		
Life insurance (9% of life insurance provisions)	984	The group's equity	4.758
Alm. Brand Bank (17.9% of risk-weighted assets)	2.568	Intangible assets	-82
Alm. Brand Bank subsidiaries	342	Tax assets	-660
Diversification effect	-300	Supplementary capital	1.803
<b>Total capital target</b>	<b>5.737</b>	<b>The group's total capital base</b>	<b>5.819</b>
<b>The group's statutory capital requirement at 31 Dec. 2010</b>			<b>3.748</b>
<b>Excess relative to statutory capital requirement</b>			<b>2.071</b>
<b>Excess relative to internal capital target</b>			<b>82</b>

The excess relative to the capital target was DKK 82 million at 31 December 2010. The group's capital base includes subordinated and hybrid capital. The group intends to redeem the supplementary capital when possible. As a result, management does not expect the company to pay dividends until after the end of the current strategy period, which expires at the end of 2012, and then only if group earnings are satisfactory and the internal capital target has been met.

In the spring of 2010, Alm. Brand A/S undertook to contribute sufficient capital to Alm. Brand Bank to ensure that Alm. Brand Bank will always meet the higher of the solvency requirement and the individual solvency need of Alm. Brand Bank. This undertaking is limited to the higher of DKK 1 billion, of which DKK 850 million was injected in the fourth quarter of 2010, and the net proceeds receivable by Alm. Brand A/S up to and including the company's annual general meeting in the spring of 2017 from borrowing from the company's principal shareholder, Alm. Brand af 1792 fmba, and from distributions from the company's subsidiaries, however, limited to a maximum of DKK 2 billion.

### 2.2.1 Future compliance with capital requirements

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.

#### 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 solvency requirement.

Future scenarios in 2011 and the negative factor in the scenarios:

Scenarios in Alm. Brand A/S	
Claims risk	
Windstorm scenario	A scenario in which Denmark is hit by two windstorms of EUR 2 billion.
Snow load and cloudburst scenario	Snow load and cloudburst as experienced by Alm. Brand in 2010.
Run-off in non-life insurance	Run-off losses in 'Commercial building' and 'Private building and change of ownership' as experienced by Alm. Brand in 2008.
Market risk	
Spread widening	100 bp widening of the yield spread between mortgage bonds and the swap curve (approximately equal to the average widening from the autumn of 2008 to the spring of 2009).
Credit risk	
Losses on mortgage deeds	Alm. Brand Bank has additional losses and impairment writedowns equal to 13% of the mortgage deed portfolio.
Group	
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 management committee each quarter in connection with the monitoring of Alm. Brand's risk tolerance. At 31 December 2010, the Alm. Brand Group would remain solvent in all scenarios but it would be necessary to transfer capital to the bank in case of a coincidence of 'Spread widening' and 'Losses on mortgage deeds'.

## 2.3 Calculation of individual solvency need and aggregate capital requirement

The rules for calculating the capital requirement for banks and financial holding companies and for insurance companies are set out in the Executive Order on Capital Adequacy and the Executive Order on Solvency and Operating Plans for Insurance Companies, respectively.

The aggregate capital requirement for the individual companies is calculated as the maximum of the minimum capital requirement, the solvency requirement and the adequate capital base and/or the individual solvency need. The aggregate capital requirement of the Alm. Brand Group is calculated as the sum of the aggregate capital requirements of the subsidiaries.

### 2.3.1 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 applied. The calculation method is in compliance with "Guidelines on adequate capital base and solvency need for credit institutions" and "Guidelines on the calculation of the individual solvency need" (for insurance companies) as well as the principles for determining credit risks agreed with the FSA.

In the Alm. Brand Forsikring Group, QIS 4 stress has been used to calculate the solvency need for Pillar I risks.

#### Model set-up

The table below shows how different risks are assessed in Alm. Brand.

Risks	The Alm. Brand Bank Group Methods described by the FSA	Insurance Group QIS 4 stress	The Alm. Brand Group Internal models
<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		X
Concentration risks			X

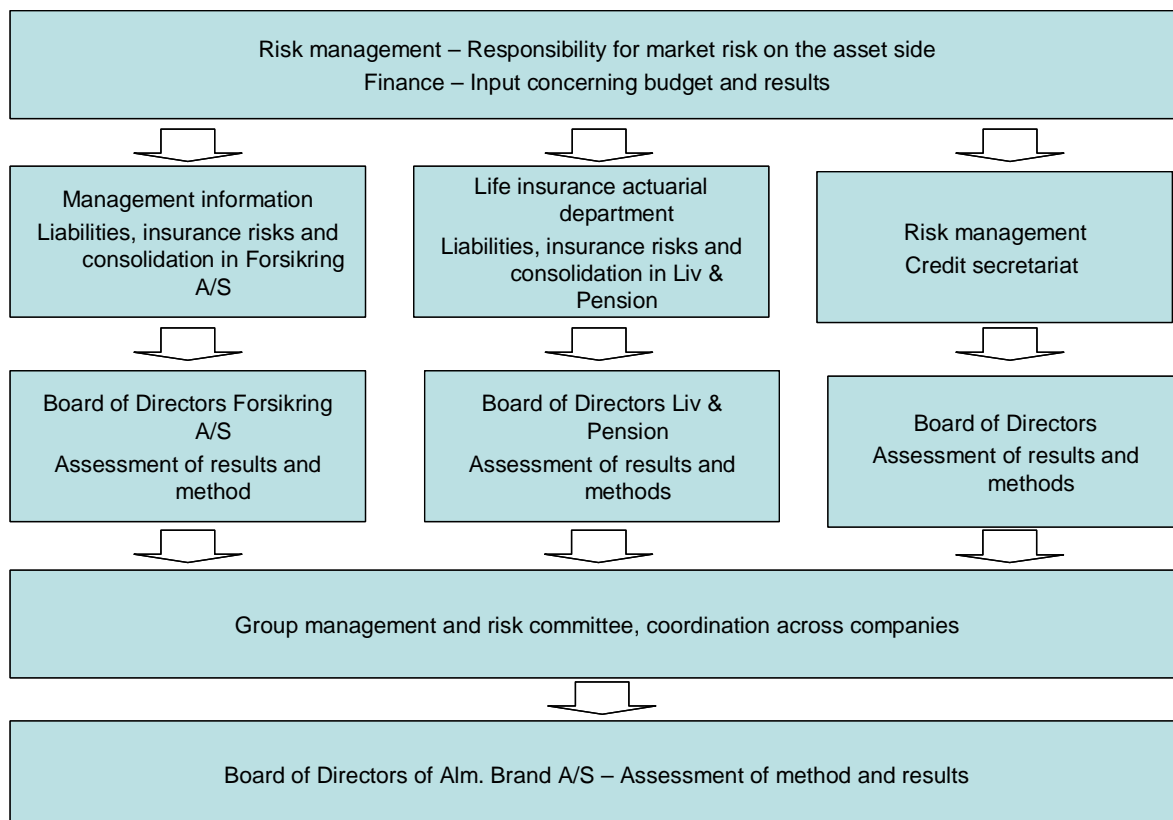
The aggregate capital requirement is, accordingly, calculated for all of the group's companies subject to supervision. For Alm. Brand Bank and the entire Alm. Brand Group, the individual solvency need is calculated by comparing the adequate capital base with the risk-weighted assets.

## 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.

The cross-functional risk management department 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 performing the independent evaluation of the calculation of the individual solvency need.

