Credit Risk 2010

Sydbank

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Introduction

This report aims to contribute to the compliance by the Sydbank Group of its disclosure obligations in relation to financial risks, cf the executive order on capital adequacy of the Danish FSA (Appendix 20).

The report focuses on credit risk. Other risk areas are described in the Group's annual report for 2010.

Appendix 1 explains some of the terms used.

Credit risk

Credit risk is the risk of loss as a result of a debtor's default on his payment obligations to the Group. Credit risk concerns loans and advances, credit facilities and guarantees as well as market values of derivatives and any holdings.

As a result of the requirements of the executive order on capital adequacy, exposure is stated as gross exposure. The table to the right shows how gross exposure (DKK 160,026m) can be compared with loans and advances (DKK 83,752m) in accordance with the financial statements. The following will mainly focus on credit risk to corporate and retail clients.

Gross exposure – credit risk

DKKm	2010
Loans and advances at fair value	10,724
Loans and advances at amortised cost	73,028
Loans and advances according to financial statements	83,752
- loans and advances to municipalities	(1,006)
Undrawn credit commitments	27,240
Derivatives	3,033
Contingent liabilities etc	11,708
Gross exposures to corporate clients and retail clients	124,727
Governments incl municipalities	3,347
Institutions	29,488
Shares	858
Other exposures	1,606
Gross exposure – credit risk	**160,026**

The year 2010

2010 was a difficult year in terms of market conditions, which has affected the overall risk scenario of the Group, in particular credit risk. Impairment charges for loans and advances represent DKK 1,400m compared with DKK 1,195m in 2009. The level exceeds the Group's expectations at the beginning of 2010.

The ordinary inspection conducted by the Danish FSA of the Group's lending portfolio was concluded at the end of Q3 2010. The Danish FSA assessed that the Group's overall level of impairment charges was satisfactory.

The development in Q4 2010 has been affected by a more cautious approach adopted by the Group as regards impairment charges for certain bank loans and advances. Consequently the increase does not reflect a deterioration in credit quality. Moreover the level reflects the situation in the real economy.

Credit exposure

The table below shows the Group's total credit exposure by category:

1. Corporate clients
2. Retail clients
3. Governments (incl municipalities and regions)
4. Institutions (banks, savings banks and cooperative savings banks)
5. Shares outside the trading portfolio (equity investments)
6. Other exposures (the Group's non-current assets etc, primarily the Group's owner-occupied property).

Breakdown of the Group's credit exposure

DKKm	Approach	Gross exposure	Credit risk mitigation	Effect of conversion factors	Exposure (unweighted)	RWA	**2010** Average exposure for the year
Exposure category							
Corporate clients	STD	5,245	(103)	(1,381)	3,761	3,798	5,705
	IRB	84,185	(16,008)	(18,974)	49,203	40,156	83,068
Retail clients	STD	813	(88)	(183)	542	416	902
	IRB	34,484	(10,499)	(263)	23,722	9,729	35,158
Total corporate clients and retail clients		**124,727**	**(26,698)**	**(20,801)**	**77,228**	**54,099**	**124,833**
Governments etc	STD	3,347	(365)	(1,284)	1,698	0	3,756
Institutions	STD	29,488	(20,115)	(2,130)	7,243	1,477	33,942
Shares	STD	858	-	-	858	858	771
Other exposures		1,606	-	-	1,606	1,606	1,659
Total		**160,026**	**(47,178)**	**(24,215)**	**88,633**	**58,040**	**164,961**
Share IRB (%)		75	56	79	84	88	72
Share STD (%)		25	44	21	16	12	28

DKKm							**2009**
Exposure category							
Corporate clients	STD	6,525	(79)	(2,425)	4,021	4,072	7,019
	IRB	89,094	(18,423)	(19,810)	50,861	43,130	89,649
Retail clients	STD	991	(84)	(228)	679	517	2,054
	IRB	34,787	(9,071)	(307)	25,409	10,775	32,124
Total corporate clients and retail clients		**131,397**	**(27,657)**	**(22,770)**	**80,970**	**58,494**	**130,846**
Governments etc	STD	6,837	(1,170)	(995)	4,672	-	4,171
Institutions	STD	31,824	(17,122)	(3,279)	11,423	1,496	22,710
Shares	STD	887	-	-	887	887	732
Other exposures		1,731	-	-	1,731	1,731	1,686
Total		**172,676**	**(45,949)**	**(27,044)**	**99,683**	**62,608**	**160,145**
Share IRB (%)		72	61	74	78	89	77
Share STD (%)		28	39	26	22	11	23

Credit exposure

The table on page 5 specifies the exposures to retail and corporate clients according to whether risk-weighted assets (RWA) are calculated in accordance with internal ratings based approaches (IRB) or according to the Standardised Approach (STD).

The exposures calculated according to STD comprise:
- Exposures in the Bank's branches in Germany
- Exposures in the subsidiary bank in Switzerland
- A few lease exposures.

Gross exposures consist of loans and advances, undrawn credit commitments, interest receivable, repo/reverse transactions, guarantees as well as counterparty risk on derivatives.

Unweighted exposure is derived by deducting the following from gross exposure:
- Credit risk mitigation (collateral)
- The effect of conversion factors.

As regards all corporate clients and the categories for which RWA is calculated according to STD, collateral which can be deducted in accordance with the executive order on capital adequacy is included. This generally means that only listed shares and bonds can be used to mitigate credit risk as regards these categories. As regards retail clients for which RWA is calculated according to IRB, internal models are used to estimate collateral value.

The conversion factor expresses the proportion of an undrawn credit commitment that will be drawn if the client defaults. The conversion factor as regards "Governments" and "Institutions" as well as corporate and retail clients for which the Group applies STD is nil in accordance with the executive order on capital adequacy.

Most of the corporate exposures calculated according to IRB, can be terminated by the Group at such short notice that the conversion factor for these exposures can be set at nil. As regards retail exposures calculated according to IRB, the Group uses internal models to estimate the conversion factor. According to these models the conversion factor of most products is around 100%.

In general this means that as regards corporate exposures calculated according to IRB the conversion factor has a considerable effect (DKK 20bn) whereas the reduction in gross exposure as regards retail clients is virtually non-existent.

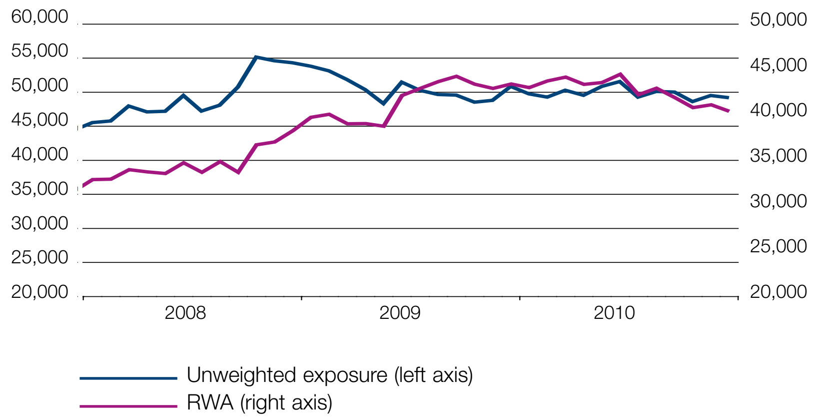
The table below shows the changes in unweighted exposure and RWA from 2009 to 2010. Unweighted exposure to corporate and retail clients decreased by DKK 3.7bn and RWA declined by DKK 4.4bn. This can be ascribed to an improvement in the credit quality of corporate clients during the year.

