Group Risk Report 2018

Arbejdernes Landsbank

Aktieselskabet Arbejdernes Landsbank | CVR no. 31 46 70 12 | Copenhagen, Denmark

Group Risk Report 2018
for Arbejdernes Landsbank

Contents

Arbejdernes Landsbank

Overall risk management

The aim of the Group Risk Report is to provide an insight into internal risk management at Arbejdernes Landsbank and into the approach to reviewing and managing risk.

This risk report has been prepared in accordance with articles 431-455 of Regulation No. 575/2013 (CRR) as well as the Executive Order on Calculation of Risk Exposures, Own Funds and Solvency Need.

The Group Risk Report covers:

- Strategies and procedures for risk management
- The structure and organisation of risk management
- The scope and nature of systems for risk reporting and measurement
- Policies for hedging, reducing and monitoring risk

Furthermore, the report includes information about risks and risk management in the annual report of Arbejdernes Landsbank. Reporting pursuant to the disclosure requirements is performed in connection with presentation of the financial statements, whereas the individual solvency need is published quarterly.

The strategy for managing risk is that Arbejdernes Landsbank is to remain a strong financial enterprise for owners and customers alike. Arbejdernes Landsbank focusses on being aware of the risks to which it is exposed and on managing these appropriately.

The information in the Group Risk Report covers the Arbejdernes Landsbank Group (Arbejdernes Landsbank). The Group includes the following companies:

- A/S Arbejdernes Landsbank (parent company)
- AL Finans A/S (subsidiary)
- Handels ApS Panoptikon[1] (subsidiary)

Both subsidiaries are fully owned by the parent company A/S Arbejdernes Landsbank. Activities in the subsidiary, AL Finans A/S, are based on funding from the parent company. There are no differences between the consolidation basis for accounting purposes and consolidation in accordance with the CRR. Unless otherwise explicitly stated in the report, the information pertains to the whole Group.

The basis for the overall structure of risk management at Arbejdernes Landsbank is as follows:

- Risk policies and guidelines for the Executive Management established by the Board of Directors
- The Audit and Risk Committee established by the Board of Directors assesses whether the internal-control, audit, risk and security systems are working effectively, including an assessment of the internal audit function, the statutory audit and the financial reporting process
- Internal risk committees at Executive Management level
- Risk reports and monitoring, including compliance with policies and guidelines

Arbejdernes Landsbank has a Risk Department managed by the CRO (Chief Risk Officer). The Risk Department is the 2nd line in the risk-management organisation, and it monitors risk management across Arbejdernes Landsbank, including correct identification, measurement, handling and reporting of all significant risks. At least twice a year, the Risk Department prepares a report to the Board of Directors and the Executive Management regarding Arbejdernes Landsbank's risks, and the report includes assessments by the CRO as well as possible recommendations. The Risk Department includes an independent compliance unit managed by the Head of Compliance. This unit is responsible for independent reporting to the Executive Management and the Board of Directors. Monitoring of IT security also falls under the Risk Department.

Measures to protect Arbejdernes Landsbank from being abused for money laundering and/or financing of terrorism are anchored in an independent department to ensure a high level of focus (the AML Department).

The Credit Departments in the Bank and in the Bank's subsidiary AL Finans A/S, respectively, are responsible for day-to-day risk management (1st line) of credit risk in the Bank's branches and in AL Finans A/S. The Credit Departments ensure compliance with the credit strategy as well as the credit policy and coordinate branch contact as well as credit advisory services for processing individual cases.

The Treasury & Finance Department is responsible for day-to-day risk management (1st line) of market risk, liquidity risk and credit risk associated with financial counterparties. Internal Risk Management and Control, which is part of the Treasury & Finance Department, is responsible for calculating, reporting, analysing and assessing the Bank's risks, and for controlling authorities and guidelines.

1 The Handels ApS Panoptikon subsidiary is currently inactive.

Management of operational risk is anchored in the individual business units in order to ensure efficient management of events that have caused, or may potentially cause, operational losses. Arbejdernes Landsbank has systems to identify risk events of an operational nature and, other than reporting for managerial purposes, these systems are used to implement continuous improvements of procedures and contingency plans. The Accounting Department is responsible for management reporting, updating risk assessments and following up on compliance with policies.

The Board of Directors and the Executive Management receive regular reports on developments in risk at Arbejdernes Landsbank. At least once a year, the Board of Directors assesses whether the risk policies need to be changed.

If activities in new areas are under consideration, the nature and scope of these are discussed by the day-to-day management. A risk analysis is prepared before a recommendation is made to the Board of Directors, either to enter into specific business or to adjust previously completed instructions. The CRO will be involved if the decisions concern acceptance of new or significant risks for Arbejdernes Landsbank.

There is focus on maintaining up-to-date IT systems in order to support risk management in significant business areas, and to quantify the size of the risks to which Arbejdernes Landsbank is exposed at any time.

Internal Audit (3rd line) is responsible for carrying out independent audit of risk management by Arbejdernes Landsbank, including the internal controls and monitoring of the risk area. Internal Audit reports on its activities and results to the Board of Directors as well as the Audit and Risk Committee.

Management declaration

Pursuant to article 435(1) of the Capital Requirements Regulation (CRR), on 19 February 2019, the Board of Directors and the Executive Management of Arbejdernes Landsbank approved Arbejdernes Landsbank‘s Group Risk Report for 2018.

In the assessment of the Board of Directors, the risk management of Arbejdernes Landsbank comply with current regulations and standards and provide assurance that the risk management systems put in place are adequate with regard to the profile and strategy of Arbejdernes Landsbank.

In the assessment of the Board of Directors, the description of Arbejdernes Landsbank and the Group‘s overall risk profile associated with the business strategy, business model and financial ratios and key figures provides a comprehensive view of the risk management, including how the risk profile interacts with the risk tolerance set by the Board of Directors.

The assessment by the Board of Directors was carried out on the basis of the business model and strategy adopted by the Board of Directors, and reporting presented to the Board of Directors by the Executive Management, internal and external audit, the CRO and the Head of Compliance, as well as on the basis of any supplementary information or statements obtained by the Board of Directors.

The overall requirements for individual risk areas associated with Arbejdernes Landsbank‘s business model are realised through the individual risk policies.

A review of the Board of Directors‘ guidelines and the authority transferred to the Executive Management shows that the actual risks are within the limitations laid down in the individual policies. The underlying guidelines and the authority transferred onward by the Executive Management are within the limitations of this authorisation.

Thus the Board of Directors assesses that the business model, policies, guidelines and the actual risks within the individual areas of activity are in alignment.

The business model describes who Arbejdernes Landsbank’s customers are, what Arbejdernes Landsbank wants to offer them, and how, commercially and organisationally, Arbejdernes Landsbank intends to realise long-term strategic goals, thus creating value for customers, employees and owners.

Arbejdernes Landsbank aims at profitable earnings based on product pricing which reflects the risk and the capital commitments accepted by Arbejdernes Landsbank as well as an overall assessment of the scope of business with customers and counterparties. Arbejdernes Landsbank aims to maintain an appropriately robust capital base which supports the business model.

Arbejdernes Landsbank‘s objective is that the excess capital ratio at Bank level as well as Group level compared with the calculated solvency need amounts to at least 6.5 percentage points. At the end of 2018, the excess cover amounted to 10.3 percentage points for the Group and 10.2 percentage points for the Bank.

The maximum risk tolerance decided by the Board of Directors is managed via the limits laid down in the individual policies and Executive Management guidelines.

Moreover, the Board of Directors considers the limits set in the supervisory diamond from the Danish FSA, see table 1, which shows the maximum limit values allowed as well as the Bank's compliance at the end of 2018.

Table 1
Benchmarks from the Danish FSA at the end of 2018

	The supervisory diamond	Bank compliance
Funding ratio	< 1	0.4
Liquidity benchmark	> 100%	247.4%
Large exposures	< 175%	53.0%
Lending growth	< 20%	0.5%
Commercial property exposure	< 25%	3.5%

Disclosure requirements regarding management systems, see article 435(2), points a-d of the CRR, are described on pp. 19-26 of the 2018 Annual Report, and on Arbejdernes Landsbank's website, https://www.al-bank.dk/om-banken/fakta-og- historik/corporate-governance/ (in Danish).

Risk management organisation

The Board of Directors has overall responsibility for defining and managing Arbejdernes Landsbank's risks, see figure 1. This is done on the basis of a business model, a strategy, risk policies and contingency plans. Based on reporting, the Board of Directors regularly follows up on risk management to ensure that it is satisfactory and that Arbejdernes Landsbank is operated responsibly and in accordance with guidelines and policies. The Audit and Risk Committee established by the Board of Directors contributes to preparing the Board's discussions and decisions with regard to accounting and auditing, and to ensuring the effectiveness of internal control systems and risk management systems.

Special issues of a cross-sectoral nature are treated by a Risk and Liability Management Committee set up by the Executive Management and including the Executive Management as well as the CRO.

A Credit Committee has been set up, tasked to authorise exposures of a certain size, approve impairment levels, approve credit management tools and deal with any other credit-related issues. The Committee is composed of the Executive Management and the Director of Credit. The CRO is also a member of the Committee, but has no authority to grant loans.

An Operational Risk Committee has also been established to monitor compliance with policies for operational risk and to support the Audit and Risk Committee in assessing operational risk. The Committee is composed of the Executive Management the CRO, the Head of Compliance, the IT Director and the CFO.

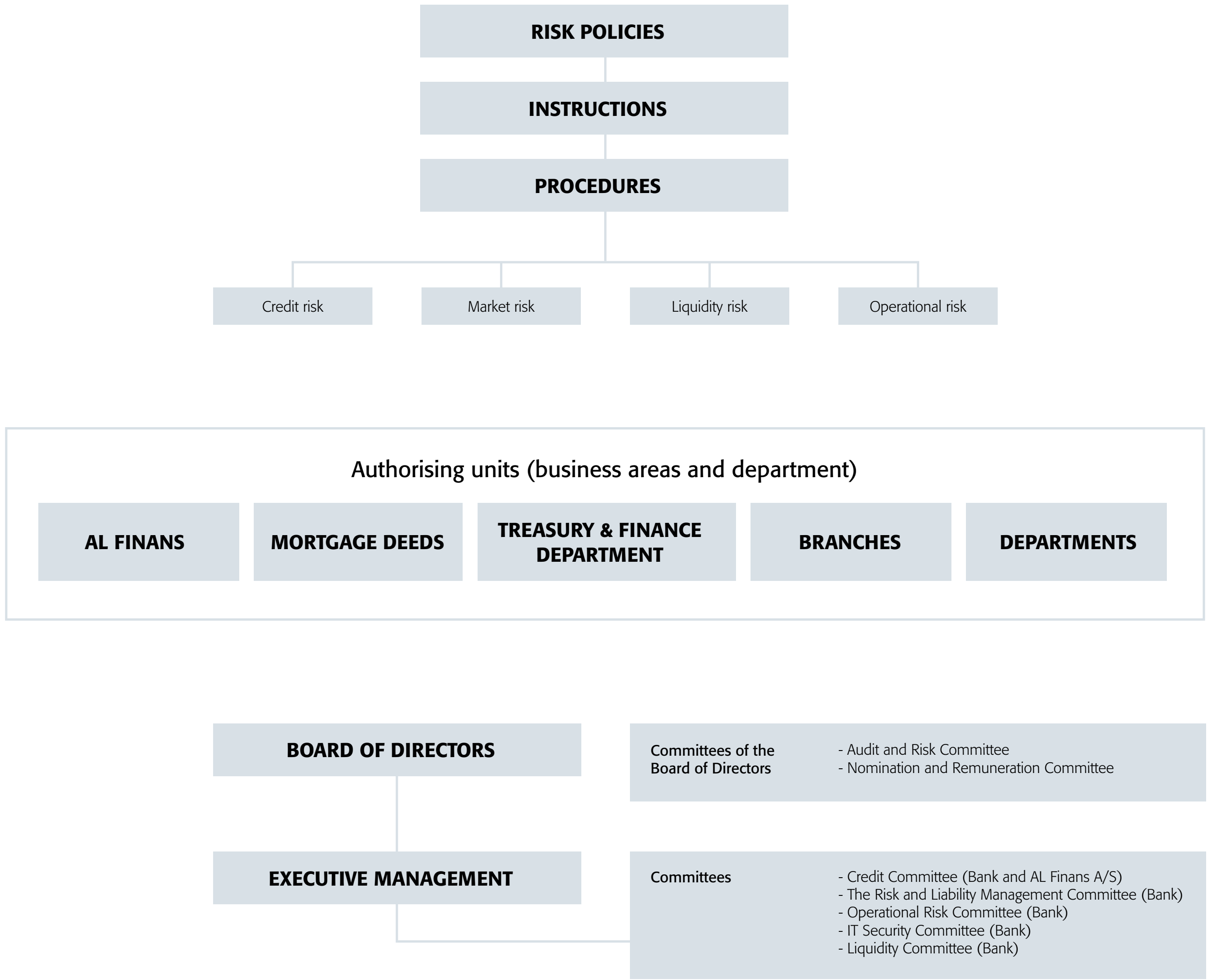
The Liquidity Committee deals with topics related to day-to-day liquidity management and the needs and possibilities associated with this. Liquidity reports are also considered by this Committee prior to submission to the Board of Directors. The Committee is composed of the Executive Management, the Deputy Bank Director, the Finance Director, the Chief Economist, and the Head of the Treasury function as well as the Head of Internal Risk Management and Control.