### **Alm. Brand Bank**

Alm. Brand Bank's calculation method for credit risks:

- A general loss level determined on the basis of the bank's historical losses and the historical losses in the industry.
- A supplement for weak exposures determined on the basis of likelihood of default multiplied by an estimate of the loss given default. These have been determined in accordance with the guidelines of the FSA. In addition, management has reviewed exposures exceeding 1% of the capital base.
- Supplement for concentration risks: Large exposures and concentration on property collateral.

Alm. Brand Bank's calculation method for market risks:

The calculation of the individual solvency need on positions with market risk is based on the guidelines of the FSA. The applied calculation approach is described below.

The calculation of the solvency need on positions with interest rate risk is based on the higher capital charge of (1) a yield curve twist of 70 bp to the detriment of the bank, the curve being broken down into positions with a duration of more or less than one year, respectively, and (2) a stressing of positions within and outside the trading portfolio of 200 bp.

The solvency need on equity positions is calculated by stressing equity positions in the trading portfolio by 30%, while equity positions in the investment portfolio in sector shares, the objective of which is to support the bank's operations, are stressed by 15%.

The capital charge on currency is calculated on the basis of the FSA's exchange rate indicator 1, the euro position being stressed by 2.25%, while other currencies are stressed by 12%.

For the purpose of calculating the solvency need on derivatives with counterparty risk, the market value of derivatives is stressed by 8%. The credit risk on the bank's portfolio of bonds is calculated on the basis of the FSA's guidelines on disclosure of capital structure and risk in insurance companies.

The calculation of operational risk is based on the basis indicator method, which calculates the operational risk as 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 individual solvency need results of the Alm. Brand Bank A/S parent company are illustrated in the figure below.

RISK TYPE	REQUIRED CAPITAL (DKKM)	% OF RISK-WEIGHTED ASSETS
Credit risk	1,807	12.6
Market risk	262	1.8
Operational risk	60	0.4
Other risks	9	0.1
Total	2,138	14.9

### **Alm. Brand Forsikring A/S**

The individual solvency need is tracked on a monthly basis and reported to management.

There is freedom of choice in terms of the methodology applied for calculating the individual solvency need. In 2010, Alm. Brand Forsikring used the QIS 4 standard model for calculating Pillar I risks (insurance risk, market risk and operational risk) and a number of stress tests for quantifying the solvency need for other risks.

In the autumn of 2010, Alm. Brand Forsikring A/S participated in the latest test calculation/consequence analysis (QIS 5) for Solvency II. QIS 5 gives rise to the following material changes:

- Recalibrated parameters in the standard model for the solvency requirement.
- The treatment of the solvency requirement in subsidiary insurance companies has been changed. The current legislation provides for deduction of the solvency requirement from the parent company's capital base (section 131(4), no. 1, of the Danish Financial Business Act). QIS 5 makes no deduction from the capital base but provides for a supplement to the parent company's solvency requirement.
- The calculation methods used for provisions differ from those applied in the financial statements.

## 2.4 Composition of capital in Alm. Brand

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

DKKm	Alm. Brand Bank	The Alm. Brand Group
<b>Shareholders' equity / Core capital</b>	<b>1,564</b>	<b>4,758</b>
Proposed dividends	0	0
Intangible assets	0	0
Deferred tax assets	-395	-520
<b>Core capital less primary deductions</b>	<b>1,169</b>	<b>4,238</b>
Hybrid Tier 1 capital (section 132, without transition scheme)	175	175
Hybrid Tier 1 capital (section 132 a, transition scheme)	<b>854</b>	<b>854</b>
<b>Core capital, incl. hybrid Tier 1 capital, less primary deductions</b>	<b>2,198</b>	<b>5,267</b>
Other deductions (half the solvency need in subsidiaries)	0	-676
<b>Core capital, incl. hybrid Tier 1 capital, less deductions</b>	<b>2,198</b>	<b>4,591</b>
Supplementary capital	375	625
<b>Capital base (before deductions)</b>	<b>2,573</b>	<b>5,216</b>
Deductions in capital base (half the solvency need in subsidiaries)	0	-676
<b>Capital base (after deductions)</b>	<b>2,573</b>	<b>4,540</b>
<b>Solvency ratio</b>	<b>17.9%</b>	<b>28.0%</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 to 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 legislative changes, financial market trends, market practices and conditions, etc.

For Alm. Brand Forsikring, credit risks are relevant for the financial instruments and the risk that reinsurers are unable to meet their obligations. The former risk is described under 'Spread risk' in the market risks section, while the latter risk is described under insurance risks (default risk). Therefore, this section on credit risks only involves 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. Material changes are discussed by the bank's board of directors, and it approves the overall credit policy once a year.

#### Credit policy

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

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.

Alm. Brand Bank grants loans to private customers and, to a limited extent, to leasing and to investment credits in Markets.

The bank's lending to private customers is based on the application of credit scoring models and calculations of budgets and disposable income. The credit scoring models have been developed over a number of years. The models are still being developed and improved on the basis of recent experience and changes in market trends. Credit scoring models are applied to secured as well as unsecured loans.

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.

In the commercial customer segment, which is in the process of being wound up, loans are only granted in connection with credit defence when it is deemed to reduce the bank's risk of losses.

## 3.2 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 overdrafts,
- 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 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.

Alm. Brand Bank operates in almost all lending areas with concepts that define whether a customer is in default or not. The bank has therefore in several lending areas extended the 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.

### 3.4 Risk reduction

Alm. Brand Bank applies financial collateral and mortgages on real property to cover credit risk 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 2010.

**Exposure broken down by remaining term and cover of collateral per exposure category for Alm. Brand Bank (DKKm)**

Exposure category	Up to 3 months	Between 3 months and up to 1 year	Between 1 year and up to 5 years	5 years or more	Total	Collateral cover
Exposures to central governments or central banks	210	155	68	295	728	0
Exposures to institutions	643	474	206	900	2,223	620
Exposures to business entities, etc.	2,457	1,813	790	3,441	8,501	777
Exposures to private customers	1,760	1,298	566	2,465	6,089	46
Exposures secured by mortgage on real property	683	503	219	956	2,361	2,361
Exposures subject to accounts overdrawn or in arrears	180	132	58	251	621	11
Other exposures	45	34	15	64	158	0
<b>Total</b>	<b>5,978</b>	<b>4,409</b>	<b>1,921</b>	<b>8,372</b>	<b>20,680</b>	<b>3,815</b>

The exposures are calculated inclusive of unutilised credit facilities and counterparty risk but less any impairment writedowns.

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 Finans, which are also secured against collateral. Moreover, Alm. Brand Bank's loans to PFI commitments are secured against collateral.

### 3.5 Impairment writedowns

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.

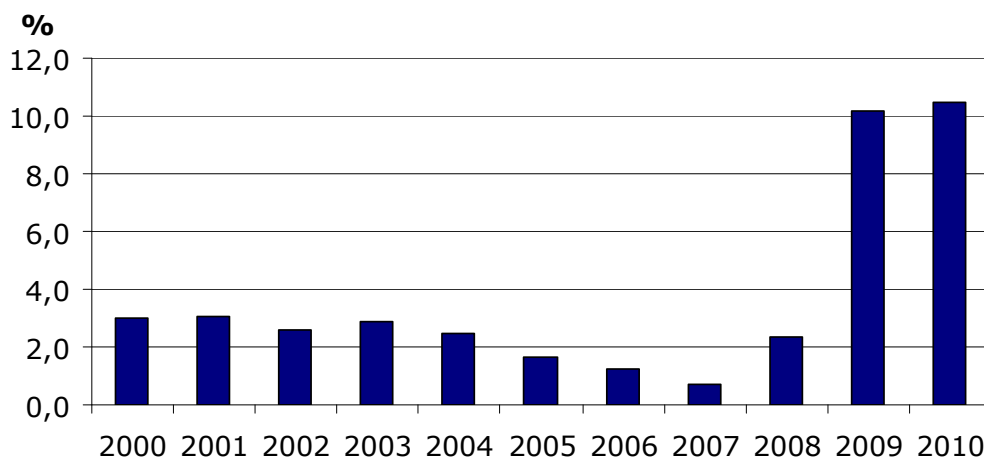
The indication of impairment is assessed on an ongoing basis via a process managed by Alm. Brand Bank's Credit Secretariat.

