Risk and Capital Management 2020

CONTENTS

Disclosure requirements

This report has been prepared in accordance with the legal disclosure requirements laid down in the EU's Capital Requirements Regulation (CRR) and, combined with supplementary data material, it meets the requirements. The supplementary data material is available at *nykredit.com/reports*.

Disclaimer

This document is an English translation of the original Danish text. In the event of discrepancies between the original Danish text and the English translation, the Danish text shall prevail.

1. **2020 IN BRIEF**

The covid-19 pandemic
2020 was a year marked by the global covid-19 pandemic. Due to the measures introduced to contain the covid-19 outbreak, Nykredit's organisation had to quickly adapt to widespread remote working to help combat the virus in Denmark. From the onset of the pandemic, Nykredit has taken a conservative approach to the official recommendations, and Nykredit's locations have been partially locked down ever since.

Nykredit was aware that the sudden transition to widespread remote working could lead to an increase in the number and consequences of operational risk events and a drop in work efficiency. However, the reality was that Nykredit's staff demonstrated a very high level of adaptability. This enabled Nykredit to keep up momentum, without a rise in the number or size of operational risk events. Also, Nykredit's technical set-up proved resilient to a sudden and persistent pressure on the IT infrastructure from new working procedures.

In 2020 many customers found that the disease control measures had a profound impact on their lives. Many business owners had to adapt to a new reality and changed consumption patterns. The Danish government has provided relief packages that have helped large parts of Danish business and industry to cope with the crisis. Because of the new circumstances, Nykredit's customers need advice about applications for support under relief packages and their financial situation in general. Nykredit has offered resources and expertise and has been very dedicated to helping our customers through the crisis. For instance, Nykredit has launched new products with lenient terms aimed especially at customers with temporary financial difficulties due to covid-19. Nykredit saw no rise in loan arrears or write-offs in 2020.

Customer numbers and lending grew comfortably throughout 2020, especially in the personal customer segment. Customer creditworthiness has proved resilient to the covid-19 crisis, not least supported by rising housing prices. However, because of the increased economic uncertainty, there has been a particular focus on ensuring that the credit risk relating to new lending remained within the risk appetite set by the Board of Directors. Intensified ongoing monitoring has confirmed this to be the case.

Nykredit's market risk has also been affected by the covid-19 crisis. In late March 2020, financial market volatility was high. This was reflected in widening yield spreads of credit and mortgage bonds and reduced equity prices. As a natural result of this, Nykredit's market risk measured by VaR models fluctuated, resulting in a number of backtest overshootings. The increased volatility also caused daily earnings to fluctuate, leading to a reduction in Q1/2020 financial results. Over the summer and autumn, yield spreads tightened again and equity markets recovered.

On the liquidity side, Nykredit experienced a temporary additional liquidity strain and a rise in funding costs, which prompted the activation of our Funding Contingency Committee. The Committee is authorised to respond quickly to signs of liquidity shortages. However, liquidity market conditions soon began to normalise again. Nykredit never had any difficulty selling bonds to fund its lending and refinancing activities, despite the market turmoil.

Increased awareness of climate-related risks
One of Nykredit's core values is corporate responsibility, and it is therefore natural that Nykredit should be committed to contributing to the green transition. Nykredit does not in itself have a significant environmental impact but is in a position to help customers act in a more sustainable way in terms of climate change. Nykredit is incorporating this aspect into its business through reporting, policies and working procedures, especially in relation to credit advisory services. Other important areas are property valuations and investment. During the year, Nykredit launched a number of green products, which our customers have embraced. Nykredit finds that Danish and European authorities are focused on engaging banks in the transition to a more sustainable society. Not least to avoid greenwashing; this aspect has been incorporated in Nykredit's approval process for new products. See Nykredit's *Corporate Responsibility Report* for a description of our strategy and efforts to contribute to the green transition.

Conduct management
Nykredit promotes a corporate culture where we can openly discuss and act on the business dilemmas that may arise when operating a responsible financial business. This is part of our conduct management efforts.

Nykredit has had an organisational conduct management framework for some years, but in 2020 we intensified our efforts in several areas. Nykredit's conduct risk efforts are divided into a culture track and a risk track. The risk track involves identification, risk assessment and reporting of conduct risks and enables an ongoing dialogue between the risk control function and the business about conduct risk mitigation. The culture track provides training of all staff in discussing and responding to irresponsible business conduct, thereby embedding conduct risk awareness in our daily activities.

Capital requirement
The Board of Directors has set the Common Equity Tier 1 (CET1) capital requirement at a minimum of 15.5-16.5% of Nykredit's risk exposure amount (REA). Nykredit has reserved CET1 capital already now to meet the upcoming Basel requirements of about DKK 14 billion, and at year-end Nykredit's CET1 capital amounted to 20.2% of Nykredit's REA. Further, Nykredit has access to new CET1 capital through Forenet Kredit's liquid assets and through investment commitments from a consortium of Danish pension companies.

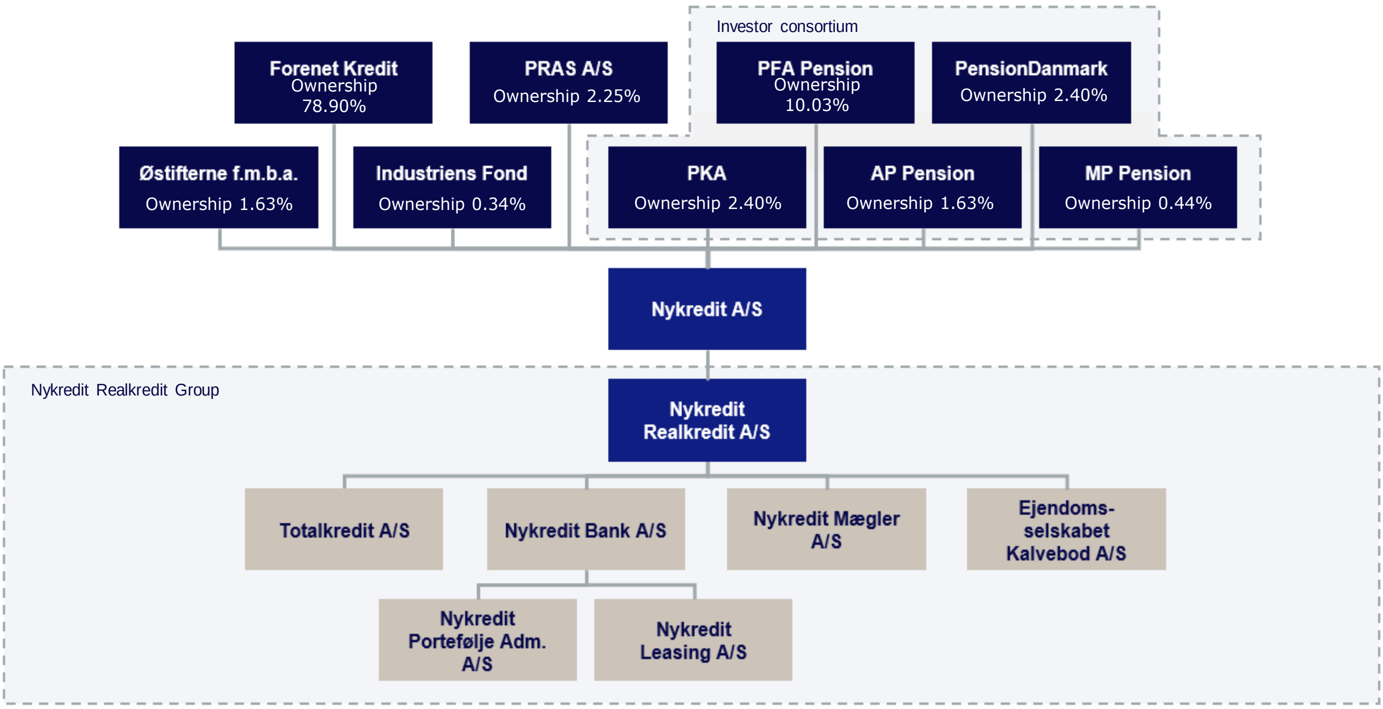
1.1 ▪ FINANCIAL HIGHLIGHTS

Nykredit Realkredit Group

Year-end DKK billion/%	2020	2019	2018
Capital adequacy and capital			
Common Equity Tier 1 capital ratio, %	20.2	19.5	21.0
Total capital ratio, %	24.3	23.7	25.4
Leverage ratio, %	4.8	4.5	4.9
Internal capital adequacy requirement, %	11.0	10.9	10.0
Total risk exposure amount, DKK billion	402	379	345
Funding and liquidity			
Liquidity Coverage Ratio (LCR), %	771	955	660
S&P long-term Issuer Credit Rating/outlook	A+/stable	A+/stable	A/positive
Fitch long-term Issuer Credit Rating/outlook	A/stable	A/stable	A/stable
Key figures and ratios			
Credit exposures, DKK billion	1,695	1,608	1,451
Total provisions for loan impairment and guarantees, DKK billion	9.9	8.1	7.9
Impairment charges for the year, DKK billion	2.3	1.0	0.4
Credit exposures in default[1], DKK billion	24	24	21

[1] Credit exposures in default include exposures to customers who have defaulted on their payment obligations. The exposure includes loans and advances, but also off-balance sheet items. The exposure is stated before loan impairments.

Nykredit
Group chart



Note: As at 1 January 2021 LR Realkredit became fully merged into Nykredit Realkredit A/S.

1.2 ▪ BOARD DECLARATION AND RISK STATEMENT

The Boards of Directors of Nykredit A/S and Nykredit Realkredit A/S have on 10 February 2021 approved this report.

- It is the Boards' assessment that Nykredit has adequate and effective risk management arrangements and controls in place with regard to Nykredit's risk profile and strategy.

- It is furthermore the Boards' assessment that the description of Nykredit's risk profile and key figures and ratios gives a true and fair view of Nykredit, including Nykredit's overall risk appetite.

The Boards' assessment is based on the continuous risk reporting and the adopted strategy, Winning the Double 2.0, as reviewed and approved by the Boards of Directors, the Executive Boards and the Chief Risk Officer.

For information and key ratios concerning Nykredit's risk profile, please refer to the relevant sections of this report.

Risk assessment

- Approximately 83% of the Group's REA derives from credit risk, which mainly relates to mortgage and bank lending. Credit risk is managed in accordance with the credit policy, including requirements for credit risk concentrations on single names, industries and geographical regions. At end-2020, DKK 9.9 billion had been provided for loan losses, corresponding to 0.7% of total lending. Loan impairment charges for the year totalled DKK 2.3 billion. The credit risk exposure does not exceed the Group's risk appetite.

- Market risk mainly relates to the activities of Nykredit Markets and the Group's investment function. Approximately 10% of the Group's REA derives from market risk. Market risk is managed in accordance with the market risk policy, including detailed limits and guidelines for various types of market risk prescribed by the Board of Directors. The market risk exposure falls within the Group's risk appetite.

- Liquidity risk is managed in accordance with the liquidity policy, including detailed limits and guidelines prescribed by the Board of Directors. At end-2020 the LCR was 771%.

- Operational risk is managed in accordance with the policy for operational risk and the pertaining guidelines. Approximately 7% of the Group's REA derives from operational risk.

- Nykredit's total risk is reflected in the internal capital adequacy requirement, which represents 11.0% of REA.

- Based on the internal capital adequacy requirement, stress tests, guidelines and expectations for the capital position, the Board of Directors has set the CET1 capital requirement at 15.5-16.5% of REA. In addition to this, Nykredit has set aside capital to meet the upcoming Basel IV requirements. Nykredit's CET1 capital represented 20.2% of REA at end-2020, while the total capital ratio was 24.3%.

Board of Directors of Nykredit A/S

Merete Eldrup *Chairman*	Nina Smith *Deputy Chairman*	Jørgen Høholt	Inge Sand	Olav Bredgaard Brusen	Michael Demsitz
Per W. Hallgren	Kristina Andersen Skiøld	Hans-Ole Jochumsen	Vibeke Krag	Allan Kristiansen	Claus E. Petersen
Ann-Mari Lundbæk Lauritsen	Lasse Nyby				

Board of Directors of Nykredit Realkredit A/S

Merete Eldrup *Chairman*	Nina Smith *Deputy Chairman*	Jørgen Høholt	Inge Sand	Olav Bredgaard Brusen	Michael Demsitz
Per W. Hallgren	Kristina Andersen Skiøld	Hans-Ole Jochumsen	Vibeke Krag	Allan Kristiansen	

Executive Board of Nykredit A/S and Nykredit Realkredit A/S

Michael Rasmussen *Group Chief Executive*	Tonny Thierry Andersen *Group Managing Director*	David Hellemann *Group Managing Director*	Anders Jensen *Group Managing Director*

2. GOVERNANCE AND MANAGEMENT OF RISK

2.1 ▪ NYKREDIT'S CHARACTERISTICS

The Nykredit Realkredit Group is a Danish financial services group serving mainly personal customers, business customers and institutional customers in Denmark. The Group carries on banking and mortgage lending as well as activities within estate agency services, administration and management of investment funds, leasing and insurance mediation.

The Nykredit Realkredit Group's core business is match-funded mortgage lending secured by mortgages on real estate. Mortgage lending is carried out under the Nykredit brand and through the subsidiary Totalkredit A/S, which is wholly owned by Nykredit Realkredit A/S. Mortgage lending to personal customers is provided only through Totalkredit A/S, while lending to business customers is provided through both Totalkredit A/S and Nykredit Realkredit A/S.

Mortgage lending in Totalkredit is based on a strategic alliance comprising 50 Danish local and regional banks. According to this business concept, the partner banks are responsible for serving customers, and Totalkredit A/S undertakes the funding of the mortgage loans. Totalkredit A/S and the individual partner bank share the risk of loss on the loans, and the partner bank receives regular fees for providing customer services. At end-2020 mortgage lending to personal customers in Totalkredit A/S made up around half of the Nykredit Realkredit Group's total mortgage lending. The Totalkredit alliance is described in more detail in *4.2.2 Totalkredit's credit approval process.*

Nykredit Bank is in itself an important part of the Nykredit Realkredit Group, but it also widely underpins the Group's mortgage business. For example, Nykredit's customer centres provide customer advisory and loan services for a large part of the mortgage business. Also, Nykredit Bank undertakes market making in the Group's covered bonds and thereby contributes to high market liquidity. Nykredit Bank's risk profile mainly relates to loans and credit facilities provided to personal and business customers.

2.2 ▪ RISK PROFILE

Nykredit's business activities, including management of the investment portfolio, involve exposure to credit risk, market risk, liquidity risk and operational risks, including reputation risk, conduct risk, as well as IT and compliance risks. Moreover, regulatory and strategic risks are areas of special focus. Risks related to climate change are also a focus area and are managed as part of the traditional risk types.

As Nykredit mainly provides mortgage lending, Nykredit's primary risk is credit risk. Mortgage lending and the underlying funding are regulated by the balance principle, which means that Nykredit incurs limited market and liquidity risk on its mortgage lending and the underlying funding. The mechanisms behind the balance principle are described in detail in *7.4 Balance principle and match funding.* Liquidity and market risks are further reduced by the Danish act regulating refinancing risk, which provides for the refinancing of mortgage loans under special circumstances.

Credit risk, market risk and operational risk are countered by holding adequate capital, while liquidity risk is mitigated through a sufficient stock of liquid assets. A few outstanding regulatory measures are factored in through capital targets or the Pillar II add-on to the internal capital adequacy requirement. The Board of Directors regularly considers the current risk levels and risk appetite.

Nykredit's risk management

To ensure a suitable risk profile, Nykredit applies a number of basic risk management principles. These principles make up the practice and culture that guide us in managing risks in relation to Nykredit's values, strategy and performance for the purpose of preserving, creating and realising value.

The principles of all of the Group's risk management activities are based on four elements:

- Risk governance, and risk and compliance culture
- Risk policies
- Risk monitoring
- Risk communication and reporting

For each of these elements, a number of principles guide the risk management practices across the organisation. This ensures a uniform and holistic approach to risk management and a close link between strategy and risk taking.

Nykredit's overall risk policy defines Nykredit's risk appetite and sets the framework for Nykredit's risks. Further, a policy has been laid down for each type of risk with specific limits and guidelines for risk taking.

2.3 ▪ RISK GOVERNANCE AND CULTURE

The Board of Directors is the supreme management body of the Company. The Board of Directors makes strategic and policy decisions and lays down guidelines for the day-to-day management undertaken and implemented by the Group Executive Board. The Board of Directors oversees the establishment of risk management procedures and monitors risks through the Board Risk Committee and the Board Audit Committee. All policies are reviewed and approved by the Board of Directors at least once a year. The Board of Directors receives regular reports on compliance with the limits and guidelines set out in the policies. The Executive Board oversees that risks are managed and controlled as determined by the Board of Directors. The Executive Board monitors risks through various committees.

The responsibility for the day-to-day control is based on three lines of defence:

First line of defence: The operational business units, which basically take, and are responsible for, the risk. The management of each business division is responsible for identifying, assessing and reporting the risks arising in connection with the performance of its duties and for ensuring that satisfactory internal controls are in place at all times in respect of the risks related to the handling of business operations.

Further, the first line of defence is to ensure that risk management is performed in compliance with current legislation and the Group's business model, policies, guidelines and business procedures, and that it meets the overall principles of risk management.

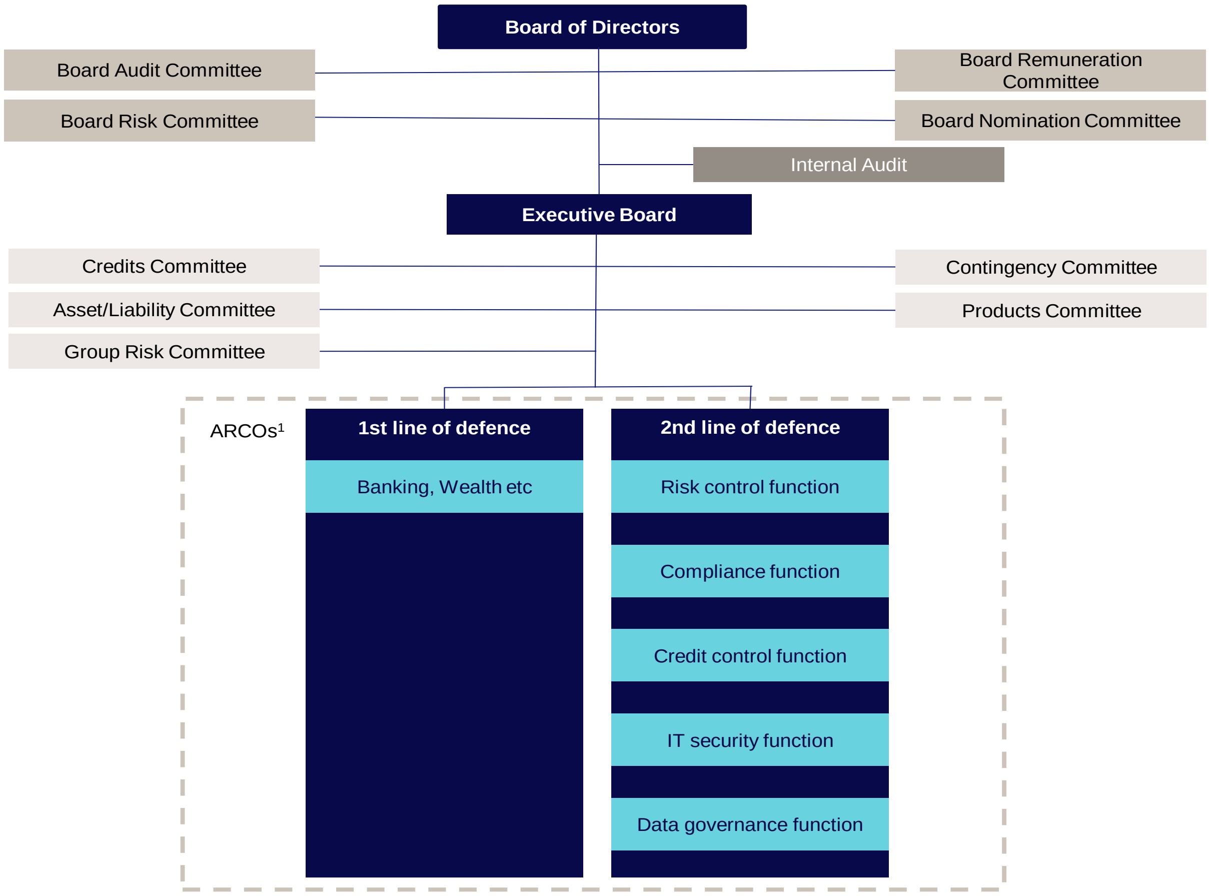
Second line of defence functions are:

- Risk control function
- Compliance function
- Credit control function
- IT security function
- Data governance function

Together, these functions are responsible for the monitoring, controlling and reporting of risks to the Executive Board and the Board of Directors and for assessing the effectiveness of first line activities.

To strengthen the organisation's efforts to address and mitigate risks, including operational and compliance risks, one or more Assistant Risk and Compliance Officers (ARCOs) have been appointed in the individual business divisions.

Nykredit Group: Risk management and governance



[1] Assistant Risk and Compliance Officers have been appointed in all business areas of Nykredit.

Their primary duty is to assist the managements of the individual business divisions in executing compliance- and risk-related tasks and to strengthen awareness of Nykredit's risk culture. ARCOs serve as links between the first line of defence and the compliance and risk control functions. However, ARCOs are also found in functions in the second line of defence.

Third line of defence: Internal Audit, which provides independent assurance over the overall management of risks and internal controls in the Group and reports on its work to the Board of Directors and the Board Audit Committee. Internal Audit is responsible for testing and providing an opinion on whether Nykredit's overall risk management approach, risk management framework, business procedures and internal controls established in all material areas and risk areas have been organised and are working satisfactorily.

The three lines of defence are mutually independent; the functions in the second line of defence work independently of the first line of defence and do not take part in business operations. Similarly, Internal Audit is independent of both the first and second lines of defence, but may base its assurance on the work performed in the second line of defence.

Risks related to ESG factors

Climate change brings new risks to Nykredit's business and customers. Efforts are made to integrate these risks in different ways into the existing risk management principles and into Nykredit's risk culture at all levels of the business.

Risks arising from climate change include physical risks and transition risks. Physical risks pertain to costs and losses arising from extreme weather conditions or long-term changes brought about by climate change. For Nykredit, one example could be the risk of flooding of low-lying homes and buildings, and, with that, the risk that the value of the assets serving as security behind mortgage loans in particular is reduced.

Transition risks pertain, in particular, to business customers' risk of incurring costs and losses as a result of new regulation, technological advances and changes in consumer behaviour in the wake of the transition to a more sustainable economy. Nykredit focuses on whether the customers Nykredit provides loans to and invests in are able and willing to prepare for a situation where their business model may be challenged by the transition to a more sustainable economy.

Nykredit is currently analysing and determining ESG risks in relation to its lending to various industries and sectors. This is a comprehensive task, and the ambition is to continuously improve the data that provide the basis for assessing and monitoring customers' ESG risks. The aim is to integrate this area in the ongoing risk management, for instance by setting targets and limits. Risks related to climate change are integrated into the work undertaken in relation to the traditional risk types – mainly credit risk, market risk and operational risk – which means that risk management and governance of ESG issues adhere to principles and working procedures already established and proven. Accordingly, new risks must be identified, controlled and managed in the customer-facing units in the first line of defence. Staff are currently being trained for this task. Monitoring and reporting take place in the first and second lines of defence, which follow developments as well as the emergence of new legislation and best practice. The Board of Directors adopts policies for the relevant areas in which risk appetites increasingly reflect these new risks and can be delegated within the organisation.

A particular effort is made to integrate climate-related risks, but focus is also on the remaining ESG risk elements.

Nykredit's efforts and initiatives in relation to ESG risks as well as risks that may have a negative impact on society, people, the environment and the climate are described in Nykredit's *Corporate Responsibility Report.*

2.4 ▪ MANAGEMENT

Board of Directors

The Boards of Directors of Nykredit A/S and Nykredit Realkredit A/S must be composed so that they possess the mix of skills required to undertake the overall and strategic management of the business and to take any measures to ensure prudent business management. Furthermore, Board members must possess the knowledge and experience required to be able to critically assess and challenge the work and proposals of the Executive Board.

The Boards of Directors review their skills profiles on an ongoing basis and have decided in this respect that they should have special skills and knowledge as regards:

- Strategy
- Sector and real estate expertise
- Economics, finance and accounting
- Capital markets, securities and funding
- Politics, public administration and associations
- Financial regulation
- Corporate governance
- Digitisation, IT and processes
- Market conditions, customer relations and sales
- Organisation/HR and processes
- Risk management and credit matters

The Board of Directors of Nykredit A/S counts 14 members, of whom nine are elected by the Annual General Meeting for a term of one year and five are elected by and among the staff for a term of four years.

The Board of Directors of Nykredit Realkredit A/S counts 11 members, of whom seven are elected by the Annual General Meeting for a term of one year and four are elected by and among the staff for a term of four years.

Further details on the composition, size and diversity of the Boards of Directors as well as the CVs of the individual Board members are available at *nykredit.com/en-gb/om-os/organisation/bestyrelsen/* and *nykredit.com/en-gb/om-os/organisation/bestyrelsen-i-nykredit-as/*.

Executive Board

The Executive Board is composed of four members. The Executive Board implements the Group strategy and is responsible for the day-to-day management and for implementing policies and guidelines laid down by the Board of Directors. The Executive Board has set up a number of committees at Group level charged with various tasks. These committees report to the Group Executive Board, implying that the Group Executive Board is briefed about committee decisions.

