2011

vestjyskBANK **Risk Report**

vestjyskBANK
It's all about people

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Vestjysk Bank A/S
Torvet 4-5, DK-7620 Lemvig
Denmark
CVR No. 34631328
Registered office: Lemvig, Denmark
Telephone (+45) 96 63 20 00
Fax (+45) 96 63 22 99
www.vestjyskbank.dk
vestjyskbank@vestjyskbank.dk

Read or download this report at vestjyskbank.dk.

Introduction

The objective of risk reports for financial institutions is to increase transparency, sharpen market discipline and thereby place investors and ratings agencies in a better position to be able to assess the risk profile and capital requirements of the individual financial institution.

Unless otherwise indicated, the disclosures provided in the present Risk Report relate to 2011. They have not been audited by internal or external auditors.

Individual disclosure requirements

The disclosure requirements set out in Annex 20 of the Executive Order on Capital Adequacy are specified in 23 general paragraphs divided into subparagraphs. The disclosure requirements contained in the 23 paragraphs are categorised as follows:

- Objectives and risk policies
- Area of application
- Capital base
- Solvency requirement and capital adequacy
- Individual solvency need and individual solvency requirement
- Counterparty risk
- Credit and dilution risk
- Application requirements for special instruments or methods

Objectives and risk policies

vestjyskBANK defines risk as any event that might have a significant negative influence on the possibility of achieving the Bank's business goals. The Bank is exposed to various kinds of risks managed and monitored at various levels within the organisation.

vestjyskBANK maintains a precautionary risk policy and strives at all times to maintain a superior quality asset portfolio in order to secure a stable platform for future growth.

The Bank's exposure to risk is absolutely central to its business transactions with customers and trading partners and to the business transactions it conducts at its own account. The Bank does not enter into business transactions without considering the risks involved.

The Bank's overall policy in this area is defined in the Bank's Policy on Risk Exposure.

Organisation

vestjyskBANK maintains a functional division between units that are transacting business with customers and are otherwise exposing the Bank to risks, and units concerned with general risk and capital management functions; likewise, controls are undertaken by a separate unit.

The Bank's overall risk management is centralised across the Credit, Credit Secretariat, Treasury, Markets and Advisory Services Departments as well as the Finance Department.

The Credit Department and Credit Secretariat handle credit-related controls and risk management.

Treasury is responsible for the Bank's equity risk, liquidity and own portfolio of securities and also manages liquidity as well as interest rate risk and foreign currency positions.

Markets and Advisory Services are responsible for customer market risks.

In most areas, control measures are carried out by the Finance Department, which also has on-going responsibility for maintaining the Bank's control systems, including monitoring the individual solvency need.

The Bank has a compliance function for risk management. The function is intended to help ensure that the Bank at all times complies with current legislation and the various orders issued by the authorities, and also that the Bank has up-to-date and updated business procedures in place.

vestjyskBANK divides risks into the following risk types:

- Market risks
- Credit risks
- Operational risks
- Liquidity risks
- Business risks etc.
- Capital base risk (solvency need)

Market risks

Definition

Market risk is defined as value at risk caused by changes in the market value of the Bank's assets or liabilities.

Objectives and policies for managing market risks

The Bank manages its market risks by, among other things, establishing limits for a number of risk targets, which together cover the level of the individual types of risks. The guidelines for the Bank's overall market risk are defined by the Supervisory Board and are issued as guidelines to the Executive Board. The Executive Board delegates risk frameworks to the Chief Financial Officer and the Investment Director. The Investment Director may delegate his authorisation to function managers and employees in the trading area in part or in full, and the Chief Financial Officer may delegate his authorisation to the Liquidity Manager in part or in full.

Market risk comprises interest rate, foreign currency and equity risk affected by both general and specific market fluctuations. Market risk is a natural part of the Bank's risk exposure, since customer trading in securities and foreign currencies is of great importance to the Bank's total earnings and is thereby part of the Bank's core business. The Bank's cash and cash equivalents are also invested in securities exposed to market risk.