For the calculation of collective impairment writedowns, a restated model was used in 2010, which is based on a model developed by the Association of Local Banks in Denmark. Alm. Brand Bank's data centre (Bankdata) is working on a new model. It is uncertain when this new model will be implemented, as the legislative framework has not yet been adopted.

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.

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

#### Impairment ratio for Alm. Brand Bank in the period 2000-2010



The percentage is calculated as the total allowance account relative to lending at amortised cost and guarantee debtors.

**Losses and impairment writedowns for Alm. Brand Bank in the period 2008-2010**

DKKm	2010	2009	2008
Exposure in the private customer segment from financing of real property	29	17	4
Exposure in the private customer segment from financing of cars	0	-9	-2
Other exposure in the private customer segment	79	108	26
Exposure in commercial customer segment	526	1,277	308
Exposure from institutions	45	17	4
Government exposures	0	0	0
<b>Total</b>	<b>679</b>	<b>1,410</b>	<b>340</b>

Calculated for the Alm. Brand Bank parent company, excluding value adjustments of mortgage deeds.

**Movements in the year for individual and collective impairment writedowns for Alm. Brand Bank in 2009 and 2010**

Individual and collective impairment writedowns for Alm. Brand Bank in 2009 and 2010 DKK	Accumulated individual impairment writedowns 2010	Collective impairment writedowns 2010	Total impairment writedowns 2010	Total impairment writedowns 2009
Impairment writedowns, beginning of period	<b>1,756</b>	<b>62</b>	<b>1,818</b>	416
Impairment writedowns for the year	678	49	727	1,428
Reversed impairment writedowns	136	29	165	20
Impairment writedowns considered lost	978	0	978	6
<b>Impairment writedowns, end of period</b>	<b>1,320</b>	<b>82</b>	<b>1,402</b>	<b>1,818</b>

Calculated for the Alm. Brand Bank parent company, excluding value adjustments of mortgage deeds.

**Loans and advances subject to impairment writedowns before and after impairment writedowns for Alm. Brand Bank in 2009 and 2010**

DKKm	Individual impairment writedowns 2010	Collective impairment writedowns 2010	Total impairment writedowns 2010	Total impairment writedowns 2009
Loans and advances written down for impairment	<b>3,473</b>	<b>6,191</b>	<b>9,664</b>	<b>11,296</b>
Impairment writedowns	1,320	82	1,402	1,818
<b>Loans and advances after impairment writedowns</b>	<b>2,153</b>	<b>6,109</b>	<b>8,262</b>	<b>9,479</b>

Calculated for the Alm. Brand Bank parent company, excluding value adjustments of mortgage deeds.

**Distribution of impairment writedowns and loans subject to impairment writedowns by object for Alm. Brand Bank in 2010**

<b>DKKm</b>	<b>Individual impairment writedowns</b>	<b>Collective impairment writedowns</b>	<b>Total impairment writedowns</b>	<b>Claims in default</b>
<b>Exposure in private customer segment, of which</b>				
Secured against real property	37	19	56	59
Secured against cars	1	0	1	1
Other exposure in the private customer segment	110	4	114	270
Exposure in commercial customer segment	1,064	59	1,123	2,955
Exposure from institutions	107	0	107	188
Government exposures	0	0	0	0
<b>Total</b>	<b>1,320</b>	<b>82</b>	<b>1,402</b>	<b>3,473</b>

Calculated for the Alm. Brand Bank parent company, excluding value adjustments of mortgage deeds.

As described in section 2 above, Alm. Brand expects further impairment writedowns up to 31 December 2010 of DKK 550 million.

### **3.6 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.

Alm. Brand Bank's existing 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. The bank's future focus on private customers will reduce concentration risk both in relation to large exposures and in relation to exposure to the property market.

The sum of large exposures, calculated in accordance with the FSA's requirements for quarterly reporting, is approximately 68% of the bank's capital base, distributed on five exposures at year-end 2010. The exposures are characterised by the credit risks actually being distributed on financing of a number of properties.

Number of exposures exceeding 10% of the capital base of Alm. Brand Bank in the period 2008–2010

<b>Year-end</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
No. of large exposures	5	8	13

## 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 bank's rules distinguish between market risk on items inside and outside the trading book, and between general and specific risk. A similar breakdown is not considered relevant for the insurance area.

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

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
- Equity price exposure is the risk of losses because of changes in equity 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 of
    - the company incurring losses because a counterparty to a contract on a derivative financial instrument is incapable of honouring its obligations to the company
  - Spread risk is the risk of loss on an asset, liability or financial instrument because of changes in the credit spread relative to the risk-free yield curve.

### 4.1 Policy and responsibility (objectives)

The purpose of managing market risk is to balance the aggregate financial risk on assets and liabilities in order to obtain a satisfactory weighting of yield and risk. In accordance with the requirements of section 70 and section 71 of the Danish Financial Business Act, policies with related guidelines determining the overall risk profile as well as the limits for the different types of

financial risk have been defined for the group as a whole. The policies for each group company have been adapted to the conditions under which the relevant company operates.

The Board of Directors of Alm. Brand A/S lays down and approves the overall policy for the group's acceptance of market risks, just as the Board of Directors defines the overall limits therefor and the required reporting.

## 4.2 Use of models

Conventional risk measures are primarily used to determine market risk, including Value-at-Risk. In addition, the insurance companies use internal asset-liability models and stress tests, among other things in the form of the FSA's risk and capital assessments. A few derivative financial products whose value depends on both the equity and fixed income markets are assessed by internal models that use a Monte Carlo simulation to estimate the equity risk and interest rate risk for the product.

The conventional risk measures are used in the daily assessment of market risk. For the purpose of assessing the interest rate risk on interest-bearing assets, the value change upon a general interest rate movement of 1 percentage point is calculated. The interest rate risk is calculated on the basis of modified option-adjusted durations.

In Alm. Brand Liv og 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 static model, it calculates the effect of an immediate interest rate change. Shareholders' equity, real 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 600 million 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 percentage point is applied, and if the discount rate is below 2.5%, a drop in interest rates of 1% is applied. Hedging is carried out on a regular basis so that the net effect on the balance sheet at the specified change in interest rates is capped at a loss of DKK 600 million.

An equity market exposure is calculated for equities that includes the sensitivities to changes in the equity market of equities, financial instruments such as futures and options and other derivative financial instruments whose value depends on the equity market.

Alm. Brand Bank calculates currency risk in accordance with the FSA's exchange rate indicators 1 and 2, which are described in section 4.7.

The FSA's risk and capital assessments are prepared for the insurance companies and constitute a stress test of the sensitivity of assets and liabilities to interest rate changes, equity 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 Alm. Brand Group's VaR model is back-tested on a daily basis. This is done by saving each portfolio's VaR level every day in a database together with the actual daily return on the portfolio.

The validity of models estimating market sensitivity of financial products that are conditional on both interest rate developments and equity 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 risk on a daily basis. The risk management department checks compliance with the investment limits defined for each company of the group.