Changes in unweighted exposure and RWA from 2009 to 2010

DKKm		Exposure unweighted	RWA
Corporate clients	STD	(260)	(274)
	IRB	(1,658)	(2,974)
Retail clients	STD	(137)	(101)
	IRB	(1,687)	(1,046)
Total corporate clients and retail clients		**(3,742)**	**(4,395)**
Governments	STD	(2,974)	0
Institutions	STD	(4,180)	(19)
Shares	STD	(29)	(29)
Other exposures		(125)	(125)
Total		**(11,050)**	**(4,568)**

The figure below shows the development in RWA and unweighted exposure as regards corporate clients since January 2008.

RWA and unweighted exposure – corporate clients

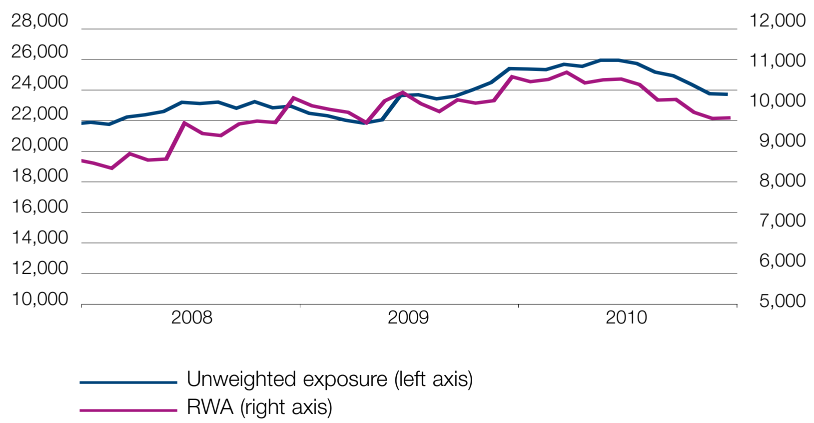


Unweighted exposure went up from DKK 45bn in January 2008 to DKK 55bn in October 2008 but has since decreased and is now at DKK 49bn. Until autumn 2008 RWA stood at around 70% of unweighted exposure but as a result of the financial crisis and subsequent deterioration in the portfolio, RWA rose until summer 2009.

The quality improved slightly during 2010 as RWA declined more than unweighted exposure.

The figure below shows the corresponding development in unweighted exposure and RWA as regards retail clients.

RWA and unweighted exposure – retail clients



Until autumn 2008 unweighted exposure rose faintly whereas RWA increased significantly during the same period as a consequence of weaker credit quality. In 2010 RWA declined substantially more than unweighted exposure, which can be taken as an indication that credit quality improved slightly during 2010.

Credit policy – general

Overall credit risk is managed according to policies and limits adopted by the Board of Directors.

The Group's credit activities are planned in accordance with the Group's visions and strategies and must therefore reflect the four core values: competent, competitive, reliable and obliging.

The Group's credit activities are applied as an active element in the Group's efforts to increase its income by:

- maintaining and increasing the portfolio of profitable and promising retail, investment and corporate clients

and by:

- maintaining and increasing clients' business volume with the Group through a balanced composition of:
  - loans and advances and guarantees
  - deposits
  - payment services transactions
  - trading in securities etc
  - financial instruments.

Risks in connection with lending must be precalculated on an informed and well-founded basis.

Procedures must be in place to ensure identification of exposures that should be strengthened or settled. A specific plan of action must be in place for such exposures.

Approval
The Board of Directors lays down the general framework for credit granting. The largest exposures are submitted on a regular basis to the Board of Directors for approval or information.

Employees with a written lending authority may grant approvals. Such authority is adjusted to the employee's experience, education and training, the client portfolio and the individual client's rating.

The objective is that, in terms of number, more than 90% of retail client exposures can be approved by the client's branch and the remaining client exposures are approved at regional level in the Bank. Major retail client exposures must be approved centrally by Credits.

As a rule corporate clients are served by the regional head office or by specially appointed corporate branches. The objective is that all small corporate exposures are approved decentrally at regional level. As regards medium-size/major exposures, approval must be granted centrally by Credits, the Group Executive Management or the Board of Directors.

Credit rating process
The Group's credit-related decisions are based on a systematic and structured review of the client's circumstances and the industry/industries to which the client belongs. The review is based on all accessible information, including industry analyses and financial statements, and moreover comprises an assessment of the corporate client's business plan.

Credit activities are conducted partly in the retail and corporate departments and partly centrally in Credits. As described in "Risk classification/rating" the Group has developed rating models to classify risks to retail clients, SMEs, corporate clients and investment clients.

Furthermore the Group has an extensive and competent credit organisation which – together with the rating models – ensures focus on the Group's credit risks in the approval process as well as the follow-up process.

The credit organisation is adjusted on an ongoing basis to ensure that the credit rating capacity reflects the Group's development as well as economic conditions.

Customer segments

The Group's credit exposure is to the following segments:
• retail and corporate clients in Denmark
• retail and corporate clients in Germany
• investment clients in the Bank's Danish and German branches as well as in the subsidiary bank in Switzerland.

The table below shows the Group's gross exposure by client's geographical location.

The Group's credit exposure by client's country of domicile

DKKm					**2010**
Exposure – geography	Denmark	Germany	Switzerland	Other	Total
Corporate clients	75,043	3,607	946	9,834	89,430
Retail clients	32,644	614	332	1,707	35,297
Total corporate clients and retail clients	**107,687**	**4,221**	**1,278**	**11,541**	**124,727**
Governments etc	3,305	30	12	-	3,347
Institutions	24,043	1,992	676	2,777	29,488
Shares	858	-	-	-	858
Other exposures	1,500	76	12	18	1,606
Total	**137,393**	**6,319**	**1,978**	**14,336**	**160,026**

DKKm					**2009**
Corporate clients	80,370	3,605	790	10,854	95,619
Retail clients	33,458	679	299	1,342	35,778
Total corporate clients and retail clients	**113,828**	**4,284**	**1,089**	**12,196**	**131,397**
Governments etc	6,685	142	10	-	6,837
Institutions	21,584	3,782	1,007	5,451	31,824
Shares	887	-	-	-	887
Other exposures	1,626	74	14	17	1,731
Total	**144,610**	**8,282**	**2,120**	**17,664**	**172,676**

As shown the vast majority of exposures are to Danish clients (86%).

During 2010 gross exposures went down by DKK 12.7bn, primarily as a result of a decline in the gross exposure to "Governments etc", "Institutions" and "Corporate clients".

The decrease of DKK 2bn in the gross exposure in Germany can be ascribed to a reduction in the gross exposure to financial institutions (DKK 1.8bn) in all material respects. This is the result of a deliberate reduction in loans and advances to clients of other Danish banks.