Chief Risk Officer

The duties of the Chief Risk Officer are laid down in the Danish Executive Order on Management and Control of Banks, etc. The Chief Risk Officer must have a general overview of the company's activities and operations as well as its risk exposures in order to assess whether risk management operations are satisfactory. The Chief Risk Officer also assesses whether the decision-making basis of the Executive Board and the Board of Directors is sufficient in risk-related matters.

The head of Nykredit's risk control function has been appointed Chief Risk Officer. Nykredit's organisational structure ensures that the risk control function is segregated from all risk-taking units and thus independent in relation to risk-related decisions. Nykredit's central risk control function performs Group-wide controls, monitors Group risks and prepares risk reports for the Boards of Directors on all risk areas. In the organisational structure, the risk control function falls within the CRO division, but with separate and independent reporting to, for instance, the relevant Executive Boards and Boards of Directors of Group companies.

Chief Compliance Officer

The duties of the Chief Compliance Officer are laid down in the Danish Executive Order on Management and Control of Banks, etc. The Chief Compliance Officer assists Nykredit's Management in identifying, assessing, advising on, controlling, monitoring and reporting on Nykredit's compliance risks. The head of Nykredit's compliance function has been appointed Chief Compliance Officer.

The compliance function assesses whether Nykredit meets the compliance rules applicable to the individual risk areas and oversees and determines whether the methods, procedures and controls implemented by Nykredit in the risk areas are adequate and effective in terms of identifying and mitigating compliance risks. In the organisational structure, the compliance function falls within the CRO division, but with separate and independent reporting to, for instance, all relevant Executive Boards and Boards of Directors of Group companies.

Responsible for anti-money laundering

The Group Executive Board and the Executive Boards of the Group companies have each appointed a Chief AML Officer at the executive level charged with delegating and ensuring managerial responsibility and focus on measures to prevent financial crime throughout the Group.

Moreover, an AML Responsible Officer has been appointed who is tasked with approving Nykredit's anti-money laundering policies, procedures and controls and to approve business relationships with politically exposed persons (PEPs) and correspondent relationships.

Data Protection Officer (DPO)

The Group Executive Board and the Executive Boards of the Group companies have appointed a Data Protection Officer charged with ensuring Nykredit's compliance with applicable data protection legislation.

The Data Protection Officer is responsible for identifying, assessing, advising on, controlling, monitoring and reporting on Nykredit's compliance risks relating to personal data processing. In the organisational structure, the Data Protection Officer falls under the compliance function, but with separate and independent reporting to, for instance, the relevant Executive Boards and Boards of Directors of Group companies.

2.4.1 Committees

Board Committees

The Board of Directors of Nykredit Realkredit A/S has appointed a Board Risk Committee, a Board Audit Committee, a Board Remuneration Committee and a Board Nomination Committee. These Board committees advise the Board of Directors on particular matters and prepare cases for review by the entire Board of Directors, each within their field of responsibility. The committees are described below.

Group committees

The Group Executive Board has set up five committees in Nykredit, to which it has delegated specific responsibilities. Each committee must report to the Group Executive Board, and the individual members may at any time resolve to have the relevant Executive Board of a Group company decide on a case.

The committees are all part of the first line of defence. The Chief Risk Officer and the Chief Compliance Officer may attend committee meetings as observers. The Chief Risk Officer is a permanent observer at meetings of the Group Risk Committee, the Products Committee and the Asset/Liability Committee. The Chief Compliance Officer is also a permanent observer at meetings of the Group Risk Committee and the Products Committee and, as required, the Asset/Liability Committee. The committees are described below.

Nykredit's Board committees

Board Risk Committee	The function of the Board Risk Committee is to oversee Nykredit's overall risk profile and strategy, including to assess the long-term capital requirement and the capital policy. It also assesses risks related to products, business model, remuneration structure and incentives as well as risk models and methodological basis. The Board Risk Committee also assists the Board of Directors in overseeing that the risk appetite defined by the Board of Directors is implemented correctly in the organisation.
Board Audit Committee	The principal tasks of the Board Audit Committee are to inform the Board of Directors of the results of the statutory audit, to oversee the financial reporting process and the effectiveness of Nykredit's internal control systems, internal audit and risk management, to oversee the statutory audit of the financial statements etc, to monitor and verify the independence of the auditors, and to be responsible for the procedure for selecting and submitting a recommendation for the appointment of auditors.
Board Remuneration Committee	The principal tasks of the Board Remuneration Committee are to qualify proposals for remuneration prior to consideration by the Board of Directors and to make recommendations in respect of Nykredit's remuneration policy, including guidelines on incentive pay, for the approval of the Board of Directors, as well as to assist in ensuring that these are observed. Moreover, the Board Remuneration Committee reviews and considers the criteria for and process of appointing risk takers, assesses whether the Group's processes and systems relative to remuneration are sufficient and takes into consideration the Group's risks, and ensures that the remuneration policy and practices are in alignment with and promote sound and effective risk management and are in accordance with the Group's business strategy, objectives, values and long-term interests. Finally, the Board Remuneration Committee ensures that the information in the Annual Report about remuneration of the Board of Directors and the Group Executive Board is correct, fair and satisfactory. Details on bonuses to risk takers as well as remuneration policy and practices can be found in Nykredit's *remuneration policy*.
Board Nomination Committee	The Board Nomination Committee is tasked with making recommendations to the Board of Directors on the nomination of candidates for the Board of Directors and the Executive Board. The Committee also advises the Board of Directors with respect to targets for the under-represented gender on the Board of Directors and laying down a diversity policy applying to the same. In addition, the Board Nomination Committee, reporting to the Board of Directors, is ultimately responsible for defining the skills profiles of the Board of Directors and the Executive Board and for the continuous evaluation of their performance and achievements.

Nykredit's Group committees

Group Risk Committee	The Group Risk Committee is charged with overseeing Nykredit's overall risk outlook and capital requirements as well as assisting the managements of the respective companies in ensuring compliance with current legislation and practices. The Group Risk Committee receives material from the other Group committees.
Credits Committee	The Credits Committee is charged with ensuring adequate credit risk management and approving and/or deciding credit applications and loan impairments as well as overseeing the management of risks in Nykredit's credits area. The Committee manages the Group's loan portfolio and submits recommendations on credit policies to the individual Executive Boards and Boards of Directors. The Committee lays down business procedures for the granting of credits within the limits of the guidelines laid down by the Group Executive Board and the Board of Directors.
Asset/Liability Committee	The Asset/Liability Committee undertakes the day-to-day responsibilities and tasks of the Executive Boards in the areas of capital, funding, liquidity and market risk according to guidelines approved by the Boards of Directors. The Committee has a governance mandate in these areas at both Group and company levels.
Products Committee	The Products Committee's overarching objective is to ensure that the Nykredit Group's products meet applicable business and regulatory requirements. The Committee must ensure that launches of new products and services, or changes to existing ones, that involve material risks for the Group, the individual companies, counterparties or customers are in alignment with the business models of the individual companies and comply with the current product policy and the Executive Board's guidelines for development and approval of new products and services. Further, the Committee must regularly monitor and evaluate the existing products and assess any need for changing or adjusting individual products or an entire product range.
Contingency Committee	The Contingency Committee has the overall responsibility for compliance with IT security policy rules in relation to contingencies (major accidents or catastrophes) and the Group's entire spectrum of contingency plans covering IT as well as business aspects.

Nykredit Realkredit Group

Risk areas reviewed by the Board of Directors

Risk management	Frequency	
Risk policies	Annually	Review of risk policies, risk guidelines and risk appetite, including:
		Overall risk policy
		Capital policy, including leverage, eligible liabilities (MREL) and debt buffer
		Credit policy and guidelines for approval of loans and other credit facilities
		Valuation policy
		Market risk policy and guidelines
		Liquidity policy and liquidity risk guidelines
		Operational risk policy and guidelines
		Compliance policy
		IT security policy
		Insurance cover policy
		Policy for the prevention of money laundering, terrorist financing and breach of financial sanctions
		Product policy
		Personal data policy
		Tax management policy
		Data governance policy
ICAAP	Annually	Review of internal capital adequacy requirement
		Conclusions from stress tests containing the impact of different scenarios on the expected loss and capital requirement
ILAAP	Annually	Evaluation of the Group's liquidity position and liquidity management, including its funding profile and funding schedule. The report includes liquidity risk calculations and assessments through liquidity stress tests etc

Risk reporting		
Capital	Quarterly	Own funds, required own funds and internal capital adequacy requirement
		Stress testing of capital strength
		Leverage ratio
Credit risk	Quarterly	Development in credit risk and parameters, and ratings
		Concentration risk by industry, loan type and geographical region
		Housing prices and loan-to-value (LTV) ratios
		Review, assessment and approval of exposures above a certain limit
		Results of credit approval controlling
Valuation risks	Quarterly	Update on risks relating to property valuation
Market risk	Monthly/	Yield spread, interest rate, foreign exchange and equity price risks (conventional measures and Value-at-Risk)
	quarterly	Earnings and market trends
		Portfolio stress testing
		Model backtesting
Liquidity risk	Monthly/	Liquidity and excess liquidity coverage for the period under review
	quarterly	Liquidity stress testing
Operational risks	Quarterly	Events and losses
Compliance risks	Quarterly	Update on compliance risks
IT risks	Quarterly	Update on IT risks
Regulatory risks	Quarterly	Update on new legislation
Strategic risks	Quarterly	Update on principal strategic risks

2.5 ▪ RISK POLICY

The risk policy sets out the overall risk appetite as well as risk appetites for the individual types of risk. Nykredit's risk management is aimed at ensuring agreement between risk profile, risk appetite and current legislation in the context of a robust capital structure and stable earnings. Risk management should contribute to ensuring financial solutions that are viable in the short, medium and long term.

2.5.1 ▪ Risk appetite

The overall risk appetite is determined on the basis of Nykredit's strategy, regulatory and credit rating agency capital requirements and the internal capital targets. The risk appetite is determined by the Board of Directors and reflects Nykredit's overall tolerance for assuming risks in the context of its business model and the Group strategy. In some areas, it is directly measurable, while in other areas the risk appetite is expressed through general objectives.

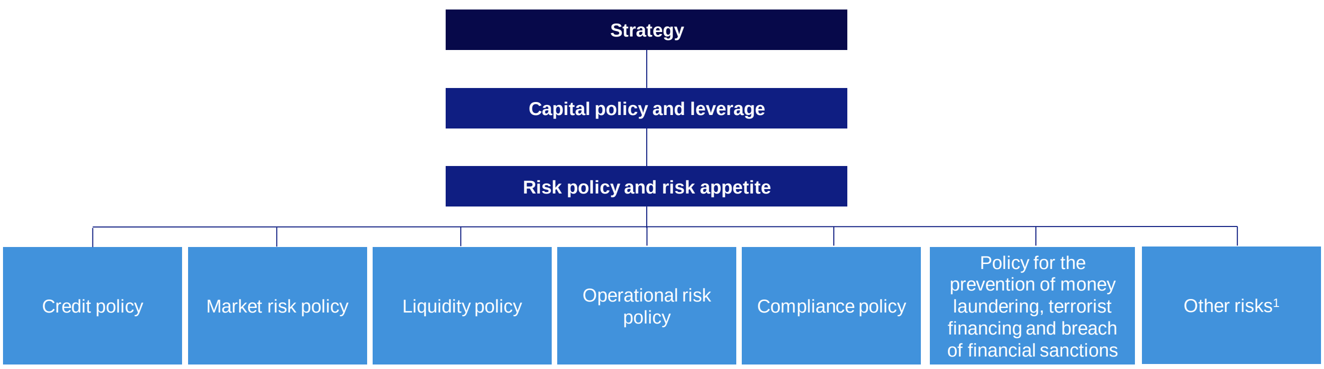
The tolerance limits for the individual risks vary according to risk type, customer exposure, product type, strategy, targets etc. These factors are described and incorporated in relevant policies and guidelines. The specific risks related to business unit activities are assessed in the context of the potential financial impact on the individual unit.

Nykredit manages its capital usage on an ongoing basis and prepares a capital budget annually. The budget should be seen in the context of the overall capital and strategy plan. Capital is allocated and prioritised according to risk profile, business returns and strategic considerations.

Nykredit's overall risk appetite

The objective is to be able to maintain active lending to core customer segments, including the Group's full-service customers and Totalkredit customers, also in a challenging economic climate.	
Capital:	by having, for instance, a minimum CET1 capital ratio of 15.5-16.5% and targets for eligible liabilities (MREL) and debt buffer. Current capital usage is managed through capital budgets.
Leverage:	by limiting financial leverage so that Tier 1 capital after regulatory deductions relative to lending as a minimum complies with the applicable regulatory requirement at any time. Capital budgets set limits for maximum lending growth, managing the risk of excessive leverage.
Credit:	by having a credit policy that regulates the level of large exposures, the loan portfolio mix as well as lending to personal customers and special lending segments. Nykredit manages credit risk according to a portfolio management approach whereby significant concentrations are avoided, reviews of single-name and weak exposures as well as continuous controls.
Market risk:	by having a market risk policy dictating that losses on the trading book may not exceed 75% of budgeted quarterly earnings. Market risk is managed by means of, for instance, estimated losses in stress scenarios. Statistical as well as forward-looking stress scenarios are used to calculate estimated losses.
Liquidity:	by having a liquidity policy which ensures that Nykredit's funding and liquidity management supports the mortgage lending business and ensures competitive prices for customers and Nykredit, regardless of market conditions. Furthermore, liquidity management must ensure that Nykredit can maintain high ratings and its position as issuer of covered bonds (SDOs).
Operational risks:	by ensuring that operational risks are low relative to other risks and are assessed on the basis of the probability of a given event occurring and the loss resulting from such event.
Compliance risks:	by ensuring that compliance risks, like operational risks, are low relative to other types of risk of the Group. Compliance risks are assessed on the basis of the probability of a given event occurring and its potential consequence in the form of losses.
Prevention of money laundering and terrorist financing:	Based on its business model and risk policy, Nykredit has defined a set of principles and attitudes aimed at preventing any misuse of Nykredit for financial crime purposes.
Other:	Nykredit's risk appetite for other risks is continuously reviewed and monitored through various forums. The Board of Directors also regularly assesses these risks.

Risk policy and risk appetite



[1] Strategic risk, property valuation risk, insurance risk, IT security risk, model risk, data quality risk and personal data processing risk.

2.6 ▪ RISK MONITORING

Risks are assessed and monitored centrally in the second line of defence on the basis of various quantitative and qualitative risk measurements prepared by specialists in the individual types of risk. Risk monitoring results are reported collectively to the relevant management levels, eg the Board of Directors, the Executive Board and the Chief Risk Officer.

Non-compliance with risk policies, including breaches of prescribed limits, is reported to the Board of Directors, the Executive Board and relevant committees. Policy governance is described in detail for the individual risk areas in this report.

*2.6.1 ▪ **Internal controls***

Risk monitoring is based on internal controls, risk management systems and analyses, which together ensure that all relevant risks are addressed. The monitoring set-up is adjusted regularly so as to reflect all relevant risk factors at any given time.

The purpose of Nykredit's controls is to ensure that policies and guidelines laid down by the Boards of Directors are observed, and to ensure timely prevention, detection and correction of any errors, deviations or omissions.

Controls must be in place for all material areas and risk areas, and overall principles and requirements for the preparation of business procedures and a process for the approval of business procedures in material risk areas have been established at Group level. The controls include control of transactions, spot checks and physical property valuation control, control of outsourced activities and IT controls.

2.7 ▪ REPORTING AND COMMUNICATION

The Board of Directors and the Executive Board receive a report covering all relevant risks at least quarterly. The risk reporting complies with current legislation and is aimed at describing the current risk outlook on the basis of quantitative data and analysis of special focus areas.

At a minimum, the risk reporting covers the areas of credit risk, market risk, liquidity risk and operational risk, including reputation risk, conduct risk as well as IT and compliance risks. Moreover, regulatory and strategic risks are areas of special focus. Risks related to climate change are also a focus area and are managed as part of the traditional risk types.

The implementation of the policies is regularly assessed together with the relevant business units to obtain a continuous assessment of the risk outlook and the contents and messages of the reporting.

3. CAPITAL MANAGEMENT

3.1 ▪ CAPITAL TARGETS 2021

In accordance with its business model, Nykredit aims to have stable earnings, a strong capital structure and competitive credit ratings. Based on a structured capital management framework with an adequate management buffer, the Group aims to be able to maintain its business activities throughout Denmark regardless of fluctuations in economic trends. This implies having access to capital to meet new regulatory requirements and in addition be able to withstand a severe economic downturn and consequent losses. At the same time, Nykredit wants to ensure sufficient own funds to generate dividend for its owners, in turn allowing Forenet Kredit to realise its key priorities. Nykredit's capital policy must also adhere to current legislation and FSA requirements.

The Board of Directors has set the Common Equity Tier 1 (CET1) capital requirement at 15.5-16.5% of the risk exposure amount (REA), whereas the overall capital need is calculated at 20-21%. Furthermore, Nykredit holds CET1 capital to meet the upcoming Basel requirements and may also obtain new CET1 capital from Forenet Kredit and through investment commitments from a number of Danish pension companies. Based on the capital resources inherent in the ownership structure, Nykredit is expected to have a capital requirement corresponding to that of a listed systemically important financial institution (SIFI) when the new Basel requirements have been implemented.

As a SIFI, Nykredit is subject to a special SIFI buffer requirement of 2%. A capital conservation buffer of 2.5% is also applicable to all financial institutions. Since the covid-19 outbreak, the countercyclical buffer rate has been 0%, as determined by the Danish Minister for Industry, Business and Financial Affairs upon recommendation from the European Systemic Risk Board. All buffer requirements are included in Nykredit's overall capital need and must be met using CET1 capital.

Capital

% of REA	Capital ratios end-2020	Total regulatory requirement[1] 2021
Nykredit Realkredit Group		
CET1 capital	20.2	10.7
Tier 1 capital	21.1	12.7
Own funds	24.3	15.5
Nykredit Realkredit A/S		
CET1 capital	16.4	9.9
Tier 1 capital	17.2	11.7
Own funds	19.6	14.1
Nykredit Bank Group		
CET1 capital	20.5	10.7
Tier 1 capital	20.6	12.8
Own funds	26.2	15.6
Totalkredit A/S		
CET1 capital	21.3	10.9
Tier 1 capital	24.3	13.1
Own funds	26.2	15.9

[1] Total regulatory requirement 2021 includes the current internal capital adequacy requirement, SIFI buffer, capital conservation buffer and countercyclical buffer.

3.2 ▪ DETERMINATION OF CAPITAL

Nykredit's own funds totalled DKK 97.7 billion at end-2020 against DKK 90.1 billion at end-2019. Own funds include CET1 capital, Additional Tier 1 (AT1) capital and Tier 2 capital. With a risk exposure amount (REA) of DKK 401.8 billion, this corresponds to a total capital ratio of 24.3% at end-2020 against 23.7% at end-2019.

Nykredit's Tier 1 capital of DKK 84.9 billion consists mainly of CET1 capital, which is the most important capital measure as this is the type of capital required to comply with most of the regulatory capital requirements. CET1 capital came to DKK 81.3 billion at end-2020, corresponding to a CET1 capital ratio of 20.2% against 19.5% at end-2019. AT1 capital totalled DKK 3.7 billion (EUR 500 million) at end-2020 and was issued by Nykredit Realkredit A/S in October 2020. However, the level is unchanged relative to the preceding year, as Nykredit Realkredit A/S was authorised by the Danish Financial Supervisory Authority (Danish FSA) to redeem a corresponding amount of AT1 capital in September 2020.

Nykredit's CET1 capital increased by a total amount of DKK 7.0 billion in 2020. The increase resulted primarily from profit for 2020 as well as the Annual General Meeting's decision in March 2020 to transfer the proposed dividend for 2019 of DKK 3.6 billion to retained earnings. Against the backdrop of the covid-19 crisis, Nykredit thus complied with the Danish government's and authorities' recommendation to financial undertakings to refrain from distributing dividend for the financial year 2019. In December 2020 the Danish FSA recommended the continued withholding of 2019 dividend payments. Nykredit will comply with this recommendation.

Capital management governance

Board of Directors and Board Risk Committee:
Lay down the capital policy and capital management guidelines, including capital requirements, maximum leverage and targets for eligible liabilities (MREL) and debt buffer.
Receive quarterly reports on capital policy compliance.
Receive separate reports in case of non-compliance with the policy, including an action plan for approval.

Executive Board and Asset/Liability Committee:
Approve and implement the capital policy and regularly review compliance based on quarterly reports.
Receive separate reports in case of non-compliance with the policy, including an action plan for approval.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

Nykredit Realkredit Group

REA and own funds

Year-end DKK million	2020	2019
REA		
Credit risk	333,600	324,627
Market risk	40,128	29,336
Operational risk	28,109	25,499
Total REA	**401,837**	**379,462**
Equity (including AT1 capital)	**89,774**	**84,378**
AT1 capital etc	(3,849)	(3,834)
Proposed dividend	(2,230)	(3,660)
Other CET1 regulatory adjustments	(2,438)	(2,539)
CET1 capital	**81,257**	**74,344**
AT1 capital	3,729	3,741
AT1 regulatory deductions	(38)	(48)
Total Tier 1 capital	**84,949**	**78,036**
Tier 2 capital	10,793	10,823
Other Tier 2 regulatory adjustments	1,932	1,224
Own funds	**97,673**	**90,083**
CET1 capital ratio, %	20.2	19.5
Tier 1 capital ratio, %	21.1	20.5
Total capital ratio, %	24.3	23.7

Also in December, the Danish FSA indicated that it was open to a dialogue with well-capitalised businesses about a prudent dividend level for 2020. Based on a dialogue with the Danish FSA in January 2021 and Nykredit's strong capital position, the Board of Directors proposes to the Annual General Meeting that dividend for 2020 be distributed in the approximate amount of DKK 2.2 billion, corresponding to 40% of profit after tax for 2020. The 2020 dividend is lower than Nykredit's long-term ambition to provide our owners with a competitive return in the form of dividend in the region of 50% of profit for the year.

Tier 2 capital including regulatory adjustments totalled DKK 12.7 billion at end-2020, which is DKK 0.7 billion higher than at end-2019. At end-2020 Nykredit had issued DKK 9.3 billion-worth of senior non-preferred debt. This does not count towards own funds, but is eligible for meeting the Danish minimum requirement for own funds and eligible liabilities (MREL) applying to the Group, the debt buffer requirement for mortgage banks as well as S&P's Additional Loss-Absorbing Capacity (ALAC) criterion for credit rating purposes. Senior non-preferred debt serves to protect unsecured creditors in case of the issuer's resolution or bankruptcy.

Determination of own funds and total REA

End-2020 DKK billion	Nykredit Realkredit Group	Nykredit Group
CET1 capital before regulatory deductions	**85.9**	**85.9**
Proposed dividend	(2.2)	(2.2)
Intangible assets excluding deferred tax liabilities	(2.1)	(2.1)
Other deductions	(0.3)	(0.7)
CET1 capital	**81.3**	**80.9**
AT1 capital	3.7	2.2
Tier 1 capital	**84.9**	**83.1**
Tier 2 capital	12.7	8.9
Own funds	**97.7**	**92.0**
REA		
Credit risk	333.6	332.4
Market risk	40.1	40.1
Operational risk	28.1	28.1
Total REA	**401.8**	**400.6**
Capital ratios		
CET1 capital ratio, %	20.2	20.2
Tier 1 capital ratio, %	21.1	20.7
Total capital ratio, %	24.3	22.9

3.2.1 ▪ Capital adequacy differences between the Groups

Although the sole activity of Nykredit A/S is its ownership of Nykredit Realkredit A/S, the determination of own funds and total REA is not entirely identical for the Nykredit Group and the Nykredit Realkredit Group. The differences are due to four factors:

1. Common Equity Tier 1 (CET1) capital
   CET1 capital totalled DKK 80.9 billion in the Nykredit Group and DKK 81.3 billion in the Nykredit Realkredit Group at end-2020. The difference is caused by a deduction from the CET1 capital of the Nykredit Group for intercompany balances with PRAS A/S and the ownership interest of PRAS A/S in Nykredit A/S.

2. Additional Tier 1 (AT1) capital in subsidiaries
   AT1 capital was issued by Nykredit Realkredit A/S and therefore cannot be included 100% in the capital determination of the Nykredit Group. This is laid down in the rules on minority interests in the Capital Requirements Regulation (CRR), which stipulate that AT1 capital may only be included at an amount corresponding to the regulatory requirement for the group concerned, in this case the Nykredit Group.

3. Tier 2 capital in subsidiaries
   Tier 2 capital was also issued by Nykredit Realkredit A/S. It has the same consequences as described for AT1 capital in 2 above.

4. Risk exposure amount (REA) – credit risk:
   As mentioned in 1 above for CET1 capital, intercompany balances and indirect ownership interests are eliminated in the Nykredit Group. This reduces total REA for credit risk in the Nykredit Group.

Nykredit Realkredit Group

Loan capital, end-2020

	Interest rate	Call date	Maturity	Capital
Nykredit Realkredit A/S				
AT1 capital	4.125%	15 April 2026	Perpetual	EUR 500 million
Tier 2 capital (CoCo)	4.00%	3 June 2021	3 June 2036	EUR 600 million
Tier 2 capital	6M Euribor + 1.71%	-	28 October 2030	EUR 50 million
Tier 2 capital	2.75%	17 November 2022	17 November 2027	EUR 800 million
Total				**EUR 1,950 million**

3.3 ▪ CONSOLIDATION METHODS

3.3.1 ▪ Consolidation methods

REA is determined according to the rules of the Danish Financial Business Act and the Capital Requirements Regulation. The determination comprises Nykredit Realkredit A/S (the Parent) and the enterprises in which Nykredit Realkredit A/S exercises direct or indirect control of the enterprises' financial and operational management.