The tasks of the IT Security Committee are to review and provide input on topics and tasks related to IT security and to ensure coordination and knowledge-sharing about IT security initiatives across the Bank. The Committee consists of the Bank's IT Director, senior employees from the IT Department, the CRO, the Bank's DPO, the Head of Compliance, the Head of IT Security, management employees from the business areas and an employee from Finance responsible for operational risk.

The Executive Management and the Director of Credit are represented on the Board of Directors of the Bank's subsidiary AL Finans A/S, and they help to ensure that the risk policies of the Group are implemented.

Organisation chart for risk management

Figure 1



1ST LINE OF DEFENCE	2ND LINE OF DEFENCE	3RD LINE OF DEFEN
Credit Department/Credit Secretariat (Credit risk - Bank)	**Risk Department** (Group)	**Internal Audit** (Group)
Internal Risk Management and Control (Market, counterparty and liquidity risk - Bank)	**Compliance** (Group)	
Credit Department (Credit risk - AL Finans)	**Compliance and Risk** (AL Finans)	
AML Department (Operational risk - Bank)		
The individual areas, business areas and departments (Operational risk - Group)		

Reporting overview

Annual reporting/approval	Quarterly reporting/approval
Individual solvency need, ICAAP Assessment and approval of model for calculating solvency need.	**Individual solvency need** Assessment of risk profile and calculation of adequate own funds.
Risk policies Review of risk policies for the individual risk areas and assessment of the need for adjustments. Follow-up on compliance with risk policy.	**Solvency and capital** Solvency and capital statements (monthly). **Credit risks** Developments in loans and guarantees broken down by customer segment, rating code, overdraft, etc.
Contingency plans Review of contingency plans (capital conservation plans, capital ratio improvement plans, IT contingency plans, and recovery plans).	**Market risks** Developments in interest-rate risks and credit-spread risks, as well as share and currency risks compared with frameworks and investment strategy (monthly).
Projections Projection of the Bank's capital, solvency, and earnings in different macro-economic scenarios (half-yearly). **Benchmark analysis** Benchmarking against comparable banks in selected areas/ratios and key figures.	**Liquidity risks** Developments in excess cover in relation to the LCR (monthly). Analysis of liquidity in the short and the long terms, including liquidity stress tests (monthly).
Calculation and assessment of liquidity position and liquidity risk (ILAAP) Overall calculation and assessment of liquidity position and liquidity risk.	**Operational risk** Review and assessment of standalone incidents with significance in terms of value. Reporting on IT security forms part of this reporting.
Risk report by the CRO Report about the work of the risk function (half-yearly) and overall assessment of the Group's risks and risk management. Follow-up on the year's risk action plan and review of next year's action plan.	**The supervisory diamond** Developments in the Bank's ratios and key figures in relation to the limits in the supervisory diamond (monthly). **Follow-up on risk indicators** Follow-up on yellow-light and red-light indicators in the recovery plan. Indicators concerning capital and liquidity (monthly).
Recovery plan Confirmation that the Group itself can initiate compensatory measures if selected risk indicators exceed set limit values.	
CSR report The CSR report accounts for the Group's corporate social responsibility.	
Compliance Report on the compliance function's work and the Group's general compliance (half-yearly).	
Annual budget Business and strategic risks are identified in the Group budget preparation process.	
Financial statements Earnings development.	

Capital management

Capital management

Capital management at Arbejdernes Landsbank is set out in plans to ensure compliance, at all times, with current legislation and realisation of internal solvency targets. The legislation concerns:

- Calculation of capital, risk exposures and capital requirements (8% requirement)
- Calculation of individual solvency need
- Combined buffer requirement

The individual solvency need is described in the Danish Financial Business Act and encompasses any additional capital requirements to cover risks which are not adequately covered by the 8% minimum requirement according to the CRR. The combined buffer requirement also derives from the CRR and entails generation of a capital preservation buffer of 2.5% as well as introduction of a countercyclical buffer of up to 2.5% that the Minister for Industry, Business and Financial Affairs may decide to activate[1].

In addition to the goals pursuant to current legislation, Arbejdernes Landsbank has set its own capital targets to ensure sufficient capital to support longer-term goals for growth and risk profile. Furthermore, the capital targets are to bolster Arbejdernes Landsbank to resist economic recession and absorb material unexpected credit losses and price fluctuations on the financial markets.

Arbejdernes Landsbank has made projections under various macro-economic scenarios, and, in combination with capital plans, capital preservation plans and solvency improvement plans, these scenarios confirm that Arbejdernes Landsbank has the required financial strength to meet its own objectives for capital buffers. Arbejdernes Landsbank has an objective for a capital ratio that, as a minimum, covers the solvency need, the full combined buffer requirement of 5.0% as well as an additional buffer of 1.5%. The solvency need amounted to DKK 9.7% at the end of 2018. The target capital ratio is therefore at least 16.2%, and with a capital ratio of 20.0% at the end of 2018, this has been fully met.

Own funds

Table 2
Calculation of Group own funds

	2018 DKK mill.	2017 DKK mill.
Share capital	300.0	300.0
Revaluation reserves	454.0	326.7
Retained earnings	5,270.2	5,285.9
Proposed dividend	-60.0	-150.0
Intangible assets	-18.7	-16.6
Deductions for prudent valuation	-20.7	-14.2
Capital instruments in financial entities <10%	0.0	0.0
Capital instruments in financial entities >10%	-160.6	-696.6
Common Equity Tier 1	*5,764.3*	*5,035.2*
Additional Tier 1 capital issued	829.0	829.0
Capital instruments in financial entities <10%	0.0	0.0
Capital instruments in financial entities >10%	-12.6	-186.6
Tier 1 capital	*6,580.6*	*5,677.6*
Tier 2 capital	0.0	0.0
Own funds	*6,580.6*	*5,677.6*

During 2018, own funds increased by DKK 903.0 mill. to DKK 6,580.6 mill. To a great extent, this improvement is attributable to reduced deductions for shareholdings in financial entities amounting to DKK 710.0 mill., primarily as a result of the agreement to sell shares in ALKA entered into in 2017, and finally completed in 2018. In addition to this, own funds were particularly affected by a transfer from profit for the year of DKK 188.2 mill., value adjustments through equity of the Bank's properties of DKK 135.4 mill., and an adjustment of equity brought forward of DKK –115.4 mill., mainly attributable to the new impairment regulations under IFRS 9. Currently, own funds consist exclusively of Tier 1 capital, of which Common Equity Tier 1 capital accounts for 88%.

Revaluation reserves amount to DKK 454.0 mill. and relate to value increases on the Bank's owner-occupied properties. Revaluation reserves have increased by DKK 127.3 mill. compared to 2017, and this is primarily attributable to revaluation of the Bank's headquarters in central Copenhagen.

1 In Denmark, the Minister for Industry, Business and Financial Affairs determines the level of the countercyclical buffer at the recommendation of the Systemic Risk Council. In other EU countries, this authority usually rests with the supervisory authorities.

The Bank has issued Additional Tier 1 capital worth DKK 829 mill. The Additional Tier 1 capital complies with the requirements in articles 52-54 of the CRR and has been recognised as part of equity.

The Bank expects to exploit the possibility of early redemption of DKK 400 mill. worth of Additional Tier 1 capital on 23 May 2019, while at the same time issuing up to DKK 900 mill. worth of Tier 2 capital, thus enhancing own funds by a net of up to DKK 500 mill. This capital improvement should be regarded in the context of strong customer growth at the Bank, and as preparation for the stricter capital requirements in CRR II to be phased-in in 2022.

Table 3
Hybrid capital issued

	2018	2017
Type	Hybrid capital	Hybrid capital
Principal amount (DKK mill.)	400.0	400.0
Own portfolio (DKK mill.)	0.0	0.0
Carrying amount (DKK mill.)	400.0	400.0
Currency	DKK	DKK
Interest rate	CIBOR-6M + 6.75%	CIBOR-6M + 6.75%
Received	2011	2011
Maturity	Indefinite	Indefinite
Possibility for redemption before maturity	23.05.2019	23.05.2018
Subsequent interest rate	CIBOR-6M + 6.75%	CIBOR-6M + 6.75%
Interest on subordinated debt (DKK mill.)	26.8	27.1
Subordinated debt recognised when calculating Tier 1 capital/own funds (DKK mill.)	400.0	400.0
Type	Hybrid capital	Hybrid capital
Principal amount (DKK mill.)	429.0	429.0
Own portfolio (DKK mill.)	0.0	0.0
Carrying amount (DKK mill.)	429.0	429.0
Currency	DKK	DKK
Interest rate	9.059%	9.059%
Received	2014	2014
Maturity	Indefinite	Indefinite
Possibility for redemption before maturity	22.01.2021	22.01.2021
Subsequent interest rate	CIBOR-6M + 7.25%	CIBOR-6M + 7.25%
Interest on subordinated debt (DKK mill.)	38.9	38.9
Subordinated debt recognised when calculating Tier 1 capital/own funds (DKK mill.)	429.0	429.0

Capital requirement (8%)

Arbejdernes Landsbank's capital ratio and Tier 1 capital ratio at the end of 2018 were both 20.0% compared with 18.3% at the end of 2017. The 1.7 percentage-point increase is attributable to an improvement in own funds. Risk-weighted exposures for the period increased by DKK 1,790.9 mill. of which DKK 1,080.0 mill. related to items with market risk and DKK 714.8 mill. related to items with credit risk.

Arbejdernes Landsbank uses the following methods to calculate the capital ratio:

- The standard method for calculation of credit risk
- The standard method to calculate market risk
- The market value method to calculate counterparty risk
- The basic indicator approach for calculation of operational risk
- Collateral in the form of securities in accordance with the extended method
- Collateral in the form of mortgages on real property and deposits with the Bank

Table 4
Capital requirement (8%)

	2018 DKK mill.	2017 DKK mill.
Exposures with credit risk etc.		
Exposures to institutions	26.0	28.3
Exposures to companies	327.6	344.5
Retail exposures	1,036.3	1,051.4
Exposures secured by mortgages on real property	142.0	121.0
Exposures in default	44.1	42.8
Exposures with particularly high risk	32.6	15.5
Exposures in investment associations	0.8	0.0
Share exposures	157.1	144.5
Other exposures	135.1	94.1
CVA risk	9.8	12.4
Total exposures with credit risk etc.	*1,911.6*	*1,854.4*
Exposures with market risk		
Debt instruments, specific risk	229.4	180.2
Debt instruments, interest-rate risk	165.4	102.0
Position risk for shares	15.0	46.2
Currency risk	11.6	6.5
Total exposures with market risk	*421.4*	*334.8*
Operational risk	292.8	293.3
Total capital requirement	*2,625.8*	*2,482.5*
Own funds for compliance with capital requirement	6,580.6	5,677.6

The capital requirement according to pillar I (8% of the risk-weighted exposures) amounted to DKK 2,625.8 mill. at the end of 2018 against DKK 2,482.5 mill. in the previous year. The capital requirement for credit risk increased by DKK 57.2 mill., which reflects growth in the loan and guarantee portfolio. The capital requirement for market risk increased by DKK 86.6 mill., and this is mainly attributable to positions in debt instruments.