Risk concentration

Under section 145 of the Danish Financial Business Act, the exposure to a single client or a group of mutually connected clients, after the deduction of particularly secure claims, may not exceed 25% of the capital base.

The table below shows the exposures which after the deduction of particularly secure claims constitute 10% or more of the capital base.

Large exposures

DKKm	**2010** Exposures according to section 145	**2009** Exposures according to section 145
Exposure > 20% of capital base	3,324	-
Exposure 10-20% of capital base	2,836	2,028
Total	**6,160**	**2,028**
% of capital base	54.4	17.2

In accordance with its credit policy, the Group does not wish to be dependent on large individual exposures and as a consequence the following must be observed:

- As a rule the 10 largest exposures may not exceed 10% of the Group's total credit portfolio.
- After deduction of the loan value of any collateral the 10 largest exposures may not exceed 5% of the total credit portfolio.
- As a rule no exposure to a single client may exceed 10% of the Group's core capital.

Exposures to credit institutions, investment funds and government enterprises are exempted from all three requirements.

At year-end 2010 the 10 largest exposures represent 4.6% of the Group's total credit portfolio. After the deduction of the loan values of collateral, the 10 largest exposures constitute 3.7% of the total credit portfolio. No exposure accounts for more than 10% of the Group's core capital.

The above exposures totalling 54.4% of the Group's capital base are all to large credit institutions.

100 largest exposures

DKKm						2010
Industry/rating category	1-3	4-6	7-9	Default	STD/NR	Total
Governments etc	-	-	-	-	1,000	1,000
Real property	1,223	1,275	260	127	-	2,885
Trade (retail and wholesale)	3,833	950	75	-	-	4,858
Investments, repo/reverse	7,421	-	-	-	-	7,421
Investments, other	4,925	2,124	652	-	-	7,701
Agriculture	335	417	19	-	-	771
Manfacturing	2,387	437	78	-	-	2,902
Building and civil engineering	673	363	17	-	-	1,053
Services (professions)	1,448	93	-	-	-	1,541
Transportation	867	239	98	-	-	1,204
Retail clients	575	103	1	-	-	679
Total	**23,687**	**6,001**	**1,200**	**127**	**1,000**	**32,015**
%	74.0	18.7	3.8	0.4	3.1	100.0

The table above shows the gross exposure of the Group's 100 largest clients calculated according to section 145 of the Danish Financial Business Act – by industry and rating category. Exposures to credit institutions, shares and other exposures are not included.

As shown below credit quality has improved substantially compared with 2009. 74% of gross exposures are now in rating categories 1-3 compared with only 44% in 2009.

100 largest exposures – changes from 2009 to 2010

DKKm						
Industry/rating category	1-3	4-6	7-9	Default	STD/NR	Total
Governments etc	-	-	-	-	150	150
Real property	507	(441)	(380)	(21)	-	(335)
Trade (retail and wholesale)	1,375	(924)	65	-	-	516
Investments, repo/reverse	7,132	(2,158)	-	-	-	4,974
Investments, other	2,585	(1,493)	(563)	-	-	529
Agriculture	(292)	25	19	-	-	(248)
Manfacturing	513	(644)	78	-	-	(53)
Building and civil engineering	177	12	14	-	-	203
Services (professions)	34	(52)	(2)	-	(5)	(25)
Transportation	298	184	49	-	-	531
Retail clients	70	(44)	(88)	-	(15)	(77)
Total	**12,399**	**(5,535)**	**(808)**	**(21)**	**130**	**6,165**
%	30.3	(25.9)	(4.0)	(0.2)	(0.2)	0.0

Note: The Group's 100 largest clients in 2010 are not necessarily the same as those in 2009.

Industries

The Group's credit exposure by industry

DKKm					2010
Industry/exposure category	Corporate clients	Retail clients	Other	Total	%
Sector guarantees	166	-	-	166	0.1
Real property	11,185	146	-	11,331	9.1
Trade (retail and wholesale)	14,900	446	-	15,346	12.3
Investments, repo/reverse	10,656	23	-	10,679	8.6
Investments, other	16,901	1,318	-	18,219	14.6
Agriculture	9,345	292	-	9,637	7.7
Manufacturing	9,067	123	-	9,190	7.4
Building and civil engineering	3,816	232	-	4,048	3.2
Services (professions)	6,631	607	-	7,238	5.8
Transportation	3,018	93	-	3,111	2.5
Retail clients	3,745	32,017	-	35,762	28.7
Total corporate clients and retail clients	**89,430**	**35,297**	**-**	**124,727**	**100.0**
Governments etc	-	-	3,347	3,347	-
Institutions, repo/reverse	-	-	20,672	20,672	-
Institutions, other	-	-	8,797	8,797	-
Sector guarantees	-	-	19	19	-
Shares	-	-	858	858	-
Other exposures	-	-	1,606	1,606	-
Total	**89,430**	**35,297**	**35,299**	**160,026**	**-**

DKKm					2009
Sector guarantees	705	-	-	705	0.6
Real property	12,236	155	-	12,391	9.4
Trade (retail and wholesale)	14,129	457	-	14,586	11.1
Investments, repo/reverse	12,828	9	-	12,837	9.8
Investments, other	19,375	575	-	19,950	15.2
Agriculture	9,697	246	-	9,943	7.6
Manufacturing	9,348	113	-	9,461	7.2
Building and civil engineering	3,849	229	-	4,078	3.1
Services (professions)	6,927	729	-	7,656	5.8
Transportation	2,867	88	-	2,955	2.2
Retail clients	3,658	33,177	-	36,835	28.0
Total corporate clients and retail clients	**95,619**	**35,778**	**-**	**131,397**	**100.0**
Governments etc	-	-	6,837	6,837	-
Institutions, repo/reverse	-	-	17,806	17,806	-
Institutions, other	-	-	13,998	13,998	-
Sector guarantees	-	-	20	20	-
Shares	-	-	887	887	-
Other exposures	-	-	1,731	1,731	-
Total	**95,619**	**35,778**	**41,279**	**172,676**	**-**

It is the aim that the composition of the Group's credit exposures to corporate clients is in line with individual industry prospects and that they do not deviate materially from the industry diversification of the banking sector. Moreover, due to risk assessments, exposures to a few industries may be underweighted deliberately by the Group.

The tables on page 12 show the Group's gross exposure to various industries as well as the breakdown by corporate client and retail client.

The industry to which individual clients belong is defined by the Group. Consequently the composition cannot be compared with the industry composition in the Group's annual report which, according to the accounting provisions, must comply with the industries determined by the Danish Commerce and Companies Agency.

The table below shows the changes from 2009 to 2010 in the Group's industry composition. As shown, the exposure to almost all industries has declined. The largest decreases are recorded within "Investments, repo/reverse", "Investments, other" and "Real property".