The Bank uses derivative financial instruments in specific areas for hedging and managing market risk. The Bank takes its own speculative positions in derivative financial instruments within established risk parameters for both foreign currency and securities instruments. Derivative financial instruments are also used by the Bank's customers. Derivative financial instruments are included in the Bank's market risk report for the underlying risk areas.

Structure of the Bank's market risk management

The Bank's investment portfolio is characterised exclusively by shareholdings in other companies with which the Bank is in strategic and long-term partnerships. The purchase and sale of fixed assets are strategic decisions based on Executive Board decisions. The Bank has decided that only the Bank's strategic fixed assets shall be excluded from its trading portfolio. Other positions on securities plus all trading and decisions on derivatives are thus included in the Bank's trading portfolio.

Reporting risks and measuring market risks

The Supervisory Board continuously receives updates regarding developments in risk and how the allocated risk framework is being utilised.

The Executive Board receives daily reports on trends in major market risks, on breaches of the instructions issued to the Executive Board and credit facilities granted by the Supervisory Board to counterparties. Purchases and sales in the trading portfolio are checked daily, and discrepancies are reported to the Supervisory Board. The market prices used are checked on an on-going basis, and the prices of unlisted securities are checked quarterly.

Systems and controls for managing market risks

The Finance Department is tasked with ensuring that established policies and instructions relating to market risks are complied with. It performs:

- daily follow-ups on compliance with the Supervisory Board's instruction to the Executive Board,
- daily follow-ups on compliance with the Executive Board's delegated instructions to the Investment Director and the Chief Financial Officer,
- price checks relative to market prices for trading in securities and financial instruments,
- on-going assessments and reporting of potential risks relating to the Bank's trading in securities and financial instruments, and
- assessments of risks related to new products exposed to market risks.

Credit risks

Definition

Credit risk is defined as the value at risk due to customers' defaulting on their payment obligations in part or in full.

Organisation

The credit area is organised as follows:

The **Credit Department** has general responsibility for

- establishing and communicating the Bank's credit policy,
- authorising and establishing funding allocation powers,
- general management of commitments, including credit facilities and management of accounts in arrears,
- drafting price policy rules for the area, and
- reviewing commitments and drafting proposals relating to impairment needs and provisions.

The **Credit Secretariat** has general responsibility for

- ensuring that the credit area is management according to the current bodies of rules,
- performing independent audits and reporting for the credit area,
- implementing new laws and rules within the credit area, and
- the administrative handling of the Bank's impairments and provisions.

Objectives and policies for managing credit risks

The Bank focuses on diversifying credit risks satisfactorily and properly across its asset portfolio, including by customer type, geographic location, industry segment, credit rating and scores of commitments as well as by types of collateral received.

Individual industry segments are not allowed to constitute a disproportionately large credit risk. The strategy for portfolio distribution measured by industry is reassessed annually. The Bank is reluctant to advance credit to companies in industries in which it has little risk assessment experience, and there are tighter requirements, and there is heightened awareness with respect to issuing credit to companies within industry segments regarded as weak or vulnerable to business cycle fluctuations.

Within the corporate customer segment, the Bank deals predominantly with small to medium-sized businesses.

vestjyskBANK has a policy stipulating an ambition to have no more than five commitments exceeding 10 percent of the Bank's capital base, after deductions calculated as set out in sec 145 of the Danish Financial Business Act. In principle the Bank will only approve a commitment of this size, if it has a long-standing relationship with the customer.

The Bank does not actively market loan-financed securities investments.

Commitments classified as credit-impaired may, as a rule, only be extended against full security.

Structure of the Bank's credit risk management

Within vestjyskBANK, powers for authorising credit have been established based on a precautionary delegation policy. The Supervisory Board's authorisations issued to the Executive Board are delegated to the Deputy Director and the Credit Director, who in turn delegates these powers to individual employees.