Solvency need

Model

An individual solvency need for both the Group and the Bank is set by Arbejdernes Landsbank.

The so-called 8+ model is used to set the individual solvency need. The model is based on an assumption that the minimum capital requirement of 8% of the risk-weighted exposures (pillar I requirement) covers the normal risks. In addition, Tier 2 capital needs for risk areas are calculated, if they are deemed not to be covered by the 8% requirement. The individual solvency need is thus composed of the minimum capital requirement of 8% and the calculated Tier 2 capital need.

The model is based on the Guidelines on adequate own funds and solvency need for credit institutions from the Danish FSA.

The solvency need is calculated as the total capital need as a percentage of the risk-weighted exposures calculated according to the provisions of the CRR. In accordance with the CRR, the risk-weighted exposures are calculated for both the Group and the Bank. The Group's risk-weighted exposures are used to calculate the solvency need.

Adequate capital and solvency need

Arbejdernes Landsbank's solvency need was 9.7% at the end of 2018 against 10.0% at the end of 2017. Adequate own funds amounted to DKK 3,199.8 mill. Calculation of adequate own funds and solvency need can be broken down into the following categories:

Table 5
Solvency need

	2018 DKK mill.	2018 %	2017 DKK mill.	2017 %
Capital to cover credit risk	2,099.2	6.4	2,049.6	6.6
Capital to cover market risk	774.2	2.4	739.0	2.4
Capital to cover operational risk	292.8	0.9	293.3	0.9
Capital to cover other risks	33.6	0.1	19.8	0.1
Adequate own funds/ solvency need	*3,199.8*	*9.7*	*3,101.7*	*10.0*

Capital to cover credit risk

Capital to cover credit risk is calculated as 8% of the risk exposures relating to credit risk plus Tier 2 capital to cover the following specific risks:

- Concentration risk on large exposures
- Large exposures with financial problems.
- Concentration risk on sectors
- Credit institutions
- Shares etc. outside the trading portfolio
- Other credit risks

Capital to cover market risk

Capital to cover market risk is calculated as 8% of the risk exposures relating to market risk plus Tier 2 capital to cover the following specific risks:

- Market risk within the trading portfolio based on the greatest value of historical utilisation of the framework during the last 12 months, and the maximum permitted exposures specified in the investment strategy approved by the Board of Directors.
- Convexity risk and volatility risk
- Liquidity risks
- Interest-rate risk outside the trading portfolio

Capital to cover operational risk

Capital to cover operational risk is equivalent to the solvency requirement according to the Basic Indicator Approach set out in articles 315-316 of the CRR. Arbejdernes Landsbank makes its own calculations of operational risk based on historical losses, among other things. These calculations show a significantly lower risk than the solvency requirement.

Capital for other risks

Capital to cover other risks includes assessments of capital requirements for the level of earnings, lending growth, leverage, risk of falling prices on owner-occupied and investment properties, as well as other aspects, including statutory requirements.

Process

Assessment of the solvency need (ICAAP process) is an integrated part of Arbejdernes Landsbank's routine budget process, in which the Board of Directors annually approves the budget and the solvency need. In addition, the solvency need is adjusted and corrected every quarter, and this is also presented to the Board of Directors.

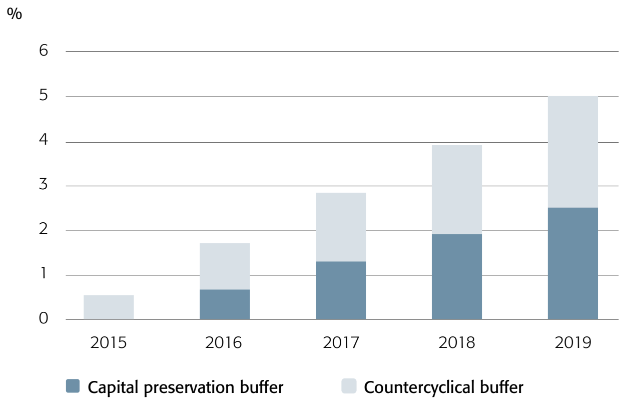
The Risk Department is responsible for completing the ICAAP process, and this takes place in a coordinated process involving all relevant departments. Risk calculations, assessments and documentation are completed by entities with the expertise within the individual risk areas. The individual risk areas are responsible for establishing controls to ensure that the calculations are correct and documented. The Risk Department and the Finance Department monitor developments in the solvency need.

Combined buffer requirement

Danish banks are obligated to comply with the combined buffer requirement as a result of implementation of the Capital Requirements Directive, CRD IV, through the Danish Financial Business Act. The combined buffer requirement covers the total requirement for Common Equity Tier 1 capital necessary to comply with the requirement for a capital preservation buffer and a countercyclical buffer. Non-compliance with the buffer requirement will result in restrictions on Arbejdernes Landsbank's possibilities to pay dividends and make other distributions.

Figure 2

Phasing-in of buffer requirements 2015-2019



The capital preservation buffer amounted to 1.875% in 2018. The capital preservation buffer was phased in by 0.625% a year in the period 1 January 2016 to 1 January 2019, and amounts to 2.5% of the total risk exposure at full phase-in on 1 January 2019.

Similarly, the countercyclical buffer, which can be activated by the Danish Minister for Industry, Business and Financial Affairs on the recommendation of the Systemic Risk Council, was phased-in in Denmark by 0.5% a year in the period 1 January 2015 to 1 January 2019. Consequently, after being fully phased-in as at 1 January 2019, the countercyclical buffer is in the range 0% to 2.5% of the total risk exposure. The countercyclical buffer will be activated in individual countries if assessments in these countries show that lending growth is causing higher macro-economic risks.

In Denmark, the countercyclical capital buffer was 0% at the end of 2018, but on the recommendation of the Systemic Risk Council, the Minister for Industry, Business and Financial Affairs has decided to activate the countercyclical capital buffer at 0.5% as at 31 March 2019 and an additional 0.5% as at 30 September 2019.

The institution-specific countercyclical buffer is calculated on the basis of the geographical distribution of credit exposures in Arbejdernes Landsbank. For countries in which credit exposures exceed 2% of total credit exposures, capital must be reserved in the event that the countercyclical buffer has been activated.

Table 6
Geographical distribution of credit exposures at the end of 2018

Own funds requirement

	General credit exposures	Exposures in the trading portfolio	Total
	DKK mill.	DKK mill.	DKK mill.
Denmark	1,853.5	152.5	2,005.9
Germany	2.2	6.3	8.6
Other countries *)	19.8	78.3	98.2
Total	*1,875.5*	*237.2*	*2,112.7*

Exposures

	General credit exposures	Exposures in the trading portfolio	Total	Percentage of total exposures
	DKK mill.	DKK mill.	DKK mill.	%
Denmark	37,236.6	17,851.1	55,087.8	89.1
Germany	235.3	2,593.4	2,828.7	4.6
Other countries *)	577.9	3,323.2	3,901.2	6.3
Total	*38,049.9*	*23,767.8*	*61,817.7*	*100.0*

*) "Other countries" refers to all exposures amounting to less than 2% of total general credit exposures and exposures in the trading portfolio. These are ascribed to Denmark when calculating the institution-specific countercyclical capital buffer.

The table above shows that, apart from Denmark, Germany is the only country in which Arbejdernes Landsbank has credit exposures exceeding 2%. As Germany has not activated a countercyclical buffer, and as the countercyclical buffer will not be activated in Denmark until 2019, the institution-specific countercyclical buffer rate is currently 0%, and the requirement for the institution-specific capital buffer is thus DKK 0.

Table 7
Combined buffer requirement

		2018	2017
Total risk exposures	DKK mill.	32,822.4	31,031.5
Capital preservation buffer rate	%	1.875	1.250
Institution-specific countercyclical buffer rate (%)	%	0.000	0.000
Capital preservation buffer	DKK mill.	615.4	387.9
Institution-specific countercyclical buffer	DKK mill.	0.0	0.0
Combined buffer requirement	DKK mill.	***615.4***	***387.9***

In 2018, the combined buffer requirement was increased to DKK 615.4 mill. as a result of annual phasing-in of the capital preservation buffer by 0.625 percentage points. As mentioned above, there will be a further increase in the combined buffer requirement in 2019 as a result of the countercyclical buffer being activated in Denmark at 1.0% from 30 September 2019, while the capital preservation buffer increased to 2.5% as at 1 January 2019.

Excess cover in relation to the total capital requirement

At the end of 2018, Arbejdernes Landsbank's capital ratio was 20.0%, which corresponds to an excess cover of 8.4 percentage points relative to the total capital requirement of 11.6% comprising the minimum capital requirement of 8.0%, the Tier 2 capital need of 1.7% and the combined buffer requirement of 1.875%.

The minimum capital requirement of 8% must be covered by at least 4.5% Common Equity Tier 1 capital. Hybrid capital may account for up to 3.5%, and Tier 2 capital may account for up to 2.0%. Corresponding relative quality requirements for capital apply to the Tier 2 capital need. The combined buffer requirement can only be covered by Common Equity Tier 1 capital.

Table 8
Capital composition in relation to the minimum requirement at the end of 2018

	Capital requirement %	Capital requirement DKK mill.	Capital DKK mill.	Surplus capital DKK mill.
Common Equity Tier 1 capital	7.4	2,415.3	5,764.3	3,349.0
Tier 1 capital	9.2	3,015.3	6580.6	3,565.4
Own funds	11.6	3,815.2	6580.6	2,765.4

The table shows that Arbejdernes Landsbank has total capital buffers of DKK 2.8 bn. relative to the minimum requirements. The higher excess cover of Common Equity Tier 1 capital of DKK 3.3 bn. compared to the excess cover of own funds shows that Arbejdernes Landsbank is in a good position to bolster its capital by issuing Tier 2 capital.

MREL requirement

According to the Danish Financial Business Act, the Danish FSA and Finansiel Stabilitet are responsible for preparing resolution plans for banks in distress. These plans state that a minimum requirement for own funds and eligible liabilities (MREL) must be determined for the individual bank. The MREL will ensure that a bank in distress has sufficient eligible liabilities to cover losses in the bank and to recapitalise the bank so that critical functions can be continued without using public funds.

The MREL requirement is composed of the individual solvency need, the combined buffer requirement and a MREL supplement, as notified to the individual institution. The requirement for the MREL supplement for Arbejdernes Landsbank is 7.0% calculated in relation to risk-weighted exposures, and this will be phased in over a 5-year period, as 0.6% in 2019, 1.9% in 2020, 3.1% in 2021, 4.4% in 2022 and 7% in 2023. On the basis of the solvency need at the end of 2018, the total capital requirement for Arbejdernes Landsbank in 2023 will thus amount to 20.2%, with a countercyclical buffer of 1.0%, and it may be as high as 21.7%, depending on the extent to which the countercyclical capital buffer is activated.

The MREL requirement can be met by the capital items included in own funds and a new type of instrument with a remaining term of more than 1 year, which is referred to as Non Preferred Senior[1].

IFRS 9

In response to new impairment rules under IFRS 9, at the beginning of 2018, Arbejdernes Landsbank made an adjustment to equity of DKK 85 mill. after tax. It is possible to apply a transitional scheme to calculate the own funds, so that the effect of the new impairment rules is phased in over a 5-year period. Arbejdernes Landsbank has decided not to use this transitional scheme because of the relatively limited effect on own funds. However, it is possible to change this decision once during the 5-year phase-in period.

CRR II/CRD V - Upcoming regulations

In December 2017, the Basel Committee published final recommendations on amended regulations for calculation of capital requirements. In the EU, these are known as CRR II and CRD V. The regulatory framework is a further development of the current CRR/CRD IV regulations. Arbejdernes Landsbank uses the standard method to calculate risks and has noted that substantial changes to market risk and credit risk have been recommended under the standard method.

1 Capital instrument that ranks prior over existing capital instruments.

Leverage ratio

The leverage ratio is calculated as Tier 1 capital in relation to the total exposure. Arbejdernes Landsbank regularly considers its leverage risk and adapts this risk to keep Arbejdernes Landsbank well-capitalised while also generating a sufficient return on equity. In its policies, Arbejdernes Landsbank has designed its business model such that it operates with a leverage ratio >7%.