Exposure – industries

	2010	2009	Change DKKm	Change %
Sector guarantees	166	705	(539)	(76.5)
Real property	11,331	12,391	(1,060)	(8.6)
Trade (retail and wholesale)	15,346	14,586	760	5.2
Investments, repo/reverse	10,679	12,837	(2,158)	(16.8)
Investments, other	18,219	19,950	(1,731)	(8.7)
Agriculture	9,637	9,943	(306)	(3.1)
Manufacturing	9,190	9,461	(271)	(2.9)
Building and civil engineering	4,048	4,078	(30)	(0.7)
Services (professions)	7,238	7,656	(418)	(5.5)
Transportation	3,111	2,955	156	5.3
Retail clients	35,762	36,835	(1,073)	(2.9)
Total	**124,727**	**131,397**	**6,670**	**(5.1)**

Industries

The Group's credit exposure by industry and rating category

DKKm						**2010**
Industry/rating category	1-3	4-6	7-9	Default	STD/NR	Total
Sector guarantees	-	-	-	-	166	166
Real property	3,887	4,334	1,825	736	549	11,331
Trade (retail and wholesale)	7,407	5,051	1,027	132	1,729	15,346
Investments, repo/reverse	10,286	393	-	-	-	10,679
Investments, other	10,349	5,270	1,732	514	354	18,219
Agriculture	2,905	4,796	1,812	58	66	9,637
Manufacturing	5,480	2,704	727	127	152	9,190
Building and civil engineering	1,645	1,753	421	122	107	4,048
Services (professions)	3,755	2,298	389	47	749	7,238
Transportation	1,479	1,230	333	19	50	3,111
Retail clients	26,470	5,902	788	466	2,136	35,762
Total corporate clients and retail clients	**73,663**	**33,731**	**9,054**	**2,221**	**6,058**	**124,727**
Governments etc	-	-	-	-	3,347	3,347
Institutions, repo/reverse	-	-	-	-	20,672	20,672
Institutions, other	-	-	-	-	8,797	8,797
Sector guarantees	-	-	-	-	19	19
Other exposures	-	-	-	-	2,464	2,464
Total	**73,663**	**33,731**	**9,054**	**2,221**	**41,357**	**160,026**
Credit exposure to real property industry by:						
Leases – residential property	788	1,200	537	26	-	2,551
Leases – commercial property	1,961	2,028	672	195	547	5,403
Purchase and sale of real property	555	689	291	313	2	1,850
Other	583	417	325	202	-	1,527
Total real property	**3,887**	**4,334**	**1,825**	**736**	**549**	**11,331**

DKKm						**2009**
Sector guarantees	-	-	-	-	705	705
Real property	2,723	5,917	2,195	737	819	12,391
Trade (retail and wholesale)	5,859	6,266	985	110	1,366	14,586
Investments, repo/reverse	10,679	2,158	-	-	-	12,837
Investments, other	7,342	8,306	2,715	531	1,056	19,950
Agriculture	3,207	5,384	1,190	44	118	9,943
Manufacturing	4,800	3,518	407	117	619	9,461
Building and civil engineering	1,536	2,090	304	103	45	4,078
Services (professions)	3,457	2,769	397	95	938	7,656
Transportation	1,636	1,049	191	17	62	2,955
Retail clients	26,432	7,301	915	399	1,788	36,835
Total corporate clients and retail clients	**67,671**	**44,758**	**9,299**	**2,153**	**7,516**	**131,397**
Governments etc	-	-	-	-	6,837	6,837
Institutions, repo/reverse	-	-	-	-	17,806	17,806
Institutions, other	-	-	-	-	13,998	13,998
Sector guarantees	-	-	-	-	20	20
Other exposures	-	-	-	-	2,618	2,618
Total	**67,671**	**44,758**	**9,299**	**2,153**	**48,795**	**172,676**

The tables on page 14 show the Group's gross exposure by industry and rating category. The rating categories are divided into the following groups:

Rating categories 1-3:	comprise the Group's best and good clients
Rating categories 4-6:	comprise clients whose credit quality is around or below average
Rating categories 7-9:	comprise the Group's poorest, albeit non-defaulted, clients
Default:	comprises clients in default
STD/NR:	comprises clients who are not rated.

The table below shows the change in gross exposure as regards rated clients from 2009 to 2010.

Changes in gross exposure as regards rated clients from 2009 to 2010

DKKm

Industry/rating category	1-3	4-6	7-9	Default	Total
Real property	1,164	(1,583)	(370)	(1)	(790)
Trade (retail and wholesale)	1,548	(1,215)	42	22	397
Investments, repo/reverse	(393)	(1,765)	-	-	(2,158)
Investments, other	3,007	(3,036)	(983)	(17)	(1,029)
Agriculture	(302)	(588)	622	14	(254)
Manufacturing	680	(814)	320	10	196
Building and civil engineering	109	(337)	117	19	(92)
Services (professions)	298	(471)	(8)	(48)	(229)
Transportation	(157)	181	142	2	168
Retail clients	38	(1,399)	(127)	67	(1,421)
Total	**5,992**	**(11,027)**	**(245)**	**68**	**(5,212)**

As shown, the exposure in rating categories 1-3 rose by DKK 6bn during 2010 whereas the exposure in rating categories 4-6 declined by DKK 11bn. The largest changes have occurred in the industry "Investments, other" where the exposure in rating categories 1-3 has increased by DKK 3bn and decreased in the other rating categories by a total of DKK 4bn. This is ascribable to the fact that some investment exposures that were rated in category 4 or lower have been settled or have been strengthened in terms of capital and can therefore be assigned to a better rating category.

Special focus industries

In terms of credit there is special focus on the industries "Real Property" and "Agriculture". Consequently exposure to these industries is further specified below.

According to the Group's credit policy, corporate exposures to these two industries may not exceed the following percentages of the Group's total lending and guarantee portfolio:

- Real property exposures, including the building and civil engineering sector: a maximum of 20%
- Agriculture: a maximum of 10%.

Real property exposures, including the building and civil engineering sector, constitute 12.3% at year-end 2010 compared with 12.5% at year-end 2009. Exposures to agriculture represent 7.7% at year-end 2010 against 7.6% at year-end 2009.

Real property

Exposures to real property are divided into four sub-industries. As illustrated in the table on page 16, exposure to this industry has fallen by DKK 1bn during 2010, equivalent to a decline of 9%. Exposure has been lowered in particular in rating categories 4-6 (DKK 1.6bn) whereas exposure in rating categories 1-3 has increased (DKK 1.2bn).

Industries

The total change in gross exposure as regards the industry “Real property” appears from the table below.

Real property – changes in gross exposure as regards rated clients from 2009 to 2010

DKKm						
Industry/rating category	1-3	4-6	7-9	Default	STD/NR	Total
Leases – residential property	195	(179)	(28)	(2)	(1)	(15)
Leases – commercial property	570	(529)	(111)	103	(266)	(233)
Purchase and sale of real property	276	(243)	(149)	(95)	(3)	(214)
Other	123	(632)	(82)	(7)	-	(598)
Total	**1,164**	**(1,583)**	**(370)**	**(1)**	**(270)**	**(1,060)**

Estimate of real property prospects
It is the Group’s opinion that the real property market has been severely affected by the financial crisis and the setback in the Danish economy. Even though the economy is gaining momentum, it is not strong enough in the short term to turn around the trend in the industry. Real property sales are limited as it is difficult to find investors who are both willing and able to pay a satisfactory price. At the same time the industry is very sensitive to any increases in interest rates. Consequently the Group pays particular attention to the risk in the portfolio.