As at end-2020 the consolidated risk exposures included:

- Nykredit Realkredit A/S
- Totalkredit A/S
- LR Realkredit A/S
- Nykredit Bank A/S
- Nykredit Leasing A/S
- Sparinvest Group
- Nykredit Portefølje Administration A/S
- Nykredit Ejendomme A/S
- Ejendomsselskabet Kalvebod Brygge A/S.

Together with other enterprises, Nykredit controls an enterprise which is not included in the Consolidated Financial Statements. This enterprise, JN Data, is recognised according to the equity method.

3.3.2 ▪ Differences compared with Financial Statements

There are differences between the Financial Statements and determinations under the CRR. This means that the figures in this report are not directly comparable with the determination of exposures in the Annual Report. This report has been prepared in accordance with Part 8 of the CRR, which defines the disclosure requirements.

Unexercised loan offers and undrawn credit and loan commitments, as well as potential future credit exposures to financial instruments are included in exposures used for the determination of REA. The same applies to guarantees. REA for securities is calculated at ISIN level. Detailed disclosures are available at nykredit.com/reports

3.3.3 ▪ Credit risk

Nykredit has obtained the approval of the Danish FSA to use the advanced IRB approach to determine REA for credit risk in relation to:

- Retail and business exposures of Nykredit Realkredit A/S, Totalkredit A/S and Nykredit Bank A/S.

The standardised approach is applied to determine REA for credit risk in relation to:

- Sovereign and credit institution exposures
- A few minor portfolios and remaining companies.

3.3.4 ▪ Market risk

For the determination of REA for market risk, Nykredit Realkredit A/S has obtained FSA approval to apply a Value-at-Risk (VaR) model to calculate the general risk related to:

- Equities
- Debt instruments
- Foreign exchange.

Nykredit Bank A/S has obtained FSA approval to apply a VaR model to calculate the general risk related to:

- Debt instruments
- Foreign exchange.

For market risk in the remaining companies and the parts of the portfolio for which REA is not determined using VaR, the standardised approach is applied.

Nykredit has a number of procedures in place ensuring that the tradability of positions in the trading book is satisfactory. All positions in the trading and banking books are tested regularly for uncertainty related to applied prices against observed prices. These tests are applied in the prudent valuation calculations. A deduction is made from Nykredit's CET1 capital for prudent valuation.

3.3.5 ▪ Operational risk

For all Group companies, REA for operational risk is determined using the basic indicator approach. This means that REA is calculated as 15% of average gross earnings of the past three years.

3.4 ▪ RISK EXPOSURE AMOUNT

At end-2020 Nykredit's risk exposure amount (REA) totalled DKK 401.8 billion.

REA increased by DKK 22.4 billion over the past year, equivalent to a rise of about 6%. Of this amount, REA for market risk was increased by DKK 10.8 billion in 2020, equivalent to a 37% rise, which was caused primarily by the financial market turbulence following the outbreak of covid-19 in March. However, REA for market risk reduced after Q2/2020 as volatility declined. For details on changes in REA for market risk, see *6.5.3. Regulatory VaR capital requirement.*

The greatest part of Nykredit's REA is related to credit risk exposures, which rose by about DKK 9.0 billion over the past year to DKK 333.6 billion at end-2020. This represents an increase of about 3%. The increase in REA for credit risk primarily resulted from capital set aside in Totalkredit A/S and lending growth in both Totalkredit A/S and Nykredit Bank A/S. Capital has been set aside to allow for upcoming regulatory requirements applying to IRB models. Improved credit quality of lending and earlier implementation of lower capital requirements for SME exposures had the opposite effect and reduced REA for credit risk. So far, covid-19 has had only a minor effect on the underlying trend in REA for credit risk, as Nykredit has not recorded increasing arrears, overdrafts or falling property prices etc, see 4.4.

Operational risks caused an increase in REA by DKK 2.6 billion, or about 10%, to DKK 28.1 billion, driven by higher gross earnings and the inclusion of LR Realkredit and Sparinvest.

Nykredit Realkredit Group

REA summary

	REA		Minimum capital requirement (8%)
DKK million	Q4/2020	Q4/2019	Q4/2020
Credit risk (excluding counterparty risk)	**306,166**	**297,415**	**24,133**
Of which the standardised approach	21,216	21,788	1,738
Of which the advanced IRB (AIRB) approach	251,650	262,375	19,955
Of which equity IRB under the simple risk-weighted approach	9,083	9,980	661
Of which assets with no counterparty	24,217	3,272	1,779
Counterparty risk	**18,716**	**19,506**	**1,503**
Of which market value	18,017	18,245	1,443
Of which risk exposure amount for contributions to the default fund of a CCP	194	281	16
Of which CVA	506	981	45
Settlement risk	0	0	0
Market risk	**40,128**	**29,336**	**3,788**
Of which the standardised approach	9,913	12,398	776
Of which the internal model approach (IMA)	30,215	16,937	3,013
Operational risk	**28,109**	**25,499**	**2,249**
Of which the basic indicator approach	28,109	25,499	2,249
Amounts below the thresholds for deduction (subject to 250% risk weight)	**8,718**	**7,706**	**626**
Total	**401,837**	**379,462**	**32,300**

3.5 ▪ REQUIRED OWN FUNDS

Pursuant to the Danish Financial Business Act, it is the responsibility of the Board of Directors and the Executive Board to determine the required own funds. The required own funds are the minimum capital required, in Management's judgement, to cover all significant risks. The determination takes into account the business objectives and capital policy targets by allocating capital for all relevant risks, including calculation uncertainties.

Required own funds are determined as the sum of Pillar I and Pillar II capital.

Required own funds totalled DKK 44.0 billion at end-2020, equal to an internal capital adequacy requirement of 11.0%.

The total regulatory requirement including capital buffers was 15.5% at end-2020, of which the minimum CET1 capital requirement represented 10.7%, including Pillar II.

3.5.1 ▪ Pillar I

Pillar I capital covers credit risk, market risk and operational risk. The Pillar I requirement is identical to the regulatory minimum capital requirement.

3.5.2 ▪ Pillar II

Pillar II comprises Nykredit's assessment of various risks not covered by the Pillar I capital requirement.

In calculating Pillar II capital, Nykredit adds a charge that factors in a weaker economic climate and changed customer credit quality. The calculation of Pillar II capital thus supports the aim of maintaining a stable capital level even if the economic climate deteriorates. In deciding the capital policy, Nykredit also takes the effects of a severe recession into account.

In case of a weaker economic climate, the need for capital will grow concurrently with falling property prices and increasing arrears. The calculations also factor in any operating losses due to higher loan impairment charges etc.

In addition to the charge for a slightly weaker economic climate, assessments are made of other risks, including effects of model updates, model risk, operational risks, IT risks, validation and backtest results, data quality, documentation requirements, concentration risk, control risk, strategic risk, external risk, interest rate risk, credit valuation adjustment (CVA) etc.

Management buffer

Nykredit applies various models to calculate the capital requirements under both Pillar I and Pillar II. The determination of the internal capital adequacy requirement includes a capital charge that serves as a management buffer, as the calculations depend on statistical methods, choice of model, model properties, unforeseen events etc.

Nykredit Realkredit Group

Total capital requirement

DKK billion	2021	2020
Credit risk	26.7	26.0
Market risk	3.2	2.3
Operational risk	2.2	2.0
Total Pillar I	**32.1**	**30.4**
Credit risk	5.0	4.7
Market risk	1.6	1.3
Operational risk	0.1	0.1
Other risks[1]	5.2	4.9
Total Pillar II	**11.9**	**11.0**
Total required own funds	**44.0**	**41.3**
Internal capital adequacy requirement	11.0%	10.9%
SIFI buffer	2.0%	2.0%
Capital conservation buffer	2.5%	2.5%
Countercyclical buffer	0.0%	2.0%
Total capital requirement	**15.5%**	**17.4%**

¹ Other risks may include fx assessment of control risk, strategic risk, external risk, concentration risk, etc.

3.5.3 ▪ *CET1 capital requirements*

As a systemically important financial institution (SIFI), Nykredit is subject to a special SIFI buffer requirement of 2.0% of REA, reflecting the systemic importance of the Group. This SIFI buffer requirement must be met using CET1 capital.

Nykredit is also subject to a capital conservation buffer requirement of 2.5% (CET1).

The countercyclical capital buffer was reduced to 0% as a consequence of the covid-19 crisis. The most recently announced countercyclical capital buffer was also 0%, effective as of 30 October 2020. The consequence of this in terms of capital is a larger buffer relative to both the regulatory requirements and the trigger levels determined by the Board of Directors and set out in the recovery plans.

In addition to this, around half of the Pillar II capital requirement must be met using CET1 capital, and Nykredit must reserve CET1 capital for lending in countries where the countercyclical buffer has been implemented. However, lending in those countries (in the Nordic region) is very limited.

Besides these requirements of a more technical nature, the results of the stress test exercises of the European Banking Authority (EBA) and the Danish FSA must be incorporated in Nykredit's capital planning.

Nykredit's capital policy, which is described in detail in *3.1 Capital targets 2021*, allows for the capital requirements combined with a deteriorating economic climate corresponding to the severe recession scenario in the Danish FSA stress test or a similar scenario.

Increased capital requirements from the Basel Committee

The Basel IV recommendations include a so-called capital floor for credit institutions applying internal models. The capital floor means that institutions, across risk types (credit, market and operational risks), will be subject to a minimum capital requirement which makes up 72.5% of the capital requirement as calculated under the standardised approach. The floor will significantly increase Nykredit's REA compared with today's level. It will impact mortgage loans in particular, as they have a very low risk of loss, which will not be allowed for in the risk determination when the floor is introduced.

Nykredit has reserved CET1 capital already now to meet the upcoming Basel requirements.

Nykredit Realkredit Group

Minimum CET1 capital requirement

% of REA	2021	2020
Pillar I	4.5	4.5
Pillar II	1.7	1.6
SIFI buffer	2.0	2.0
Capital conservation buffer	2.5	2.5
Countercyclical buffer	0.0	2.0
Total	**10.7**	**12.6**

3.6 ▪ LEVERAGE RATIO

The leverage ratio is defined as the relationship between Tier 1 capital and the balance sheet total (incl off-balance sheet items). Under the applicable rules, the ratio does not factor in any collateral. The leverage ratio is calculated separately for each company and included in their capital management.

In the capital policy the Board of Directors has set an internal leverage target, which is reviewed annually. Determination of this target is based on a stressed scenario and also takes into account other impacts on earnings and own funds as well as balance sheet movements, which may ultimately affect the leverage ratio. Each company has an individual target.

Nykredit's balance sheet mainly consists of match-funded mortgage loans. Match funding ensures a match between the maturities and cash flows of loans and the underlying funding. Because of Nykredit's balance sheet composition, the risk of excessive leverage is therefore limited. The balance sheet and consequently the leverage ratio remain largely unaffected in a stressed scenario.

Nykredit continuously monitors the development in the leverage ratio, which is a central element of Nykredit's capital and liquidity policy. The leverage ratio is determined on a quarterly basis and projected based on the expected balance sheet and Tier 1 capital development. The results are submitted to the Asset/Liability Committee, which considers any required action. The Executive Board and the Board of Directors, among others, are briefed through the regular risk reporting.

The Board of Directors receives regular reports on the leverage ratio measured against the internal leverage target. Leverage ratios are also included in recovery plans and the ICAAP documentation, which are also submitted to the Board of Directors and the Danish FSA.

At end-2020 Nykredit's leverage ratio was 4.8%. The leverage ratio rose by 0.3 percentage points in the course of 2020, from 4.5% at end-2019. The rise was primarily due to an increase in Tier 1 capital.

Nykredit Realkredit Group

Leverage ratio

DKK billion	2020	2019
Tier 1 capital	85	78
Leverage ratio exposures	1,753	1,722
Leverage ratio	**4.8%**	**4.5%**

3.7 ▪ STRESS TESTS AND CAPITAL PROJECTIONS

Nykredit holds additional capital to be applied in particularly stressed situations. Under the applicable rules, Nykredit is required to hold capital resources totalling at least 15.5% of REA, currently equivalent to DKK 62 billion. In addition to this, a stress buffer is determined annually along with the capital policy, which is based on a cross-section of stress impacts in both internal and external exercises over a number of years.

At end-2020 Nykredit's own funds totalled DKK 98 billion, equivalent to 24.3% of REA. In addition to these capital resources, Nykredit may obtain new CET1 capital from Forenet Kredit and through investment commitments from a number of Danish pension companies.

A number of model-based stress tests and capital projections are permanent elements of Nykredit's capital management. They are used to assess the impacts of different macroeconomic scenarios. The results are applied at both Group and company levels and are included in the annual assessments by the individual Boards of Directors of the internal capital adequacy requirement as well as in the continuous determination of the capital requirement.

The stress test calculations include the macroeconomic factors of greatest importance historically to Nykredit's customers.

The most important macroeconomic factors identified are:

- Property prices
- Interest rates
- Unemployment
- GDP growth.

Nykredit generally applies three macroeconomic scenarios: a baseline scenario, a weaker economic climate and a severe recession. Other relevant scenarios are evaluated as appropriate, for instance prompted by the covid-19 crisis in 2020.

The capital requirement for credit risk builds primarily on correlations between the macroeconomic factors, the Probability of Default (PD) and Loss Given Default (LGD). These correlations are an essential element of the capital projection model. Operating losses in a stress scenario increase the capital requirement, whereas operating profits are not included. The impacts of both rising and falling interest rates are tested in the projection scenarios to determine the greatest stress impacts.

Other stress scenarios are used as required for Nykredit Bank and Totalkredit, and/or the scenarios are supplemented with assessments of factors that may have an adverse impact on the companies' risk exposures or capital.

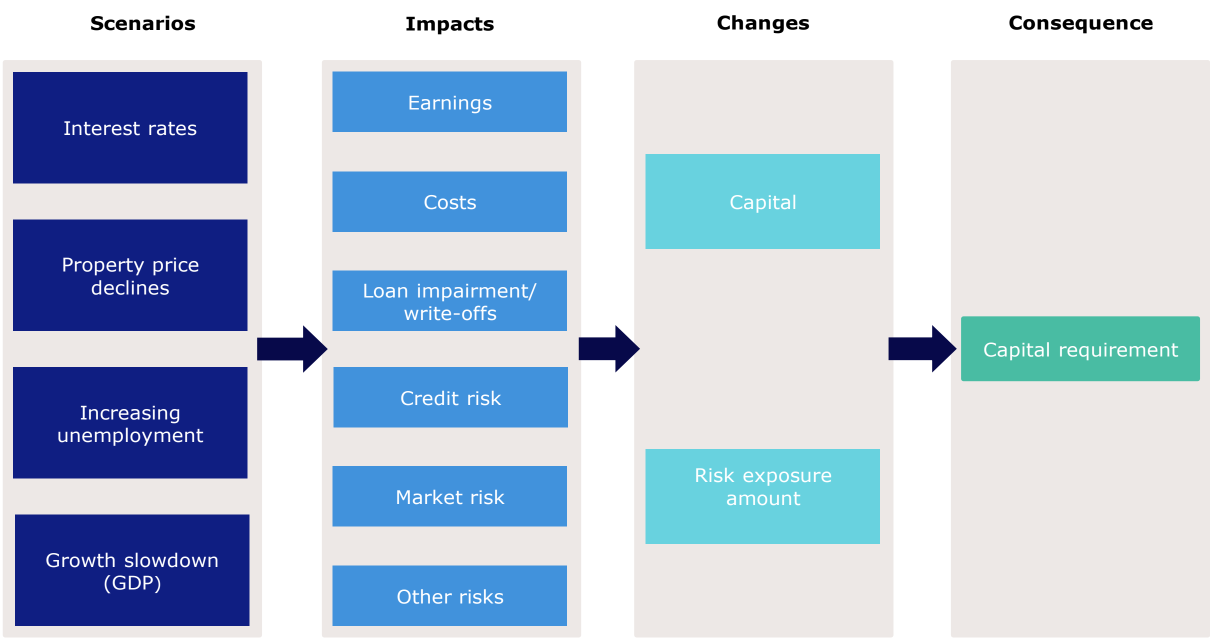
Baseline scenario

This scenario is a neutral projection of the Danish economy based on Nykredit's assessment of the current economic climate.

Stress scenario: Weaker economic climate

The stress scenario is designed to illustrate a weaker economic climate relative to the baseline scenario. Nykredit considers a scenario with rising interest rates and one with falling interest rates. The capital charge is calculated based on either the scenario with the harder impact of the two or a current risk scenario such as during covid-19, if this is more severe. The capital charge reflects how much Nykredit's capital requirement would increase if this scenario occurred. The results are included in the determination of the internal capital adequacy requirement.

Nykredit Realkredit Group
Structure of stress tests and capital projections



Stress scenario: Severe recession

Nykredit's capital policy aims at ensuring a robust capital level, also in the long term and in a severe recession. Therefore, Nykredit continually evaluates the impact of severe recession. The stress scenario reflects an unusual, but not unlikely, macroeconomic stress scenario. The calculations are factored into the annual determination of the stress buffer in the capital policy.

The results reflect the increased capital requirement in case of plunging housing prices, falling or rising interest rate levels and high unemployment.

Other stress scenarios

As part of the Group's capital policy, in addition to calculating its own stress scenarios, Nykredit also assesses the stress scenarios prepared by the Danish FSA. The results are compared regularly.

The covid-19 crisis was under close monitoring in 2020, and the stress scenarios are supplemented with covid-19-related stress tests to more accurately assess the potential impacts.

Based on the actual macroeconomic trends and current outlook, Nykredit finds that any covid-19-related stress impacts will be more than adequately covered by internal scenarios as well as the Danish FSA's stress scenarios.

Nykredit also participates in the EU-wide stress test exercises of the EBA, which in 2020 were postponed due to covid-19 but have been rescheduled for 2021. The results of the stress tests conducted in recent years have shown that Nykredit's CET1 capital ratio will drop by approximately 4 percentage points in a severe recession when stress tested based on the current capital need. The decrease is within the scope set out in Nykredit's capital policy, thus indicating that Nykredit is sufficiently resilient to withstand a severe macroeconomic stress.

Internal process

The Boards of Directors of Nykredit's individual companies determine at least annually the capital policy, including required own funds and internal capital adequacy requirement (ICAAP result), of their respective companies.

The Boards of Directors will reassess the capital needs if any major unexpected events occur.

The determination by the Boards of Directors of the capital needs of the individual Group companies is based on a number of stress tests as well as an assessment of the company's business model, risk profile and capital structure.

Furthermore, the Board Risk Committee and the Group Risk Committee closely monitor the development in the capital needs of the individual companies and are briefed quarterly. The Asset/Liability Committee monitors and coordinates the capital, funding and liquidity of the Group and the individual Group companies.

Nykredit Realkredit Group

Stress scenarios to determine the capital need

%	2021	2022	2023
Baseline scenario			
Interest rates[1]	(0.2)%	(0.2)%	0.0%
Property prices, growth	3.3%	1.7%	1.5%
GDP growth	3.7%	2.6%	2.4%
Unemployment	5.1%	5.0%	4.9%
Weaker economic climate (scenario applied under Pillar II)			
Interest rates[1]	1.0%	2.1%	3.1%
Property prices, growth	(3.0)%	(3.0)%	(2.0)%
GDP growth	1.0%	0.5%	0.1%
Unemployment	5.7%	6.4%	6.9%
Severe recession (scenario applied for capital policy)			
Interest rates[1]	2.5%	3.5%	4.5%
Property prices, growth	(12.0)%	(10.0)%	(5.0)%
GDP growth	(3.0)%	(2.0)%	0.0%
Unemployment	7.4%	9.1%	9.7%

[1] Average of 3-month money market rates and 10-year government bond yields.

3.8 ▪ FSA SUPERVISORY DIAMONDS

3.8.1 ▪ Banks

The Supervisory Diamond for banks applies to all Danish banks. It is a strictly Danish initiative and does not stem from EU legislation.

The Supervisory Diamond model sets out the following benchmarks for five key ratios that indicate when a bank is operating at an elevated risk:

- The sum of large exposures should be less than 175% of own funds.
- Lending growth should be less than 20% year-on-year. The limit value is determined exclusive of reverse repurchase lending and after impairments.
- Total exposure to the property segment should be less than 25% of total lending.
- The funding ratio should be less than 1.0. The ratio is calculated as loans and advances at amortised cost relative to working capital less bonds in issue with times-to-maturity of less than 1 year.
- The liquidity benchmark should be more than 100%. The liquidity benchmark indicates a bank's ability to withstand a liquidity stress for a period of at least three months.

The current limit values of the Supervisory Diamond model are shown in the table below. Nykredit Bank A/S operates comfortably within the limit values.

Nykredit Bank A/S

Supervisory Diamond for banks

Benchmark	2020	2019
Large exposures (limit value <175%)	132.3%	109.9%
Lending growth (limit value <20%)	8.7%	8.1%
Property exposure (limit value <25%)	12.6%	10.2%
Funding ratio (limit value <1.0)	0.60	0.57
Liquidity benchmark (limit value >100%)	150.7%	194.9%

3.8.2 ▪ Mortgage lenders

The Supervisory Diamond for mortgage lenders is a strictly Danish initiative and does not stem from EU legislation. In parallel to the Supervisory Diamond, bank loans resembling mortgage loans will be subject to special supervision.

The Supervisory Diamond model sets out the following benchmarks for five key ratios that indicate when a mortgage bank is operating at an elevated risk:

- Annual lending growth may not exceed 15% in each of the segments personal customers, commercial residential property, agriculture and other business.
- The sum of the 20 largest exposures must not exceed equity.
- Borrower's interest rate risk relating to residential properties: The proportion of lending where the LTV ratio exceeds 75% of the LTV limit and where the loan rate is fixed for up to 2 years only may not exceed 25% of the total loan portfolio.
- Interest-only (IO) loans to personal customers: The proportion of IO loans for owner-occupied and holiday homes with an LTV ratio above 75% of the statutory LTV limit may not exceed 10% of total lending.
- Limitation of short-term funding: The proportion of loans to be refinanced must be below 12.5% per quarter and 25% per year.

The current limit values of the Supervisory Diamond model are shown in the table below. Nykredit operates comfortably within the limit values.

Nykredit Realkredit Group

Supervisory Diamond for mortgage lenders

Benchmark	2020	2019
Lending growth in segment		
Personal customers (limit value <15%)	6.0%	7.4%
Commercial residential property (limit value <15%)	6.3%	5.3%
Agriculture (limit value <15%)	(1.3)%	(0.9)%
Other business (limit value <15%)	3.1%	3.7%
Borrower's interest rate risk		
Loans to private individuals and for residential rental (limit value <25%)	11.0%	12.6%
Interest-only loans		
Personal customers (limit value <10%)	7.2%	7.7%
Loans with short-term funding		
Refinancing (annually) (limit value <25%)	9.7%	12.5%
Refinancing (quarterly) (limit value <12.5%)	2.3%	2.6%
Large exposures		
Loans and advances:equity (limit value <100%)	39.7%	36.7%

4. CREDIT RISK

Credit risk reflects the risk of loss resulting from Nykredit's customers and counterparties defaulting on their obligations.

It is Nykredit's policy to always offer responsible products and financial solutions that match customers' financial position and risk appetite. This approach serves to contain Nykredit's overall credit risk.

Nykredit's credit risk stems mainly from bank and mortgage lending, but also from financial products. Most of the credit exposure derives from mortgage loans secured by real estate, which also serves to keep credit risk low.

2020 was characterised by the covid-19 pandemic and its impact on the Danish and global economies. However, so far the covid-19 crisis has not significantly affected Nykredit's credit portfolio. Arrears ratios as well as write-offs are low. The property market has also performed well during the covid-19 crisis, and housing prices have continued their upward trend in most of Denmark, thereby increasing mortgage security and home equity. The commercial property market has generally also shown positive trends, although covid-19 effects are noticeable in selected segments. The Danish economy was resilient already before the crisis, as businesses and households were financially robust and public finances were sound. This has enabled the introduction of extensive financial relief packages for businesses and individuals and helped Denmark weather the crisis better than many other European countries. Since the gradual reopening of the economy, activity has recovered significantly. Unemployment has dropped but is still some 30,000 higher than the pre-covid-19 level. Nykredit has set aside impairment provisions for potential credit quality deterioration against the background of the covid-19 crisis.

Nykredit actively manages its credit portfolio. This includes adjusting portfolio targets in the credit policy and managing individual exposures. Some of Nykredit's customers are facing liquidity challenges due to the covid-19 crisis. Like all customers, these customers will be subject to an individual credit assessment, but as a general rule, Nykredit offers overdrafts, payment holidays and limit increases to customers that were creditworthy before the covid-19 pandemic. The extent of approvals relating directly to covid-19 is very limited and mainly concerns Nykredit Bank exposures.

4.1 ▪ CREDIT POLICY

Nykredit has a nationwide presence across Denmark and a comprehensive distribution network, and customers are served by certified advisers at Nykredit's customer centres and advisers at local Totalkredit partner banks.

Nykredit's credit risk profile, and consequently risk appetite, is laid down in the credit policy. The credit policy is laid down by the Boards of Directors and is based on the Nykredit Group's strategy and the aim that customers should perceive Nykredit as a reliable and qualified financial partner. Building long-term relationships with financially sound customers is an integral part of Nykredit's strategy. All credit applications are assessed against the credit policy by financially trained staff. Specifically, they assess the willingness and ability of customers to meet their obligations. An overall evaluation of a customer's financial circumstances and other risk elements is made, taking into account Nykredit's total exposure to the customer and any mortgage security provided. The assessment of a customer's creditworthiness is the core element.