Leverage risk is defined in the CRR, but a final limit value for the leverage ratio has not yet been set. A requirement of a minimum 3% is likely, corresponding to a maximum leverage of approximately 33 times Tier 1 capital. At the end of 2018, Arbejdernes Landsbank had a leverage ratio of 10.5% and thus complies with the expected requirement of at least 3% by a solid margin.

Table 9
Leverage at the end of 2018

	DKK mill.
Leverage-weighted exposures	
Total assets	54,973.8
Adjustments for derivatives	132.8
Adjustments for repo/reverse transactions	0.8
Adjustments for exposures not recognised in the balance sheet	7,614.8
Other adjustments	-58.9
Total leverage-weighted exposures	*62,661.7*
Exposures recognised in the balance sheet, excl. derivatives and repo/reverse transactions	
Assets excl. derivatives and repo/reverse transactions	54,647.4
Assets deducted in Tier 1 capital	-212.6
Total exposures recognised in the balance sheet, excl. derivatives and repo/reverse transactions	*54,434.8*
Derivative exposures	
Positive market value	48.9
Potential risk	132.8
Total derivative exposures	*181.8*
Repo/reverse transactions	
Gross exposures	429.7
Counterparty risk	0.8
Total repo/reverse transactions	*430.5*
Exposures not recognised in the balance sheet	
Gross exposures	12,231.2
Adjustments	-4,616.4
Total exposures not recognised in the balance sheet	*7,614.8*
Capital and leverage-weighted exposures	
Tier 1 capital	6,580.6
Leverage-weighted exposures	62,661.7
Gearingsgrad	10.5%
Total exposures recognised in the balance sheet (excl. derivatives, repo/reverse transactions and non-recognised exposures)	
Exposures treated as exposures to central governments	4,886.5
Institutions	784.8
Exposures secured by collateral in the form of mortgages on real property	2,601.8
Retail exposures	15,574.7
Companies	3,803.1
Exposures in default	435.2
Other exposures (e.g. share exposures, securitisation and other assets which are not debt obligations)	3,188.5
Exposures outside the trading portfolio	*31,274.5*
Exposures in the trading portfolio	23,372.1
Total exposures recognised in the balance sheet	*54,646.6*

Overview of capital, risk exposures and ratios and key figures

Table 10
Capital, risk exposures and ratios and key figures

	2018 DKK mill.	2017 DKK mill.
Common Equity Tier 1 capital		
Share capital	300.0	300.0
Revaluation reserves	454.0	326.7
Retained earnings from previous years	5,068.5	4,137.1
Transferred from profit for the year less proposed dividend	141.8	998.8
Common Equity Tier 1 capital before statutory adjustments	*5,964.3*	*5,762.6*
Statutory adjustments - Common Equity Tier 1 capital		
Intangible assets	-18.7	-16.6
Deductions for prudent valuation	-20.7	-14.2
Capital instruments in financial entities (Common Equity Tier 1 capital) >10%	-160.6	-696.6
Total statutory adjustments of Common Equity Tier 1 capital	*-200.0*	*-727.4*
Total Common Equity Tier 1 capital	*5,764.3*	*5,035.2*
Additional Tier 1 capital		
Additional Tier 1 capital issued	829.0	829.0
Statutory adjustments - Additional Tier 1 capital		
Capital instruments in financial entities (Tier 1 capital) >10%	0.0	-87.1
Capital instruments in financial entities (Tier 2 capital) > 10%	-12.6	-99.6
Total statutory adjustments of Additional Tier 1 capital	*-12.6*	*-186.6*
Total Additional Tier 1 capital	*816.4*	*642.4*
Tier 1 capital	*6,580.6*	*5,677.6*
Tier 2 capital	0.0	0.0
Own funds	*6,580.6*	*5,677.6*
Amounts under the thresholds for deduction		
Capital instruments in financial entities <10%	556.8	470.6
Capital instruments in financial entities >10%	592.5	573.2
Deferred tax assets	23.6	11.7

Overview of capital, risk exposures and ratios and key figures

Table 10, continued
Capital, risk exposures and ratios and key figures

	2018 DKK mill.	2017 DKK mill.
Risk-weighted exposures		
Exposures with credit risk	23,895.0	23,180.2
Exposures with market risk	5,267.4	4,185.4
Exposures with operational risk	3,660.0	3,665.9
Total risk-weighted exposures	***32,822.4***	***31,031.5***
Ratios and key figures		
Common Equity Tier 1 capital ratio	17.6%	16.2%
Tier 1 capital ratio	20.0%	18.3%
Capital ratio	20.0%	18.3%
Requirements for institution-specific buffer	0%	0%
Common Equity Tier 1 capital available for buffers	12.0%	10.3%
Leverage ratio	10.5%	10.6%

Exposure classes

Exposure classes calculated using the standard method for credit risk pursuant to articles 111-141 of the CRR. Exposures are calculated after impairment charges and before taking account of the effects of credit risk reductions.

Table 11
Development and average for exposures with credit risk

	Average 2018 DKK mill.	Status 31.12.2018 DKK mill.	Status 30.09.2018 DKK mill.	Status 30.06.2018 DKK mill.	Status 31.03.2018 DKK mill.	Status 31.12.2017 DKK mill.
Exposures to central governments and central banks	4,063.7	4,886.6	3,358.3	2,715.6	3,581.9	5,775.9
Exposures to institutions	1,236.1	1,248.6	1,284.5	1,213.1	1,065.5	1,368.7
Exposures to companies	6,229.2	5,905.2	5,741.6	6,289.4	6,326.7	6,883.3
Retail exposures	22,885.8	23,059.0	23,191.1	23,284.7	22,529.9	22,364.3
Exposures secured by mortgages in real property	4,762.9	5,140.1	4,921.1	4,820.5	4,553.6	4,379.2
Exposures in default	519.9	500.2	494.6	458.6	617.1	529.0
Exposures with particularly high risk	337.3	303.1	421.3	476.7	326.7	158.7
Investment associations	1.9	9.4	0.0	0.0	0.0	0.0
Share exposures	990.2	1,070.5	1,010.2	982.0	944.4	944.2
Other exposures	1,748.0	2,062.4	1,780.9	1,774.3	1,579.4	1,542.8
Total exposures with credit risk	*42,775.0*	*44,185.1*	*42,203.6*	*42,014.8*	*41,525.1*	*43,946.1*

Table 12
Items recognised in the balance sheet *) broken down by remaining maturity

End of 2018

	On demand DKK mill.	0-3 months DKK mill.	3 months to 1 year DKK mill.	1-5 years DKK mill.	More than 5 years DKK mill.
Exposures to central governments and central banks	656.4	4,228.4	0.6	1.0	0.0
Exposures to institutions	596.3	132.3	0.0	55.8	0.4
Exposures to companies	606.5	1,143.3	994.7	616.3	442.3
Retail exposures	117.8	901.6	1,859.2	6,349.7	6,346.3
Exposures secured by mortgages in real property	54.3	156.2	426.1	967.9	997.2
Exposures in default	34.9	44.8	95.0	173.2	87.3
Exposures with particularly high risk	128.5	15.5	46.0	10.7	5.1
Exposures in investment associations	0.0	0.0	0.0	0.0	9.4
Share exposures	0.0	0.0	0.0	4.0	1,066.5
Other exposures	259.4	415.0	55.7	47.5	1,125.3
Total items recognised in the balance sheet	*2,454.2*	*7,037.2*	*3,477.2*	*8,226.1*	*10,079.9*

End of 2017

	On demand DKK mill.	0-3 months DKK mill.	3 months to 1 year DKK mill.	1-5 years DKK mill.	More than 5 years DKK mill.
Exposures to central governments and central banks	654.8	5,116.6	0.6	0.9	0.0
Exposures to institutions	53.3	774.5	0.0	56.0	3.8
Exposures to companies	469.6	999.4	1,252.2	678.4	501.4
Retail exposures	132.4	849.7	1,926.5	6,590.9	5,914.5
Exposures secured by mortgages in real property	21.6	143.2	405.4	835.3	1,000.9
Exposures in default	38.7	39.1	111.6	174.9	70.6
Exposures with particularly high risk	10.7	94.6	18.2	6.2	0.0
Share exposures	0.0	0.0	0.0	0.0	944.2
Other exposures	347.8	225.6	27.1	47.5	894.8
Total items recognised in the balance sheet	*1,729.0*	*8,242.7*	*3,741.5*	*8,390.2*	*9,330.2*

*) Items recognised in the balance sheet are calculated according to the standard method in the CRR.

Table 13
Distribution by sector of exposure categories at the end of 2018

	Exposure categories											
	Central governments and central banks	Institu-tions	Com-panies	Retail	Mortgage on real property	Default	Parti-cularly high risk	Invest-ment associa-tions	Shares	Other items	Total	*- of which SMEs*
	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	
Public authorities	60.0	0.0	119.1	36.3	0.1	0.1	0.0	0.0	0.0	0.0	*215.6*	
Business												
Agricul-ture, hunting forestry and Fisheries	0.0	0.0	0.1	43.5	0.9	0.6	0.0	0.0	0.0	0.0	*45.1*	43.2
Industry and extraction of raw materials	0.0	0.0	998.4	294.0	8.1	9.6	0.0	0.0	3.2	0.0	*1,313.2*	674.3
Energy supply	0.0	0.0	35.6	5.3	0.1	0.0	0.0	0.0	0.1	0.0	*41.2*	40.4
Building and construction	0.0	0.0	284.8	529.6	25.5	11.6	18.1	0.0	0.0	0.0	*869.5*	687.2
Trade	0.0	0.0	663.2	1,094.4	41.0	22.3	0.0	0.0	4.8	0.0	*1,825.6*	1,555.1
Transport, hotels and restaurants	0.0	0.0	212.1	216.8	28.0	18.3	0.0	0.0	0.0	0.0	*475.2*	448.2
Information and communication	0.0	0.0	537.5	76.4	2.6	1.0	0.0	0.0	1.5	0.0	*619.0*	79.3
Financing and insurance	4,826.6	1,248.6	962.1	187.2	10.4	29.8	153.0	9.4	905.8	0.0	*8,332.9*	786.1
Real property	0.0	0.0	579.1	300.8	112.9	91.8	129.3	0.0	14.8	0.0	*1,228.7*	887.2
Other business	0.0	0.0	1,215.8	926.9	40.6	13.9	0.0	0.0	139.6	0.0	*2,336.8*	1,666.4
Total business	*4,826.6*	*1,248.6*	*5,488.5*	*3,674.9*	*270.1*	*198.9*	*300.4*	*9.4*	*1.069.8*	*0.0*	*17,087.1*	*6,867.3*
- of which SMEs			3,162.7	3,465.5	239.1						*6,867.3*	
Private	0.0	0.0	297.6	19,347.8	4,870.0	301.2	2.7	0.0	0.7	0.0	*24,820.0*	
Other items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2,062.4	*2,062.4*	
Total	*4,886.6*	*1,248.6*	*5,905.2*	*23,059.0*	*5,140.1*	*500.2*	*303.1*	*9.4*	*1,070.5*	*2,062.4*	*44,185.1*	

Table 14
Credit risk reduction and guarantees for exposures with credit risk

	Adjusted value of the collateral		Guarantees used	
	2018 DKK mill.	2017 DKK mill.	2018 DKK mill.	2017 DKK mill.
Credit risk reduction and guarantees used				
Exposures to companies	103.6	201.9	0.0	0.0
Retail exposures	213.2	200.1	0.0	0.3
Exposures secured by mortgages on real property	7.6	6.4	0.0	0.0
Exposures in default	6.0	6.5	0.0	0.0
Exposures with particularly high risk	2.3	9.2	0.0	0.0
Total items with credit risk	*332.6*	*424.0*	*0.0*	*0.3*

Table 15
Exposures with counterparty risk

	2018 DKK mill.	2017 DKK mill.
Exposures with counterparty risk		
Currency contracts		
Forward contracts/futures	72.9	58.3
Interest-rate contracts		
Forward contracts/futures/repo/reverse	6.9	20.6
Interest-rate swaps and swaptions	*102.3*	*117.0*
Total	*182.5*	*195.9*

Credit risk

Credit risk is the risk that a counterparty is wholly or partly unable to make payments, or fails to make payments. Arbejdernes Landsbank's credit policy is to conduct business transactions with customers with the ability and willingness to repay their loans.