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

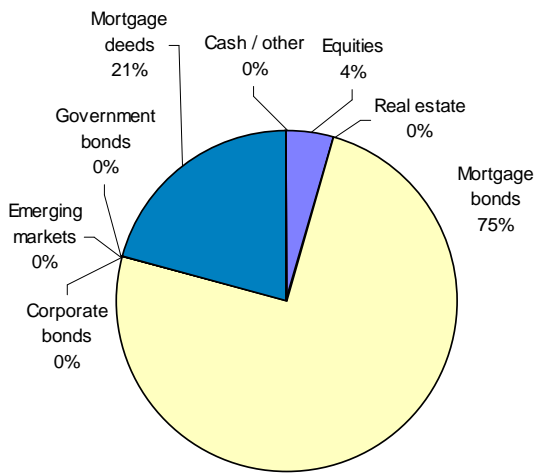
## 4.5 Asset allocation in Alm. Brand

### Asset allocation in general

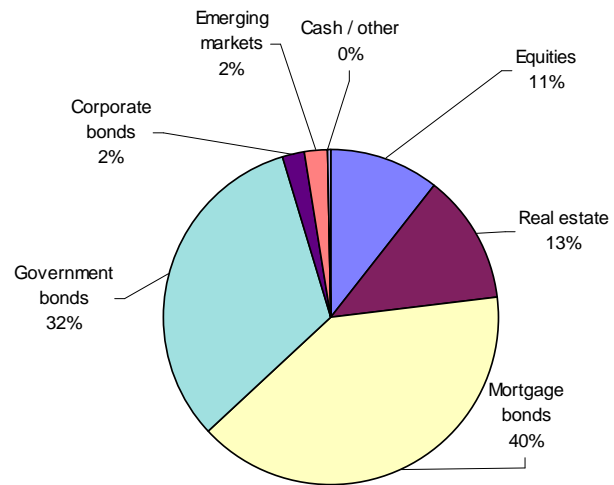
Alm. Brand traditionally takes a prudent approach to allocation of own and customer investment funds. Both for the bank and for the insurance companies, this implies limited holdings of equities and a ban on investments in exotic products.

**Bank, asset allocation  
31 december 2010**

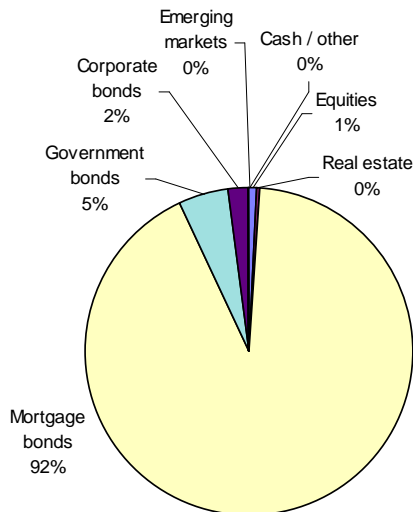
The figure shows Alm. Brand Bank Pro rata



**Life, asset allocation  
31 december 2010**



**Non-life, asset allocation  
31 december 2010**



## 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 Alm. Brand's interest rate risks have been further specified below.

### Interest rate risk in the bank

Alm. Brand Bank has a significant ownership interest in the subsidiary 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 the ownership interest in this subsidiary.

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 2010, Alm. Brand Bank's pro rata overall interest rate risk amounted to a loss of DKK 18 million, equivalent to -1.1% of the bank's equity, including interest rate risk outside the trading portfolio in a positive amount of DKK 36 million and interest rate risk in the trading portfolio in a negative amount of DKK 54 million.

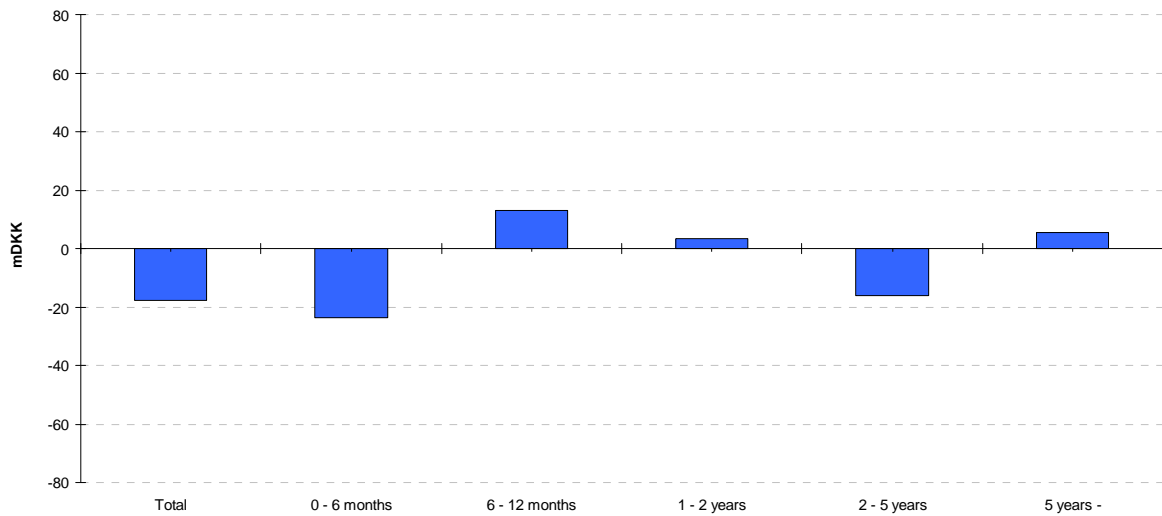
The bank's interest rate risk in the trading portfolio is primarily derived from trading on behalf of customers. The bank only engages in own-account trading to a limited extent. Most of the bank's interest rate risk outside the trading portfolio is derived from the bank's bond and mortgage deed portfolios.

The bank's management of interest rate risk is furthermore based on a pro rata calculation of 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, 2–3.6 years, 3.6–5 years and 5 years or more. The bank's risk policy in this respect permits a total interest rate risk or interest rate risk per interval of a minimum of minus DKK 70 million and a maximum of plus DKK 70 million on a pro rata basis for Alm. Brand Bank.

### Interest rate risk

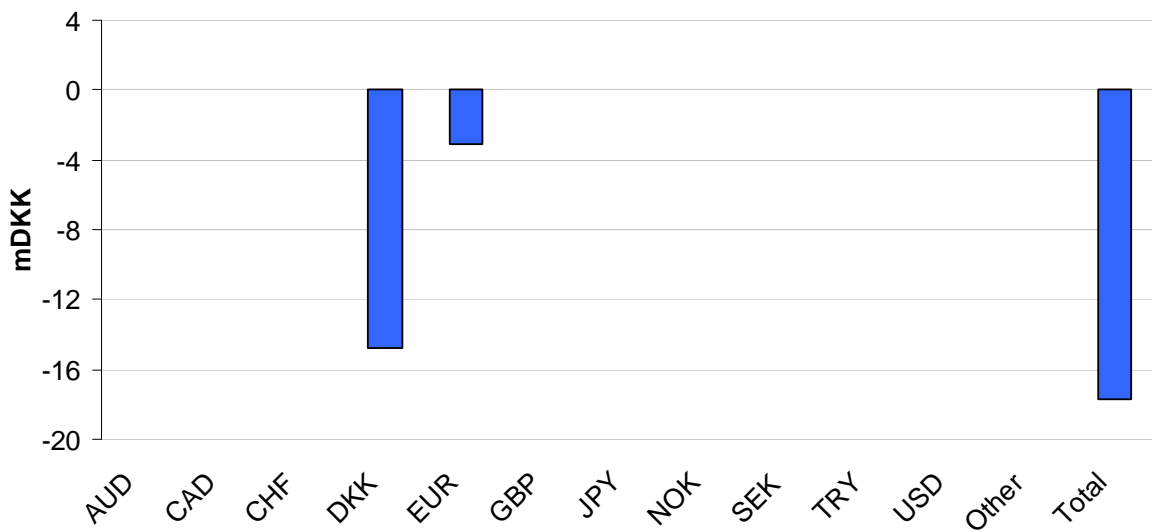
	Alm. Brand Bank parent company	Alm. Brand Bank (pro rata)	Alm. Brand Bank group
Interest rate risk	-32	-18	0
Accounting interest rate risk	63	77	95

### Interest rate risk by buckets, 31 Dec 2010



Most of the bank's interest rate risk is exposed to DKK. Alm. Brand Bank seeks to keep interest rate risk in currencies other than DKK and EUR at a minimum.