Credit risk governance

Board of Directors and Board Risk Committee:
Lay down the credit policy, including risk appetite and limits for portfolios, and credit guidelines. Receive quarterly reports on credit policy compliance.
Receive separate reports in case of non-compliance with the policy, including an action plan for approval.

Executive Board and Credits Committee:
Approve and implement the credit policy and regularly review compliance based on quarterly reports.
Receive separate reports in case of non-compliance with the policy, including an action plan for approval.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

Climate change is a challenge that requires sustainable transition in many parts of society. Nykredit wants to contribute to society's goals of reducing greenhouse gas emissions and adapting to the new climate conditions. For many businesses, this development will bring new opportunities, but at the same time many customers are facing substantial risks. Climate change and the necessary transition to more sustainable solutions will challenge the business models, production and markets of many of our business customers. Nykredit is dedicated to being a constructive partner to all its customers in the green transition.

The credit policy describes a number of ESG factors to be considered as part of customer assessments. They include, in particular, physical risks and transition risks, but also other elements of a customer's individual ESG factors will be considered where relevant. The aim is to identify relevant risks and opportunities, which will then form part of the overall credit assessment and customer advisory services.

Also, Nykredit keeps up with new rules and regulations implementing regulatory requirements and recommendations and adjusts working procedures as needed.

Nykredit wants to maintain close relationships with its customers to be able to prevent potential payment difficulties from arising. Prompt action benefits both the customer and Nykredit and limits arrears etc, making it more likely that the customer will recover. Alternatively, losses will be minimised to the advantage of both Nykredit and the customer, who will typically be liable for any unpaid debt.

Totalkredit's mortgage lending is based on a strategic alliance with 50 Danish local and regional banks undertaking the distribution of Totalkredit loans, customer advisory services, credit assessments and case processing. Totalkredit loans are subject always to final approval by Totalkredit.

The credit policy ensures that credit is granted in accordance with the risk appetite determined by the Board of Directors and with the Totalkredit concept, Danish mortgage legislation, the Danish Financial Business Act, good business practice and any other relevant rules and regulations. The aggregate credit granting by the Group companies is undertaken within the credit policy limits for large exposures as well as limits for portfolio distribution by industry, geography and other risk types.

Reviews of credit policy compliance are undertaken by a credit control function whose duties are segregated from those of the credit approving units.

4.2 ▪ LENDING GUIDELINES AND PROCESS

Nykredit's customer centres have been authorised to process most credit applications independently. The authority comes with a requirement of credit policy and business procedure certification every three years, in addition to the statutory certification. It is Nykredit's aim that most credit decisions should be made locally.

The level of Nykredit's credit approval hierarchy at which business customers' credit applications are determined generally depends on the size of the exposure. Nykredit has five regional credit units that process business customers' credit applications that exceed the authority assigned to the customer centres. Applications exceeding the authority of the regional credit units are processed centrally by Group Credits, unless they involve exposures requiring escalation to Nykredit's Credits Committee, the Executive Boards or the Boards of Directors.

The level of the credit approval hierarchy at which the credit applications of personal customers of Nykredit are determined depends on a combination of the size of the exposure and any credit circumstances requiring particular attention (credit approval rules). The level of the credit approval hierarchy determines whether credit applications are processed by the customer centres or centrally by Group Credits.

However, the level of the credit approval hierarchy at which the mortgage loan applications of personal customers of Totalkredit are determined depends on the value of the property serving as security for the loan. As regards credit applications of business customers of Totalkredit, the level is determined by the size of the exposure, in the same way as for customers of Nykredit.

The Groups' largest exposures are presented to the Boards of Directors of the Group companies on an ongoing basis. The Boards are also briefed quarterly on the highest write-offs and impairment provisions.

4.2.1▪ Nykredit's credit approval process

Nykredit applies its own internally estimated ratings to the vast majority of its customers. A customer rating indicates the probability of the customer defaulting on its obligations. Customer ratings are used for a number of purposes, including credit assessment.

For the approval of loans, the customer rating is supplemented with a thorough assessment of the customer's current financial position and resilience as well as other relevant characteristics, such as businesses' managerial strength. This assessment is based on credit approval rules and guidelines in the credit policy. The assessment also considers the quality of any security provided. Security by way of mortgages on real estate is assessed by valuers or estate agents.

The approval of financial products is based on a customer's creditworthiness, the life of the product, the contractual basis and an assessment of the quality of the security provided etc.

4.2.2 ▪Totalkredit's credit approval process

As regards Totalkredit loans, assessments of personal customers are mostly carried out by the regional and local banks, while the final approval of credit applications is undertaken by Totalkredit. Assessments of business customers and approval of business credit applications are carried out centrally by Totalkredit on the basis of an initial credit assessment by the partner bank.

A specific model has been developed for personal customers of Totalkredit, who represent the greater part of the exposure.

Totalkredit and the individual partner bank share the loss risk relating to the loans according to the principles set out in the collaboration agreement with the partner banks. The partner banks provide security to Totalkredit by way of a right of set-off and/or guarantees for the loans distributed by them. In return for the provision of security, Totalkredit passes on part of the administration margin payments from the customers to the partner banks. This security provides an incentive for the partner banks to carry out a thorough and comprehensive assessment of customer creditworthiness, thereby minimising the risk of loss in relation to the customer. In case of high-risk loans where the ordinary business procedures are derogated from, the partner banks must provide a guarantee exceeding the level of security provided for ordinary loans. Ultimately, Totalkredit's credit risk is therefore low, due to the security model.

4.3 ▪ CONTROL AND REVIEW

Group Credits is responsible for managing and monitoring credit risk in accordance with guidelines laid down by the Board of Directors and the Group Executive Board. The unit is also responsible for reviewing certain individual exposures as well as credit policy limits for large exposures and limits for portfolio distribution at Nykredit and Totalkredit.

Credit risk review is based on a portfolio management approach categorising customers according to industry and monitoring them against a number of key credit parameters. Furthermore, individual exposures are reviewed to assure the quality of lending. Approvals are reviewed regularly, as are weak exposures. The controls are performed independently of the approving units.

The risk control function monitors the continuous control and review. In addition, Internal Audit oversees the internal control environment and credit risk management.

*4.3.1 ▪ **Portfolio management***

The mix and trends of portfolios are monitored by means of portfolio reports, sector and thematic analyses as well as the regular risk exposure reporting to the Boards of Directors. This enables the Boards of Directors to evaluate the credit policy and make the required adjustments in relation to lending at single-name level (guidelines) and portfolio level (portfolio limits and size requirements). The aim is to avoid any single-name risk or concentration of risk which may have a material impact on the Group in the event of default.

In addition to the above, a number of other elements are part of day-to-day credit management based on, for instance, the limits for large exposures and for portfolio distribution. This is supplemented with central credit instructions with respect to individual portfolios and industries, which advisers should allow for in their customer assessments.

*4.3.2 ▪ **Control of individual exposures***

Individual exposures are controlled and reviewed at decentralised and central levels in several areas.

New approvals

With respect to decentralised reviews, the heads of Nykredit's customer centres are responsible for local day-to-day credit management, comprising spot checks as well as reviews. Controlling new approvals at individual exposure level is also part of the decentralised review procedure. The same applies to Totalkredit's business exposures. Totalkredit's personal exposures are reviewed at decentralised level by the individual partner bank.

Central reviews are performed by the Group's credit control function, which is responsible for credit controlling in all the Group's companies, assessing new approvals against the credit policy. As regards Nykredit Bank, Nykredit Realkredit and Totalkredit's business exposures, monthly spot checks are carried out for each approving unit. As regards Totalkredit's personal exposures, quarterly spot checks are carried out for each partner bank. It is a requirement that the spot checks are random and sufficiently comprehensive so as to provide results that describe, at a high confidence level, the risk appetite of each approving unit and partner bank in relation to new approvals. Credit controlling is aimed at detecting, for instance, any breaches of approvals, processing errors and derogations from the credit policy guidelines. It is assessed whether the overall level of approvals is within the credit risk appetite.

Renegotiations

Decentralised reviews of renegotiations are part of the monitoring of credit exposures, and the largest business exposures are reviewed by the account manager at least annually. The review is based on financial statements, ratings and customer data and is a key element of the control environment. In addition, the heads of the customer centres conduct regular spot checks of the frequency and quality of renegotiations as part of the decentralised review procedure. Central reviews and control of the frequency and quality of renegotiations are performed by the central credit control function on an ongoing basis.

Review of weak exposures

Nykredit identifies weak exposures based on the rating categories with the highest probability of default, with or without objective evidence of credit impairment. Objective evidence of credit impairment is determined on the basis of a number of statutory indicators of credit-impaired exposures. If Nykredit identifies objective evidence of credit impairment, the exposure will be assigned the lowest possible rating.

If supported by additional objective data, an override of the customer's rating may be performed. Customer exposures involving rating overrides are reviewed at least once a year. As a result, the customer rating may be maintained or adjusted, or the override may be removed. The use of overrides is assessed in connection with the regular validation of rating models performed by Nykredit's independent validation unit.

Weak exposure reviews are carried out by the units responsible for the processing of weak exposures. Weak exposures are reviewed at least annually, except for personal customers with a rating of 2. Business bank exposures are reviewed quarterly, with a few exceptions. The reviewing units are responsible for preparing a credit strategy including an action plan for the purpose of implementing loss control measures and restoring the customer's financial strength. The account manager is responsible for executing the credit strategy. Weak exposure reviews also include assessment of the customer's credit status and consequently rating, data control and, in some cases, impairment calculations. Regular spot checks are made of the quality of weak exposure reviews conducted.

For Totalkredit mortgage loans, exposures are designated as weak if there is reasonable doubt as to whether the customers are able and/or willing to honour their obligations to Totalkredit. For Totalkredit business mortgages and Totalkredit personal mortgages arranged by the Nykredit Group, ratings are also used to identify weak exposures.

Central reviews and control of the frequency and quality of the weak exposure reviews conducted are performed by the central credit control function on an ongoing basis. The central credit control function controls Nykredit's and Totalkredit's reviews of weak exposures. The purpose of the spot checks is to ensure that the weak exposure reviews comply with relevant business procedures and process descriptions. This credit control serves to support the approving units' handling of weak exposures through ongoing dialogue about the results of controls performed.

4.3.3 ▪ ***Impairment provisions***

For the purposes of both financial reporting and capital determination, Nykredit applies IFRS 9 to calculate general and specific credit risk adjustments. The calculations are divided into four parts:

- A model is used for impairment of all exposures without objective evidence of credit impairment, irrespective of exposure size.
- A model is used for impairment of personal exposures with objective evidence of credit impairment and business exposures below DKK 5 million with objective evidence of credit impairment.
- Expert judgement is used for impairment of large business exposures, based on the customer's financial position.
- Management judgement is used for impairment of loan portfolios based on factors not reflected in the above impairment calculations.

According to IFRS 9, impairments are divided into three stages:

Stage 1 covers loans and advances etc without significant increase in credit risk since initial recognition. For this category, impairment provisions are generally made corresponding to the expected credit losses over a 1-year period.

Stage 2 covers loans and advances etc with significant increase in credit risk since initial recognition. For this category, impairment provisions are made corresponding to the expected credit losses over the remaining life of the asset. Stage 2 is subdivided into the categories of "strong" and "weak", "weak" designating the highest-risk exposures where customers' ability to pay is characterised by significant signs of weakness.

Stage 3 covers credit impaired loans etc, which have been subject to individual provisioning based on a specific assessment that the customers will default on their loans.

All mortgage and banking exposures above a certain limit as well as all weak exposures are reviewed individually on a regular basis for the purpose of identifying any objective evidence of credit impairment. If a customer is deemed to be in financial difficulties, impairment provisions will be made for the exposure in accordance with IFRS 9, and the exposure will be transferred to stage 3 or stage 2 (weak).

The size of the exposure and the customer segment determine whether impairments are calculated using a calculation model or by individual assessment, see above.

Management judgement in relation to model-based impairment is supplemented with an assessment of an improved/adverse macroeconomic scenario for the long-term probability of default.

Impairments are made for all exposures with objective evidence of credit impairment and all exposures in default. For some customers, this will not give rise to impairment, the reason being that the collateral provided (less a safety margin) exceeds the exposure.

For a more detailed description and definitions of model parameters relating to credit risk, including default, see *4.6 Models for determination of credit risk*. A detailed description of impairment rules is provided in the Nykredit Group's Annual Report available at nykredit.com/reports

4.3.4 ▪ ***Debt collection***

Nykredit's substantial lending business inevitably involves arrears. In a minor number of these cases, the customer's inability to pay becomes permanent, and the security provided for the loan is not sufficient to cover Nykredit's risk of loss. In these cases, the debt is written off when all possibilities of collection or recovery have been exhausted.

Customers with debt that has been written off will remain personally liable for it, and Nykredit will continue to pursue its claim with a view to getting the customers to settle their debt should their financial situation so permit at a later date. At end-2020 Nykredit had approx 23,000 of such cases where claims against personal customers of Nykredit Realkredit, Totalkredit or Nykredit Bank are being pursued, involving a total amount outstanding of more than DKK 7 billion, which has been written off in full.

Nykredit has engaged an external debt collection agency to collect these personal debts. Immediately after writing off a non-performing loan, Nykredit transfers its claim to the external business partner, which will attempt to collect the debt from the debtor on behalf of Nykredit. The debt collection agency is specialised and experienced in this area and has in-depth knowledge of debt collection law, statutes of limitation, legal processing of cases etc. There is significant liaising between Nykredit and the debt collection agency about many of the cases, especially where a customer disputes Nykredit's claim.

At the request of the Danish FSA, Nykredit reviewed its debt collection process in 2020 to determine whether its debt collection systems and procedures are satisfactory. Nykredit's review did not identify any general or systematic errors in the part of the process performed by Nykredit, in the part of the process performed by legal advisers assisting us with the debt collection or in the part of the process performed by the debt collection agency. The review identified a few possible sources of error in connection with the transfer of cases to Nykredit's external business partner. Due to these few sources of error, a small number of Nykredit Bank customers may, to a very limited extent, have repaid debt which was, at the time of payment, barred by limitation. Affected customers are being contacted and will receive the compensation to which they are entitled.

4.4 ▪ CURRENT RISK PROFILE AND DEVELOPMENT

Nykredit's loan portfolio mainly consists of mortgage lending, which represents 77% of total credit exposures. The rest of the loan portfolio primarily consists of bank loans and financial instruments.

Nykredit Realkredit accounts for 32% of the Group's lending and guarantees, concerning mainly business customers, while Totalkredit's lending, mainly to personal customers, accounts for 56%. At end-2020 Nykredit Bank's lending represented 12% of Nykredit's total lending and guarantees.

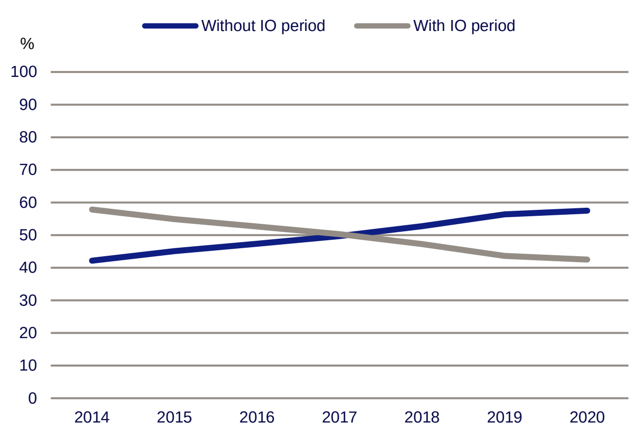
The customer portfolio is characterised by low loan-to-value (LTV) ratios (currently 61%) and a low proportion of loans in default (currently 2%). Customers' internal ratings are predominantly at the high end of the scale. The calculated ratings are based on customers' financial positions and payment behaviour (see *4.6 Models for determination of credit risk*).

Covid-19 left a deep mark on 2020. The spring lockdowns resulted in the largest quarterly GDP decline ever, but the Danish economy has recovered faster than expected. Much of the decline in economic activity has already been reversed, and the rise in unemployment has been lower than feared. However, a number of business sectors are still hard hit by the covid-19 crisis and the disease control measures introduced, for example the accommodation and food service sectors and the arts, entertainment and recreation sectors. Nykredit's credit exposure to these sectors is limited. A particular focus in 2020 was on credit management in the areas most exposed to the impact of covid-19. Moreover, Nykredit increased its focus on sustainability in 2020, including in particular risks relating to climate change.

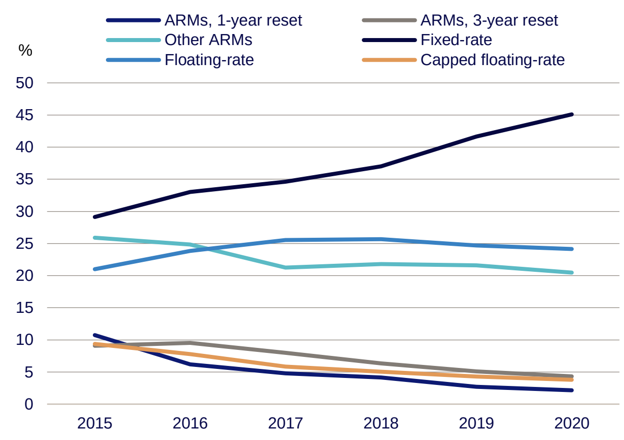
Despite the covid-19 crisis, the Danish housing market was surprisingly strong in 2020, showing high trading activity and rising prices of flats, single-family houses and, in particular, holiday homes. As a result, collateral values and home equity have risen for personal lending over the past year. At the onset of the covid-19 crisis, households were financially robust, having accumulated substantial buffers following several years of high savings ratios and economic upswing. Nykredit has not observed higher arrears ratios in the personal lending portfolio. This is in line with internal analyses, which show a very limited risk of loss resulting from a covid-19-induced rise in unemployment among customers. Declining housing prices pose the greatest risk of loss in relation to the Nykredit Group's personal lending.

Nykredit's personal lending exposure grew in 2020, driven by high net new lending, and now accounts for 59% of the Group's total credit exposures. The credit quality of the personal loan portfolio is generally good, and LTVs have generally declined over the past year. Also, there has been a shift towards fixed-rate repayment loans, not least because of the continued low interest rates.

Nykredit Realkredit Group
Private residential lending with/without IO periods, EAD-weighted



Nykredit Realkredit Group
Private residential lending by loan type, EAD-weighted



Note: Other ARMs includes capped floating-rate loans and adjustable-rate mortgages with interest periods longer than 5 years.

Nykredit Realkredit Group
Geographical distribution of exposures

31.12.2020 DKK billion	Denmark	Sweden	Germany	Norway	Spain	France	United Kingdom	Other countries[1]	Total
Businesses	521.8	41.4	17.5	1.2	2.1	1.6	1.9	10.0	597.5
Retail	931.1	0.1	0.1	0.0	3.8	2.9	0.0	0.1	938.1
Equities	5.5	0.4	0.0	0.0	0.0	0.0	0.2	0.2	6.3
Other exposures	24.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	24.2
Total IRB approach	**1,482.6**	**41.9**	**17.6**	**1.3**	**5.9**	**4.6**	**1.9**	**10.5**	**1,566.1**
Standardised approach	**105.7**	**8.5**	**2.3**	**1.1**	**0.0**	**3.8**	**4.0**	**3.6**	**129.1**
Total	**1,588.3**	**50.4**	**19.8**	**2.4**	**5.9**	**8.4**	**6.0**	**14.0**	**1,695.2**

[1] Other countries are mainly the US and Switzerland.

Over the past few years, Nykredit has launched a number of credit initiatives, at its own and the Danish FSA's initiative, in order to increase the financial robustness of its customers. The interest rate sensitivity of personal customers has diminished with the rising number of customers opting for fixed-rate loans. The share of fixed-rate loans relative to total private residential lending has increased substantially since 2015 when it made up less than 30%. At end-2020 fixed-rate loans accounted for 45% of all private residential mortgage lending. This is due to a combination of declining interest rates, making it attractive to lock in loan rates for a longer period, changed loan terms and stricter loan rules.

More personal customers are amortising their mortgage loans. In 2016 more than half of private residential mortgage loans included an interest-only (IO) period, while this was the case for 43% at end-2020. This development is supported by the economic development and the low interest rates, which have provided the financial leeway for customers to amortise their housing debt.

The business loan portfolio has also proved very resilient to the covid-19 crisis. The crisis is not yet clearly reflected in risk metrics such as PD (Probability of Default) or LGD (Loss Given Default). Thus, the business loan portfolio remains characterised by generally high credit quality and a low risk of loss. Nykredit's impairment provisions have increased to prevent any covid-19-induced losses, while write-offs are still low. Lending is well diversified across sectors.

Nykredit has the highest credit exposure to the residential and commercial rental sectors. The sectors are characterised by favourable key figures and a low risk of loss. The residential and commercial property markets were marked by the covid-19 pandemic in 2020. The spring lockdown in Denmark caused transaction volumes to plummet. They have recovered since, supported by the low interest rates and high market liquidity. Return requirements are still low, and accordingly customers' sensitivity to price declines and interest rate rises is still high. The credit policy requirements for customers in the property rental sector have been tightened continuously over the past few years, and a requirement has been introduced for the calculation of sensitivity to an interest rate rise or a property price decline in connection with facilities approved by regional credit units or centrally by Group Credits. Most recently, the guidelines for creditworthy customers have been tightened, resulting in stricter property location requirements. This area is still being monitored closely.

Limited industry-specific risks exist in the loan portfolio. Especially the agricultural loan portfolio has a relatively high share of weak exposures and a relatively high loss rate compared with the rest of the portfolio, even though agricultural trends have been favourable for the last couple of years. This should be seen in the context of an agricultural sector that is sensitive to price declines, interest rate rises, failing crop yields etc. There are several uncertainties, for instance regarding exports to the UK after Brexit, the impact of future climate and environmental requirements and the new EU budget. The African swine fever outbreak in Germany in autumn 2020 did not have an immediate impact on Nykredit's credit exposure.

The fear of mutated covid-19 virus spreading between mink and humans caused the culling of all mink in the Danish fur industry. This had a credit risk impact, despite the fact that the segment in itself accounts for less than 1% of Nykredit's agricultural exposures. Nykredit's risk mainly derives from related industries, such as fur trading, where Nykredit's exposure is very limited. Overall, Nykredit's risk of loss on agricultural exposures is low considering the size of its agricultural loan portfolio. The reason is that the loans are mainly mortgage loans and the portfolio generally has low LTVs. In 2019 Nykredit made credit policy adjustments, targeting lending at agricultural customers with the lowest leverage ratios relative to the general market.

Nykredit Realkredit Group
Exposure by sector

DKK billion	31.12.2020	31.12.2019
Personal customers	789.9	711.2
Public housing	80.0	75.4
Other residential rental	21.0	14.0
Other services	33.6	34.5
Construction	21.5	21.3
Retail and wholesale	33.9	31.0
Finance and insurance	6.8	48.8
Manufacturing	60.4	52.1
Public administration, institutions and education	16.1	17.5
Professionals	103.8	74.8
Agriculture	89.8	92.6
Transport and goods handling	15.5	13.0
Private housing cooperatives	44.2	44.6
Rental	241.0	231.0
Other	137.7	146.3
Total	**1,695.2**	**1,608.2**

4.4.1 ▪ Concentration risk

Concentration risk is the risk of being particularly exposed to credit events in groups of customers with identical or similar credit risks.

Nykredit's largest credit exposure consists of mortgage lending in Denmark. At end-2020 94% of Nykredit's total credit exposures were in Denmark, consisting mostly of mortgage loans. Historically, the Danish mortgage market has proved robust and stable, involving limited risk. During the years of the financial crisis, Nykredit's mortgage lending grew by 5-9% a year, and loss ratios were consistently low at levels not exceeding 1.9%.

A majority of the loans were granted to customers in Denmark; of these, 62% were granted to homeowners and 38% to business customers. 6% of total lending consists of mortgage loans to finance properties abroad, most of them granted to customers with ties to Denmark. Private residential lending is broadly diversified across loan type, age, region, maturity and size of debt outstanding.

Within business mortgage lending, Nykredit's lending to the commercial and residential rental segments represented 36% at end-2020. The loan portfolio is diversified across different property types, and property uses are diversified across industries. Agricultural lending made up 16% of business lending, while Nykredit's industrial lending accounted for 10%.

The vast majority of foreign exposures are mortgage loans to property companies in Sweden and Germany, and mortgage loans have also been granted to personal customers in Scandinavia with homes in Spain and France.

Based on the above and a number of indicators, such as geography, property type and sector, Nykredit's business lending is not deemed to be concentrated in specific sectors. Nykredit has a high share of private residential lending, but considering the high geographical diversification across Denmark, Nykredit is not deemed to have any notable concentration risk. In 2020 Nykredit had an increased focus on climate-related credit risks. Nykredit's lending to the most carbon-intensive sectors predominantly consists of agricultural lending.

Pursuant to the Capital Requirements Regulation (CRR), credit exposures to a single customer must not exceed 25% of eligible capital in the three Nykredit Group companies Nykredit Bank A/S, Nykredit Realkredit A/S and Totalkredit A/S, see the rules on large exposures. Nykredit had no exposures exceeding this limit in 2020.

Nykredit Bank's largest single exposure to a non-financial counterparty represented 16.5% of the Bank's eligible capital at end-2020, equal to DKK 4.4 billion. Nykredit Realkredit's largest exposure represented 7.7% of eligible capital, and Totalkredit's largest exposure represented 0.5% at end-2020.

A minor amount has been allocated under Pillar II to cover concentration risk in accordance with the Danish FSA's guidelines.