Credit risk is the largest risk item in the risk statement and amounted to 65.6% of the solvency need at the end of 2018 (66.1% at the end of 2017). Thus, Arbejdernes Landsbank has allocated most funds to this item in order to meet unforeseen losses.

Credit policy

The overall credit risk is managed in accordance with policies and frameworks adopted and stipulated by the Board of Directors. Authorisation guidelines are established by the Board of Directors and passed on to the Executive Management and then further on in the organisation.

A central element in Arbejdernes Landsbank's business model is to advise on, and grant loans, credits and other financial products to private individuals, associations and businesses, including financing solutions for car loans, leasing and factoring through the Bank's subsidiary AL Finans A/S.

The primary target group of the Bank is private customers, associations, as well as small and medium-sized Danish business customers where full-scale customer relationships are formed. Full-scale customer relationships provide a better insight into the overall financial situation of the customer, and this insight forms the basis for providing the best advisory services possible, and makes it easier to assess the risk of the individual exposure. Furthermore, the Bank aims at ensuring that the Bank's group of owners has the opportunity to conduct various forms of banking. The target group of the Bank's subsidiary, AL Finans A/S, is also private customers as well as small and medium-sized Danish business customers.

Generally, Arbejdernes Landsbank does not participate in geared investment transactions, nor does it wish to finance projects of a speculative nature. When providing credit, the assessment is based on an ethical profile and a desire to diversify risk over sectors, as well as the size of the exposure. This is important for the establishment of a sustainable foundation for Arbejdernes Landsbank's further development.

Credit organisation

Arbejdernes Landsbank has 71 branches and two independent business centres as well as the Bank's subsidiary, AL Finans A/S.

The authority to grant loans is structured such that the branches, business centres and AL Finans A/S may authorise loans in the majority of cases, but in larger and more complex cases, as well as cases deviating from the general rule for credit risk profile, the branches, business centres or AL Finans A/S make a recommendation for authorisation to the central Credit Department, the Bank's Credit Committee or the Board of Directors.

Arbejdernes Landsbank has a structural separation between customer functions and the control and monitoring function. The Bank also has independent departments responsible for property assessments, debt collection and mortgage deeds.

The Credit Department is responsible for day-to-day credit management, controlling, monitoring and reporting to the branch network.

Rating

For several years, the Bank has been using its own internally developed rating models for private as well as business customers to support assessment of credit risk.

The rating models are based on a combination of payment behaviour as well as objective information about the customer, including financial statements for business customers and financial information about private customers. Rating categories are from 1-11, where rating 1 is the best and rating 11 is the poorest.

- Rating categories 1-5: Customers with exposures of good/normal credit quality
- Rating categories 6-8: Customers starting to show weakness/certain signs of weakness
- Rating category 9: Customers with significant signs of weakness but without objective evidence of impairment (OEI).
- Rating categories 10-11: Customers with OEI, with and without individual impairment.

Regardless of the customer's rating, the individual credit decision will always be based on a total assessment of the customer.

The Bank's rating of customers is a central tool in ongoing monitoring and credit management and monitoring of the portfolio and in the Bank's model for impairments. Ranking of exposures into stages is based on Bankernes EDB Central's (BEC) PD values, supplemented with the Bank's internal rating and various other criteria for credit weakness.

Rating distribution and rating development are monitored on an ongoing basis at portfolio as well as individual customer level.

Internally developed rating models are not used in the Bank's subsidiary AL Finans A/S. In AL Finans A/S, customers are generally dealt with on the basis of individual assessments.

Credit risk management and monitoring

Arbejdernes Landsbank has ongoing focus on improving processes and tools that can contribute to more effective management and monitoring of credit risk.

With regard to the Bank, the branch network is responsible for collecting, registering and documenting the basis for authorising loans and for ongoing follow-up on customer relationships. This includes updating the credit basis and registrations used by the business, in the Bank's various follow-up tools, and in the Bank's rating model.

The branch management is responsible for ensuring that the employees have the required expertise, insight and detailed knowledge about the Bank's credit policy and their authorisations. The branch management is also responsible for ensuring that authorisation of credit that goes beyond the authority of the branch is recommended for authorisation by the Bank's central Credit Department.

The central Credit Department is responsible for ensuring that the branches comply with the Bank's credit strategy as well as its credit policy. Furthermore, the central Credit Department carries out branch contact, including credit advisory services and authorisation/recommendations on cases from branches and cases of a more complex nature that exceed the branch management's authority to grant loans.

The central Credit Department carries out ongoing inspection of branches, including reviewing large samples of weak customers and new-loan authorisations, focusing on the general management of exposures. There is a rotation system which ensures that, as a general rule, all branches are reviewed every three years. Where assessed necessary, the branch will then be required to prepare action plans for follow-up by the Credit Department.

There is also an annual asset review of Arbejdernes Landsbank's exposures on the basis of a materiality and risk-based approach. This review also covers the Bank's subsidiary AL Finans A/S. The Credit Department assesses current and future risks on selected exposures, checks compliance with the credit policy and with the authority to grant loans, and ensures satisfactory credit management and fair risk classification and impairment. The conclusions are reported to the Board of Directors.

Overdrafts are processed daily at the branches. The Credit Department monitors the processing of overdrafts on an ongoing basis.

Weak customers are dealt with on an ongoing basis, and each quarter, customers classified as stage 3 customers and stage 2 weak customers are reviewed individually, based on selected materiality criteria, in order to prepare action plans, and to assess whether the customer is credit-impaired and whether there is a need for impairment charges. The selected materiality criteria ensure that weak customers exceeding a certain threshold are reviewed at least once a year. Impairment charges concerning the part of the portfolio that is not credit-impaired, are calculated on the basis of a model calculation. The Bank's subsidiary, AL Finans A/S, has a procedure for reviewing loans with signs of weakness that entails individual impairments. For other loans, the impairment calculation is based on a model calculation.

Arbejdernes Landsbank validates the calculation of expected losses. The purpose of the validation is to ensure that the allowance account is sufficient to cover the risk of losses on Arbejdernes Landsbank's loan and guarantee portfolio, and possibly to make an impairment allowance representing management estimates for areas in which the model does not adequately reflect the default risk. The validation includes both a quantitative and a qualitative validation.

All large lending exposures are regularly reassessed, and, at least once a year, on the basis of the customer's financial statements etc. If developments in objective indicators are assessed to warrant individual impairments, impairment charges are made according to regulations laid down for this purpose.

In practice, major lending exposures are reassessed more frequently, for example in connection with ongoing customer contact or the quarterly statement of the individual solvency need, when all lending exposures exceeding 1% of own funds are assessed. For weak exposures exceeding 2% of own funds, a further assessment is made to determine whether there are increased risks that call for an addition to the solvency need.

Credit risk is reported to the Executive Management and the Board of Directors. The report includes more detailed comments on developments in risk ratios and key figures, sectors and customer segments, and on achievement of and compliance with credit policy goals and requirements stipulated in the credit policy.

Moreover, various management reports are prepared to provide additional monitoring of credit quality as well as relevant analyses to support credit monitoring.

The Risk Department (2nd line) monitors that credit management as well as internal controls are adequate. The Risk Department is also responsible for credit risk reports to the Bank's Executive Management and Board of Directors.

Risk hedging and risk reduction

Arbejdernes Landsbank uses all the options available to mitigate risk, and these generally involve securing collateral in the assets financed.

Arbejdernes Landsbank applies prudent collateral values on all significant asset types. This implies that, for reasons of prudence, some assets are calculated at a reduced value, and therefore the real collateral value is assessed to be higher than the value calculated. To ensure independence and relevant competences, the valuation process is managed by specialised units. Focus is on ensuring that assessments of mortgaged assets are updated and documented. The most common collateral is in the form of mortgages on real property, cooperative housing and cars.

For individually assessed exposures, collateral is calculated in impairment calculations at estimated fair value according to rules from the Danish FSA, while recognition of collateral values for model impairments is more prudent.

See table 19 on page 26 for total collateral at Arbejdernes Landsbank.

Credit risk on Group customer loans

Arbejdernes Landsbank's loan portfolio is described in the sections below, whereas impairments and provisions are described in more detail in "Impairments and provisions on loans and guarantees", see page 28.

Loans and guarantees

Total exposure at Arbejdernes Landsbank, expressed as gross loans and guarantees, as presented in the 2018 Financial Statements, was DKK 29.3 bn., see table 16.

Historically, the private portfolio of Arbejdernes Landsbank has been relatively large compared with its business portfolio. The private segment percentage of total gross loans and guarantees amounted to 76.0%, see table 16.

The business segment percentage of total gross loans and guarantees at the end of 2018 amounted to 24.0%, see table 16. Apart from a few larger corporate exposures, the business segment at Arbejdernes Landsbank is characterised by a large number of small and medium-sized, primarily owner-managed, enterprises.

As a result of the basic philosophy and historical foundation at Arbejdernes Landsbank, the Bank has a certain exposure to associations, including trade unions and social housing organisations. These form part of the business segment.

Table 16
Group gross and net loans and guarantees broken down by stages at the end of 2018

	Stage 1 DKK mill.	Stage 2 DKK mill.	Stage 3 DKK mill.	Credit-impaired on initial recognition DKK mill.	Total DKK mill.
Private					
Loans before impairments	12,953.4	2,977.8	1,025.0	76.4	17,032.6
Guarantees before provisions	4,555.6	590.2	85.0	0.0	5,230.8
Total loans and guarantees before impairments etc.	*17,509.0*	*3,567.9*	*1,110.0*	*76.4*	*22,263.3*
Total impairments etc.	25.7	83.0	513.7	35.5	657.9
Total loans and guarantees after impairments etc.	*17,483.3*	*3,484.9*	*596.3*	*40.9*	*21,605.4*
Business					
Loans before impairments	3,032.2	2,382.0	932.2	6.6	6,353.1
Guarantees before provisions	543.4	86.1	61.9	0.0	691.4
Total loans and guarantees before impairments etc.	*3,575.7*	*2,468.2*	*994.0*	*6.6*	*7,044.5*
Total impairments etc.	25.2	52.3	582.2	5.1	664.8
Total loans and guarantees after impairments etc.	*3,550.5*	*2,415.8*	*411.9*	*1.5*	*6,379.7*
Total					
Loans before impairments	15,985.6	5,359.8	1,957.2	83.0	23,385.6
Guarantees before provisions	5,099.0	676.3	146.9	0.0	5,922.2
Total loans and guarantees before impairments etc.	*21,084.6*	*6,036.1*	*2,104.1*	*83.0*	*29,307.8*
Total impairments etc.	50.9	135.3	1,095.9	40.6	1,322.7
Total loans and guarantees after impairments etc.	*21,033.8*	*5,900.8*	*1008.2*	*42.4*	*27,985.1*

Note: The statement excludes receivables from credit institutions.

The private and business segments are primarily ranked as stage 1 and stage 2, accounting for 94.7% and 85.8%, respectively, of loans and guarantees before impairments etc., see table 16.

Loans are geographically distributed across all the regions of Denmark, though predominantly in the Capital Region of Denmark, followed by the Central Denmark Region and the Region of Southern Denmark. The Capital Region of Denmark accounts for 53.6% of total gross loans and guarantees at Arbejdernes Landsbank, see table 17.

If the private segment is considered separately, the distribution is the same, see table 17. Among other things, this is due to the relatively large share of housing loans secured against owner-occupied properties and cooperative housing, where cooperative housing in particular is typically concentrated in major cities.

The business segment is concentrated in the Capital Region of Denmark, which accounts for 64.4% of total gross loans and guarantees in the business portfolio. The remaining percentage of the business portfolio has a sound diversification over the other regions of Denmark, see table 17.

Table 17
Group gross loans and guarantees broken down by regions at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
Capital Region of Denmark	11,159.0	4,537.3	15,696.3
Region of Zealand	2,407.8	292.9	2,700.8
Region of Southern Denmark	3,611.3	821.4	4,432.8
North Denmark Region	1,275.7	335.5	1,611.2
Central Denmark Region	3,809.5	1,057.2	4,866.8
Total	*22,263.3*	*7,044.5*	*29,307.8*

Note: The statement excludes receivables from credit institutions.

Of Arbejdernes Landsbank's total gross loans and guarantees, 90.1% are in low-risk rating categories (rating 1-5) or medium-risk rating categories (rating 6-8), see table 18. Rating is calculated at individual customer level and does not take into account that Group members with higher credit quality can support customers with lower credit quality.