In order to ensure the best credit assessment possible, the approval powers are delegated in such a way that each branch director has an approval authority which, among other things, is based on the size of the branch, the branch director's experience and the area in which he or she works.

Commitments beyond the branch director's approval authority are transferred to the Credit Department for consideration. Depending on the size of the commitment, credit applications need to be authorised by the Credit Department, the Credit Director, the Deputy Director, the Executive Board or, ultimately, the Supervisory Board. In the network of branches, the delegated approval authority is delegated in such a way that all corporate customer commitments and major retail customer commitments are considered by a minimum of two people.

When assessing credit for corporate commitments, vestjyskBANK emphasises that the customer's business concept must be viable and that the customer must possess the necessary competencies. An important aspect of the Bank's credit assessment is analysing the customer's accounts and budgets. When assessing credit for retail customers, the customer's disposable income and assets are the deciding factors.

All customers are credit-risk classified. This segmentation is reassessed on an on-going basis and is also incorporated as an element in the Bank's price structure with a view to ensuring correlation between price and risk.

The industry distribution of commitments is assessed quarterly in order to ensure that individual industries do not come to represent too much of a disproportionate risk for the Bank. Similarly, trends in the distribution of commitments in the various risk classes are monitored.

All overdrafts with balance movements are considered daily by the responsible customer management employee. Once a month, the customer management employee considers all overdrafts regardless of movements in the account. The Credit Department considers all daily overdrafts of DKK 100,000 or more and, for credit-impaired commitments, all daily overdrafts of DKK 25,000 or more.

The Bank is particularly alert to warning signs in the day-to-day processing of commitments. Credit-impaired commitments flagged as showing signs of weakness, and commitments directly written down or for which provisions have been made as a result of an objective indication of impairment are almost exclusively handled by the Credit Department, the Credit Director, the Deputy Director and the Executive Board. The individual branch directors only have very limited approval authority for processing such commitments.

Credit-impaired commitments are monitored closely. Action plans as well as cautious risk estimations are drawn up for commitments for which impairments/provisions have been made; these are reassessed quarterly. Cases involving distressed corporate customer commitments are handled by the individual branches in close dialogue with the Credit Department and the Bank's legal function. All collection proceedings involving retail customers are processed by collection management personnel in the Credit Secretariat.

Risk reporting and measurement of credit risks

The Credit Department reviews all major corporate commitments for reapproval annually. Additionally, a fresh review is performed for all commitments exceeding DKK 10 million, commitments with impairments of DKK 1 million and above as well as any commitments flagged as impaired in the amount DKK 1 million and above. The review includes assessments of accounts and budgets as well as action plans for credit-impaired commitments.

The individual departments review all other commitments in the same manner by focusing on commitments that are or might soon be exhibiting signs of impairment.

The Credit Secretariat submits quarterly development and status reports on credit-related risks to the Supervisory and Executive Boards.

Such reports contain:

- Status of individual departments' credit analyses
- Overview of major commitments
- Overdraft statistics
- Briefing on major overdrafts
- Distribution by industry segment, including trends in individual industry segment groups
- Migration analysis of customer risk classifications
- Trends in impairments and provisions

The Supervisory Board is presented with the approximately 125 largest and the most credit-impaired commitments once annually.

Methods for hedging and reducing risks

The Executive Order on Capital Adequacy stipulates special requirements for banks that apply the rules for calculating credit risk reduction. The Bank's ability to give a low weighting to exposures, where mortgages have been taken on financial securities and property, is conditional on meeting these requirements.

As in previous years, in 2011 vestjyskBANK has measured credit risk by applying the standardised approach.

Systems and controls for managing credit risks

In addition to systems used on a daily and periodic basis for the management and control of credit risks, systems for flagging credit-impaired commitments have been put in place.

Operational risks

Definition

Operational risk is defined as the value at risk associated with internal and external conditions caused by inappropriate or defective internal procedures, human or system-related errors as well as external conditions, including legal risks.