4.4.2 ▪ Write-offs, impairments and arrears

Nykredit's impairment provisions for potential future losses on mortgage and bank lending totalled DKK 9.9 billion at end-2020, equivalent to 0.15% of total lending. Provisions for mortgage loan impairment totalled DKK 6.7 billion (0.5% of mortgage lending). Provisions for bank loan impairment totalled DKK 3.0 billion (4.1% of bank lending).

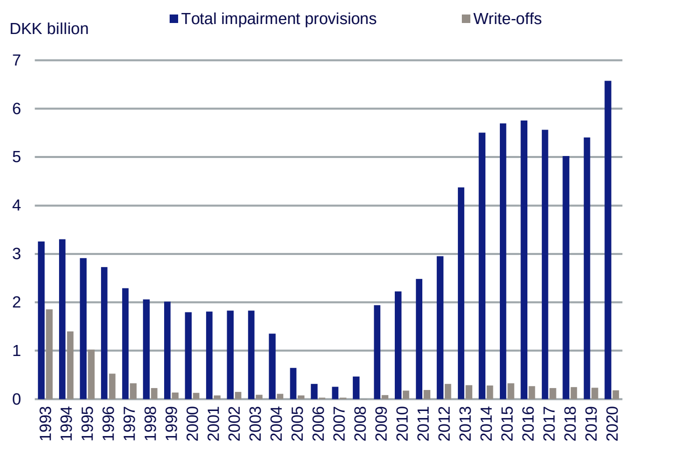
About 22% of exposures in default have been provided for, equivalent to DKK 5.2 billion. The proportion of exposures provided for relative to exposures in default was lower for Nykredit Realkredit and Totalkredit than for Nykredit Bank, as mortgage exposures are secured by mortgages on real estate, which may be enforced in the event of default.

Total write-offs on the Group's exposures in 2020 were DKK 0.6 billion. Of this amount mortgage activities represented approximately DKK 0.5 billion and bank activities DKK 0.1 billion. About 74% of write-offs on mortgage loans concerned private residential lending, while 26% concerned business lending.

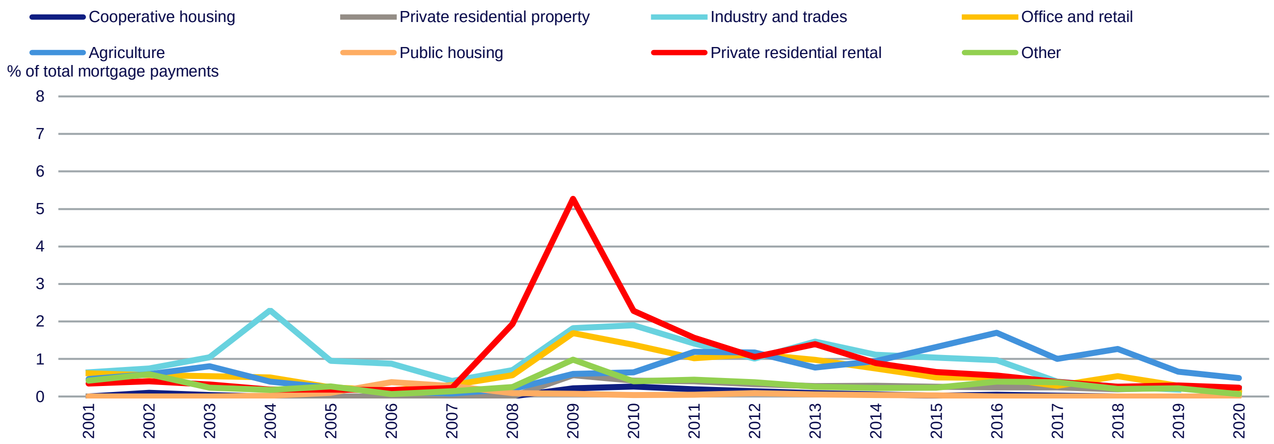
An equally favourable trend is seen in arrears. The average arrears ratio is still low, at 0.3%. Generally, the Danish economy performed better than expected in 2020, supported by government relief packages, sound public finances and the absence of major imbalances in the housing market, whether among households or businesses, all contributing to the relative low levels of write-offs and arrears. The combination of low interest rates and low unemployment particularly supports personal customers' ability to pay.

The portfolio of properties acquired by foreclosure counted six properties at end-2020. The property portfolio has reduced every year since 2012.

Nykredit Realkredit Group
Impairment provisions and write-offs, mortgage lending



Nykredit Realkredit Group
Arrears ratio, 75 days past due



4.4.3 ▪ Customer ratings

In 2020 Nykredit's customers were still characterised by strong key figures and good ratings. The credit quality of 87% of Nykredit's exposures was in the range of ordinary to high (ratings 6-10) at end-2020. These customers typically have robust finances and make timely payments.

This type of customer made up 91% of Nykredit's personal customers, and for business customers, excluding Corporates & Institutions (C&I), the percentage was 68%. In the C&I segment, comprising the largest customers with which Nykredit maintains particularly close contact, the credit quality of 94% of the customers was in the range of ordinary to high.

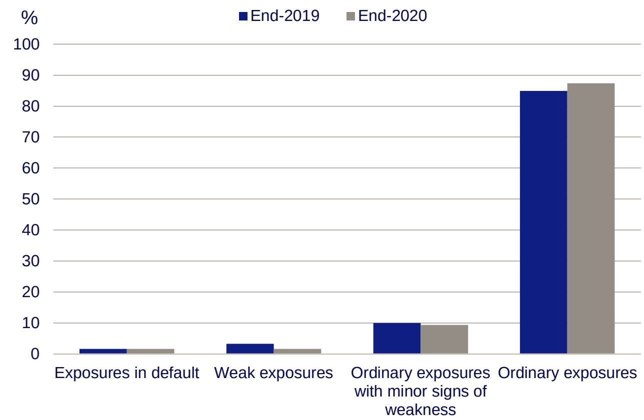
At end-2020 9% of Nykredit's customers were considered "ordinary exposures with minor signs of weakness" (ratings 3-5). These customers typically have less robust finances, but make timely payments. They made up 6% of personal customers, and for business customers, excluding C&I, the percentage was 24%. The percentage for C&I was 5%.

The rest of Nykredit's customers were weak exposures (ratings 0-2, 2%) and exposures in default (2%). This category primarily consists of customers that have defaulted on their payments, customers with a negative net worth or equity, and customers with low or negative earnings. Customers with objective evidence of credit impairment are also in this group.

Customer ratings generally improved in 2020 relative to 2019. The share of exposures in default remained stable. Exposures in default made up 1.6% of total exposures at end-2020.

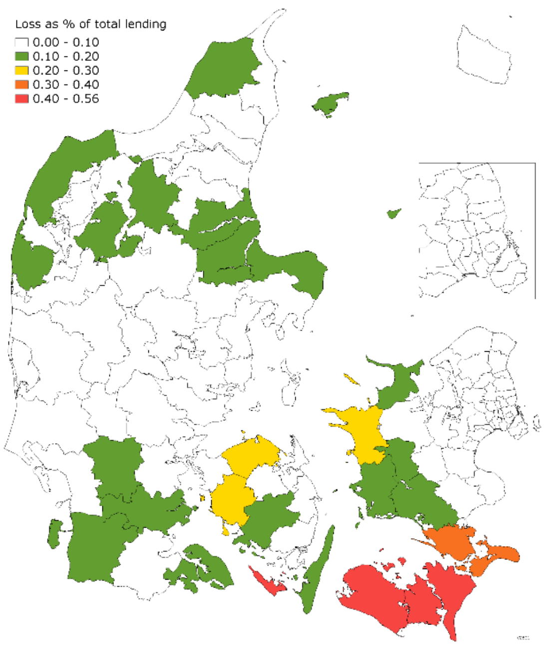
Nykredit Realkredit Group

Rating distribution, EAD-weighted



Nykredit Realkredit Group

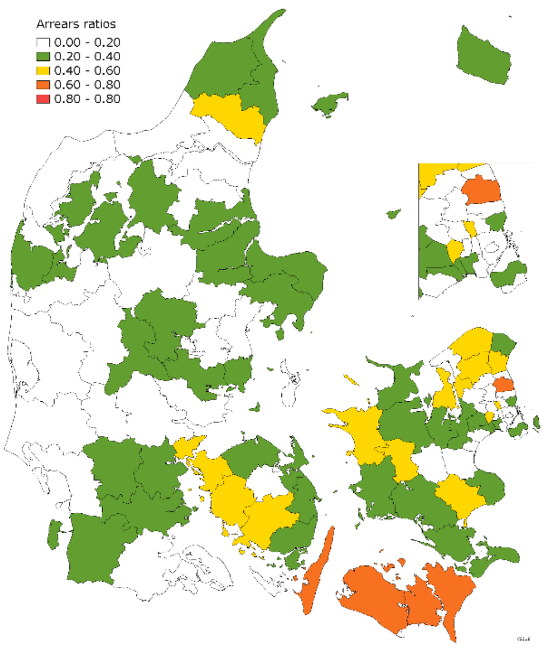
Private residential lending – write-offs relative to total lending 2020



Note: The loss ratio for private residential lending was 0.06% at national level at end-2020.

Nykredit Realkredit Group

Private residential lending – arrears 2020



Note: The 75-day arrears ratio for private residential lending was 0.23% at national level at end-2020.

4.5 ▪ SECURITY

The approval of loan applications is based on the customer's creditworthiness but supported by the security provided. The greater part of Nykredit and Totalkredit's lending is secured by mortgages on real estate. Other types of security are guarantees and financial collateral.

4.5.1 ▪ Real estate

Mortgages on real estate reduce credit risk substantially. The mortgageable value of a property is determined initially at the time of loan granting. Valuations are based on the marketability, price volatility, alternative use, letting potential etc of the property. As a general rule, properties are valued by a valuation officer based on a physical inspection. In addition, a statistical model is used for the valuation of detached and terraced houses and owner-occupied flats where statistical valuation is particularly reliable and where the Danish FSA has approved the use of a property value model. Such valuations are subject to approval by the valuer in the relevant geographical area and are monitored centrally.

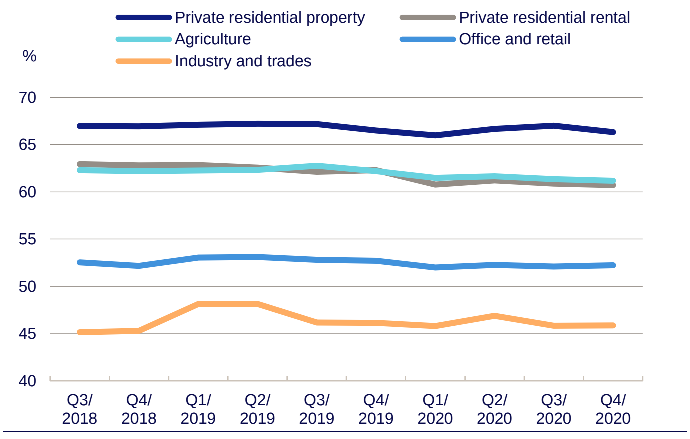
A shared valuation unit has been set up by Totalkredit and a number of partner banks. As part of this collaboration, Totalkredit handles all valuations of private properties through the shared valuation unit. The shared valuation unit also values properties, including commercial properties, for purposes other than Totalkredit loans. This could be, for instance, bank loans. The shared valuation unit supports uniform and consistent valuations.

In some geographical areas, the Danish climate involves risks of storm surges, flooding and erosion. Valuations of properties in exposed geographical areas therefore focus on whether the property has been protected from future climate change impacts and on the property's marketability in view of its exposed position.

Energy efficiency and green transition will be considered important where their impact on the value of a property can be documented.

Following the initial valuation, the market value of a property is monitored regularly. Nykredit has set up a subcommittee to monitor market trends and the quality of statistical valuations and identify areas and property types to be monitored separately.

Nykredit Realkredit Group
LTVs – property segments



The LTV ratio denotes the debt outstanding relative to the property value. LTV ratios play a significant role in several contexts and are used for:

- Determining maximum loan amounts for the purpose of loan approvals
- Monitoring Nykredit's mortgage lending
- Calculating customers' credit risk for the purpose of, for instance, credit assessment and capital calculations
- Calculating supplementary collateral for properties with SDO-funded loans
- Calculating IFRS impairments, stages 1 and 2
- Calculating returns on individual customer exposures.

At end-2020 the average LTV level of the Group's total loan portfolio was 61% compared with 62% at end-2019. At end-2020 the average LTV level of the Group's private residential lending was 66% against 67% at end-2019. The LTV levels of sectors comprised in total business lending were in the range of 46-61% at end-2020, compared with a range of 46-62% in 2019. Generally, LTV levels are thus historically low relative to the statutory LTV limits, and customers are resilient to credit events.

LTVs have trended down over the past years as a result of rising property prices and favourable economic trends.

4.5.2 ▪ ***Guarantees and financial collateral***

Nykredit mainly receives guarantees from public authorities and other banks. Guarantees issued by public authorities mitigate credit risk; for instance the Danish government guarantees mortgage lending for public housing, against payment of commission.

The bank guarantees include land registration guarantees, guarantees for interim loans and loss guarantees.

Guarantees are widely applied in the day-to-day management of Nykredit's credit risk, particularly in customer relationships where a parent company supports the capitalisation of group companies.

The Totalkredit partner banks provide security by way of a right of set-off and guarantees to Totalkredit for the loans distributed by them, see *4.2.2 Totalkredit's credit approval process*.

Financial collateral includes deposits in DKK or other currencies, positions in listed Danish government and covered bonds, other high-rated liquid Danish and foreign bonds, and listed equities.

Nykredit assigns an internal collateral value to the different types of financial collateral depending on the risk involved. For the purpose of calculating the risk exposure amount (REA), Nykredit assigns internal collateral values based on internal estimates of the reduction in the value of the collateral in case of enforcement.

4.6 ▪ MODELS FOR DETERMINATION OF CREDIT RISK

The determination of credit risk using the advanced IRB approach is based on three key parameters: Probability of Default (PD), expected Loss Given Default (LGD) and expected Exposure at Default (EAD). These three key parameters are referred to as risk parameters. Nykredit estimates risk parameters on the basis of Nykredit's default and loss history.

4.6.1 ▪ Modelling principles

According to the CRR, PDs must be estimated on the basis of historical 1-year PDs while at the same time reflecting a suitable weighting between the long-term average and the current level. For the purpose of determining capital requirements, LGD estimates must always reflect an economic downturn.

The above principles applied to estimate the risk parameters ensure that the Group's risk exposure amount (REA) remains more stable throughout an economic cycle than if the calculations had exclusively reflected the current economic climate.

Elements of credit risk determination

PD	Probability of Default (PD) is the probability of a customer defaulting on an obligation to Nykredit within a year.
LGD	Loss Given Default (LGD) is the expected loss rate of an exposure in case of the customer's default.
EAD	Exposure at Default (EAD) is the total estimated exposure to a customer in DKK at the time of default, including any drawn part of a credit commitment.
REA	Risk Exposure Amount (REA) is credit risk exposures factoring in the risk relating to the individual customer. REA is calculated by risk-weighting credit exposures. The risk weighting is calculated on the basis of, for instance, PD and LGD levels.
Default	*Applicable until 31 December 2020:* An exposure is deemed to be in default where a significant amount has been in arrears for 75 days (mortgage loans) or at the time of sending the third reminder (bank loans). Exposures subject to impairment under certain circumstances or write-off are also considered in default. This applies to customers classified in stage 3 and some customers classified in stage 2 in accordance with the rules of IFRS 9. Moreover, exposures for which a direct loss has been incurred are also considered in default. *Applicable from 1 January 2021:* With effect from 1 January 2021, Nykredit has updated its definition of exposures in default and defined, for both mortgage and bank exposures, a number of events that make it unlikely that a customer will be able to pay its credit obligations without realisation of collateral. The main ones are: events leading to IFRS 9 stage 3, bankruptcy, distressed restructuring and significant arrears/overdrafts (90 days past due).

4.6.2 ▪ Probability of Default (PD)

PD expresses the probability of a customer defaulting on an obligation to Nykredit within a period of one year. Nykredit calculates a PD for each individual customer.

PDs are calculated using statistical models. These models are based on, for instance, data on the customer's financial position and payment behaviour as well as any impairment. Corporate and institutional clients and farming businesses are also required to submit financial statements regularly, which will be applied in the determination of their PDs.

4.6.3 ▪ Ratings

The PDs of individual customers are translated into ratings from 0 to 10, 10 being the highest rating. Exposures in default are placed in a category of their own, outside the rating scale, while exposures with objective evidence of credit impairment are assigned a rating of 0. The individual rating categories have been defined based on fixed PD ranges, which means that, in periods of high business activity, a high rating will be assigned to relatively more customers, while the opposite will apply during an economic downturn.

A rating reflects the customer's financial position and creditworthiness, and besides being included in the determination of capital requirements, the customer rating is also a key element of any customer assessment.

4.6.4 ▪ Loss Given Default (LGD)

For each customer exposure, Nykredit calculates an LGD, reflecting the percentage share of the exposure which is expected to be lost in case of customer default.

The LGD calculations factor in any security provided, including the type of security (typically mortgages on real estate), geography, the quality of the security etc.

Expected LGDs vary with economic trends. In periods of high business activity, default will often not lead to any loss, as the value of the security will typically exceed the value of the loan. This applies in particular to loans secured by mortgages on real estate. Conversely, more and greater losses would be expected during an economic downturn.

For the determination of capital requirements, LGDs are calibrated to reflect losses during a severe economic downturn.

4.6.5 ▪ ***Exposure at Default (EAD)***
Nykredit estimates an EAD for all exposures relating to a customer, reflecting the total expected exposure to the customer at the time of default, including any additional drawn parts of approved credit commitments. The latter is factored in using conversion factors (CF).

4.6.6 ▪ ***Other models***
Besides rating, loss and credit exposure models, Nykredit has a variety of other credit-related models.

The property value model calculates the value of properties serving as security for the Group's lending. The results are used to determine the need for supplementary security, as inputs in rating and loss models and as a substitute for physical inspections of detached and terraced houses and owner-occupied flats that are subject to an exemption granted by the Danish FSA.

For the purpose of calculating impairments under the accounting standard IFRS 9, the Group uses internal models for determination of credit risk and methods developed particularly for impairment calculations.

4.6.7 ▪ ***Approval, validation and testing of credit risk models***
Nykredit develops and improves its credit risk models on an ongoing basis. Focus is on achieving models that are accurate and provide consistent and stable parameters.

All changes to Nykredit's models are subject to an internal standard approval procedure. Also, major changes must be approved by, and minor changes notified to, the Danish FSA. Model changes are validated as part of the approval procedure.

The credit risk models are validated independently of Nykredit's risk modelling and credit approval units.

To ensure a good forecasting ability and consistent estimates, all credit risk models are validated annually. The validation results are used in the ongoing internal capital adequacy assessment process (ICAAP). If validation shows that a model contains significant inaccuracies, a capital charge will be provided under Pillar II until the model has been adjusted to reflect the actual risk.

The Group Risk Committee monitors and manages Nykredit's model risks. Models subcommittees undertake the preparatory work in relation to the models. This includes assessing new models, model changes and results of model validation. The overall conclusions on model risks and validation are reported to the Board of Directors and the Executive Board.

Ongoing control and validation comprises quarterly monitoring and annual validation.

Quarterly monitoring includes the models' customer ranking, model estimates compared with actual observations, rating distributions, migration etc.

Annual validation includes more in-depth analysis of the functioning of a model, including its accuracy, the data applied, follow-up on the quarterly monitoring and a qualitative review of the model and its elements, documentation, implementation, use etc.

Monitoring and validation of rating models include model-based PDs as well as PDs adjusted by overrides. In addition, the use of overrides for manual ratings adjustment is subject to an annual general validation.

4.7 ▪ COUNTERPARTY RISK

Nykredit applies financial instruments, such as interest rate derivatives and repurchase agreements (repo transactions), for serving customers. Liquidity and market risks are also managed internally by Nykredit using financial instruments.

The market value of a derivative changes according to the underlying market parameters, such as interest rates and exchange rates. This may lead to market values in favour of both Nykredit and its counterparties.

In some cases, a counterparty is unable or unwilling to meet its payment obligations (default). This gives rise to counterparty risk.

Nykredit mitigates its counterparty risk through financial netting agreements as well as agreements on financial collateral. The contractual framework is based on market standards, such as ISDA or GMRA agreements. Nykredit uses central counterparties (CCPs) for professional derivatives clearing. Swaps and repo transactions are cleared.

The counterparty risk exposure is affected by the market value of the financial instruments and the probability of customer default. Thus, counterparty risk involves both market and credit risk.

Derivatives are subject to value adjustment (xVA) in financial statements. Value adjustments are affected by several factors, including the level of long-term interest rates, credit spreads, funding spreads, the maturities of contracts as well as customers' creditworthiness.

4.7.1 ▪ Risk management

Monitoring and reporting

Nykredit monitors counterparty risk on a daily basis by means of capital market systems (market data, calculation of market values etc). This task is performed by Nykredit's risk control function together with the credit control function or the individual risk-taking unit. More specifically, it is checked whether the settlement and counterparty risks relating to the individual counterparties are within the approved limits.

The Board of Directors and the Board Risk Committee receive quarterly counterparty risk reports.

Nykredit monitors xVA on a daily basis and reports on xVA sensitivity to interest rate movements, ie market risk. Furthermore, credit spreads and credit spread sensitivity are reported on in order to reflect market-implied credit risk, and funding spreads and funding spread sensitivity are reported on as well.

Approval of credit lines

The use of derivative instruments is governed by the general credit approval rules and credit policies, supplemented with a number of restrictions and guidelines. The level of the credit approval hierarchy at which an application is determined thus depends on the amount of the credit line. In addition to limits to amounts and maturities, the use of derivatives is subject to requirements relating to the type, exposure and creditworthiness of the customer.

Collateral management

Nykredit is subject to the requirements relating to risk-mitigation techniques, see the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR). Nykredit prevents any inconsistencies with non-cleared OTC derivatives transactions by daily monitoring and the implemented controls.

4.7.2 ▪ Methods

For the purpose of determining capital requirements, counterparty risk exposures are calculated according to the mark-to-market method, ie as any positive market value of the transaction plus the potential future credit exposure.

Both the IRB approach and the standardised approach are used to determine risk. The IRB approach is used for business counterparties, while the standardised approach is used for institutions and sovereigns.

Market values, maturities etc are extracted from capital market systems, which are also used to calculate exposure profiles and PFE (potential future exposure) values.

The capital requirement for credit valuation adjustment (CVA) risk is determined using the standardised approach.

According to Articles 111 to 134 of the CRR, counterparties whose capital requirements for default risk are determined using the standardised approach must be risk-weighted based on their credit quality step.

S&P Global Ratings and Moody's provide information to Nykredit about the credit ratings of sovereigns, counterparties and issues. These external credit ratings are used as an integrated part of Nykredit's data flows and are updated daily. If the external providers assign different ratings to a counterparty, Nykredit will use the lower rating.

The mapping of credit ratings to credit quality steps is based on the mapping table of the EBA and is shown below.

Nykredit Realkredit Group
Long-term credit ratings

Risk weight Credit quality step – rating	Institutions	Corporates	Sovereigns
1 - AAA to AA-	20%	20%	0%
2 - A+ to A-	50%	50%	20%
3 - BBB+ to BBB-	50%	100%	50%
4 - BB+ to BB-	100%	100%	100%
5 - B+ to B-	100%	150%	100%
6 - CCC+ and below	150%	150%	150%

Nykredit Realkredit Group
Short-term credit ratings

Risk weight Credit quality step – rating	Institutions	Corporates
1 - A-1+	20%	20%
2 - A-1	50%	50%
3 - A-2 to A-3	100%	100%
4 - Below A-3	150%	150%

Value adjustment of derivatives in financial statements

Nykredit makes fair value adjustment of derivatives in accordance with the International Financial Reporting Standards (IFRS), which provide for CVA and FVA for accounting purposes. This includes individual value adjustments of customers showing objective evidence of credit impairment, CVA based on customers' current credit quality as well as management judgement.

The Danish FSA has encouraged the adoption of a prudent approach to the assessment of customers with swap contracts. This means that swap contracts with customers showing objective evidence of credit impairment (rating 0 and exposures in default) are value adjusted in full, whether or not these customers still make timely payments to Nykredit.

4.7.3 ▪ Current risk profile and development

Market value

A large part of Nykredit's swap portfolio was established in the period 2005-2008 when business customers hedged the risk of rising interest rates on their variable-rate mortgage loans using swap contracts. From the perspective of the customers, the interest rate declines in the ensuing years caused the market values of the individual swap contracts to become negative.

In March 2015 the negative market value was DKK 23.3 billion, but since then the development in market values has generally been positive.

At end-2020 the negative market value of derivatives relating to customer exposures was about DKK 14 billion. During the year, credit value adjustments were moderately affected by interest rate changes, while the widening of credit spreads had a positive impact. Portfolio run-offs had an adverse impact. At end-2020 Nykredit's total provisions amounted to DKK 2.6 billion, of which credit value adjustments represented DKK 2.1 billion.

Part of Nykredit's swap portfolio is designated as legacy swaps. An example of legacy swaps is long-term interest rate swaps. The portfolio of legacy swaps is in run-off.

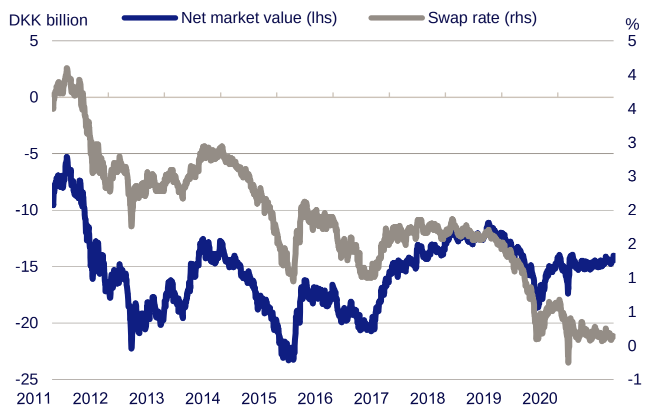
At end-2020 legacy swaps represented 51.7% of the total negative market value of derivatives relating to customer exposures. The market value has been value adjusted by 19%.