When considered individually, both the private segment and the business segment have a sound risk diversification, in which 92.3% and 83.2%, respectively, of gross loans and guarantees are in rating categories with low or medium risk, see table 18.

Table 18
Group gross loans and guarantees broken down by ratings at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
Rating 1-5	14,007.7	3,079.7	17,087.4
Rating 6-8	6,545.3	2,780.8	9,326.1
Rating 9	505.8	169.2	675.1
Rating 10-11	1,204.5	1,014.7	2,219.2
Total	*22,263.3*	*7,044.5*	*29,307.8*

Note: The statement excludes receivables from credit institutions.

Collateral and security

The most important collateral received by Arbejdernes Landsbank is mortgages in properties, which alone account for 66.5% of total collateral. This high percentage is attributable to the private segment, where mortgages in property alone account for 80.3%, see table 19.

The relatively high percentage of mortgages in cars for the private and business segment is due to the Bank's subsidiary, AL Finans A/S.

Table 19
Group collateral broken down by type of collateral at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
Properties	8,885.8	745.9	9,631.7
Securities, bonds, cash deposits, etc.	178.5	275.3	453.8
Cars	1,963.0	1,111.7	3,074.7
Warranties and guarantees	1.7	6.0	7.7
Other collateral	33.5	1,280.0	1,313.5
Total	*11,062.5*	*3,419.0*	*14,481.5*

Note: Collateral is calculated at the mortgage value in accordance with the Group's procedures, and excludes the value of surplus collateral.

The total unsecured exposure for Arbejdernes Landsbank amounts to 48.3%, see table 20.

With the prudent collateral values applied by Arbejdernes Landsbank, the actual unsecured exposure is lower than 48%.

For the Bank's subsidiary AL Finans A/S, by far the majority of all loans have collateral in the form of the mortgaged asset.

Table 20
Group net loans and guarantees, collateral and unsecured exposures at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
Loans and guarantees after impairments etc.	21,605.4	6,379.7	27,985.1
Collateral	11,062.5	3,419.0	14,481.5
Unsecured exposures	48.8%	46.4%	48.3%
Percentage of total loans	77.2%	22.8%	100.0%

Note: Impairments include impairment charges and provisions at all stages. The figures are excluding receivables from credit institutions.

Arrears and loans in arrears

Arrears at Arbejdernes Landsbank amount to DKK 74.7 mill. and are primarily broken down by arrears with a duration of less than 30 days and arrears with a duration of more than 90 days. Of Arbejdernes Landsbank's total arrears, arrears for the private segment account for 53.9%. and arrears for the business segment account for 46.1%, see table 21.

Table 21
Arrears broken down by age of arrears at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
2 - 30 days	21.1	14.1	35.2
31 - 60 days	1.5	3.6	5.0
61 - 90 days	3.7	0.6	4.4
91+ days	14.0	16.1	30.2
Total	***40.3***	***34.4***	***74.7***
Percentage of total arrears	53.9%	46.1%	100.0%

Note: The figures are excluding credit institutions.

Loans in arrears totalled 1.9% of Arbejdernes Landsbank's total net loans and guarantees at the end of 2018. Of this, loans less than 30 days in arrears accounted for 1.4%, see table 22.

Arbejdernes Landsbank has "early warning" procedures to reduce the number of customers with long-term arrears.

Generally, targeted work is carried out in collaboration with the customer to reduce the level by finding lasting solutions to any financial challenges.

Table 22
Loans in arrears broken down by age of arrears at the end of 2018

	Private DKK mill.	Business DKK mill.	Total DKK mill.
2 - 30 days	308.2	75.5	383.6
31 - 60 days	9.9	5.6	15.5
61 - 90 days	8.2	3.0	11.3
91+ days	52.5	55.8	108.3
Total	***378.7***	***139.9***	***518.7***

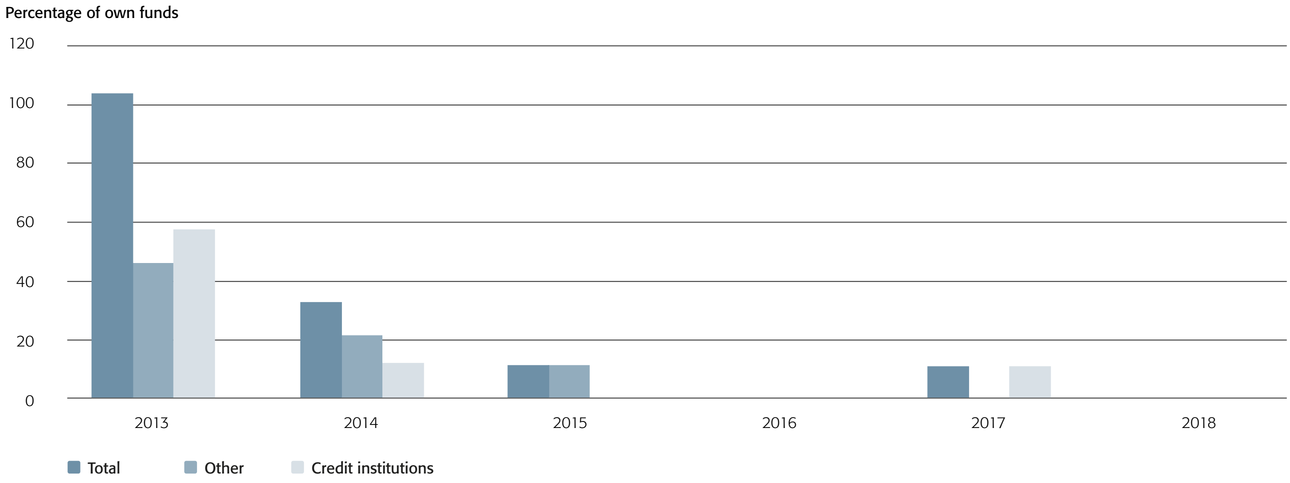
Note: The figures are excluding credit institutions.

Largest credit exposure risks

Arbejdernes Landsbank aims at avoiding dependence on single exposures and seeks to maintain a low percentage.

The sum of consolidated exposures after deductions which are greater than or equal to 10% of own funds at group level, is calculated at 0% of own funds at the end of 2018, including exposures to credit institutions.

Figure 3
Development in the "Sum of large exposures"



Note: The figures are calculated on the basis of consolidated exposures after deductions greater than or equal to 10% of own funds. Regulations for risk-reducing measures were changed with effect from 2014.

Credit risk on credit institutions

Credit risk on credit institutions is the risk of suffering a loss as a consequence of credit institutions defaulting on their obligations. The risk is managed in accordance with policies and frameworks adopted by the Board of Directors.

Arbejdernes Landsbank follows developments in the creditworthiness of its counterparties, and at least once annually, or in connection with establishing new lines, an analysis is carried out of the credit institutions' creditworthiness. As a point of departure, credit is only granted to credit institutions having a natural cooperation potential with Arbejdernes Landsbank within other business areas.

Impairments and provisions on loans and guarantees

Arbejdernes Landsbank's statement of impaired exposures is pursuant to sections 51-52 of the Danish Executive Order on Financial Reports for Credit Institutions and Investment Firms, etc. Arbejdernes Landsbank's model for impairments for expected credit losses is described in the accounting policies section in the annual report.

Impairments, provisions and losses show net revenue recognition of DKK 58.5 mill. in 2018, see table 23, against recognition as an expense of DKK 14.3 mill. in 2017[1].

The calculations in tables 23 and 24 include credit institutions and unutilised credit lines and commitments.

After this, accumulated impairments and provisions at Arbejdernes Landsbank amounted to DKK 1,380.0 mill. at the end of 2018.

1 Net revenue recognition in 2018 does not include reversed reserves for losses on loans that were credit-impaired on initial recognition.

Table 23
Breakdown by sector for credit-impaired exposures at the end of 2018

	Credit exposures DKK mill.	Credit-impaired/ defaulted exposures DKK mill.	Impairment charge/provision DKK mill.	Impairment charge/ provision and loss recognised in the income statement DKK mill.
Public authorities	147.6	0.0	1.1	0.9
Business				
Agriculture, hunting, forestry and fisheries	106.3	64.1	62.8	13.7
Industry and extraction of raw materials	1,050.9	92.6	43.9	2.6
Energy supply	15.1	0.0	0.2	0.1
Building and construction	927.5	99.5	53.0	1.7
Trade	2,166.1	254.3	86.1	11.7
Transport, hotels and restaurants	570.4	152.7	35.2	-2.5
Information and communication	157.6	4.9	2.5	-8.6
Financing and insurance	6,910.3	233.9	219.9	4.4
Real property	1,311.0	225.5	124.5	-24.2
Other business	2,992.2	118.6	73.7	-8.5
Total business	*16,207.3*	*1,246.0*	*701.8*	*-9.5*
Private	25,133.8	1,277.5	677.2	-49.9
Total	*41,488.7*	*2,523.6*	*1,380.0*	*-58.5*

Table 24
Changes in the allowance account at the end of 2018

	Impairments on credit institutions DKK mill.	Impairments on loans DKK mill.	Provisions on guarantees DKK mill.	Provisions on other items with credit risk DKK mill.	Total DKK mill.
Accumulated impairment charges/provisions on loans and guarantee debtors brought forward (opening balance sheet)	30.3	1,373.5	40.5	53.5	1,497.8
Impairments/provisions during the year (gross)	0.6	393.2	15.5	40.2	449.5
Reversal of impairment charges (gross)	-4.1	-430.1	-33.2	-45.3	-512.7
Other changes	0.0	15.5	0.0	0.0	15.5
Actual loss (written off) previously subject to individual impairment charges/provisions	-17.8	-52.3	0.0	0.0	-70.1
Accumulated impairment charges/ provisions on loans and guarantee debtors carried forward	9.0	1,299.9	22.8	48.4	1,380.1
Actual loss (written off) not previously subject to individual impairment charges/provisions	0.0	-17.6	-1.0	0.0	-18.6
Recognised in claims previously written off	0.0	14.0	0.0	0.0	14.0

Note: See note 10 of the annual report for further details.

Counterparty risk

Counterparty risk is the risk of suffering a loss as a consequence of financial counterparties or customers defaulting on their obligations in connection with trade in derivative financial instruments. Counterparty risk is managed in accordance with policies and frameworks adopted by the Board of Directors.

Management of counterparty risk is based on calculations of the net value of transactions in which the market value is positive for Arbejderens Landsbank. The risk is monitored daily, as is compliance with lines granted.

Arbejdernes Landsbank endeavours to reduce counterparty risk by entering into netting agreements and by demanding a cash collateral in derivative transactions wherever possible.

Table 25
Derivative financial instruments at the end of 2018

	Carrying amount before offsetting	Financial instru-ments set off	Carrying amount after offsetting	Offsetting possibility according to master netting agreement	Collateral	Net value
	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.	DKK mill.
Offsetting possibilities *						
2018						
Derivative financial instruments with positive market value	50.9	0.0	50.9	14.3	0.0	36.6
Derivative financial instruments with negative market value	327.1	0.0	327.1	14.3	309.1	3.7
2017						
Derivative financial instruments with positive market value	67.4	0.0	67.4	6.7	1.0	59.7
Derivative financial instruments with negative market value	262.9	0.0	262.9	6.7	254.2	2.0

*) The Bank has master netting agreements with a number of financial counterparties, and this entitles the Bank to further offsetting in relation to a counterparty in default, but does not meet the conditions for offsetting in the balance sheet.

Assets provided as collateral for own debt obligations with Danmarks Nationalbank, clearing centres and credit institutions with which the Bank has entered into CSA agreements are all based on standard agreements conventionally used between financial market participants. These agreements define the terms on which collateral is transferred between the counterparties in order to reduce risk. With regard to collateral concerning fair value of derivative financial instruments, the CSA agreements stipulate daily exchange of collateral (cash).

ECAI

Arbejdernes Landsbank has appointed Standard & Poor's Ratings Services as its credit rating agency (ECAI). Arbejdernes Landsbank uses external ratings from Bankernes EDB Central (BEC), which receives external credit ratings from Standard & Poor's Ratings Services.

The data centre converts the credit rating categories of Standard & Poor's Ratings Services to credit quality steps using the conversion table from the Danish FSA. The individual credit quality steps are linked to a weight by which the exposures in the individual credit quality steps are to be weighted when calculating risk-weighted exposures according to the standard method for credit risk pursuant to Articles 111-134 of the CRR. External ratings are used for the exposure class "Institutions".