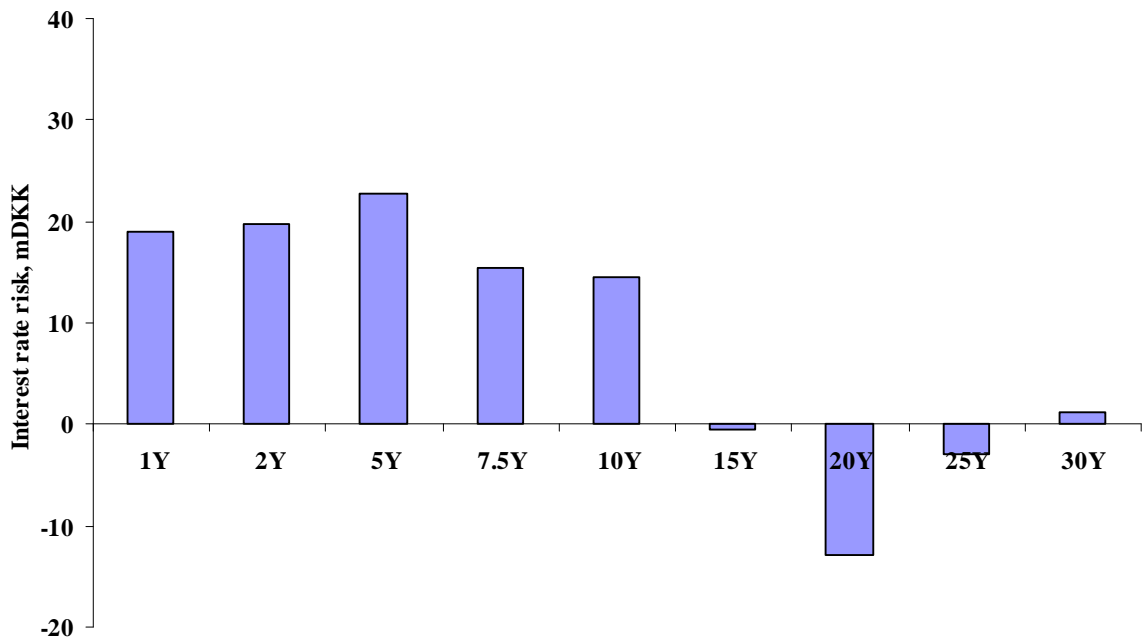
### Total interest rate risk per currency, 31 Dec 2010



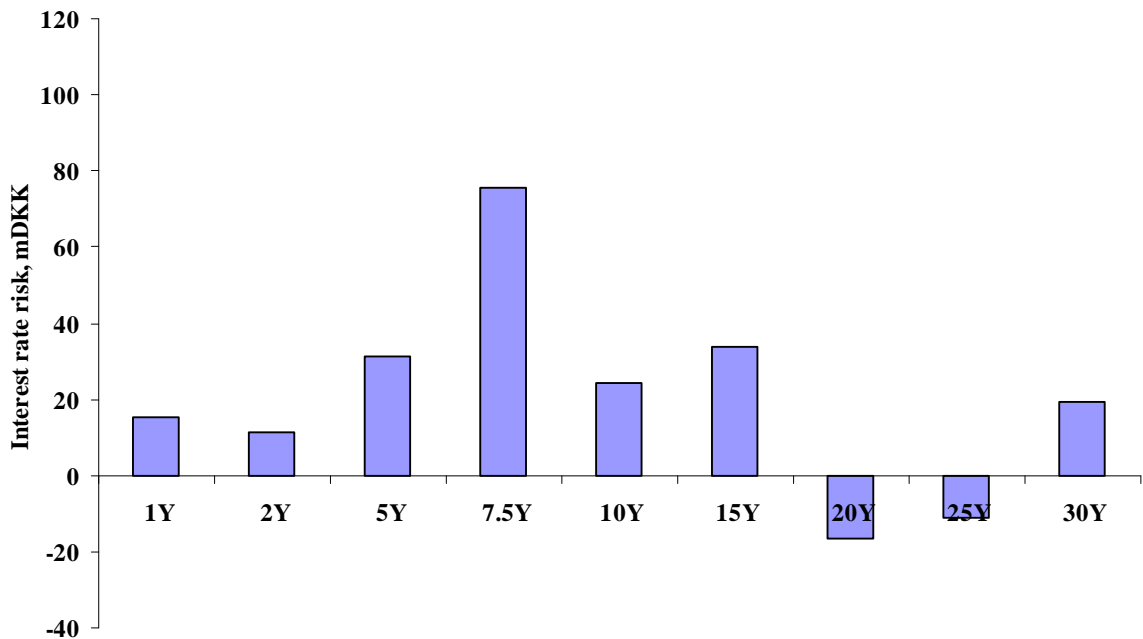
### Interest rate risk in the non-life and life insurance companies

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 2010**



**Distribution of net interest rate risk in the life insurance company, 31 Dec 2010**



In connection with the new executive order on the contribution principle, Alm. Brand Liv og Pension's portfolio at 1 January 2011 has been divided into three interest rate contribution groups in order to facilitate a division of the investment return. The risk is then also measured specifically for each interest rate contribution group. The division increases the company's risk as the buffers can no longer be used across the contribution groups. Only the group's own buffers may be used to cover the group's losses. However, this risk may be countered by an individual hedging programme for each interest rate contribution group.

Moreover, the division means that each interest rate contribution group has its own investment composition which is adjusted to the liabilities. Alm. Brand Liv og Pension generally applies the approach that the company has a given risk tolerance on an overall level. This risk tolerance is distributed on each portfolio according to the size of the portfolio. Accordingly, a risk tolerance of DKK 1 is identical, irrespective of the guarantees issued in the interest rate group. As a result, portfolios with large investment buffers will have a higher number of risky assets than a group with small investment buffers, as the risk relative to equity should be identical.

## 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 bank calculates currency risks on a daily basis in accordance with the FSA's risk-weighted exchange rate indicator 1 in which the risk exposure is the higher of the sum of long and short net positions per currency. Foreign currency risk is calculated as positions in each currency, and a risk limit has been defined for two currency categories, on which calculation, management and monitoring are based.

Foreign currency risk is calculated and managed on a day-to-day basis across the banking group. Most of the bank's currency exposure relates to the portfolio of Swedish mortgage deeds and to the ownership interest in the subsidiary Alm. Brand Formue A/S, which may have unhedged currency positions. The bank only engages in own-account trading to a limited extent. Alm. Brand Bank seeks to the extent possible to hedge currency risk by way of derivative financial instruments.