Agriculture
As shown in the table below, gross exposure to agriculture represents DKK 9.6bn, equivalent to 7.7% of the Group’s total exposure to corporate and retail clients. This largely corresponds to the level of 2009. The industry is divided into four segments. The segment “Other” consists of exposures to forestry, nurseries and small farms with mixed activities, including poultry and mink farming.

Agriculture – gross exposure

	DKKm	%
Cattle	2,349	24.4
Pigs	2,664	27.6
Crop production	2,093	21.7
Other	2,531	26.3
Total	**9,637**	**100.0**

Estimate of agricultural prospects
Following a very difficult year in 2009, the tide has turned and the Group projects that the agricultural sector in general will break even in 2010-12. Despite these improvements, the projected earnings of an average farm remain unsatisfactorily low. The biggest problem facing the industry is its high debt and therefore the industry is extremely sensitive to rises in interest rates.

Cattle and milk producers
Milk producers posted exceptionally poor financial results in 2009. At present it looks as though milk producers, on average, will break even in the years 2010-12.

Pigs
Rises in settlement prices for pigs in early 2010 boded well for the industry but increases in fodder prices have stifled optimism and as a result operating losses are also forecast in the years to come. Consequently it is the opinion of the Group that more farms are at risk of shutting down.

Crop production
Crop producers must expect to post an operating loss also in 2010 despite significant rises in corn prices in autumn 2010. This is due to a slightly lower harvest in 2010 than usual and considerable expenses for drying and treating the wet corn. Since it is projected that the currently high level of prices will continue until the next harvest, it is assessed that the industry will break even in 2011.

Collateral

The Group applies the options available to mitigate the risk on individual transactions in the form of charges on assets, netting agreements, guarantees etc. The most frequent types of charges include mortgages and charges on financial assets (shares, bonds and units).

The Group receives different kinds of guarantees for exposures. Many of these are provided by companies or individuals who have a group relationship with the debtor. For precautionary reasons no independent value is attached to such guarantees.

The value of the collateral provided is assessed on an ongoing basis. The value is determined as the expected net proceeds on realisation. As regards the most frequent types of collateral, the Group has established models that estimate the value of the assets in question. As regards types of collateral where no valuation model exists, the value is determined on the basis of expert assessments.

The unsecured portion of an exposure is calculated as the gross exposure less the collateral value which is assessed prudently.

Risk classification/rating

The Group has developed rating models to manage credit risks to retail and corporate clients. The overriding objective is to monitor regularly the financial circumstances of a client and to identify as early as possible any financial difficulties – in order to work out a plan of action in cooperation with the client.

Model development is based on the recommendations submitted by the Basel Committee. Through dialogue with other interested parties in the market (credit institutions, supervisory authorities, rating agencies etc) the Group has ensured that the models comply with market standards.

In connection with the calculation of the Group's Pillar I capital requirements, the Group estimates on an ongoing basis the risk parameters, PD, LGD and EAD, as regards the Group's retail clients as well as PD as regards the Group's corporate clients where:
- PD represents the probability that the client will default on his obligations to the Group within the next 12 months
- LGD represents the proportion of an exposure that is expected to be lost if the client defaults within the next 12 months
- EAD represents the expected exposure if the client defaults.

In order to calculate EAD the Group estimates a conversion factor for the purpose of converting undrawn credit commitments to expected exposure at default.

The risk parameters are moreover included in the calculation of a number of important internal ratios and key figures concerning the Group's credit portfolio including expected loss. Furthermore the risk parameters constitute a vital management tool in the Group's credit process in connection with eg:
- the targeting of sales activities, including pricing
- lending authority
- credit treatment and risk follow-up
- the determination of accounting impairment charges.

The Group applies the advanced IRB approach to calculate the capital requirement as regards retail exposures and the foundation IRB approach to calculate the capital requirement as regards corporate exposures.

On the basis of the rating models clients are assigned to categories 1-10 where category 1 represents the best credit quality and category 10 represents the category of clients who have defaulted on their obligations to the Group.

Clients are rated in the four models shown below and all models are based on statistical processing of client data for the purpose of classifying clients according to their probability of default (PD) within the next 12 months.

Retail clients
The retail client model is based primarily on account behaviour. On the basis of this data and inherent statistical correlations, retail clients are rated according to their probability of default (PD) vis-à-vis the Group within the next 12 months.

SMEs
The SME model is to a large extent identical to the retail client model albeit the data has been supplemented by further variables.

Corporate clients
The corporate client model is based on the client's accounting data supplemented by appraisals made by the account manager of the corporate client's current strength profile as well as an industry analysis.

Investment clients
The investment client model is based on the following:
- excess cover within the investment exposure
- approved stop loss
- volatility of the investment exposure
- strength profile of the client.

Governments, regions and municipalities
The Group has no internal public sector model. The Danish FSA has approved the Group's use of the Standardised Approach to calculate RWA concerning this asset class.

Exposures outside the rating models
A small part of the exposures – mainly exposures via foreign entities and to a limited extent parts of the Group's lease exposures – is not yet comprised by the rating models. In connection with the Danish FSA approval, the Group has been granted exemption in this respect. In the course of 2011 the Group's exposure in Germany will be rated after which only exposures in the subsidiary bank in Switzerland and a few lease exposures are not rated.

The Group's exposure to corporate clients by rating category (IRB)

						2010
			Exposure-weighted, average			
Rating category	Gross exposure (DKKm)	Exposure after effect of conversion factors (DKKm)	PD (%)	LGD (%)	Risk weight (%)	RWA (DKKm)
1	5,034	4,477	0.0	20.7	8.3	371
2	22,243	16,475	0.1	19.0	14.3	2,351
3	18,280	12,582	0.4	38.3	54.1	6,808
4	12,857	9,537	0.9	39.0	71.3	6,796
5	11,056	8,878	1.7	41.8	94.6	8,402
6	4,199	3,542	3.3	41.1	111.7	3,957
7	2,636	2,371	4.7	41.8	124.8	2,958
8	1,882	1,748	5.6	44.0	134.2	2,345
9	3,999	3,650	10.7	42.2	169.0	6,168
10 (default)	1,999	1,951	100.0	43.2	-	-
Total	**84,185**	**65,211**	**-**	**-**	**-**	**40,156**

						2009
1	5,567	4,611	0.0	22.8	9.1	421
2	19,752	14,968	0.1	15.8	12.1	1,812
3	15,199	10,325	0.4	40.0	55.9	5,767
4	17,558	12,463	0.9	40.0	74.6	9,297
5	15,125	12,504	1.7	34.2	78.1	9,766
6	5,317	4,491	3.3	41.4	114.9	5,160
7	4,041	3,755	4.7	38.1	112.0	4,206
8	1,665	1,543	5.7	40.7	131.9	2,035
9	2,965	2,772	10.8	40.9	168.3	4,666
10 (default)	1,905	1,852	100.0	44.0	-	-
Total	**89,094**	**69,284**	**-**	**-**	**-**	**43,130**

The table above shows the rating of corporate clients' gross exposures after the deduction of the conversion factor as well as exposure-weighted LGD, PD and average risk weight. The average risk weight is determined according to the executive order on capital adequacy as a function of LGD and PD. RWA is calculated as the exposure after the conversion factor multiplied by the risk weight.