Objectives and policies for managing operational risks

The policy defines the types of events considered to belong to operational risk and identifies registration and reporting requirements. The Bank's goal is to limit its exposure to operational risk on an on-going basis taking due account of associated costs.

Written procedures have been drawn up in all major areas with a view to minimising dependence on individuals and also to ensure that where transactions etc. are entered into, this is done in accordance with the Bank's adopted policy. Contingency plans have also been drawn up for IT intended to limit losses in the event of IT outages or other similar crisis situations.

Systems and controls for managing operational risks

The Bank is constantly developing tools for identifying, monitoring and managing risks that can affect the Bank on a daily basis.

The Finance Department has coordinating as well as overall responsibility for operational risks.

Liquidity risks

Definition

Liquidity risk is defined as the value at risk resulting from the Bank's being unable to honour its payment obligations using its normal liquidity reserves.

Objectives and policies for managing liquidity risks

The Bank's target is to have liquidity coverage of at least 50 percent measured in relation to the statutory requirements in order to satisfy the Supervisory Diamond's requirements for surplus liquidity, and that there is sufficient liquidity to cover the day-to-day fluctuations in liquidity needs.

The overall aim of the Bank's liquidity management policy is to:

- monitor and manage developments in the Bank's short-term and long-term liquidity, and

- ensure that the Bank holds sufficient liquidity at all times in both Danish and foreign currency.

The Bank's general liquidity policy is to maintain a sound and thoroughly diversified funding base distributed amongst different funding sources (including geographically), the use of different funding structures and also an even distribution of loan duration.

In order to ensure flexible and effective access to the international credit and capital markets, the Bank makes use of various types of loans, including bonds, syndicated loans, bilateral agreements and revolving credit facilities. For that the Bank utilises several different intermediaries and counterparties so that in this area, too, there is a high degree of independence and diversification, thereby ensuring that the Bank has significant flexibility in choosing terms to maturity, foreign currencies, interest rates (fixed/variable) and, to some extent, also geographical markets. This means that the Bank is in a position to match its on-going financing to the prevailing market rates.

In order to create a solid platform for the future in the merged bank, the focus is sharpened on the relationship between deposits and lending. In the future, the Bank will therefore be placing greater emphasis on increasing deposits in relation to lending.

vestjyskBANK has published a capital plan, cf. the Bank's company announcement of 25 January 2012 (see below).

Structure of the Bank's liquidity risk management

The Supervisory Board determines the size of the desired risk profile and adopts liquidity goals through its liquidity policy and adopted cash resources plan. The Executive Board is responsible for complying with the targets/framework as set out in the mandate granted to the Executive Board.

The Bank's immediate cash resources are calculated in accordance with the guidelines in section 152 of the Danish Financial Business Act. The general liquidity risk is calculated on the basis of budgets, historical and statistical material and known future deposits to and withdrawals from business transactions already entered into.

The Bank continuously monitors all significant sources of funding, including their terms to maturity, counterparty distribution, geographical location etc. The Bank generally emphasises sound diversification, with a special focus on customer deposits.

Risk reporting and measurement of liquidity risks

The Bank assesses its future liquidity requirements on a continuous basis and submits monthly reports to the Supervisory Board. Among other things, the model ensures that the Bank is sufficiently liquid in relation to its risk profile, strategy and earnings forecast.

The Bank's liquidity management is based on legislation and also the instructions of the Executive Board. These control parameters have all been calculated and included in the Bank's report and are reported on a daily basis to the Executive Board and executive employees and also in monthly reports to the Supervisory Board.

Systems and controls for managing liquidity risks

The Bank employs the liquidity forecasting and stress testing model approved by the Association of Local Banks, Savings Banks and Cooperative Banks in Denmark (Lokale Pengeinstitutter).

Business risks

Definition

Business risk is defined as the value at risk due to changes in external circumstances or events that damage the Bank's reputation or earnings.

Objectives and policies for managing business risks

The Bank focuses constantly on the building and maintenance of strong relationships with all its stakeholders – shareholders, customers, suppliers, employees and, in consequence, with the local communities in the areas in which the Bank operates. This is regarded as the basis for continued growth and development opportunities.