Exposure, netting and collateral

The gross exposure to all types of counterparties was DKK 77.0 billion at end-2020. Derivatives represented DKK 20.0 billion, while DKK 58.0 billion related to securities financing transactions (repo transactions/reverse repurchase lending). After netting and collateral, but before potential future exposures, the counterparty risk exposure was DKK 12.7 billion. Of this amount, DKK 11.0 billion related to derivatives and DKK 1.7 billion related to securities financing transactions.

Nykredit's derivatives contracts do not include rating triggers, and therefore a credit rating downgrade would not trigger a requirement for additional collateral.

Nykredit Realkredit Group
Net market value of derivatives contracts with business customers



Nykredit Realkredit Group
Value adjustment of portfolio of customer derivatives (swaps)

DKK million 31.12.2020	CVA Customers without objective evidence of credit impairment	Customers with objective evidence of credit impairment	Management judgement	Total CVA	FVA	Other	Total value adjustment	Market value	Value adjustment as % of market value
Derivatives offered	118	214	14	346	85	126	557	6,773	8%
Legacy derivatives	182	1,264	351	1,797	112	148	2,057	7,237	28%
Total	**300**	**1,478**	**365**	**2,143**	**196**	**275**	**2,614**	**14,010**	**19%**

Nykredit Realkredit Group
Impact of netting and collateral held on exposure values

DKK billion 31.12.2020	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
Derivatives	20.0	5.7	14.3	3.3	11.0
Securities financing transactions	58.0	-	58.0	56.2	1.7
Total	**78.0**	**5.7**	**72.3**	**59.6**	**12.7**

Note: Figures in the table are not directly comparable with accounting figures, as the capital adequacy rules provide for additional netting compared with the accounting rules.

5. OPERATIONAL RISK

Operational risk comprises the areas that are not covered by quantifiable financial risks. Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risks.

Nykredit's operational risk review process extends to several underlying areas, of which the main risk areas are set out in the table below.

Operational risks are mitigated through improved processes, business procedures and other mitigating measures and covered by holding the requisite capital.

Main non-financial risk areas	
IT security	The risk that Nykredit or Nykredit's customers are exposed to cybercrime, data breaches or the like
Compliance	The risk that legal or regulatory sanctions are imposed on Nykredit or that Nykredit suffers financial losses or reputational damage caused by non-compliance with legislation, market standards or internal rules
Conduct management	The risk of a bad reputation or financial losses as a result of improper business conduct. For instance, conduct risk may be related to Nykredit's products, business practices or conduct, or the conduct of Nykredit's customers or business partners
Data quality	The risk that inadequate data quality leads to determination errors, flawed decision-making etc
Model risk	The risk of loss resulting from decisions based mainly on mathematical and statistical model results
Prevention of money laundering and terrorist financing	The risk that Nykredit is misused for purposes of money laundering or terrorist financing
Personal data protection	The risk that the personal data of Nykredit's customers are misused as a result of a data breach at Nykredit

5.1 ▪ OPERATIONAL RISK POLICY

The Board of Directors lays down the Group's policy and guidelines for operational risk, including its risk appetite in this area.

It is Nykredit's policy to promote a culture where openness about and awareness of operational risks are natural elements of the everyday work of all staff members, and to ensure that the Executive Board and the Board of Directors are briefed regularly on key risk areas.

Operational risks are assessed based on the probability that a risk materialises into an operational event and the consequences of such event. The risks are measured on a 4-point scale from low to very high. The operational risk policy stipulates that operational risks should be low relative to other types of risk to which Nykredit is exposed. The nature of operational risks must not be such as to potentially jeopardise the financial stability of Nykredit and/or the individual subsidiaries.

5.2 ▪ OPERATIONAL RISK GUIDELINES

The Board of Directors' guidelines to the Executive Board set out tasks and responsibilities for ensuring that the operational risks are mitigated and managed in accordance with the principles and limits of the operational risk policy.

In connection with strategic and business decisions, it is assessed whether these could imply operational risks that are inconsistent with the policy laid down by the Board of Directors. The same applies in connection with approval of new products.

The Executive Board has delegated the ongoing monitoring of operational risk to the Group Risk Committee. The Committee regularly reviews material risks, considers specific action plans and determines whether specific risks should be presented to the Board of Directors. Risks that fall outside Nykredit's risk appetite are always presented to the Board of Directors for consideration.

Operational risk governance

Board of Directors and Board Risk Committee:
Lay down the operational risk policy, including the risk appetite.
Receive quarterly reports on compliance with the operational risk policy. Receive separate information about risks with very high risk scores and events with very high impacts and a report on the handling of the case and risk mitigation.

Executive Board and Group Risk Committee:
Approve and implement the operational risk policy and regularly review compliance based on quarterly risk outlook reports.
Receive quarterly reports on compliance with the operational risk policy. Receive separate information about risks with high risk scores and events with high impacts and a report on the handling of the case and risk mitigation.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.3 ▪ OPERATIONAL RISK MANAGEMENT

Given its special characteristics, operational risk is best mitigated and managed in the first line of defence through the day-to-day business conduct. The responsibility for the day-to-day management of operational risks is therefore decentralised and rests with the individual business divisions. Operational risk management activities are coordinated centrally to ensure coherence and consistency across the Group.

Operational risks are mapped by each business division identifying, assessing and mitigating own significant risks on an ongoing basis. Nykredit's risk control function holds quarterly risk meetings with selected business divisions for the purpose of reviewing the divisions' operational risks. The business divisions are selected according to a risk-based approach so that divisions with significant risks are reviewed more often. Risk meetings are held with each business division at least annually. At the risk meetings, the operational risks of the division are reviewed, and it is assessed whether the risks are adequately managed through controls and other risk-mitigating actions, or whether additional measures are required to reduce risk. Operational risk mapping identifies particularly risky processes, systems, products or conduct and therefore constitutes a general management tool.

In addition to the identification of operational risks, all operational loss events of DKK 10,000 or more are systematically recorded, categorised and reported. Moreover, operational risk gain events, potential operational loss/gain events and events that did not lead to a loss/gain (near-miss events) are recorded.

The recording of operational risk events must include information about the type of product, process and risk concerned as well as about any insurance cover and the time spent dealing with the event. In relation to events that are significant in terms of size or number, an assessment will be made of the need to implement new risk-mitigating measures.

To strengthen the efforts to address and mitigate operational and compliance risks, one or more Assistant Risk and Compliance Officers (ARCOs) have been appointed in the individual business divisions. Their primary duty is to assist the managements of the individual business divisions in executing compliance- and risk-related tasks and to strengthen awareness of Nykredit's risk culture. ARCOs serve as links between the first line of defence and the compliance and risk control functions (second line of defence). ARCOs are also found in functions in the second line of defence.

5.3.1 ▪ Insurance risk

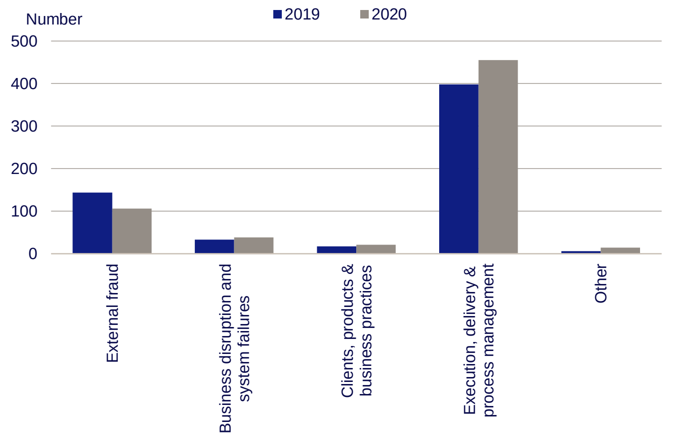
Nykredit covers certain types of operational risk by taking out insurance in accordance with the insurance cover policy laid down by the Board of Directors. This includes statutory and other insurance to ensure that any damage or claims for damages will not noticeably affect the Group's financial results or operating conditions. Overall, Nykredit ensures adequate insurance cover of risks, taking into account Nykredit's business activities, organisation and resources as well as the market conditions under which Nykredit operates.

5.4 ▪ CAPITAL REQUIREMENT FOR OPERATIONAL RISK

Nykredit determines the capital requirement for operational risk using the basic indicator approach. This means that the capital requirement is calculated as 15% of average gross earnings of the past three years. REA for operational risk was DKK 28.1 billion throughout 2020.

Nykredit Realkredit Group

Operational loss events by category



Note: Other includes: Internal fraud, employment practices and workplace safety as well as damage to physical assets. The risk type external fraud mainly includes credit card misuse.

5.5 ▪ IT SECURITY

The services provided by the Nykredit Group are based mainly on digital solutions, and it is therefore essential that the IT solutions used by Nykredit are user-friendly, reliable and secure.

Most of the operation of Nykredit's IT systems has been outsourced to external providers. Close collaboration with these providers ensures that they comply with service agreements and maintain a satisfactory IT security level.

5.5.1 ▪ Risk assessment and management

Nykredit regularly conducts IT risk assessments to ensure that risks are identified and assessed as well as addressed according to a risk-based approach taking into account both risk and materiality. Thanks to this approach, resources are allocated to the areas where they are most needed and provide the most value to Nykredit. The objective is not to eliminate all risks, but rather to identify them and subsequently decide how to manage the risks.

The following risks are deemed to be the most critical risks faced by Nykredit at end-2020:

- Inability to maintain vital services/functions due to a critical event affecting a key provider and
- Cyberattacks from an organised hacker group or government, including ransomware attacks.

5.5.2 ▪ Mitigating measures

The Nykredit Group's IT security policy and IT guidelines follow the ISO 27001/2 standards. The aim is to support a more efficient information security management system adapted to Nykredit's special needs and to ensure that it is retained through a continuous security optimisation process.

Furthermore, Nykredit has launched a range of measures which have strengthened Nykredit's overall defence against phishing, hackers and virus attacks. Nykredit has increased security, for instance by implementing advanced security software and awareness campaigns and optimising the processes for efficient handling of security incidents.

Self-checking and penetration testing

IT Security annually checks whether, in practice, Nykredit and relevant business partners comply with the IT security policy and guidelines. These checks are performed as audits based on selected security requirements from the IT security policy.

Nykredit conducts penetration tests of Nykredit's cyberdefence, including Nykredit's ability to handle security incidents, at least once a year. The tests are conducted by external business partners. Any potential risks identified are subsequently reduced through mitigating measures. Further, Nykredit participates in large-scale emergency preparedness exercises at sector level.

Awareness and training

To ensure that all Nykredit staff have satisfactory knowledge of IT security, all new staff members must complete an e-learning programme on IT security. The programme ends with a mandatory test that must be passed. Nykredit also conducts regular e-learning and phishing tests aimed at its staff.

IT security governance

Board of Directors and Board Risk Committee:
Lay down the IT security policy, including the risk appetite, stipulating general IT security requirements.
Receive quarterly reports on compliance with the IT security policy as well as separate reports, possibly including an action plan, in case of major security incidents.

Executive Board and Group Risk Committee:
Approve and implement the IT security policy and regularly review compliance based on quarterly risk outlook reports.
Are notified of major security incidents and consider risk mitigation.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.6 ▪ COMPLIANCE

Operational risk includes compliance risk. Compliance risk means the risk that legal or regulatory sanctions are imposed on Nykredit or that Nykredit suffers financial losses or reputational damage caused by non-compliance with legislation, market standards or internal rules applicable to Nykredit.

The Boards of Directors have adopted a separate compliance policy that defines risk tolerance in the compliance area as well as requirements for ongoing reporting of identified risks and ad-hoc reporting of critical events. Like operational risks, compliance risks should be low relative to other types of risk of the Group.

The compliance function is charged with assessing, monitoring and reporting on the efficiency of Nykredit's methods and procedures to ensure legal compliance. Compliance performs an annual risk assessment, identifying the areas to be reviewed in the year to come. Compliance regularly reviews identified compliance risks until mitigated and assesses and monitors whether any new risks are addressed adequately.

Furthermore, Compliance has a continuous, strong focus on strategic measures and legislation that may alter the risk profile of the organisation, currently including anti-money laundering law, the General Data Protection Regulation (GDPR), MiFID and IT, including data governance.

Compliance governance

Board of Directors and Board Risk Committee:
Lay down the compliance policy, including the risk appetite. Receive quarterly reports on compliance with the policy and identified compliance risks.

Executive Board and Group Risk Committee:
Approve and implement the compliance policy and regularly review compliance based on quarterly risk outlook reports.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.7 ▪ CONDUCT MANAGEMENT

Nykredit's advice, products and services must be responsible, both in a societal context and relative to the finances of the individual customer. This calls for an organisation which is in every way prepared to act responsibly and correctly, complying with not only the letter, but also the spirit of the law, and a culture where we openly air, discuss and act on the dilemmas that may arise in a financial undertaking. This is part of our conduct management efforts.

In 2020 Nykredit stepped up its conduct management efforts, launching a two-pronged initiative:

1) A risk management initiative where we continually identify, assess and act on the Group's conduct risks as part of the ongoing risk management practices.

2) A broad initiative for all staff members aimed at increasing awareness of responsible business conduct and training managers and staff in identifying, discussing and responding to irresponsible business conduct.

Common to both initiatives is that they support a safe and open culture where both managers and staff talk about and adjust behaviours and practices to ensure responsible business conduct in all areas of our organisation.

The Group's conduct risk is included in the established risk management practices. Risk meetings are held regularly with the managers of the individual business units, at which conduct risks are identified, discussed and reduced, for instance by a change of practices or conduct.

In tandem with the work of identifying and assessing conduct risks, several initiatives have been launched to support a culture where Nykredit's staff have room to identify, discuss and act on situations perceived as irresponsible. This is not a process with a defined beginning and end, but rather an ongoing process to promote a culture where it is natural and safe for our staff to speak up if they experience something that does not live up to Nykredit's objective of being a responsible business.

One of the initiatives in 2020 was the development of a training module where the players in a fictitious online banking universe must make a number of business ethical choices in situations with personal customers, corporate customers, investment and management. All staff members will complete the training in 2021 and become better prepared, via the fictitious cases used, for responding to similar situations in future.

Furthermore, conduct management is included as a topic in management and talent programmes and in the introductory programme for new staff. Also, Nykredit's Code of Conduct was updated in 2020 to ensure that all Nykredit staff have an up-to-date and clear framework within which to act responsibly in their day-to-day work.

5.8 ▪ DATA QUALITY

As a financial institution, the Nykredit Group is dependent on the quality of the data it uses, as they form the basis for business decisions made by Nykredit. A strong data governance set-up is therefore crucial to minimise the risk that data quality across the Group does not satisfy Nykredit's business needs and regulatory requirements in this area.

At the beginning of 2020 Nykredit started working on a framework for the future data governance activities. Part of this work involved preparing a data governance policy with associated guidelines that introduce five main themes defining the scope and laying the foundation for Nykredit's data governance.

Nykredit's five main themes of data governance are:

- *Roles and responsibilities*, which involves identification of critical data elements, grouped into data domains, and assigning ownership to named staff members.

- *Process standardisation*, where the goal is to reduce complexity and inefficiency by introducing standardised processes, data structures and technologies.

- *Data quality measurements*, where the objective is to ensure higher efficiency and trust in data by introducing a common standardised data quality process, including quality targets and reporting as well as delegation of operational responsibility for implementation of data quality controls and error correction.

- *Information architecture*, which involves appointment of authoritative sources to ensure one version of data.

- *Change management*, where the aim is to ensure that development takes place in accordance with the data governance strategy.

Data have been divided into 10 data domains, together comprising all data used by Nykredit. Ownership lies with data domain owners, each holding overall responsibility for the implementation of data governance in their respective areas.

Data quality governance

Board of Directors and Board Risk Committee:
Lay down the policy, and overall principles, for data governance and data quality targets.
Receive quarterly reports on compliance with the policy and data maturity.

Executive Board and Group Risk Committee:
Approve and implement the data governance policy and regularly review compliance based on quarterly risk outlook reports.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.9 ▪ MODEL RISK

Model risk is the risk of loss resulting from decisions based mainly on mathematical and statistical model results. Nykredit uses such models in connection with various business decisions and to determine risk limits, capital, capital adequacy, impairments etc. Model risk is the risk of weaknesses in, or in relation to, these models or the risk that output from the models are used in an inexpedient way. Model weaknesses may result from errors or weak data in connection with the development or implementation of the models, or from weaknesses in the data to which the models are applied. Over the past few years, the focus of authorities on model risk as an independent risk area has increased significantly.

The Board of Directors has adopted a model risk policy, which defines the risk appetite in the area and lays down requirements for ongoing reporting and review.

Nykredit has a set-up that ensures active management and monitoring of model risk and structured governance of models and model changes. Nykredit has a comprehensive model register that provides an overview and clear definitions of roles and responsibilities. The model register is also used as a central tool for measurement and assessment of model risks. Nykredit has a governance structure in place for changes and approval of models as well as an established framework for the ongoing monitoring and reporting of model risk.

Model risk is monitored closely by domain-specific model committees, which are also responsible for governance in respect of model approval and model changes. This ensures that model risk is managed and assessed in a uniform way across the Group and that model risk becomes visible in Nykredit's overall risk landscape.

Model risk governance

Board of Directors and Board Risk Committee:
Lay down the model risk policy, including the risk appetite. Receive quarterly reports on compliance with the model risk policy and on the risk outlook.

Executive Board and Group Risk Committee:
Approve and implement the model risk policy and regularly review compliance based on ongoing reporting. Review and approve main model risks.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.10 ▪ PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING

Nykredit is continuously working to strengthen processes, monitoring and controls throughout the Group as an effective safeguard against misuse of the Group's products and services for purposes of money laundering or terrorist financing. Nykredit's set-up for preventing money laundering, terrorist financing and breaches of financial sanctions is laid down in a Group policy. The Group's business procedures, processes and controls are prepared within the framework of this policy.

Responsibility for this area has been broadly delegated across the Group. A member of the Group Executive Board has been charged with delegating and ensuring managerial responsibility and focus on measures to prevent money laundering, terrorist financing and breaches of financial sanctions throughout the Group. The Executive Boards of the other Group companies have each appointed a Chief AML Officer at the executive level. The Nykredit Group also has a Chief Compliance Officer and an AML Responsible Officer covering all relevant Group companies.

In 2020 Nykredit increased its efforts to reduce the risk of money laundering, terrorist financing and breaches of financial sanctions. This included hiring more staff in this area, introducing a more extensive risk assessment method, implementing additional system support and implementing new and improved processes as well as new business procedures in the area.

Staff awareness and vigilance are important elements of the defence against money laundering, terrorist financing and breaches of financial sanctions. To ensure that all Nykredit staff possess the requisite knowledge, a mandatory e-learning programme on preventing money laundering, terrorist financing and breach of financial sanctions has been introduced. All staff must complete the programme, and the programme ends with a test that must be passed every year. The number of staff working full-time with the prevention of money laundering, terrorist financing and breaches of financial sanctions increased throughout 2020.

Nykredit acknowledges the importance of integrating measures to prevent money laundering, terrorist financing and breaches of financial sanctions into all business activities. Nykredit wants to be known for its integrity and regulatory compliance, in accordance with the expectations of customers, society, authorities and other stakeholders.

AML governance

Board of Directors and Board Risk Committee:
Lay down the policy for the prevention of money laundering, terrorist financing and breach of financial sanctions, including the risk appetite.
Receive reports on the Group's risk assessment with respect to financial crime and updates on progress of strategy and compliance with FSA orders as well as separate reports on material issues, possibly including an action plan.

Executive Board and Group Risk Committee:
Approve and implement the policy and guidelines and regularly review compliance based on ongoing reporting and risk assessments with respect to financial crime. Are notified of material issues and consider risk mitigation.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

5.11 ▪ PERSONAL DATA PROTECTION

Nykredit focuses strongly on ensuring that personal data are treated as confidential and processed in compliance with the General Data Protection Regulation (GDPR) and the data protection legislation. Relevant policies and business procedures have been laid down, and processes have been established to ensure that personal data are processed in compliance with applicable law.

Responsibility for personal data processing is decentralised and supported by privacy leads in all units of the organisation. The local privacy leads are responsible for ensuring that data protection rules are complied with locally and for identifying possible challenges and solutions. Privacy leads also extend knowledge of Nykredit's policies and guidelines in this field locally in the organisation.

Group Legal holds central governance responsibility, including responsibility for the overall policies and guidelines, and assists the business in implementing the rules through advice, support and training.

Data breaches must be reported and treated in compliance with the guidelines of the Danish Data Protection Agency. Nykredit continuously monitors for personal data breaches in the Group. Most data breaches in Nykredit have been related to procedural errors involving a few customers, for instance e-mails sent to the wrong recipient or with the wrong documents attached.

Nykredit's compliance function includes a Data Protection Officer (DPO) tasked with assessing, monitoring and reporting on the effectiveness of Nykredit's methods and procedures relating to personal data processing.

All Nykredit staff must complete an e-learning programme on personal data processing once a year. The programme ends with a test that must be passed.

Data protection governance

Board of Directors and Board Risk Committee:
Lay down the personal data policy with descriptions of risk appetite.
Receive reports on compliance with the personal data policy and on the risk outlook as well as separate reports, possibly including an action plan, in case of material breaches.

Executive Board and Group Risk Committee:
Approve and implement the personal data policy and regularly review compliance based on ongoing reporting.
Are notified of material breaches and consider risk mitigation.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive

6. **MARKET RISK**

Market risk is the risk of loss as a result of movements in financial markets and includes interest rate, yield spread, foreign exchange, equity price and volatility risks etc.

Nykredit's aggregate market risk is divided into the trading book exposure and the banking book exposure. Portfolios with positions held for trading are placed in the trading book. Long-term investments held until maturity, however, are placed in the banking book. Nykredit has laid down guidelines defining criteria for the valuation of securities and financial instruments and their allocation to the trading and banking book, respectively.

Nykredit's market risk in the trading book mainly stems from investment of equity and Nykredit's liquidity reserves. Investments are mainly made in Danish and European covered bonds as well as government bonds. Moreover, investments are made in credit bonds issued by financial undertakings and, to a lesser degree, in other types of financial products. In addition, Nykredit Bank A/S and Nykredit Realkredit A/S incur market risk when trading bonds, swaps and other financial products.

In the banking book, Nykredit holds a portfolio of assets held for business purposes, which primarily consist of investments in a number of regional banks with which Nykredit has business relationships and private equity. These investments have a long-term purpose and are therefore placed in the banking book. In addition, the banking book comprises portfolios of credit bonds and short-dated bonds from the liquidity reserves.

Nykredit's main market risks are yield spread risk on covered bonds in the trading book and equity price risk on equities held for business purposes in the banking book. Yield spread risk is the risk of movements in the spreads between yields of covered bonds/credit bonds and swap rates, which may lead to gains as well as losses. Equity price risk is the risk of movements in equity prices affecting the values of Nykredit's portfolios, which may lead to gains as well as losses.

The market risk relating to Nykredit's largest business area, mortgage lending, is, in practice, negligible. This is because mortgage lending is governed by a statutory balance principle and match-funded, see the description in *7. Liquidity risk and funding*.

Nykredit's investee companies are screened quarterly to identify any breaches of international conventions etc. Such screening is based on Nykredit's responsible investment policy, which covers all Nykredit's portfolios, including alternative investments. The policy also serves to implement Nykredit's corporate responsibility policy laid down by Nykredit's Board of Directors.

6.1 ▪ MARKET RISK POLICY AND GUIDELINES

The Board of Directors has laid down a market risk policy setting out principles for the overall market risk in Nykredit's trading and banking books. The main principle of the policy is that the probability of losses from market risk exposures exceeding Nykredit's expected aggregate quarterly results must be low. This is monitored daily, for instance by measuring budgeted quarterly results against the estimated losses of a number of stress scenarios that may, with some probability, occur in the trading book or the banking book.

In addition to the market risk policy, Nykredit's Board of Directors has laid down guidelines for market risk in the trading book and banking book, respectively, which are used in day-to-day market risk management. In accordance with these guidelines, the Executive Board delegates specific limits for the different types of market risk to the Group companies through the Asset/Liability Committee. Read more about the Asset/Liability Committee in *2.4.1 Committees.*

The market risk guidelines lay down measurable limits on the total portfolio risk and also permit the use of financial instruments. However, it is a condition that the risk relating to the financial instruments can be measured and managed sufficiently accurately. Risk limits covering both the trading book and the banking book are applied to all types of financial instruments involving market risk.

6.2 ▪ CONTROL AND REVIEW

On a daily basis, the risk control function checks that the market risk policy and guidelines are complied with. Also on a daily basis, the current utilisation of the limits set out in the guidelines is reported to the head of Nykredit's risk control function, the Asset/Liability Committee and the heads and dealers of the acting units. Any breaches of these limits are reported to the Asset/Liability Committee, the Board of Directors of Nykredit Realkredit or other Boards of Directors depending on the nature of such breaches.

Moreover, the risk control function continuously reports on the Group's current market risk outlook to the Boards of Directors, Executive Boards, the Asset/Liability Committee and the Group Risk Committee. The current utilisation of risk limits is determined by Nykredit's risk control function and thus independently of the acting units.