Risk classification/rating

LGD as regards corporate clients depends partly on the extent of collateral which is deductible in accordance with the executive order on capital adequacy and partly on the 45% LGD of the exposure, as provided by the directive, less collateral approved.

As a result LGD of corporate exposures cannot exceed 45% – and the greater the collateral, the lower the percentage. As regards rating categories 3-10 LGD stands at around 40% and as regards rating categories 1 and 2 LGD represents around 20%.

LGD at around 20% as regards rating categories 1 and 2 reflects that a number of the Group's investment exposures, ie exposures where the Group grants loans and credits for the clients' purchase of securities, are assigned to the best rating categories as a result of substantial excess cover of collateral.

The table on page 21 shows the rating distribution of gross exposures to retail clients after the deduction of the conversion factor as well as exposure-weighted LGD, PD and average risk weight. The average risk weight is determined according to the executive order on capital adequacy as a function of LGD and PD. RWA is calculated as the exposure after the conversion factor multiplied by the risk weight.

As regards retail clients, LGD depends partly on the extent of collateral which is valued according to the Group's internal models and partly on the statistically calculated expectation of dividend payments. LGD in rating categories 2-9 stands at around 50% whereas it is somewhat lower in rating category 1 and somewhat higher in rating category 10 (default). The lower LGD in rating category 1 reflects that a number of the Group's investment exposures, ie exposures where the Group grants loans and credits for the client's purchase of securities, are in this rating category as a result of substantial excess cover of collateral.

It appears from the comparative figures for 2009 that calculated collateral in rating category 7 was significantly higher than in 2010. The reason is that a number of investment exposures in 2009 were assigned to this rating category due to excess cover of the exposures which did not qualify for a better rating category. To a large extent these exposures have now been settled or been strengthened in terms of capital and are therefore assigned to better rating categories.

The Group's exposure to retail clients by rating category (IRB)

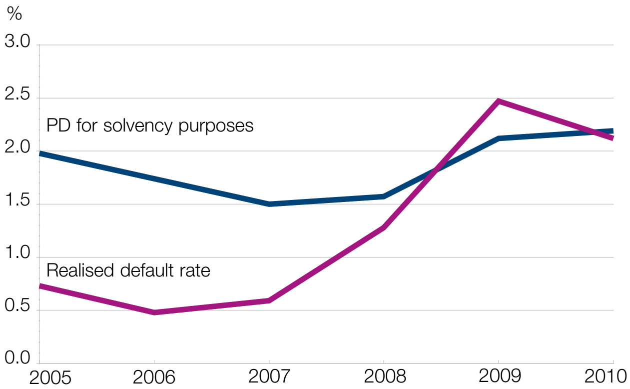
			Exposure-weighted, average			2010
Rating category	Gross exposure (DKKm)	Exposure after effect of conversion factors (DKKm)	PD (%)	LGD (%)	Risk weight (%)	RWA (DKKm)
1	11,480	11,367	0.0	42.5	5.5	627
2	10,216	10,135	0.1	47.0	14.2	1,443
3	6,410	6,369	0.4	49.9	35.8	2,278
4	3,219	3,201	1.1	49.9	61.7	1,974
5	1,902	1,895	2.1	48.7	84.2	1,595
6	498	497	3.6	47.0	103.7	515
7	80	79	5.1	50.7	126.2	100
8	46	46	6.4	52.7	138.0	64
9	411	410	13.1	51.6	197.1	807
10 (default)	222	222	100.0	59.6	-	326
Total	**34,484**	**34,221**	**-**	**-**	**-**	**9,729**

						2009
1	10,118	9,995	0.0	48.4	6.3	630
2	10,526	10,423	0.1	48.9	14.7	1,533
3	6,508	6,461	0.4	51.0	36.9	2,383
4	3,497	3,482	1.1	50.9	62.2	2,167
5	2,541	2,525	2.1	49.7	85.6	2,162
6	722	721	3.7	47.9	107.5	774
7	267	267	4.7	38.0	77.7	207
8	105	105	6.4	52.5	132.9	139
9	255	254	12.8	50.6	184.4	470
10 (default)	248	247	100.0	63.8	-	310
Total	**34,787**	**34,480**	**-**	**-**	**-**	**10,775**

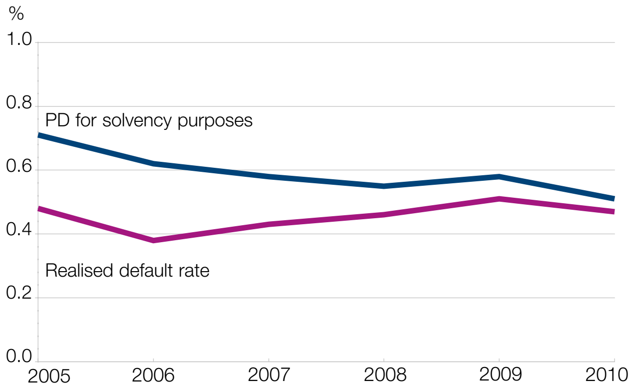
Risk classification/rating

The charts and the table below show the average PD for solvency purposes used to calculate the Group's RWA at the beginning of the year as well as the realised annual default rates for 2005 to 2010.

Probability of default, corporate



Probability of default, retail



Probability of default

%	Corporate PD solvency purposes 31 Dec	Corporate Realised default rate	Retail PD solvency purposes 31 Dec	Retail Realised default rate
2005	1.98	0.73	0.71	0.48
2006	1.74	0.48	0.62	0.38
2007	1.50	0.59	0.58	0.43
2008	1.57	1.28	0.55	0.46
2009	2.12	2.47	0.58	0.51
2010	2.19	2.12	0.51	0.47

As shown above PD for solvency purposes decreases from year-end 2005 to year-end 2007 as economic conditions improve and the rating basis changes. PD for solvency purposes increases again at the beginning of 2009 as a result of changed economic conditions relating to the financial crisis.

The Group's PD for solvency purposes aims to give a true picture seen over an entire economic cycle, ie it encompasses a long-term element.

As a result of the method applied to calculate the Group's PD for solvency purposes, annualised PD fluctuations decrease. In contrast realised default rates are the actual rates for the years in question and any direct comparison with the PD for solvency purposes must therefore be made with caution. Another consequence is that the realised default rate will typically be lower than the PD for solvency purposes during periods of favourable economic trends whereas the opposite will apply during periods of adverse economic trends.

Loss given default
Loss given default (LGD) reflects the proportion of the expected loss on the exposure if the client defaults on his obligations vis-à-vis the Group. As a rule the size of the loss will vary depending on the category of the borrower as well as the realisable value of any collateral or other type of hedging.

As regards retail clients the Group uses its own estimates of the realisable value of collateral as well as own estimates of the loss on the unsecured part of the exposure. The realisable value reflects the market value of collateral net of the expected decline in asset values during a recession, liquidity as well as any currency mismatch between collateral and exposure.