In relation to internal monitoring of issuer and counterparty risk, Arbejdernes Landsbank uses the most recent and current long-term issuer rating from the credit rating agencies Standard & Poor's Ratings Services, Moody's or Fitch Ratings. Furthermore, Arbejdernes Landsbank reports on the Bank's bond portfolio based on the bond issue's S&P-equivalent rating from these agencies.

Table 26
Exposure class for which credit ratings from Standard & Poor's Ratings Services are used

	2018 DKK mill.	2017 DKK mill.
Institutions:		
Exposure value prior to risk weighing	254.2	526.0
Exposure value after weighting with credit quality step	127.0	187.6

Market risk

Arbejdernes Landsbank regularly accepts various forms of market risk, primarily as interest-rate risk, share-price risk or currency risk, as well as credit risk for certain types of financial instruments. Market risks arise partly as a result of servicing customers' needs, and partly from Arbejdernes Landsbank's positions in financial instruments. The primary tool to hedge and manage market risks is derivative financial instruments.

Market risk covers positions, the market value of which depends on developments in the general levels of a number of market variables such as interest rates, share prices, and currency rates, as well the volatility related to these. Furthermore, with respect to bonds, market risk covers more specific risks linked to market assessments of credit risks on individual issuers of bonds. The calculations include market risks on both balance-sheet items and off-balance-sheet items, and the calculations also include positions in the trading portfolio and transactions outside the trading portfolio.

Market risk is the second-largest risk item in the risk statement for Arbejdernes Landsbank and amounted to 24.2% of the solvency need at the end of 2018 (23.8% at the end of 2017).

Management of market risks

Market risks at Arbejdernes Landsbank are dealt with centrally by the Bank's Treasury & Finance Department.

The overall market risk is managed in accordance with policies and frameworks adopted and stipulated by the Board of Directors. Measures are taken to ensure a well-defined allocation of responsibility for risk assumption at all levels by stipulating frameworks for both the Executive Management and the management of the Treasury & Finance Department. On the basis of this, frameworks are delegated to the individual areas under the Treasury & Finance Department.

The individual risk types are monitored regularly in relation to the frameworks set. Daily follow-up on this is via reports to the Executive Management and there are regular reports to the Board of Directors. Internal Risk and Control monitors utilisation of the frameworks set. The Risk Department monitors procedures as well as controls.

Short-term investments are managed by the Bank's trading function within set limitations that are continuously monitored.

Strategic positions are assessed on the basis of both the returns and the risk, taking into account Arbejdernes Landsbank's overall risk appetite, as well as ongoing maintenance of a cash resource in the form of liquid assets.

In addition to daily calculations of the overall market risk, periodic stress tests of the portfolio are performed.

Interest-rate risk is the risk of losses as a result of interest-rate fluctuations. The interest-rate risk associated with the trading portfolio primarily derives from the bond portfolio as well as derivative financial instruments. The interest-rate risk is calculated as the change in market value of an instrument in the event of a change in interest rate of +1 basis point for each time interval on the yield curve. Risks on convertible mortgage-credit bonds and bonds with an interest ceiling etc. are based on information obtained from leading market participants on the option-adjusted interest-rate risk. Other types of interest-rate-related option risks are based on a delta valuation calculation. The calculations are made in individual currencies and for each time interval on the yield curve.

Arbejdernes Landsbank's exposure is primarily in DKK, EUR and USD, while the net interest-rate risk across currencies is relatively limited.

The calculation of interest-rate risk is supplemented by a number of stress scenarios aimed at measuring yield curve risk and convexity risk.

The calculation of interest-rate risk distinguishes between interest-rate risk inside and outside the trading portfolio. Table 27 shows Arbejdernes Landsbank's total interest-rate risk.

Table 27
Interest-rate risk

	2018 DKK '000	2017 DKK '000
Broken down by type of business		
Bonds etc.	-5,093	-3,523
Derivative financial instruments	4,888	3,992
Mortgage deeds	-735	-799
Other items	629	742
Total	*-311*	*412*
Broken down by currency		
DKK	-1,197	108
USD	382	457
EUR	544	-89
GBP	-10	-17
NOK	-7	-10
CHF	-16	-15
SEK	-8	-21
Other	0	0
Total	*-311*	*412*

Note: Interest-rate risk has been calculated for a change in interest rates of +1 basis points. A positive interest-rate risk expresses a gain in the event of an interest-rate increase, and a loss in the event of an interest-rate fall. Conversely, a negative interest-rate risk expresses a gain in the event of an interest fall and a loss in the event of an interest-rate increase.

Share-price risk is the risk of losses as a result of changes in share prices. The calculation of share-price risk distinguishes between share-price risk inside and outside the trading portfolio. The latter is described in the section Shares etc. outside the trading portfolio.

Shares inside the trading portfolio are shares acquired for trading. Share-price risk inside the trading portfolio is calculated according to a risk target stating how much Arbejdernes Landsbank can expect to lose in the event of a general fall/increase on the share markets of 10%. At the end of 2018, the risk target was DKK 9.2 mill.

Currency risk reflects the risk of losses on positions as a result of changes in currency exchange rates. Currency risk is calculated according to currency indicator 1 and 2 (currency indicator 2 is including currency risk from investment associations), and is furthermore calculated as a weighted sum of net positions in the individual currencies, where weighting takes volatility into account.

Credit-spread risk associated with the bond portfolio is the risk of losses as a result of changes in credit spread, reflecting the market pricing of the bond-issuers' credit worthiness as well as the seniority and liquidity of the bond. Credit-spread risk is not only relevant for credit bonds, but also for mortgage-credit and government bonds.

Most of the bonds in the bond portfolio at Arbejdernes Landsbank are investment-grade (i.e. rating BBB- or higher) and the portfolio primarily consists of mortgage-credit bonds and government bonds.

A smaller part of the bond portfolio consists of corporate bonds and bonds issued by banks (financial bonds). At the end of 2018, these accounted for 4.4% and 7.1%, respectively, of the total bond portfolio and are denominated in DKK and EUR.

Credit-spread risk is calculated daily. To ensure sound risk management, a framework has been set for government bonds, mortgage-credit bonds, corporate bonds and financial bonds, respectively, on the basis of the risk-weighted credit-spread exposures. The risk weights are based on historically observed volatilities.

Table 28
Bond portfolio broken down by rating

	2018	2017
Rating		
AAA	51.8%	63.9%
AA+, AA, AA-	28.1%	3.6%
A+, A, A-	5.2%	8.8%
BBB+	2.1%	3.0%
BBB	5.9%	10.0%
BBB-	2.6%	2.9%
Rating < BBB-	0.9%	1.8%
No rating	3.4%	6.1%
Total	*100.0%*	*100.0%*

Interest-rate risk outside the trading portfolio

Interest-rate risk outside the trading portfolio primarily arises from customers' fixed-interest loans and deposits (including the mortgage deed portfolio) or from floating-rate loan products with built-in option elements. At Arbejdernes Landsbank, derivative financial instruments are used to hedge interest-rate risk. Interest-rate risk outside the trading portfolio is calculated according to the same principles as for interest-rate risk inside the trading portfolio.

Arbejdernes Landsbank does not have fixed-interest deposits with indefinite maturity. Certain loans are offered at fixed interest with the possibility of early redemption.

Interest-rate risk is part of the Treasury & Finance Department's daily calculations of interest rate risk and it is managed within set limits. To some extent, and where the variation in interest-rate risk is modest, the risk is not calculated on a daily basis, but is included in the overall calculation at previously calculated risk levels.

Interest-rate risk at Arbejdernes Landsbank is mainly in DKK. At the end of 2018, the net interest-rate risk outside the trading portfolio amounted to DKK -0.1 mill. against DKK -0.06 mill. at the end of 2017 (for a change in interest-rate of + 1 basis point).

Shares etc. outside the trading portfolio

Shares etc. outside the trading portfolio are shares not acquired for trading. Along with other credit institutions, Arbejdernes Landsbank holds equity investments in a number of sector companies. These equity investments are part of the investment securities, and serve to support Arbejdernes Landsbank's business within mortgage credit, IT, money transmission services and investment associations.

In 2018, Arbejdernes Landsbank established a share portfolio outside the trading portfolio, including shares acquired for long-term investment, and shares deemed not to have the potential to be sold in the short term. In 2018, Arbejdernes Landsbank completed the sale of ALKA Forsikring, and this has reduced the portfolio of shares outside the trading portfolio. The principles for valuation of shares with no market price are described in note 41 to the annual report.

Table 29
Shares outside the trading portfolio

	2018 DKK mill.	2017 DKK mill.
Fair value brought forward	1,826.2	1,095.0
Realised capital gain	30.6	0.4
Unrealised capital gain	101.2	620.7
Net purchases	-611.2	110.1
Fair value carried forward	**1,346.9**	**1,826.2**

The composition of shares outside the trading portfolio at Arbejdernes Landsbank is shown in table 30.

Table 30
Share exposures outside the trading portfolio at the end of 2018

	Listed DKK mill.	Unlisted DKK mill.	Total DKK mill.
Bank, credit institution and insurance	275.5	581.5	857.0
Investment firm	0.0	335.0	335.0
Investment association	39.3	14.0	53.3
Private Equity	2.4	53.4	55.8
Industry	27.3	1.0	28.3
Trade and service	0.2	17.2	17.4
Total	**344.8**	**1,002.1**	**1,346.9**

Liquidity risk

Liquidity risk is the risk of losses resulting from Arbejdernes Landsbank having to pay more for the liquidity required to cover its payment obligations and to maintain normal liquidity reserves in a situation where Arbejdernes Landsbank itself, or the sector as a whole, is affected by extraordinary circumstances. Liquidity risk thus reflects a mismatch in the balance between maturity of assets and liabilities, where the loan portfolio generally has a longer duration than deposits and other financial transactions.

Most of Arbejdernes Landsbank's liquidity risk is in DKK, while the rest of the risk is concentrated in major currencies, i.e. EUR and USD.

The liquidity policy sets the overall framework for liquidity transactions and the financing structure. The liquidity policy supports liquidity management and ensures that Arbejdernes Landsbank is able to meet its payment obligations and comply with current legislation at any time.

Generally, Arbejdernes Landsbank maintains a very prudent liquidity policy in order to ensure that any requirements or needs for liquidity facing Arbejdernes Landsbank can be met at any time. Another aim of the liquidity policy is to ensure compliance with statutory requirements and to provide a basis for the future development of Arbejdernes Landsbank.

Arbejdernes Landsbank must comply with common European LCR (Liquidity Coverage Ratio) requirements for credit institutions. The requirements were fully phased in from 1 January 2018 and constitute an important part of liquidity management.

Operational responsibility for compliance has been delegated to the Treasury & Finance Department, which constitutes the liquidity management function at Arbejdernes Landsbank. Internal Risk Management and Control calculates and monitors liquidity on a daily basis in relation to set frameworks.

The Treasury & Finance Department is responsible for short-term liquidity transactions and management, and for operational management of Arbejdernes Landsbank's liquidity so as to ensure compliance with all statutory requirements, internal policies and objectives. The Risk and Liability Management Committee assesses short-term and long-term liquidity developments in relation to the general commercial development of Arbejdernes Landsbank in the capital-market area as well as in deposits and lending.

In addition to regular liquidity forecasts and calculations of the excess liquidity cover, stress tests of Arbejdernes Landsbank's liquidity in the long term are carried out in order to reveal sensitivity to significant changes in ongoing terms of funding.

The Board of Directors has adopted a financial resources plan which defines initiatives to be launched if liquidity deteriorates relative to the adopted liquidity policy.

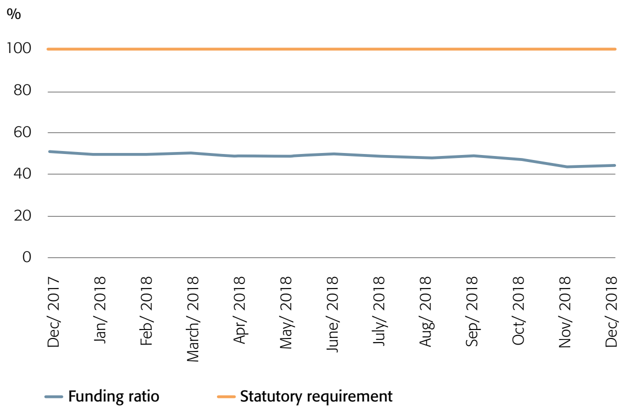
At the end of 2018, Arbejdernes Landsbank's LCR was calculated at 268.1% and is thus significantly higher than the 100% requirement. Based on Arbejdernes Landsbank's liquidity forecast, cash resources are expected to be adequate throughout 2019.