Nykredit's Boards of Directors monitor and evaluate the current market risk and its elements monthly, and this forms the basis for an annual review and approval of the market risk policy and market risk guidelines.

6.3 ▪ CURRENT RISK PROFILE AND DEVELOPMENT

Market risk is assessed on the basis of a range of different metrics that express sensitivity to movements in the financial markets combined with two market risk models, Value-at-Risk (VaR) models, for calculating an aggregate risk level for Nykredit Realkredit and Nykredit Bank, respectively.

The metrics and market risk models are supplemented with a number of stress tests which, based on the current portfolios, quantify potential losses in the event of large, but likely, fluctuations in financial markets.

Market risk governance

Board of Directors and Board Risk Committee:
Lay down the market risk policy and market risk guidelines, including risk appetite and risk limits for eg equities, bonds and financial instruments.
Receive quarterly reports on compliance with the market risk policy and on the risk outlook.
Receive separate reports, possibly including an action plan, in case of non-compliance with the policy or guidelines.

Executive Board and Asset/Liability Committee:
Approve and implement the market risk policy and guidelines and regularly review compliance based on quarterly and monthly reports.
Receive separate reports and action plans in case of non-compliance with the policy, guidelines or limits.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

In March 2020, the covid-19 outbreak caused substantial fluctuations in Nykredit's market risk, which were reflected in the VaR models as described below. The model limits were breached, which was reported appropriately and responded to by the Executive Board and the Board of Directors. At the same time, daily earnings fluctuated heavily, leading to a reduction in Q1/2020 results.

The elevated market risk in spring was the result of volatile yield spreads of eg credit and covered bonds and reduced equity prices. However, over the summer and autumn, yield spreads tightened and equity prices rebounded, so levels have more or less returned to pre-covid-19 levels.

*6.3.1 ▪ **Trading book risk***

Basically, Nykredit's market risk is determined based on calculations of a number of traditional metrics that may be regarded as portfolio sensitivity tests. They are used to calculate the effect on the value of the individual portfolios in case of changing market conditions involving, for example, rises or falls in interest rates, equity prices or volatilities. The calculations are made on the trading book as well as the banking book. Nykredit's key risks are interest rate risk, yield spread risk and equity price risk.

The traditional metrics do not indicate the probability of an event occurring, but rather how much the occurrence of the given event would affect the value of a portfolio. To incorporate the probabilities of different events in day-to-day risk measurement, Nykredit applies VaR models. In addition, stress and scenario tests are used.

Value-at-Risk (VaR)

In day-to-day risk management, Nykredit uses VaR to calculate one risk measure covering most of Nykredit's trading book positions. VaR captures Nykredit's maximum potential losses in one day at a probability of 99%. The Nykredit Group's VaR totalled DKK 60 million at end-2020.

Since end-2019 daily VaR has risen by DKK 46 million, mainly due to the covid-19 outbreak and, to a lesser degree, Nykredit's implementation of new market risk models to calculate VaR for Nykredit Realkredit and Nykredit Bank. The sum of the results returned by the two models is the total VaR of the Nykredit Realkredit Group as shown in the chart below.

Daily VaR calculations are based on historical daily fluctuations in, for instance, yield spreads, equity prices and interest rates over the past 250 trading days. In March the covid-19 outbreak caused historically large financial market fluctuations, including in yield spreads. The heightened market volatility in March 2020 was reflected in VaR calculations for the subsequent period, and the VaR level is still high from a historical perspective.

The consequences of a high VaR level are seen in two areas in particular: Utilisation of the market risk (VaR) limit set by the Board of Directors and determination of the capital requirement for portfolios involving market risk.

For a detailed description of VaR, see *6.4. Models for determination of market risk.*

Yield spread risk

Yield spread risk is the risk of loss as a result of spreads between individual bonds and general interest rate levels widening by 1 percentage point. In historical terms, spread widening of 1 percentage point is much rarer than a general interest rate rise of 1 percentage point.

In the Group's trading book, the yield spread exposure on covered bonds was DKK 1.5 billion at end-2020, while the yield spread exposure on the credit bond portfolio was DKK 23 million. The chart below shows the development in yield spread risk in Nykredit's trading book.

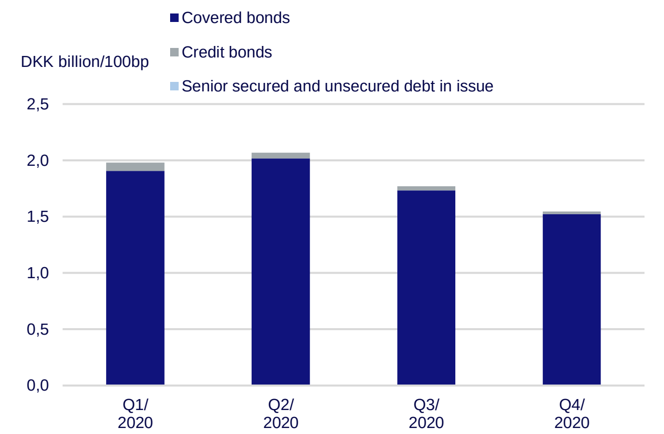
Interest rate risk

Interest rate risk is the risk of loss as a result of interest rate changes. Nykredit's interest rate risk is measured as the change in the market value of Nykredit's portfolios resulting from a general interest rate increase of 1 percentage point in respect of bonds and financial instruments.

Nykredit's interest rate exposure in the trading book was DKK 187 million at end-2020.

Nykredit Realkredit Group
Value-at-Risk, trading book

Nykredit Realkredit Group
Yield spread risk, trading book



Equity price risk

Equity price risk is the risk of loss as a result of changes in equity prices, and it is expressed by the aggregate market value of Nykredit's equity portfolios. The Group's equity price risk exposure in the trading book amounted to DKK 244 million at end-2020. For more details on equity price risk in the banking book, see *6.4.2. Equity price risk in the banking book*.

6.3.2 ▪ ***Daily stress tests***

Systematic stress tests are performed on a daily basis to measure the risk of loss during turbulent market conditions. The tests are based on a number of forward-looking scenarios characterised by significant, but likely, market movements and events that are likely to occur during the next 3-5 years. In addition, a historical stress scenario is used, calculating portfolio losses for the most stressed periods of the past approximately 12 years. Overall, the different stress tests are used to assess portfolio losses, should these events occur. The stress tests are also used for reporting on compliance with the Board of Directors' market risk policy, as losses estimated by the stress tests are measured against the market risk appetite set out in the policy.

6.3.3 ▪ ***Other market risks***

Besides the market risks addressed above, Nykredit is exposed to foreign exchange risk and volatility risk in relation to equity, foreign exchange and interest-bearing instruments, such as options. These risks only make up a minor amount of the total market risk exposure.

Nykredit hedges its foreign exchange risk and only has minor tactical foreign exchange positions held to achieve a gain. Therefore, the Group had only minor positions in currencies other than EUR in 2020.

Nykredit's volatility risk mainly relates to investments in, for example, callable covered bonds with embedded call options, as these bonds may be prepaid. Interest rate expectations will affect the market value and may in consequence lead to gains as well as losses. However, the risk is limited and stems mainly from the portfolio of Danish callable covered bonds, but also from other interest rate and equity derivatives.

6.3.4 ▪ ***Banking book risk***

The market risk exposure of the trading book can quickly be increased or reduced, as positions tend to be very liquid. This is not necessarily the case with the banking book. Basically, the same types of market risk are found in the banking book, but much stricter requirements apply to the frequency of trading of such positions.

The market risk exposure of Nykredit's banking book generally derives from equities held for business purposes, which are illiquid, as many of them are unlisted and the portfolio is concentrated in a few securities. Further, the banking book comprises a private equity portfolio and some long-dated, interest rate-hedged bond portfolios, relating to the lending operations. Also, a number of short-dated credit and covered bond portfolios were included in the banking book in 2020.

Interest rate risk

Interest rate risk in the banking book is limited and derives mainly from the lending operations of Nykredit Realkredit and Totalkredit, as well as LR Realkredit and Nykredit Bank. The interest rate risk of the mortgage banks is very limited due to the statutory match-funding principle governing covered bond issues.

The interest rate risk exposure in the banking book totalled DKK 178 million net at end-2020.

Yield spread risk

Yield spread risk in the banking book mainly derives from the investment of proceeds from unsecured debt issued by Nykredit for purposes such as meeting the debt buffer and MREL requirements. Secondarily, it derives from portfolios containing bonds in all ISINs for loan redemptions, allowing customers to prepay their loans at any time.

In the banking book, the yield spread risk on covered bonds was DKK 1.0 billion net at end-2020.

Equity price risk

Equities in the banking book comprise Nykredit's equities held for business purposes and private equity holdings.

Equities held for business purposes comprise equities in regional and national banks with which Nykredit has business relationships as well as equities in property companies. The aggregate market value of these portfolios was DKK 5.2 billion at end-2020.

Given the relatively large equity portfolio, equity price risk represents a substantial proportion of the Group's total market risk. For capital adequacy purposes, the risk associated with equities held for business purposes is determined as credit risk exposure.

Nykredit Realkredit Group

Interest rate risk in the banking book by maturity

2020

DKK million	0-1 year	1-3 years	3-6 years	Over 6 years	Total
Nykredit Realkredit A/S	59	27	34	(10)	**110**
Totalkredit A/S	5	(2)	0	0	**3.5**
Nykredit Bank A/S	62	4	(2)	1	**65**
Total	**127**	**29**	**31**	**(9)**	**178**

6.4 ▪ MODELS FOR DETERMINATION OF MARKET RISK

In addition to the traditional risk metrics of interest rate risk and equity price risk etc, Nykredit uses market risk models to calculate VaR as described above. Nykredit Realkredit and Nykredit Bank use different models.

Both models are applied in day-to-day internal risk management and in the determination of the regulatory capital requirement for positions involving market risk. Use of the models to determine capital requirements is subject to the approval of the Danish Financial Supervisory Authority (FSA), which oversees the models.

The market risk models are also subject to the same internal approval, validation and control procedures as credit risk models so as to assure their quality. Read more in *4.6.7. Approval, validation and testing of credit risk models.*

On 1 January 2020 Nykredit implemented two new VaR models. Both models were approved by the Danish FSA in December 2019. The new models are both based on historical simulation and constitute a significant improvement on the previous models in several ways. In particular, the modelling of, for instance, covered bonds and credit bonds has improved with the new models.

6.4.1 ▪ VaR for day-to-day management

VaR model results are reported on a daily basis against prescribed limits and are determined as the 0.99 fractile of the distribution of daily returns over a rolling 1-year period. Daily VaR limits have been laid down at Group, company and organisational unit levels.

The VaR limits were breached in March 2020 when the covid-19 outbreak caused substantial market movements.

6.4.2 ▪ Backtesting of market risk models

To measure VaR model performance, the model results are backtested against realised returns on Nykredit's portfolios on a daily basis. In the backtests, daily earnings (gains/losses) are compared with the model estimates of maximum losses.

As the models apply a 99% probability, there will likely be backtest overshootings, indicating losses exceeding the VaR model estimate, 2.5 times per year.

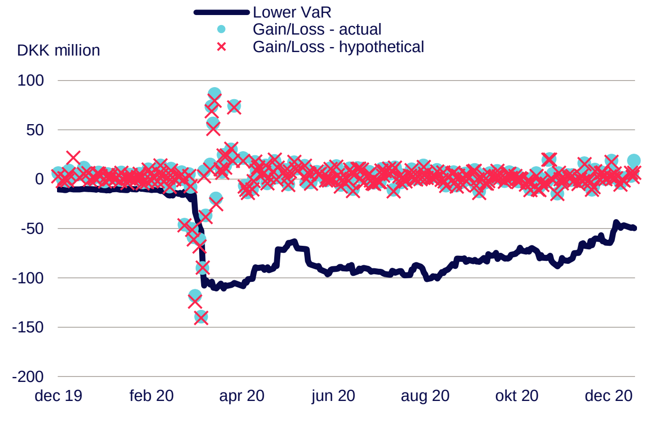
If losses exceed the model estimate of maximum losses five times or more within a year, an additional regulatory capital charge will be added to Nykredit's VaR capital requirement.

VaR backtests for Nykredit Realkredit A/S and Nykredit Bank A/S are shown in the charts below.

Nykredit Realkredit A/S recorded six backtest overshootings in 2020, and Nykredit Bank A/S recorded four. All overshootings relate to the covid-19 outbreak in March 2020. As a result of volatility in global financial markets caused by the covid-19 pandemic, the EBA has temporarily relaxed a number of its capital requirements, implying that covid-19-related overshootings will not count towards the determination of capital requirements. Thus, these overshootings will have no impact on the capital positions of Nykredit Realkredit and Nykredit Bank.

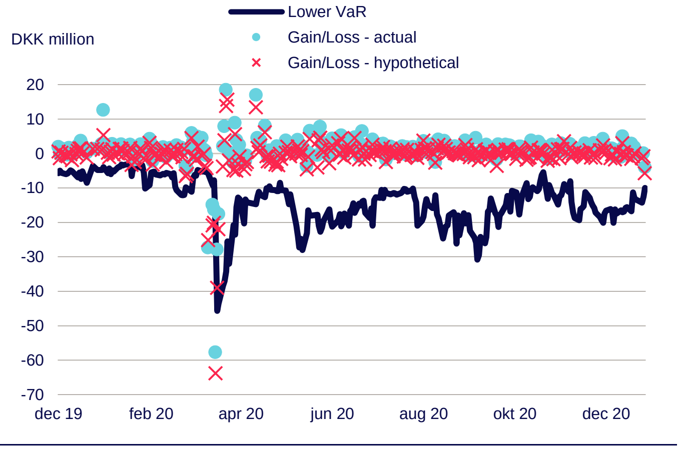
Nykredit Realkredit A/S

VaR model backtesting



Nykredit Bank A/S

VaR model backtesting



6.4.3 ▪ ***Regulatory VaR capital requirement***

In determining the risk exposure amount (REA) for market risk, Nykredit uses a combination of market risk models and the standardised approach, and the risk exposures are furthermore divided into general risk and specific risk. General risk means risk affecting financial markets in general, and specific risk is the risk related to single-name issuers.

Nykredit applies the current VaR models for determination of the regulatory capital requirement for general market risk. These models have been approved for use on the trading books of Nykredit Realkredit A/S and Nykredit Bank A/S. Totalkredit A/S and LR Realkredit A/S only apply the statutory standardised approach, as they do not have approved internal VaR models.

To determine the VaR capital requirement, the time horizon has been scaled up to 10 days instead of 1 day as used in day-to-day management. Total REA for general market risk in the portfolio is calculated daily under current as well as stressed market conditions by including:

- The largest losses over the past 12 months based on the current portfolio (VaR)
- The largest losses over a historical 12-month period when markets were particularly distressed based on the current portfolio (stressed VaR).

Until the covid-19 outbreak in March 2020, the period of the Lehman Brothers collapse in September 2008 was used to calculate stressed VaR. The Lehman Brothers crisis was characterised by significant yield spread widening, particularly on short-dated bonds, which had a large impact on covered bond positions with maturities of up to 5 years.

Since the covid-19 outbreak, however, Nykredit Realkredit has used the period in March as the basis for stressed VaR calculation. During that period, credit and yield spreads of especially (long-dated) callable covered bonds widened substantially, which affected portfolios of such bonds in particular.

For Nykredit Bank, however, the period serving as the basis for stressed VaR calculation has not changed as a result of the covid-19 pandemic, as the composition of Nykredit Bank's portfolios is different compared with those of Nykredit Realkredit.

Total REA for market risk came to DKK 40.1 billion at end-2020. Nykredit's REA calculated using VaR models amounted to DKK 30.2 billion at end-2020, of which stressed VaR amounted to DKK 17.3 billion.

Thus, REA is up DKK 10.8 billion on end-2019 when it amounted to DKK 29.3 billion. The rise is mainly due to an increase in REA calculated using VaR models caused by the large increase in VaR in Q1/2020 following the covid-19 outbreak, see *Value-at-Risk (VaR)* in 6.3.1.

Nykredit Realkredit Group

Risk exposure amount (REA) for market risk

			2020	2019
	Specific risk	General risk	Total REA	Total REA
Internal models (VaR):	**-**	**30,215**	**30,215**	**16,937**
Value-at-Risk (99%, 10 days)	-	12,947	12,947	2,859
Stressed Value-at-Risk (99%, 10 days)	-	17,268	17,268	14,078
Standardised approach:	**7,424**	**2,489**	**9,913**	**12,398**
Debt instruments	5,663	2,184	7,847	9,211
Equities	1,761	50	1,811	2,932
Foreign exchange risk	-	-	-	-
Collective investment schemes	-	255	255	255
Settlement risk	-	-	-	-
Total market risk exposure			**40,128**	**29,335**

7. LIQUIDITY RISK AND FUNDING

Nykredit's liquidity risk is the risk that Nykredit is unable to fulfil its financial obligations and meet regulatory requirements and rating criteria in the short, medium and long term. Liquidity risk is also the risk of funding shortages, preventing Nykredit from pursuing the adopted business model, or the risk that Nykredit's costs of raising liquidity become prohibitive.

The composition of Nykredit's liquidity and funding is much affected by regulatory requirements and rating criteria. Nykredit therefore has a strong focus on existing and future requirements, including the Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR), Minimum Requirement for own funds and Eligible Liabilities (MREL), Additional Loss-Absorbing Capacity (ALAC), debt buffer and Supervisory Diamond benchmarks.

7.1 ▪ LIQUIDITY POLICY AND LIQUIDITY RISK GUIDELINES

Nykredit's liquidity policy is laid down by Nykredit's Board of Directors and defines Nykredit's overall risk appetite in relation to its liquidity risk profile and funding structure. One aim of the liquidity policy is to ensure that Nykredit's funding and liquidity management supports the mortgage lending business and ensures competitive prices for customers and Nykredit, regardless of the market conditions. Furthermore, the liquidity management framework must sustain Nykredit's ability to maintain high credit ratings and its status as issuer of covered bonds (SDOs).

In addition to the liquidity policy, Nykredit's Board of Directors has laid down guidelines on the day-to-day liquidity management. In accordance with the guidelines provided by the Board of Directors, the Executive Board delegates liquidity management limits to the Group companies through the Asset/Liability Committee.

The guidelines provide limits for Nykredit's day-to-day liquidity management and for short-, medium- and long-term management. Limits have also been set for the composition of the stock of liquid assets, the LCR, Nykredit Bank's deposits, the use and diversification of funding sources, leverage, MREL, the debt buffer, rating criteria as well as future regulatory requirements.

Nykredit annually prepares a report on areas such as liquidity management and the Internal Liquidity Adequacy Assessment Process (ILAAP), which is submitted to the Board of Directors and the Danish FSA for their review.

7.2 ▪ CONTROL AND REVIEW

The risk control function continuously reports on the Group's liquidity and funding risk profile to the Board of Directors, the Board Risk Committee, the Asset/Liability Committee and the Group Risk Committee.

The current utilisation of risk limits is determined by Nykredit's risk control function and thus independently of the acting units. Also, the current utilisation of the limits set out in the guidelines is reported daily to the head of Nykredit's risk control function, the chairman of the Asset/Liability Committee and the heads and dealers of the acting units.

The Board of Directors oversees and evaluates the current liquidity and funding risks on a monthly basis, and this forms the basis for an annual review and approval of the liquidity policy and guidelines. Risk outlook reporting is part of the quarterly reporting to the Board of Directors, the Board Risk Committee and the Group Risk Committee.

Liquidity and funding governance

Board of Directors and Board Risk Committee:
Lay down the liquidity policy and liquidity risk guidelines, including risk appetite and limits. Receive regular reports on liquidity policy compliance and the risk outlook.
Receive separate reports, possibly including an action plan, in case of non-compliance with the policy or guidelines.

Executive Board and Asset/Liability Committee:
Approve and implement the liquidity policy and guidelines and regularly review compliance based on quarterly and monthly reports. Receive separate reports and action plans in case of non-compliance with the policy, guidelines or limits.

Control functions (second line of defence):
Perform continuous control and monitoring independently of the risk-taking units. Prepare independent reports for the Board of Directors and the Executive Board.

7.3 ▪ CURRENT RISK PROFILE AND DEVELOPMENT

Like the rest of Denmark, Nykredit is affected by the covid-19 crisis. The national lockdown in March 2020 resulted in a period of increased financial market volatility and a general economic slowdown.

The situation triggered a short period of price declines, spread widening and increased volatility of covered bonds. However, in line with past experience, Nykredit did not have any difficulty selling bonds to fund its lending activities despite the market turmoil.

Prompted by the covid-19 crisis, Nykredit activated its Funding Contingency Committee. The Committee is authorised to deliver an agile response to signs of liquidity shortages etc. Nykredit's low liquidity risk helped Nykredit weather the crisis.

Nykredit's liquidity buffer has not been significantly affected by the covid-19 crisis, and Nykredit has maintained its capacity to provide the liquidity required by its customers.

Despite the covid-19 crisis, property prices were up in 2020, reducing the need to provide supplementary collateral in connection with SDO issues.

Nykredit Bank has also reduced its use of short-term funding sources over the past few years, thereby reducing its risk.

After a brief rise as a result of the covid-19 outbreak, the funding margins on senior and subordinated debt have returned to pre-covid-19 levels.

7.4 ▪ BALANCE PRINCIPLE AND MATCH FUNDING

Nykredit's mortgage lending is governed by the balance principle, which provides limits to the financial risks Nykredit may assume in relation to lending and funding.

Nykredit operates according to the general balance principle, which allows the use of derivatives for risk hedging under certain conditions. In practice, Nykredit's mortgage lending is match funded. As a result, Nykredit's lending and related funding activities only involve negligible financial risks. Nykredit currently does not apply derivatives in connection with mortgage lending.

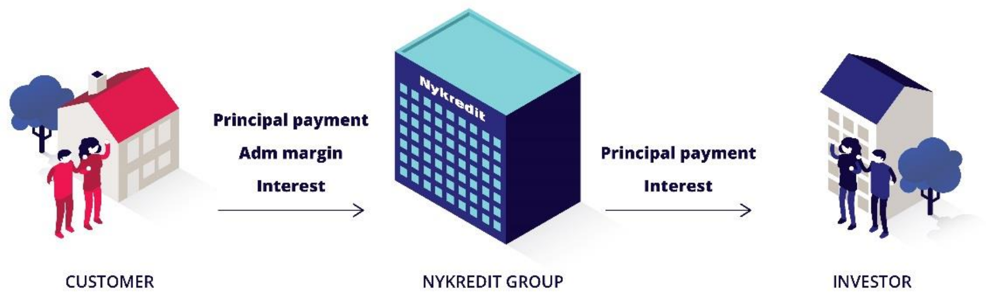
To eliminate interest rate risk and foreign exchange risk, the interest rate and foreign exchange terms of mortgage loans match those of the bonds funding the loans. Long-term fixed-rate loans maintain the same funding throughout the term of a loan. Adjustable-rate mortgages (ARMs) and variable-rate loans are funded by bonds with maturities shorter than the terms of the underlying loans, which are refinanced on maturity of the bonds. The loan rate is adjusted upon refinancing according to the yield-to-maturity of the new bonds sold.

The outstanding funding is reduced by principal payments and loan redemptions. Borrowers cover Nykredit's costs of redemption.

The due dates of payment of interest and principal are fixed so that Nykredit receives the funds on or before the dates when the payments to bondholders fall due, provided borrowers make timely payments.

Thus, match funding ensures a match between the interest and principal payments of a loan and the underlying funding. Nykredit's earnings margin consists of a separate so-called administration margin, which is most often calculated on the basis of borrowers' debt outstanding. In addition, various fees may be charged.

Balance principle and match funding



7.5 ▪ REGULATORY REQUIREMENTS

Legislation lays down a number of requirements for the composition and amount of Nykredit's liquidity and funding in the short, medium and long term. At end-2020 all requirements had been met.[1] Over the next few years, new regulation will be introduced that will affect Nykredit's funding requirement.

7.5.1 ▪ Liquidity Coverage Ratio (LCR)

The regulatory requirement of LCR is used to assess Nykredit's short-term liquidity risk. Nykredit's LCR reflects the share of liquid assets relative to net cash outflows over a 30-day period and must be at least 100%. Under this requirement, Nykredit must hold an adequate stock of liquid assets to withstand a liquidity stress for a period of at least 30 days.

As appears from the table below, Nykredit's LCR was 771% and the excess liquidity coverage was DKK 93.4 billion at end-2020. The aggregate LCR of Nykredit's mortgage banks was 5,064%, while Nykredit Bank's LCR was 178%. Liquid assets used to comply with the requirement of supplementary collateral in Nykredit Realkredit and Totalkredit are considered to be encumbered and consequently ineligible for the purpose of LCR determination. For more details, see *7.5.4 Supplementary collateral*.

The Danish FSA has granted Nykredit permission not to include mortgage lending and its funding in the calculation of LCR for Nykredit Realkredit and Totalkredit. The permission was motivated by the fact that match funding limits liquidity risk in relation to mortgage lending and its funding. The condition for the permission is that Nykredit must comply with a minimum LCR requirement. This means that the stock of liquid assets must make up at least 2.5% of Nykredit Realkredit's and Totalkredit's total mortgage lending. At end-2020, liquid assets eligible for meeting the minimum requirement amounted to 4.3%, or DKK 56.9 billion, against a requirement of DKK 33.3 billion.

Over the next few years, the minimum LCR requirement will be replaced by an LCR Pillar II add-on. The add-on will cover a potential liquidity requirement resulting partly from remortgaging cases where borrowers have terminated an existing loan for prepayment but have not raised a new loan, partly from the liquidity risk related to borrowers in arrears. The Danish FSA has developed a model for this, which is expected to enter into force in 2023. The existing minimum LCR requirement will therefore be maintained for now.