Currency risk is generally measured in DKK. According to the weighted exchange rate indicator 1, the overall currency exposure of Alm. Brand Bank (pro rata) was DKK 6 million at 31 December 2010. The currency exposure for the yellow scenario calculated on the basis of the FSA's exchange rate indicator 2 for Alm. Brand Bank (pro rata) was DKK 10.5 million at 31 December 2010, see the figure below. The yellow scenario of the FSA's exchange rate indicator 2 indicates the maximum loss within ten days with a probability of 99.5%.

### Currency risk

	Alm. Brand Bank parent company	Alm. Brand Bank (pro rata)	Alm. Brand Bank group
Weighted exchange rate indicator 1	3	6	9
Exchange rate indicator 2	8	11	14

The non-life insurance group is exposed to limited currency risk.

## 4.8 Equity risk

Equity risk is the risk of losses because of changes in equity prices.

Equity risk is calculated as the net sum of the fair value of short and long positions in equities and equity-related instruments. The management of equity risk distinguishes between listed and unlisted equities, and the position in individual companies is calculated and monitored separately.

Alm. Brand is mainly exposed to equity risk in the bank, as Liv og Pension's equity investments are made for customer funds, and the risk is to the extent possible hedged by way of financial instruments. Apart from this, the exposure is limited (see section 4.5). Finally, the collective bonus potential of Liv og Pension constitutes a buffer against capital losses.

### Equity risk in the bank

#### Exposures in the trading portfolio

The bank is exposed to equity risk in the trading portfolio. The trading portfolio comprises equities and unit trust certificates and is intended to facilitate the bank's asset management department and trading on behalf of customers. It also comprises equities acquired in connection with redemption of collateral from defaulted customers. In addition, the bank has a number of equity portfolios acquired in connection with non-performing exposures. The bank's policy is to reduce such portfolios.

#### 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.

Most strategic sector shares are unlisted shares. Because the shares are not listed on a stock exchange, which would ensure regular pricing in the market, the bank uses alternative valuation methods.

A few of the companies are owned by a group of banks according to a system where the ownership interest is reallocated annually to reflect each bank's business volume with the company. The bank's valuation is typically based on the net asset value calculated on the basis of the relevant companies' financial statements.

The other strategic sector shares are valued, if liquidity in the shares is deemed to be sufficient based on the most recently known selling price. Alternatively, the shares are recognised at their book value in connection with the companies' financial reporting.

In the bank's financial statements, the value of the shares is adjusted through the bank's income statement in accordance with the financial reporting rules.

Alm. Brand Bank's portfolio of sector shares in the investment portfolio amounted to DKK 215 million at 31 December 2010. Unrealised capital gains on sector shares in the investment portfolio totalled DKK 3 million at 31 December 2010, while no capital gains were realised in 2010.

In connection with Alm. Brand Bank's acquisition of Alm. Brand Pantebreve at the end of 2010, the assets of the mortgage deed company were taken over by the bank. The company is being liquidated, and the bank's portfolio of shares has been written down to zero.

Alm. Brand is exposed to the equity market through Alm. Brand Formue and seeks to hedge this exposure on a pro rata basis in a relatively limited interval.

#### Equity risk

	Alm. Brand Bank parent company	Alm. Brand Bank (pro rata)	Alm. Brand Bank group
Sector shares in investment portfolio	215	215	215
Equity exposure in the trading portfolio	-32	122	321
Total equity exposure	183	337	536

## 4.9 Other market risks

Other market risks include property risks, credit and counterparty risks, spread risks and concentration risks.

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

Credit and counterparty risks for Alm. Brand Bank are described in section 3. For Alm. Brand Forsikring and Alm. Brand Liv og Pension, counterparty risk is reduced through the use of collateral agreements when entering into derivative contracts.

As concerns spread risk, Alm. Brand Bank has defined limits ensuring that the scale of spread risk is capped. For Alm. Brand Forsikring and Alm. Brand Liv og Pension, spread risk is limited indirectly through limits on investments in credit bonds and rating limits in general.

## 5 Liquidity risks

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 and Alm. Brand Liv og Pension. 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, whereas a windstorm event would exert the greatest pressure on Alm. Brand Forsikring's liquidity. However, liquidity risk is limited as a result of premiums in the companies being pre-paid. In addition, both companies have very good possibilities of procuring capital by realising assets, as a result of the companies' substantial portfolios of liquid government and mortgage bonds.

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, and
- 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. Moreover, the bank strives to comply with the FSA's supervisory diamond in terms of liquidity ratios as well.

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 internally defined limits for the composition of funding, including sources of funding and the maturity structure thereof.

## 5.1 Short-term liquidity management

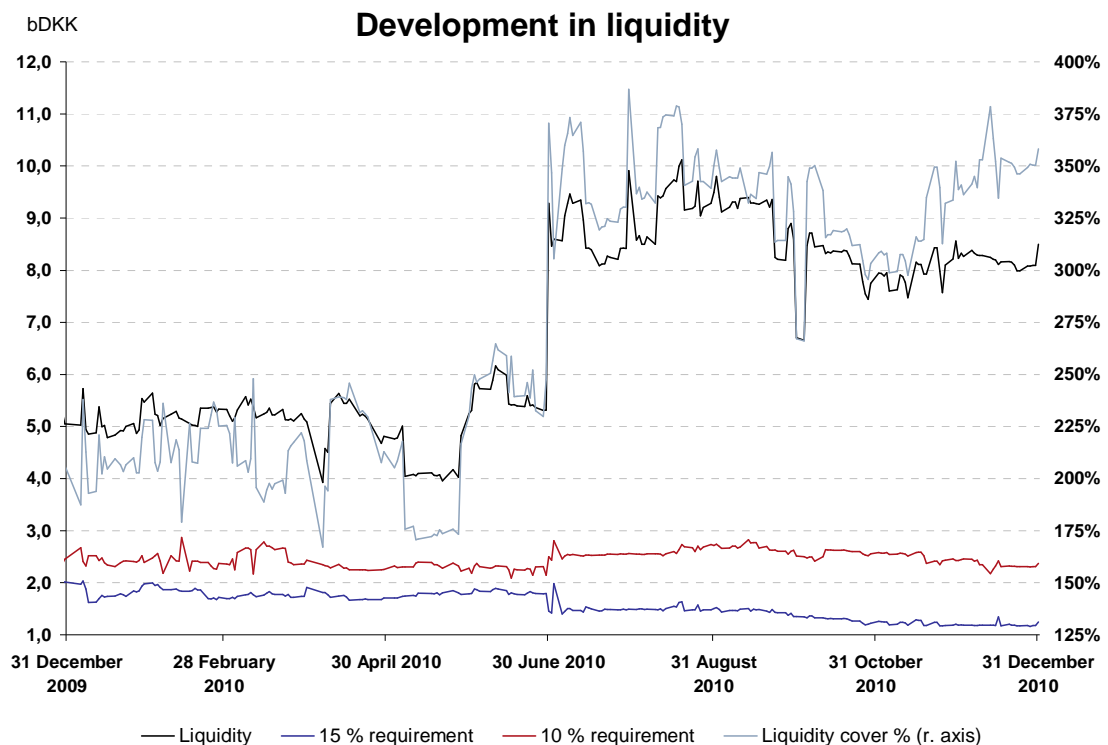
Alm. Brand Bank's short-term liquidity management aims partly at neutralising imminent liquidity effects, thereby maintaining liquidity within the limits defined by the Board of Directors, and partly at securing financial resources in the form of certificates of deposit and undrawn money market lines 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 five business days;
- Maturity of money market transactions with customers and banks is taken into consideration;
- Next, known effects from the bank's currency and securities trading activities are included; and
- 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 2010 it was in the interval 167–387%, as can be seen in the figure below.