As regards corporate clients the Group applies supervisory parameters of collateral as well as of the loss on the unsecured part of the exposure in accordance with the foundation IRB approach. This approach sets a number of limitations as to eligible forms of collateral. As a consequence of these limitations the Group cannot at present deduct relatively large positions of units or physical assets held as collateral when determining the Pillar I capital requirement.

The table below shows the average estimated and realised LGD rates of retail clients in the period 2005-2010.

Loss given default – retail clients

%	Estimated	Realised
2005	67	67
2006	66	66
2007	67	73
2008	66	78
2009	64	69
2010	65	66

Comparing estimated and realised LGD is difficult as the estimated values reflect the percentage of the loss of the original exposure when the loss has been finally determined and repayments on the exposure can no longer occur. As regards virtually all exposures in default this period lasts several years and quite often significant payments are recorded several years after the exposure was in default.

Consequently any comparison is only of value when the calculation of realised losses is more than two years old. As a result it is expected that recent years' realised losses will decline in the years ahead and therefore be more consistent with the estimates for the relevant years.

Risk classification/rating

Conversion factor

As regards exposures with undrawn credit commitments a conversion factor is estimated indicating the expected utilisation of an undrawn credit commitment at the time of default. Exposure at default is then calculated as the amount already drawn plus expected additional drawings until default.

The Group uses its own conversion factor estimates as regards retail clients. In connection with corporate clients the conversion factor is determined in accordance with the Danish FSA rules on the foundation IRB approach.

The table below shows average-estimated and realised conversion factors of undrawn credit commitments in connection with retail clients in default in the period from 2005 to 2010.

As shown the Group's conversion factor estimates as regards retail clients were around 100% throughout the period, corresponding to full recognition of undrawn credit commitments. The realised conversion factors were significantly lower except for 2008 when the realised value was almost identical to the estimate.

Conversion factor – retail clients

%	Estimated	Realised
2005	99	36
2006	100	79
2007	100	48
2008	100	103
2009	96	49
2010	99	36

Default

According to the Group's rating system, a client is in default if at least one of the following events has occurred:

- A write-off has been recorded as regards the client.
- The client has as least one non-accrual credit facility.
- An impairment charge/provision has been registered in connection with the client indicating that the loss must be regarded as certain.
- The exposure has been transferred to the Group's central department for non-performing exposures.

Moreover the Group has adopted procedures under which all exposures in arrears for more than 90 days are either approved or transferred to the Group's department for non-performing exposures.

Validation

The risk parameters are monitored and validated on an ongoing basis in compliance with the Group's business procedures which reflect Danish FSA requirements, the supplementary guidelines issued by the Committee of European Banking Supervisors (CEBS) as well as internal requirements.

The validation process includes an assessment of:

- model ability to rank clients by default risk
- realised values compared with expected values (backtesting)
- data quality
- model application.

Backtesting of the corporate client rating model for the period 31 December 2009 to 31 December 2010 shows the following:

Backtest of the corporate client rating model

Rating category	Number	Number of realised defaults	Number of estimated defaults
1	61	-	-
2	1,048	-	2
3	2,088	8	10
4	2,553	14	23
5	2,309	36	41
6	1,090	24	37
7	411	16	20
8	308	24	18
9	679	117	86
Total	**10,547**	**239**	**236**

At the beginning of the period 236 defaults were expected and 239 were realised. This backtest shows that the model was better than expected to predict defaults as there are fewer realised defaults than expected in the good rating categories and more realised defaults than expected in the poorer rating categories.

Backtesting of the retail client rating model for the period 31 December 2009 to 31 December 2010 is shown below where it can be seen that only 70% of the expected defaults were realised. The number of realised defaults is well below the number of expected defaults.

Backtest of the retail client rating model

Rating category	Number	Number of realised defaults	Number of estimated defaults
1	80,517	3	32
2	66,806	52	90
3	34,377	107	173
4	11,500	112	129
5	7,168	106	158
6	2,005	68	77
7	524	17	29
8	427	12	29
9	389	64	53
Total	**203,713**	**541**	**770**

Credit monitoring

The central unit Credits is responsible for managing and monitoring credit risks in accordance with the guidelines stipulated by the Board of Directors, the Group Executive Management as well as for internal and external reporting of credit risk.

Credit Follow-up monitors credit quality and compliance with credit policies. This process involves “desk research” using information from the Group’s database on all exposures as well as control visits at the individual branches. The aim is to review every branch at least every third year. Moreover Credit Follow-up conducts annual quality analyses of the Group’s new exposures.

Credit Follow-up also assesses whether the Group’s rating systems, from a credit viewpoint, rank clients correctly.

All regional corporate departments have identified a number of exposures to which particular focus is given and these are analysed and reviewed at least every six months at the initiative of Credits. The purpose is to ensure that follow-up and adjustment of the Group’s action plans as regards these exposures are carried out on an ongoing basis.

Finally Credits encompasses a number of experts who are assigned to exposures with a risk of loss exceeding DKK 3m. These exposures are closely monitored and Credits is actively involved in preparing solutions to mitigate the Group’s credit risk.

Maturity

In accordance with the Group's credit policy, settlement of the Group's funding must be adjusted to the economic life of the asset financed, which as a rule may not exceed 20 years. In connection with funding for the acquisition of enterprises, particular risks arise. Therefore, as a rule, such exposures must be settled over a period not exceeding 10 years.

Credit exposure by exposure category and maturity

DKKm **Exposure – maturity**	Non- allocated	3 months or less	Over 3 months not exceeding 1 year	Over 1 year not exceeding 5 years	Over 5 years	**2010** Total
Corporate clients	-	56,279	17,884	8,901	6,366	89,430
Retail clients	-	12,733	10,156	3,956	8,452	35,297
Total corporate clients and retail clients	**-**	**69,012**	**28,040**	**12,857**	**14,818**	**124,727**
Governments etc	650	2,030	641	-	26	3,347
Institutions	-	28,368	1,113	4	3	29,488
Shares	858	-	-	-	-	858
Other exposures	1,606	-	-	-	-	1,606
Total	**3,114**	**99,410**	**29,794**	**12,861**	**14,847**	**160,026**

The table shows the maturity of the Group's exposures broken down into different segments. According to the Group's documents, the majority of corporate exposures can be terminated at very short notice and retail exposures can normally be terminated at a notice of three months.

Impairment

Credit exposure by credit quality

DKKm	Corporate clients	Retail clients	Other	**2010** Total
Neither past due nor impaired	88,185	34,838	35,299	158,322
Past due but not impaired	48	45	-	93
Impaired after impairment charges	1,197	414	-	1,611
Total	**89,430**	**35,297**	**35,299**	**160,026**

DKKm				**2009**
Neither past due nor impaired	93,783	35,413	41,279	170,475
Past due but not impaired	83	69	-	152
Impaired after impairment charges	1,753	296	-	2,049
Total	**95,619**	**35,778**	**41,279**	**172,676**

Impaired amounts owed include amounts owed by clients where there is objective evidence of individual impairment.
Past due amounts consist of loans and advances from a client's first day of arrears where there is no objective evidence of impairment.
A very limited share of past due amounts concerns high credit risk clients.