The Danish FSA has introduced an additional liquidity requirement concerning foreign currencies. Under this requirement, Danish SIFIs must meet an LCR-like requirement in respect of significant currencies except for SEK and NOK. The currency requirement contributes to ensuring a suitable currency match between liquid assets and cash flows. This requirement, which for Nykredit only concerns EUR, applies to the Nykredit Realkredit Group. The LCR in foreign currencies must be 100% or more. At end-2020, Nykredit's LCR in EUR was 422%.

[1] The determination does not include LR Realkredit, which reports its own regulatory liquidity data. As from 2021, LR Realkredit's data will be integrated with those of the Nykredit Realkredit Group.

Nykredit is under a statutory obligation to disclose derivatives exposures and their effect on the LCR. Nykredit uses derivatives to hedge risks relating to the stock of liquid assets. The market value of the derivatives portfolio will vary over time, which will impact Nykredit's posting of collateral. Therefore, when calculating the LCR, an amount is allocated to cover any negative fluctuations in required collateral.

7.5.2 ▪ Liquidity and funding benchmarks

The Supervisory Diamond for banks includes two liquidity and funding risk benchmarks: the liquidity benchmark and the funding ratio.

The liquidity benchmark is based on the LCR and must be 100%, but over a 3-month period. It means that Nykredit Bank must have sufficient liquidity to withstand a liquidity stress for a period of at least three months. At end-2020 Nykredit Bank's liquidity benchmark was 151%.

The funding ratio indicates the relationship between lending and stable funding, which includes deposits, bonds in issue with a time-to-maturity of more than one year, subordinated debt and equity. The funding ratio is calculated as the ratio of lending to stable funding and must be below one. The purpose of the funding ratio is to ensure that the funding of Nykredit Bank's lending is sufficiently stable. At end-2020 Nykredit Bank's funding ratio was 0.53.

7.5.3 ▪ Intraday liquidity risk

Nykredit Bank's intraday liquidity risk is the risk that the Bank will not be able to meet its intraday financial obligations. Nykredit Bank actively controls, manages and monitors its intraday liquidity risk.

The intraday liquidity risk of Nykredit Realkredit and Totalkredit is limited, as the mortgage lending model is designed so as to eliminate any structural intraday liquidity requirement.

Liquidity Coverage Ratios

DKK billion	31.12.2020	31.12.2019
Nykredit Realkredit Group		
LCR (%)	771	955
Excess liquidity coverage (DKKbn)	93.4	104.0
LCR, EUR (%)	422	483
Nykredit Realkredit and Totalkredit		
LCR (%)	5,064	3,482
Excess liquidity coverage (DKKbn)	31.0	26.3
Nykredit Bank		
LCR (%)	178	153
Excess liquidity coverage (DKKbn)	22.0	20.9

7.5.4 ▪ Supplementary collateral

In order for the Capital Centres E and H to maintain their SDO status, Nykredit must provide supplementary collateral for loans in case of property price declines where the LTV ratios exceed the statutory LTV limits.

Supplementary collateral is not required for public housing loans issued through SDO Capital Centre J, as these loans and bonds are government guaranteed.

As the prices of commercial and residential property have generally risen in recent years, the supplementary collateral requirement has decreased. The supplementary collateral requirement for Capital Centres E and H amounted to DKK 9.7 billion at end-2020 against DKK 12.5 billion at end-2019.

It is Nykredit's policy to have a collateral buffer in case of declining property prices. The minimum buffer is determined by means of stress testing.

Thanks to the buffer, Nykredit would have been able at end-2020 to absorb an immediate property price decline of about 18% without additional funding. The funding of the debt buffer requirement and the minimum requirement for own funds and eligible liabilities (MREL) raises Nykredit's ability to absorb a property price decline.

7.5.5 ▪ Debt buffer and MREL requirements

The purpose of the MREL requirement is to ensure that the Nykredit Group can be recapitalised and restructured through a principal write-down or conversion of capital and debt instruments, should Nykredit Bank meet the conditions for resolution. The approach of Nykredit's resolution strategy is to keep the Group together in a resolution situation. As mortgage banks, Nykredit Realkredit and Totalkredit are exempt from the MREL requirement, and the MREL requirement therefore only applies to the banking activities.

At end-2020 the MREL requirement for Nykredit Bank was DKK 33.7 billion. Nykredit currently meets the requirement and expects to continue meeting it going forward, while at the same time complying with the debt buffer requirement for the mortgage banks.

Nykredit Realkredit and Totalkredit comply with the regulatory requirement stipulating that Danish mortgage banks must have a debt buffer of at least 2% of their mortgage lending. The debt buffer serves to bolster the loss-absorbing capacity of a failing mortgage bank without impairing its lending capacity. In 2022 the debt buffer requirement will be adjusted so that, together with own funds and the MREL requirement, it will amount to at least 8% of the consolidated balance sheet.

The MREL and debt buffer requirements may be fulfilled using the Group's own funds and senior non-preferred debt.

7.5.6 ▪ Net Stable Funding Ratio (NSFR)

The revised Capital Requirements Regulation (CRR2) has been adopted, introducing the new, long-term liquidity measure, the NSFR.

The purpose of the NSFR is to ensure that credit institutions apply sufficiently stable, long-term funding when issuing loans. The NSFR is the ratio of an institution's amount of available stable funding to the amount of its required amount of stable funding. To meet the NSFR requirement, this ratio must be at least 100%. The level of stable funding is calculated by weighting assets according to their liquidity and maturity. Funding with times-to-maturity of more than one year is considered more stable than other types of funding.

Nykredit expects to meet the NSFR requirement when it takes effect in mid-2021.

7.5.7 ▪ New covered bond regulation

The EU has adopted a Covered Bond Directive aimed at harmonising and strengthening existing covered bond regulation. The Covered Bond Directive enters into force in July 2022.

The Danish covered bond legislation already complies with the requirements of the Directive to a very large extent, and Nykredit therefore does not expect the Directive to imply significant changes to the Danish mortgage system. However, the Directive includes aspects which may be of significance to Nykredit's funding. For instance, a minimum over-collateralisation (OC) requirement of 5% is introduced. This requirement may be lowered (but not below 2%) at national level if the OC requirement is risk-based, as it is in Denmark today. The funding need in relation to OC is therefore expected to grow.

7.5.8 ▪ Stress testing

To sustain Nykredit's business model and also to ensure that Nykredit has sufficient liquidity to meet regulatory requirements, liquidity stress tests are conducted for the short, medium and long term. They show the development in excess liquidity coverage in an expected scenario and in stress scenarios, taking into account regulatory requirements and rating criteria.

The stress tests show the resilience of the liquidity position in a situation where Nykredit has no access to a significant part of its usual funding sources.

7.6 ▪ S&P GLOBAL RATINGS KEY RATIOS

In its rating criteria, S&P Global Ratings (S&P) has included a number of key ratios defined by S&P itself. These key ratios form part of S&P's overall credit rating of an institution.

7.6.1 ▪ Additional Loss-Absorbing Capacity (ALAC)

Nykredit has made use of S&P's option to obtain a higher rating by strengthening its capital position. This is achieved using ALAC, which consists of excess capital and of senior debt designated to absorb losses in case of recovery or resolution of Nykredit, thus protecting the ordinary senior debt.

ALAC is calculated as a percentage of risk-weighted assets determined based on S&P's calculation method (S&P RWA). An ALAC maintained at 8% of S&P RWA or higher will currently trigger a 2-notch uplift of Nykredit's Issuer Credit Rating/senior rating. At end-2020 Nykredit's ALAC was 9.5%. The raising of funding to meet the new debt buffer requirement is expected to make ALAC rise.

7.6.2 ▪ Overcollateralisation behind bond rating

When rating the Danish covered bonds issued by Nykredit Realkredit and Totalkredit, S&P applies its criteria to assess the collateral posted in the capital centres. In addition to the security by way of mortgages on real estate, Nykredit posts additional collateral in the form of liquid securities (overcollateralisation – OC). A condition of obtaining the highest possible rating (AAA) is the posting of OC of at least DKK 320 billion. The required OC is determined as the result of S&P's individual assessments of the OC requirement for each individual mortgage loan. Each assessment includes a large number of parameters, including property type, location, LTV ratio, loan type and payment history. In total, Nykredit Realkredit and Totalkredit had liquid assets of DKK 89.8 billion eligible for OC purposes at end-2020.

7.7 ▪ ESG RATINGS

The mounting general awareness of climate and environmental sustainability as well as governance is also present among investors and issuers. ESG ratings (Environmental, Social and Governance) are a tool used by investors and other stakeholders to assess a company's position relative to sustainability, corporate responsibility and governance.

Nykredit focuses on the ESG rating agencies, MSCI and Sustainalytics, which consider all ESG factors, as well as on CDP (Carbon Disclosure Project), which reflects environmental impact. Nykredit finds that these agencies are currently the most used among our investors. The agencies have published unsolicited ratings of Nykredit based solely on publicly available information.

In December CDP upgraded Nykredit's rating by one notch, from B to A-. In November 2020 MSCI upgraded Nykredit's ESG rating by one notch from BBB to A. Nykredit's rating from Sustainalytics of 16.5 remained unchanged in 2020. The table below shows Nykredit's ESG ratings.

Nykredit Realkredit Group
ESG ratings at 31.12.2020

ESG rating agency End-2020	Nykredit's rating	Scale[1]
MSCI	A	AAA to CCC
Sustainalytics	16.5	0 to 100
CDP	A-	A to D-

[1]Highest to lowest rating.

7.8 ▪ FUNDING

Nykredit has a sizeable balance sheet and extensive market activities for the purpose of funding the Group's lending. This includes daily tap issuance to fund Nykredit's mortgage lending. Moreover, Nykredit regularly refinances ARMs, floating-rate loans etc. Nykredit also issues capital market funding to comply with regulatory requirements and rating criteria.

Nykredit raises funding in the following markets:

- Danish covered bonds (SDOs/ROs)
- Senior secured debt (currently not issued)
- Secured and unsecured bank loans
- Senior unsecured debt
- Senior non-preferred (SNP) debt
- Tier 2 and Additional Tier 1 capital

As shown in the chart Funding sources below, covered bond issues are the primary funding source. For the Bank, the primary source is deposits.

7.8.1 ▪ Covered bonds

Nykredit's balance sheet mainly consists of lending secured by mortgages on real estate funded through the issuance of mortgage covered bonds (SDOs and ROs). Mortgage covered bonds are issued through daily tap issuance coupled with refinancing auctions for ARMs, floating-rate loans etc.

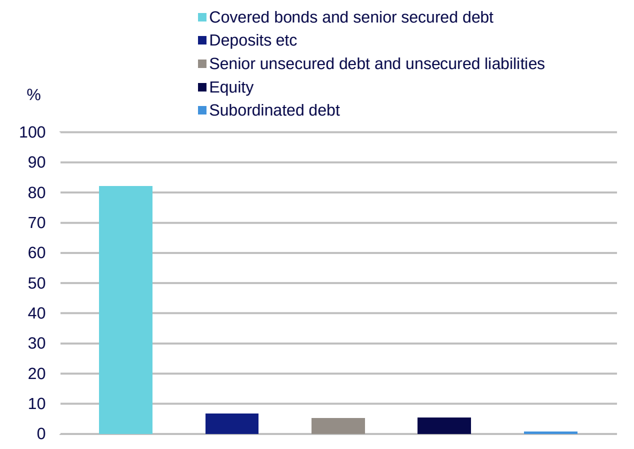
Nykredit strives to build large, liquid benchmark bond series to obtain an effective pricing of its bonds. Nykredit Realkredit and Totalkredit's joint bond issuance contributes to creating large volumes and high liquidity in the Group's key bond series.

In 2020 Nykredit had primary dealer arrangements with a number of securities brokers for the purpose of underpinning liquidity in the bond series and ensuring consistent market making in and efficient pricing of Nykredit's bonds.

Due to the rules determining which liquid assets are eligible for the LCR calculation, many banks prefer to invest in bonds with outstanding amounts of more than EUR 500 million and high credit ratings. As shown in the chart below, as much as 91% of the outstanding amounts of Nykredit's active bond series are today classified in the top LCR category (Level 1), while 5% are in the second-best category (Level 2A).

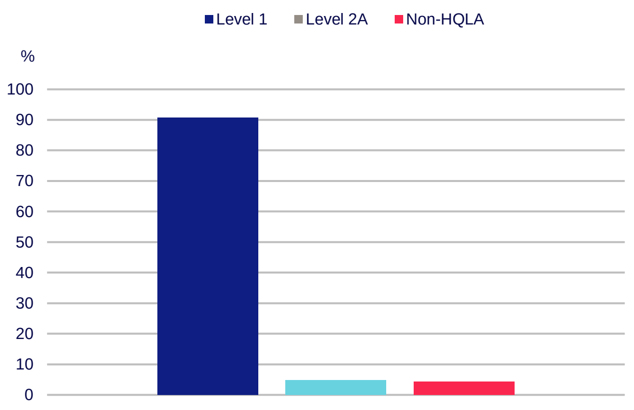
Nykredit Realkredit Group

Funding sources



Nykredit Realkredit Group

Covered bonds by LCR category (percentages, end-2020)



Nykredit strives to have a range of bonds that best suits customers' needs while at the same time meeting investors' increased preference for very liquid bond series. The chart Mortgage lending by loan type below shows Nykredit's products and the distribution of Nykredit's mortgage lending.

Over the past few years, Nykredit has reduced its refinancing risk. As shown in the chart Refinancing auctions, SDOs and ROs below, short-term mortgage loans funded by 1-year and 3-year bullet covered bonds represent a decreasing share of total mortgage lending. Because of the low interest rate levels, borrowers increasingly choose longer-term loans funded by bonds with maturities from 5 to 30 years. Nykredit's annual refinancing volumes are expected to be maintained at around DKK 160 billion going forward.

To support the liquidity of bullet covered bonds, Nykredit is working towards a gradual phase-out of the refinancing of ARMs on 1 April and 1 October. Going forward, the refinancing of ARMs will be concentrated on the payment dates of 1 January and 1 July. Other products, such as Cita-linked loans, will continue to be refinanced on 1 April and 1 October, which serves to spread the amounts and dates of bonds maturing over the individual payment dates. Over the past few years, Nykredit has introduced quarterly refinancing auctions with almost equal refinancing volumes, see the chart below.

Nykredit Realkredit Group
Refinancing in 2021

DKK billion	2021
Refinancing[1]	
Total maturity before set-off of self-issued bonds	**252.5**
- ordinary principal payments and scheduled[2] prepayments (paid up)	66.4
- ordinary principal payments and scheduled[2] prepayments (unpaid)	22.9
- pre-issued bonds and interest rate risk[2]	4.8
Total refinancing volume	**158.3**
- pre-auctioned amount sold under forward contracts	(19.9)
Refinancing volume remaining for 2021	**138.4**
- of which SDOs and ROs	138.4
- of which other issues	0

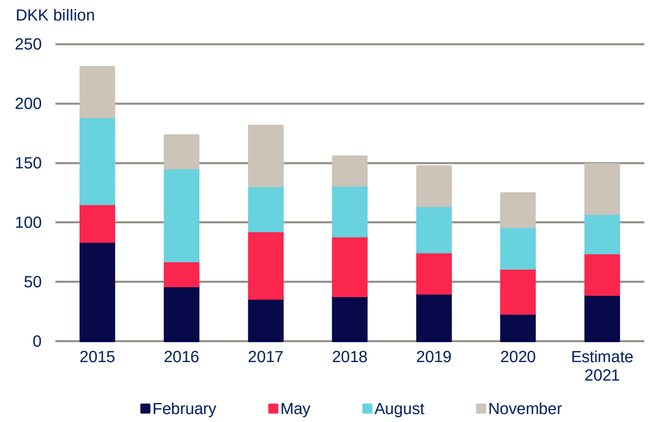
[1] Applicable for the January, April, July and October 2021 payment dates.
[2] Known as at 31 December 2020.

7.8.2 ▪ Green bonds

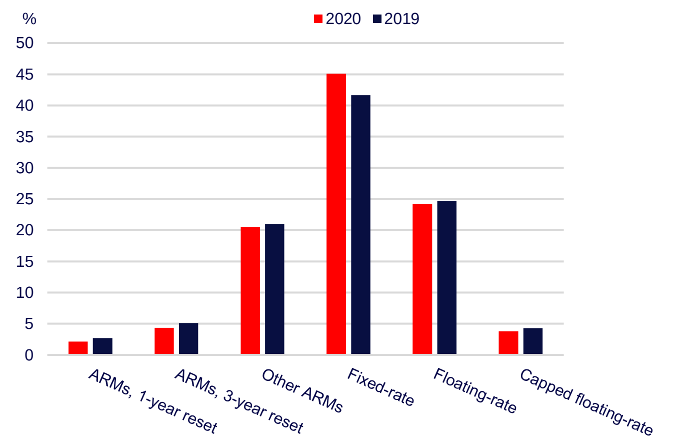
Nykredit launched its first green bonds in 2019. Green mortgage loans are offered to finance energy-efficient buildings with energy label A or B or equivalent certification. The loans are currently offered to corporate clients. About DKK 9 billion-worth of green bonds had been issued at end-2020.

In 2020 Nykredit updated its Green Bond Framework, which was established in compliance with ICMA's Green Bond Principles (GBP) and describes the principles of green loans. This allows Nykredit to finance a wide variety of sustainable assets such as renewable energy, energy renovations etc. through green bonds.

Nykredit Realkredit Group
Refinancing auctions, SDOs and ROs



Nykredit Realkredit Group
Mortgage lending by loan type



7.8.3 ▪ Capital market funding

Nykredit raises capital market funding mainly for the purpose of meeting regulatory capital requirements.

In 2020 Nykredit issued senior non-preferred debt of approximately DKK 15 billion to meet the debt buffer/MREL requirements. Senior non-preferred debt in issue totalled DKK 41.7 billion at year-end.

In H1 the Danish FSA relaxed its subordination requirement for MREL, which allowed Nykredit to meet part of the MREL requirement with senior preferred debt. As at 31 December 2020 Nykredit had issued senior preferred debt of DKK 5.6 billion.

On 6 October 2020 Nykredit Realkredit A/S issued Additional Tier 1 (AT1) capital of EUR 500 million (DKK 3.7 billion).

The Bank's senior unsecured debt outstanding consisted of Euro Medium Term Notes (EMTN) of DKK 0.5 billion and short-term euro commercial paper (ECP) of DKK 4.9 billion as at 31 December 2020.

Debt to fund Nykredit Bank is issued by Nykredit Realkredit, and the proceeds are transferred to Nykredit Bank by way of long-term intercompany funding.

The total funding and ECP issuance requirement will depend on the development in customer deposits and lending as well as the Bank's other business activities. The chart below shows the current maturity profile of Nykredit's capital market funding.

7.8.4 ▪ Issuance schedule

Nykredit Realkredit will continue to issue covered bonds on tap and at refinancing auctions.

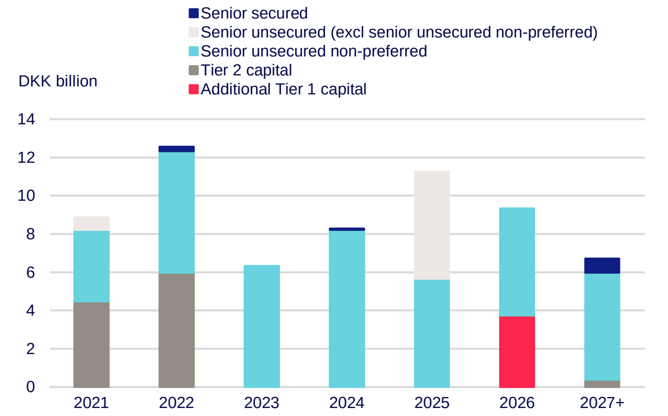
Nykredit expects to refinance bonds worth DKK 39 billion and DKK 35 billion at the auctions in February and May 2021, and DKK 33 billion at the auctions in August 2021.

Due to the debt buffer requirement, Nykredit must increase its senior non-preferred debt by end-2021. Nykredit expects to issue about DKK 15 billion in 2021, primarily senior non-preferred debt. Nykredit has issued DKK 0.9bn-worth of senior non-preferred debt in January 2021.

In recent years, the scope of Nykredit Bank's wholesale funding has been reduced in the light of a growing surplus of deposits relative to lending. ECP issuance will continue through Nykredit Bank. The total issuance requirement will depend on the development in customer deposits and lending as well as the Bank's other business activities.

Nykredit Realkredit Group

Maturity profile of capital market funding



Nykredit Realkredit Group		DKK million
Bonds in issue	31.12.2020	31.12.2019
Covered bonds (ROs)	138,260	152,406
Covered bonds (SDOs)	1,282,909	1,262,714
Senior secured debt	852	934
Senior preferred debt, Nykredit Bank A/S	516	595
Senior preferred debt, Nykredit Realkredit A/S	5,579	
Senior non-preferred debt	41,651	30,306
Tier 2 capital	10,893	11,004
Additional Tier 1 capital, Nykredit Realkredit A/S	3,720	3,735
ECP issues, Nykredit Bank A/S	4,885	3,185

7.8.5 ▪ Credit ratings

Nykredit Realkredit and Nykredit Bank collaborate with the international credit rating agencies S&P Global Ratings (S&P) and Fitch Ratings regarding the credit rating of the Companies and their funding.

S&P Global Ratings

S&P has assigned Nykredit Realkredit and Nykredit Bank long-term and short-term Issuer Credit Ratings of A+/A-1 with a stable outlook and long-term and short-term Resolution Counterparty Ratings of AA-/A-1+.

Senior non-preferred debt has a BBB+ rating with S&P.

SDOs and ROs issued by Nykredit Realkredit and Totalkredit through rated capital centres are all rated AAA by S&P, which is the highest possible rating. The rating outlook is stable.

Covered bonds issued by LR Realkredit are not and will not be rated.

Fitch Ratings

Nykredit Realkredit and Nykredit Bank each have long-term and short-term Issuer Credit Ratings of A/F1 with Fitch with stable outlooks and long-term and short-term senior unsecured preferred debt ratings of A+/F1.

Senior non-preferred debt is rated A by Fitch.

Nykredit Realkredit Group

Credit ratings

End-2020	Nominal DKK billion[1]	S&P	Fitch
SDOs, ROs and senior secured debt			
Nykredit Realkredit A/S			
- Capital Centre C (covered bonds, RO)	0.5	AAA	
- Capital Centre D (covered bonds, RO)	17.6	AAA	
- Capital Centre E (covered bonds, SDO)	614.8	AAA	
- Capital Centre G (covered bonds, RO)	69.4	AAA	
- Capital Centre H (covered bond, SDO)	640.0	AAA	
- Capital Centre H (senior secured bonds)	0.8	AA	
- Capital Centre I (covered bonds, RO)	8.0	AAA	
- Nykredit Realkredit In General (covered bonds, RO)	0.3	AAA	
Totalkredit A/S			
- Capital Centre C (covered bonds, RO)	4.5	AAA	
Other ratings			
Nykredit Realkredit A/S			
- Short-term Resolution Counterparty Rating		A-1+	
- Long-term Resolution Counterparty Rating		AA-	
- Short-term Issuer Credit Rating		A-1	F1
- Long-term Issuer Credit Rating		A+	A
- Short-term senior unsecured debt		A-1	F1
- Long-term senior unsecured debt		A+	A+
- Senior non-preferred (SNP)/ Senior Resolution Notes (SRN)		BBB+	A
- Tier 2 capital		BBB	BBB+
- Tier 2 capital (CoCo)		BBB	BBB+
- Additional Tier 1 capital		BB+	
Nykredit Bank A/S			
- Short-term Resolution Counterparty Rating		A-1+	
- Long-term Resolution Counterparty Rating		AA-	
- Short-term Issuer Credit Rating		A-1	F1
- Long-term Issuer Credit Rating		A+	A
- Short-term senior unsecured debt		A-1	F1
- Long-term senior unsecured debt		A+	A+
- Short-term deposits		A-1	F1
- Long-term deposits		A+	A+

[1] Bonds in issue at nominal value at 31 December 2020.

7.9 ▪ ENCUMBERED ASSETS

Nykredit's main activity is to provide loans secured by mortgages on real estate. Nykredit's mortgage lending to customers is match funded through the issuance of bonds. The loans remain on Nykredit's balance sheet until they mature, and they are ring-fenced to ensure timely payments to bond investors in the event that Nykredit should fail. Ring-fencing assets for creditors/investors is referred to as asset encumbrance. Liquid assets used to comply with the requirement of supplementary collateral are considered to be encumbered for the purpose of LCR determination.

Moreover, Nykredit provides collateral in connection with derivatives trading and repo transactions. Nykredit provides collateral to other credit institutions for movements in the market value of Nykredit's OTC derivatives contracts and margin collateral in connection with exchange-traded derivatives. Nykredit also provides collateral to central clearing counterparties (CCPs). Such collateral is also considered to be encumbered assets.

Encumbered assets made up 82% of Nykredit's total assets at end-Q3/2020[2], the same level as at end-2019. It is natural that Nykredit should have a relatively high asset encumbrance ratio. It follows from the Danish mortgage lending model under which mortgage loans serve as collateral in favour of bondholders in the individual capital centres. The vast majority of the encumbered assets are in DKK. After netting for accounting purposes, encumbered assets in EUR are not significant.

Totalkredit's mortgage lending is also encumbered. The lending activities of Totalkredit and Nykredit Realkredit are jointly funded, which means that most of their mortgage lending is subject to intercompany encumbrance.

Nykredit's asset encumbrance is monitored and reported to the Danish FSA on a quarterly basis. The level of asset encumbrance is stable over time.

[2] The Q4 level will not be known until after release of the Risk and Capital Management 2020 report, and the Q3 level is reported instead.