### Alm. Brand Bank – Development in liquidity in 2010



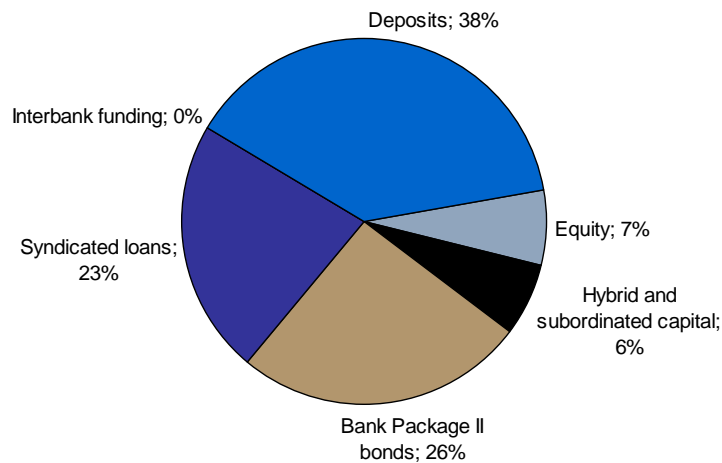
## 5.2 Long-term liquidity management

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

The funding composition is based on high equity and capital base ratios, ensuring a solid capital base with a high solvency ratio. Moreover, the bank aims for a funding base founded on deposits and bond issues, while interbank funding is used to the extent necessary.

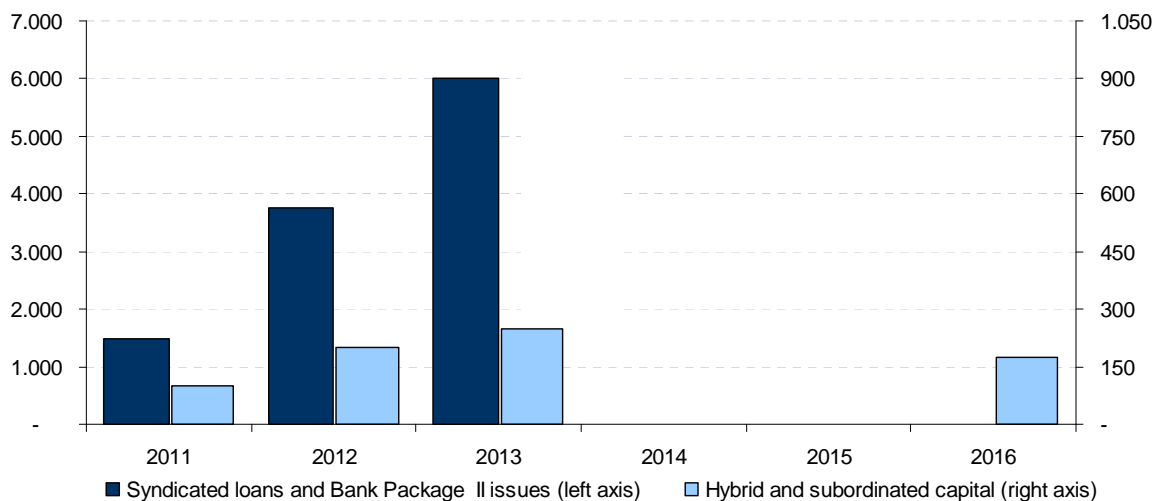
At 31 December 2010, deposits accounted for 38% of the funding, hybrid capital and equity accounted for 13%, whereas the remaining 49% was composed of bond issues, including issues under the Bank Package II guarantee.

**Funding composition at 31 December 2010**



At 31 December 2010, Alm. Brand Bank's 12-month maturity structure of market instruments accounted for 12%. The bank's 5-year maturity structure appears from the figure below.

**Maturity structure of Alm. Brand Bank's bond issues and subordinated and hybrid capital**



### **5.3 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.

### **5.4 Risk related to Alm. Brand Bank's need to refinance its funding**

A significant part of Alm. Brand Bank's current funding, including Alm. Brand Bank's bond loan with individual government guarantee and an aggregate principal amount of DKK 6 billion, will mature during the period until 30 June 2013. Accordingly, Alm. Brand Bank will need to refinance part of its current funding by that date. Refinancing will be sought through a combination of reducing total lending and increasing total deposits.

## 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 catastrophe risks (extreme events costs). There are also primary risk sources such as market risks (changes in interest rates, equity 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 regular reporting is provided to the Board of Directors and the Management Board of Alm. Brand Forsikring A/S.

#### **Premium risk**

Premium risk is the risk that expenses related to claims and costs exceed earned premiums. This is assessed for each type of business, for which reason there are several premium risks. If, in any one year, the company records a high number of large claims, or if the tariff is out of step with trends in the underlying risk, the premium may prove insufficient to cover the claims expenses and the company's costs.

The risk is reduced by using reinsurance and by frequently monitoring trends in tariff parameters. The risk was reduced in 2009 and 2010 by way of premium increases as a result of years of significant claims inflation. For example, the number of theft burglary has been surging in recent years, resulting in adjustment of the tariffs for household and commercial contents insurances. The risk is measured using the QIS 5 standard model and in the company's in-house risk model.

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 of all significant products written and sales channels used. 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 are reported on a monthly basis and large risks written are reported separately. Writing of risks exceeding a specified limit must 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 risk**

Reserve risk means that the provisions made are too low in comparison to the ultimate cost of claims. At the end of the financial year, the company reserves funds for payment of unsettled claims and claims incurred but not reported to the company. The payments and other liabilities to the policyholders may prove greater than assumed at the beginning of the year. In such case, the company incurs a loss.

The company's claims provisions are estimated by actuaries. The company has established a provisions committee in which key claims employees provide the actuaries with input on new trends, changed legal practice and similar matters that may affect expectations for upcoming claims payments. Over a prolonged period of time, Alm. Brand Forsikring has measured and reduced the number of outstanding cases in the claims department, thereby ensuring that the company has an up-to-date picture of the claims situation. The risk is measured using the QIS 5 standard model and in the company's in-house risk model. The amount of run-off gains and losses is also evaluated in the annual actuarial report relative to the expectations from the in-house model.

### **Catastrophe risk**

Catastrophe risks are those related to extreme events. The largest single risks in non-life insurance are risks of windstorm/hurricane and terrorist attacks. Catastrophe risks are covered through reinsurance. Once a year, the Board of Directors defines and approves the reinsurance strategy. The strategy outlines requirements for scope of cover, retention, reinsurers' required ratings, etc. The reinsurance department is responsible for the tactical and operational handling of reinsurance.

For 2011, Alm. Brand Forsikring has chosen to increase its cover relative to the reinsurance programme at the beginning of 2010. Under the 2011 programme, hurricane and other natural disaster claims are covered down to DKK 75 million. The decision to increase the reinsurance cover was made on the basis of the company's in-house risk model, and the increase was considered by the company's management to be a natural corollary of price versus risk reduction. The risk is measured using the company's in-house risk model and is alternatively elucidated by the use of different scenarios.

## **6.2 Biometric risks related to life insurance and pension products**

Biometric risks primarily consist of mortality, life expectancy and disability. The risk premium of market value provisions covers any future fluctuations of 12% 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 og 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.