Past due amounts

DKKm			**2010**			**2009**
	Retail clients	Corporate clients	Total	Retail clients	Corporate clients	Total
0-30 days	42	42	84	64	79	143
31-60 days	3	6	9	4	3	7
61-90 days	-	-	-	1	1	2
Total	**45**	**48**	**93**	**69**	**83**	**152**

Where there is objective evidence of impairment of loans and advances or amounts owed, individual impairment charges are recorded. The charge equals the difference between the carrying amount of the loans and advances and the present value of expected future cash flows from the loans and advances, including realisation of any collateral. Determination of the expected future cash flows is based on the most likely outcome.

Clients with exposures subject to objective evidence of impairment who are not in default are automatically downgraded to rating category 9 while clients in default are automatically downgraded to rating category 10.

Loans and advances without objective evidence of impairment are collectively assessed for impairment. Such assessments concern groups of loans and advances with uniform credit risk characteristics. The models applied are based on classifications where group classification is defined by the clients' current rating. Collective impairment charges are determined by the rating at the balance sheet date compared with the rating on the establishment of the loans. The consequence of rating changes as regards the groups' future cash flows is determined on a net basis.

The cash flows are specified by means of parameters used to calculate the capital requirement and by means of historical loss data adjusted for accounting purposes. Where the Group becomes aware that deteriorations or improvements which the models have not yet taken fully into account have occurred at the balance sheet date, the impairment charge is adjusted accordingly.

Impairment testing is conducted on a regular basis by the centralised credit organisation.

Impairment charges for loans and advances etc are recognised in the income statement as follows:

Impairment charges for loans and advances etc

	Sydbank Group		Sydbank A/S	
DKKm	2010	2009	2010	2009
Impairment of loans and advances recognised in the income statement				
Impairment and provisions	709	972	709	973
Write-offs	880	465	880	465
Recovered from debt previously written off	33	69	33	69
Impairment of loans and advances etc	**1,556**	**1,368**	**1,556**	**1,369**

The table below shows impairment charges and provisions by geography.

Individually impaired loans and advances and guarantees as well as impairment charges and provisions by client's country of domicile

DKKm			**2010**			**2009**
	Individually impaired loans/advances and guarantees	Individual impairment and provisions	Impaired after impairment charges	Individually impaired loans/advances and guarantees	Individual impairment and provisions	Impaired after impairment charges
Denmark	2,925	1,462	1,463	3,401	1,521	1,880
Germany	215	91	124	174	59	115
Other	68	44	24	111	57	54
Total	**3,208**	**1,597**	**1,611**	**3,686**	**1,637**	**2,049**

Impairment

The tables below show individually impaired loans and advances and guarantees as well as impairment charges and provisions by industry.

Individually impaired loans and advances and guarantees as well as impairment charges and provisions by industry

DKKm **Industry/rating category**	Individually impaired loans/advances and guarantees	Individual impairment and provisions	**2010** Impaired after impairment
Sector guarantees	-	-	-
Real property	497	207	290
Trade (retail and wholesale)	301	179	122
Investments, other	614	405	209
Agriculture	359	150	209
Manufacturing	322	150	172
Building and civil engineering	187	63	124
Services (professions)	103	63	40
Transportation	58	27	31
Retail clients	767	353	414
Total	**3,208**	**1,597**	**1,611**
Individually impaired loans/advances	3,020	1,565	1,455
Sector guarantees	-	-	-
Other guarantees	188	32	156
Total	**3,208**	**1,597**	**1,611**

			2009
Sector guarantees	377	220	157
Real property	967	300	667
Trade (retail and wholesale)	283	135	148
Investments, other	681	309	372
Agriculture	169	74	95
Manufacturing	239	121	118
Building and civil engineering	108	56	52
Services (professions)	203	78	125
Transportation	42	23	19
Retail clients	617	321	296
Total	**3,686**	**1,637**	**2,049**
Individually impaired loans/advances	3,126	1,397	1,729
Sector guarantees	377	220	157
Other guarantees	183	20	163
Total	**3,686**	**1,637**	**2,049**

Credit risk to financial counterparties

Trading in securities, currencies and derivatives, as well as payment services etc involve exposure to financial counterparties in the form of delivery risk or credit risk.

Delivery risk is the risk that the Group does not receive payments or securities in connection with the settlement of securities or currency transactions equalling the securities or payments delivered by the Group.

Management grants delivery risk lines and credit risk lines to financial counterparties based on the risk profile of the individual counterparty which is assessed in terms of rating, earnings, capital and size. Risks and lines to financial counterparties are monitored continuously.

The Group participates in an international foreign exchange settlement system, CLS®, which aims to reduce delivery risk. In CLS® payment is made on the net position for each currency, and only one amount for each currency is paid or received. In addition this net exposure is to one counterparty only, who is the Group's partner in the system.

The Group aims to mitigate credit risk to financial counterparties in many ways, eg by concluding netting agreements. Moreover the Group has executed Credit Support Annexes with a number of the largest counterparties to ensure credit risk mitigation of derivatives. Exposures are calculated on a daily basis after which the parties settle collateral. Consequently exposures are reset in all material respects on a daily basis.

Appendix 1 – Definitions

CEBS	The Committee of European Banking Supervisors.
CLS®	Continuous Linked Settlement. A settlement system operating on the principle of “payment on delivery”, which minimises the settlement risk of currency transactions concluded between CLS® participants.
Conversion factor	The proportion of the undrawn credit commitment which the client is expected to have drawn at default.
CSA	Credit Support Annex. An annex to an ISDA agreement according to which Sydbank is entitled to collateral if the counterparty’s negative market values exceed a pre-agreed fixed amount.
Default	A client who is not expected to meet all of his payment obligations to the Group.
EAD	Exposure At Default. The expected portion of an exposure if the client defaults in the next 12 months.
Gross exposure	Loans and advances, undrawn credit commitments, interest receivable, repo/reverse transactions and guarantees as well as counterparty risk on derivatives. Exposures are determined after impairment charges and provisions.
IRB	Internal ratings based approaches to manage credit risk and calculate the capital requirement as regards credit risk.
ISDA agreement	International Swaps and Derivatives Association. A standardised agreement concluded with a counterparty. The agreement allows for netting of derivatives transactions concluded.
LGD	Loss Given Default. The proportion of a client exposure which is expected to be lost if the client defaults in the next 12 months.
Net exposure	Gross exposure after inclusion of the conversion factor and after deduction of collateral.
Netting agreement	Agreement according to which the rights and obligations of two or more parties are netted. Credit risk is mitigated via netting agreements.
OEI	Objective evidence of impairment and therefore impairment charges must be calculated.
PD	Probability of Default. Probability that a client will default in the next 12 months.
RWA	Risk-weighted assets calculated in accordance with prevailing capital adequacy rules.
Settlement risk	The risk of loss as a consequence of payment obligations between Sydbank and its counterparties not being settled as agreed.
STD	Standardised Approach to calculate credit risk.
Unsecured portion	The portion of an exposure for which the Group does not have collateral following a cautious assessment of collateral provided.

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