Table 31
LCR liquidity statement 2018

	Q1	Q2	Q3	Q4
LCR liquidity statement weighted average in DKK bn.				
Total liquidity buffer	15.0	15.4	15.7	19.7
Net outflow	7.6	7.6	7.1	7.6
LCR (%)	198%	204%	221%	257%

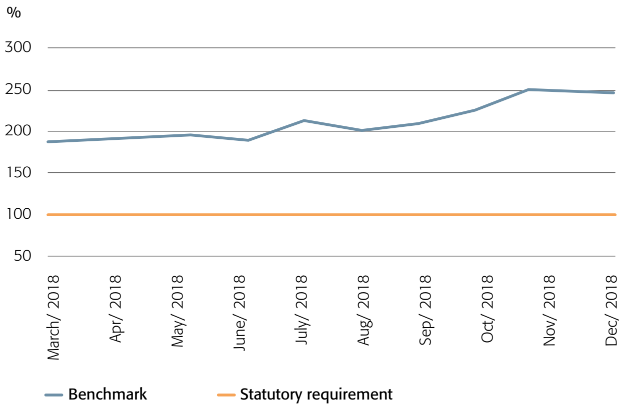
The funding ratio included in the supervisory diamond forms part of Arbejdernes Landsbank's management of its funding structure. Arbejdernes Landsbank is comfortably below the requirement of 100%, as illustrated in Figure 4.

Figure 4
Funding ratio in the supervisory diamond



The liquidity benchmark also forming part of the supervisory diamond was implemented in June 2018, and Arbejdernes Landsbank comfortably meets the benchmark, and has done so since it was introduced.

Figure 5
The new liquidity benchmark in the supervisory diamond



Future regulations for NSFR aim to ensure stable funding profiles for individual banks, with focus on the relationship between the lifetime of assets and funding. The NSFR is calculated for a one-year time horizon. The requirement is expected to enter into force from 2021. Arbejdernes Landsbank already complies with the requirement, and it will be calculated and followed regularly so that Arbejdernes Landsbank will meet the requirement when it enters into force. Well in advance of the entry into force of the NSFR requirement, Arbejdernes Landsbank will implement the requirement in its liquidity policy and business processes.

Encumbered assets

To a certain extent, Arbejdernes Landsbank has encumbered assets in connection with market-risk-taking and liquidity transactions, including assets pledged as collateral at Danmarks Nationalbank for securities clearing and retail clearing.

Arbejdernes Landsbank uses collateralisation with other credit institutions for developments in the market value of Arbejdernes Landsbank's OTC derivative transactions and margin deposits in connection with derivatives traded on the stock market. Furthermore, Arbejdernes Landsbank pledges collateral with CCPs (central counterparties).

To a lesser extent, Arbejdernes Landsbank uses repurchase agreements in bonds as part of interest-rate-risk and liquidity management.

Table 32
Encumbered assets

	Carrying amount 2018 DKK mill.	Fair value 2018 DKK mill.	Carrying amount 2017 DKK mill.	Fair value 2017 DKK mill.
Assets				
Encumbered assets				
Shares	0.0	0.0	0.0	0.0
Bonds	0.0	0.0	780.1	780.1
Other assets *)	1,469.6	1,469.6	281.7	281.7
Total encumbered assets	*1,469.6*	*1,469.6*	*1,061.7*	*1,061.7*
Unencumbered assets				
Shares	1,446.9	1,446.9	2,045.3	2,045.3
Bonds	18,834.3	18,834.3	11,032.3	11,032.3
Other assets	33,355.7	33,483.4	33,229.5	33,383.9
Total unencumbered assets	*53,636.9*	*53,764.6*	*46,307.2*	*46,461.6*
Collateral received, available for encumbrance				
Bonds at fair value				
Encumbered collateral	302.7	302.7	54.8	54.8
Unencumbered collateral	124.6	124.6	118.7	118.7
Total bonds at fair value	*427.3*	*427.3*	*173.5*	*173.5*
Encumbered assets/collateral received				
Encumbered assets and collateral	1,772.3	1,772.3	1,116.5	1,116.5
Counterpart liabilities	614.1	614.1	325.0	325.0

*) Encumbrance related to VP settlement and derivative transactions.

Operational risk

Operational risk means the risk of losses as a consequence of inappropriate or incomplete internal procedures, human errors and systems failure, or as a consequence of external events, including legal risks.

Operational risks are categorised according to the seven types of risk defined by the CRR:

- Employment practices and workplace safety
- External fraud
- Business disruption and system failures
- Internal fraud
- Clients, products, and business practice
- Execution, delivery and process management
- Damage to physical assets

Policies

The Board of Directors has laid down a policy for operational risk, the purpose of which is to create an overview of operational risks, minimise the number of errors, and reduce losses at Arbejdernes Landsbank due to operational errors, taking into account related costs.

Arbejdernes Landsbank wants an open culture among its employees aimed at increasing the awareness of operational risks and ensuring knowledge-sharing among employees.

To maintain an acceptable operational risk level, the policy includes a definition of risk appetite as determined by the Board of Directors. Risks exceeding the defined risk appetite are assessed by the Board of Directors every six months.

Management and monitoring

All activities in the organisation are associated with operational risks. In order to reduce the risk of operational events leading to significant losses, Arbejdernes Landsbank monitors and manages operational risks.

Management of operational risk, including the role as risk facilitator, is anchored in the Finance Department, while general issues concerning operational risk are managed by the Operational Risk Committee.

The business managers are responsible for day-to-day risk management as risk owners.

The risk identification process is carried out in cooperation with the individual business units, who also assess frequency and consequence. The risk identification process supports risk reduction and contributes to stronger awareness of operational risks in the organisation. In cooperation with the business units, an annual evaluation is performed regarding the risk scenarios and the risk exposures.

Developments in operational risk are monitored continuously to provide the best possible foundation for operational risk management.

In 2018, Arbejdernes Landsbank implemented a new IT solution to ensure more efficient identification and management of operational risks.

Loss events

Arbejdernes Landsbank registers and categorises loss-making events of more than DKK 5,000, both with respect to actual losses and potential loss situations. Each event report must include a description of the event and state the cause of the error and the source of loss. Systematic registration and classification is used to manage operational risks at Arbejdernes Landsbank, and to create a record of experience and knowledge-sharing in the organisation.

Depending on the specific operational event, management of losses comprises an assessment and, if necessary, an adjustment of Arbejdernes Landsbank's organisation and operations in the form of segregation of duties, controls, employee competences, business procedures, physical security, etc.

In 2018, loss events at Arbejdernes Landsbank were primarily in the external fraud category and the clients, products and business practices category.

Reporting

There is ongoing registration of identified events, with reports to the CRO, the Executive Management and the Board of Directors, according to more detailed criteria stated in the policy.

The reports are sent quarterly to the Executive Management and the Board of Directors.

Fraud

External fraud primarily concerns abuse of credit card schemes and online banking fraud, for example in the form of phishing for customer information through fraudulent emails and text messages. Arbejdernes Landsbank is aware that increased digitisation, with ever more communication taking place online, may add to the risk of external fraud online in the form of cyber crime. Most cases of attempted fraud are prevented by Arbejdernes Landsbank's IT supplier, BEC, and through internal control environments and alert employees.

IT security

In the assessment of Arbejdernes Landsbank's operational risk, IT constitutes a significant area. IT is essential to support business activities at Arbejdernes Landsbank, and consequently, it is vital to protect the IT environment of Arbejdernes Landsbank against loss of availability, integrity and confidentiality. In particular, the growing cyber threat has led to increased focus on IT security.

The Head of IT Security is part of the 2nd line of defence in the organisation of Arbejdernes Landsbank. The Management also regularly considers IT security.

Arbejdernes Landsbank's work with IT security is based on various standards and best practice guidelines. This includes increased focus on safeguarding the critical systems managed by BEC, through ongoing supplier management ensuring that the IT systems at Arbejdernes Landsbank maintain the required level of security.

Capital need

The calculation of capital need to cover operational risk at Arbejdernes Landsbank is based on the basic indicator approach. At the end of 2018, the operational risk amounted to 11.2% of the total risk exposure, which results in a capital requirement (8% requirement) of DKK 292.8 mill.

Compliance

Operational risk includes compliance risks, which means the risk that Arbejdernes Landsbank is not operated according to legal and statutory requirements, standards on the market and good business ethics.

Arbejdernes Landsbank has an independent compliance function anchored in the Risk Department. The aim of the compliance function is to assist the Management in ensuring compliance with current legislation, market standards and internal rules, thus identifying and reducing the risk that Arbejdernes Landsbank is ordered to take restrictive measures, suffers loss of reputation, or that Arbejdernes Landsbank or its customers suffer significant financial losses. The compliance function regularly reviews the critical business procedures in order to assess risks and recommendations for limiting each risk.

Arbejdernes Landsbank has strong focus on anti-money laundering (AML), including risk mitigation measures to be implemented in order to prevent abuse of Arbejdernes Landsbank for money laundering and financing of terrorism.

The task of the AML Department is to ensure that Arbejdernes Landsbank complies with the Act on Measures to Prevent Money Laundering and Financing of Terrorism as well as EU regulations on transfers of funds and combating terrorism. The AML department refers directly to the Executive Management. The AML Department was considerably reinforced during 2018.

Other risks

Business risk

Business risk is the risk of losses due to changes in external conditions or events which may harm the image of Arbejdernes Landsbank, or the operating income, including strategic risks.

The risk becomes apparent in unexpected falls in revenues or unexpected rises in costs.

Examples of reasons may be:

- Sharpened competitive pricing leading to a drop in business volume or falling revenues on the existing volume of business.
- Increasing product-development costs to match new products from competitors.
- Increasing marketing costs arising from negative press coverage.
- Incorrect estimates of revenues from new activities.

Arbejdernes Landsbank continually assesses this type of risk, and always when setting the individual solvency need.

Property risk

Property risk is the risk of losses on Arbejdernes Landsbank's portfolio of properties, arising from a general drop in property prices.

Arbejdernes Landsbank had a portfolio of properties of DKK 1,125.3 mill. at the end of 2018. The properties are primarily used for operation of the Bank. In addition, small parts of certain properties are rented out as residential properties or to businesses.

The properties are located throughout Denmark, although in terms of carrying amount there is an overweight in Greater Copenhagen.

The sensitivity of measurements regarding Arbejdernes Landsbank's properties is expressed by a positive change in the return on properties of 0.5 percentage points, which will reduce the value of the properties by approx. DKK 118.4 mill.

Remuneration risk

Among other things, the pay policy contains guidelines for remuneration to the Board of Directors and the Executive Management of Arbejdernes Landsbank. The Management makes regular assessments, at least once a year, that this is the case.

The pay policy stipulates that the Management must be paid remuneration in conformity with the market and which reflects the Management's work for Arbejdernes Landsbank. The pay policy also stipulates that the remuneration paid to the Board of Directors and the Executive Management must be a fixed remuneration, such that no form of incentive pay is included. The same applies to the employees in the management group, the Group's Chief Audit Executive, the CRO and the Head of Compliance.

Employees at Internal Audit, Internal Risk Management and Control, and Risk and Compliance are subject to special conditions in which variable remuneration components within the framework of the collective agreement are not affected by changes in the results of Arbejdernes Landsbank and depend exclusively on the department's and the employee's own performance.

Similarly, other risk takers and employees in control functions are not paid variable remuneration components outside the framework of the collective agreement.

Page 20 of the Annual Report for 2018 describes the basis for the Nomination and Remuneration Committee established by the Board of Directors. Pages 22-26 as well as note 8 describe the remuneration etc. paid to the Board of Directors, the Executive Management and other risk takers etc. who significantly influence the risk profile.

The group of employees (risk takers) with significant influence on the risk profile is adjusted when employees leave and are replaced by new ones, and/or based on an assessment of employees' functions and job content.

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