In connection with the new executive order on the contribution principle, Alm. Brand Liv og Pension's portfolio has been divided into contribution groups for mortality, life expectancy and disability, respectively. In line with the profit target, which has been adjusted to the effect that 100% of the risk result is allocated to equity, the company has reduced its dependence on the investment result from 2011 but increased the risk on the core business, viz. the biometric risk.

The division into contribution groups means that there is no collective bonus potential in the contribution groups for mortality, life expectancy and disability, respectively. This generally means that losses incurred in these groups will be paid through equity. However, the overall buffers may be applied through the use of negative bonus, thereby limiting the risk to the reaction rate of bonus rate adjustments.

## 6.3 Default risk

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

risks of reinsurers not being able to pay,

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 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. In addition, Alm. Brand Forsikring limits the risk by spreading its reinsurance cover on a large number of reinsurers.

## 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 Board of Directors has defined limits for the company's risk tolerance in a number of areas. For each line, the Board of Directors has considered the maximum acceptable loss for a claim expressed by the company's maximum retention. A fixed procedure is observed when new products are introduced for purposes of ensuring correct risk

assessment and pricing. Windstorms and similar natural disasters may hit many insurances at the same time, and the Board of Directors has also approved the company's choice of reinsurance with respect to cover for this loss exposure.

The management of risk tolerance in connection with new business written has been described in the company's acceptance policy. The acceptance policy contains rules as to what type and size of risks may be written on a contract. Compliance with these rules is monitored on an ongoing basis and reports are submitted to management on a regular basis.

## **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 does not lead to an unacceptable loss of capital, and also to reduce the size of fluctuations in technical results.

Approved annually by the Board of Directors and the Management Board, the reinsurance programme also defines the group's retention on different insurance events. 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 2011 is based on the same guidelines as in 2010, but with several minor coverage enhancements. For 2011, Alm. Brand has bought catastrophe reinsurance for up to DKK 4.4 billion with retention of DKK 75 million. Personal injury on personal accident and workers' compensation insurances is covered up to DKK 700 million with retention of DKK 20 million. Coverage is DKK 400 million for property damage with retention of DKK 30 million. The portfolio comprises a few large risks, all of which are covered individually (facultatively). As part of the company's risk management, all such risks are assessed independently by at least two engineers. In addition to the risk of large, individual fire claims, there is a risk of individual years being hit by many fire claims. Therefore, the company has covered this risk by way of a frequency programme covering claims between DKK 5 and DKK 30 million. However, the cover will not take effect until Alm. Brand has incurred claims in the amount of at least DKK 150 million in this interval.

Moreover, the company has taken out a programme for 'medium-size' cloudburst and snow load claims totalling between DKK 85 and DKK 185 million. Motor (comprehensive and liability) and liability claims in general are covered under a programme with retention of DKK 20 million.

The largest single risk in the non-life business is for windstorm/hurricane losses. In order to determine the size of this risk, the group works with a number of windstorm scenarios based on the portfolio's exposure and on calculated probability, which shows that, as a minimum, the current programme covers claims up to a 200-year event.

Alm. Brand's risk in case of a terrorist event is considered to be largely covered by the recently established terrorism pool and the government guarantee scheme covering nuclear, biological or chemical claims events and by the relevant parts of the reinsurance programme after retention under the relevant programmes or to be exempted in the risks insured.

If the business area proposes to change existing products' scope of coverage or to implement new products, such proposals are submitted 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.

### **Life insurance**

In Alm. Brand Liv og Pension, the policy is to not write any business without the customer disclosing personal health information. This 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 insurances with a guaranteed average benefit. Until 1994, the life group wrote policies with average guaranteed benefits of 4.5% after tax on pension returns. From 1994 to 1999, the benefit was 2.5% after tax on pension returns, and since 1999 it has been 1.5%. The rate is expected to be reduced to 0.5% by 1 April 2011, at the latest.

Alm. Brand Liv og 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 therefore partly offset by corresponding changes in the value of the technical provisions and the collective bonus potential. Shareholders' equity may, however, be affected if the average return generated over the life of the policies fails to cover guaranteed benefits.

The investment assets that correspond to Alm. Brand Liv og Pension's shareholders' equity are held in a separate account. At 31 December 2010, 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.

In addition, customer satisfaction and other surveys are performed annually for customers who have taken out insurance in the previous year.

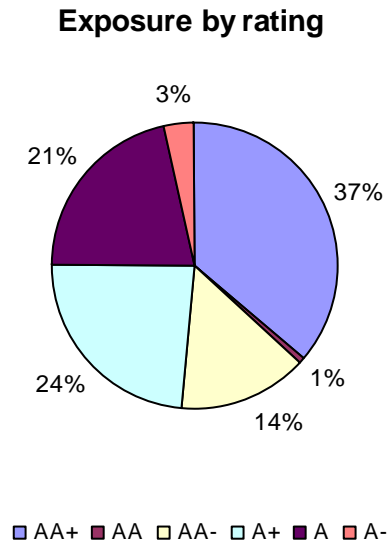
Based on the results of these random tests and the surveys, it is determined whether the acceptance policy has been observed and on this basis, a number of proposals for implementing improvements are prepared. This may, for example, imply updating of business processes, additional training of employees, restructuring of competencies for a number of 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 so, under what terms.

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



## 7 Other risks

Aside from credit risks, market risks, liquidity risks and insurance 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 risk
  - Earnings
  - 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 involves inability to maintain the daily operations and the daily activities.

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

- Inadequate recording
  - A lack of recording of data relating to claims, payments, premiums, etc. and poorly operating systems with little interaction
  - Poor or no data discipline
  - Poor or no reporting data
- Inadequate or outdated training levels
- Inadequate descriptions/business procedures for operational tasks, etc.
- Access to systems not adapted to the individual employee's knowledge
- Key resource issues

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 include:

- Controls in connection with preparing financial data

- Controls in connection with writing business, claims handling, 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 measures is balanced against the related expenses.

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 has 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 A/S. The operational risks in this area have, accordingly, been reduced substantially.

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, an 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 which 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 employees**

The issue of key employees is addressed in a key employee policy which includes a number of extended requirements for specific job descriptions. Key employees are also subject to special severance clauses.

## **Compliance department**

Alm. Brand has set up a compliance department. This cross-firm function has been established to ensure that Alm. Brand observes effective legislation, regulations, 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 it is deemed to exceed the amounts provided, the calculation of the aggregate individual capital requirement will take this into account.

## **7.2 Other business risks**

In addition to credit risks and insurance risks, business risks comprise risks of losses as a result of changes in external circumstances or events that damage the group's image or earnings. Business risks also include risks relating to a decline in earnings, risks as a result of strategic decisions and risks relating to settlements.

### **External risks**

External risks comprise risks of external factors affecting 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 from time to time 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 increased compensation.

Alm. Brand seeks to participate in and contribute to the pre-legislative work phase (among other things through the Danish Insurance Association 'Forsikring & Pension') in order to influence future legislation.

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

Economic conditions affect Alm. Brand's calculation of the individual solvency need as economic developments will have an impact on credit portfolio quality and bonus potential in Liv og 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 need.

### **Reputational risk**

Reputational risk is risk resulting from a poor reputation.

Alm. Brand makes an active effort to reduce reputational risk through controls and business procedures. Alm. Brand Forsikring has a quality assurance 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.

### **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 a company will experience increased difficulties in absorbing potential losses in the future. The Alm. Brand Group aims to have a pricing policy implying that the relation of price to risk ensures earnings in all lines and business areas.

### **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 og Pension, the portfolio consisting of the holdings under Forenede Gruppeliv is closely monitored, and the premium is adjusted annually.