This is reflected in the Bank's mission and vision which strive to ensure that all rather than individual interests are advanced. The Bank's set of underlying values is incorporated into all parts of the organisation as a natural part of the way in which vestjyskBANK operates its business.

In order to ensure that employees' competencies at all times correspond to the demands made on a business of vestjyskBANK's size, it is the Bank's policy that employees are trained on an on-going basis.

The structure of the Bank's business risk management

The Bank has an established procedure for approving new products, which ensures that the Bank does not offer products that have not been pre-approved.

In order to ensure that customers are offered the best product range possible, and in order to ensure that the Bank is supported optimally, the Bank cooperates with a well-established network of competent cooperation partners. Here, the Bank is ensured strong representation in various partnership forums which provide vestjyskBANK with a great deal of influence.

The Bank strives to ensure that dependence on these cooperation partners is minimised at all times.

Systems and controls for managing business risks

The compliance function ensures that procedures are drawn up within the central areas of financial legislation. These procedures thus apply to good practice, investor protection, money laundering, handling of personal data, trading in securities by employees, customer complaints etc.

Capital base risk

Definition

Capital base risk is defined as the value at risk as a result of the Bank's not having sufficient capital to honour the solvency requirement and the solvency need, if the latter is greater.

Objectives and policies for managing capital base risk

Management establishes a solvency target, which is included in the capital management.

The structure of the Bank's capital base risk management

The Supervisory Board determines the solvency target and the criteria for the calculation of the solvency need. The Executive Board is responsible for ensuring that the targets/guidelines are adhered to.

The Bank's capital base is calculated in accordance with the Executive Order on Calculation of Capital Base in the same way as the financial resources plan.

The Bank's Finance and Treasury Departments continuously monitor the capital base and the structure thereof.

Risk reporting and risk measurement of the capital base risk

Reports relating to the Bank's solvency are submitted to the Executive Board on an ad hoc basis and to the Supervisory Board on a monthly basis.

Area of application

vestjyskBANK has no subsidiaries and therefore does not produce any consolidated accounts.

Capital base

The table below shows the Bank's capital base at 31 December 2011.

Statement of capital base

	TDKK
1. Actual core capital	1,674,497
Share capital	125,000
Retained profit or loss	1,549,497
2. Primary deductions from actual core capital	410,411
Intangible assets	107,065
Deferred capitalised tax assets	303,346
3. Actual core capital after primary deductions	1,264,086
4. Hybrid core capital	1,175,344
5. Core capital including hybrid core capital after primary deductions	2,439,430
6. Other deductions from the core capital	97,491
Accumulated value adjustments of hedging instruments in hedging cash flows	11,814
Half of the total of equity interests etc. > 10 percent	85,677
7. Core capital including hybrid core capital less deductions	2,341,939
8. Tier 2 capital	938,190
Subordinated loan capital	515,898
Revaluation reserves	30,848
Hybrid core capital	391,444
9. Included tier 2 capital	938,190
10. Capital base before deductions	3,280,129
11. Deductions from capital base	85,677
Half of the total of equity interests etc. > 10 percent	85,677
12. Capital base after deductions	3,194,452

Solvency requirement and capital adequacy

In accordance with legislation, the Supervisory Board and the Executive Board must ascertain vestjyskBANK's individual solvency need. A description of the model, process and method used is given in the section "Further explanation of the methods used for calculating the adequate capital base and the solvency need".

The solvency requirement is calculated according to the criteria below since vestjyskBANK is covered by section 124(2)(1) of the Danish Financial Business Act.

Standardised approach for measuring credit risk

vestjyskBANK uses the standardised credit risk approach for measuring risk-weighted items and is required to state 8 percent of the risk-weighted exposures for each of the categories listed in section 9 of the Executive Order.

Internal rating-based approach

vestjyskBANK currently has no plans to use an internal approach for calculating credit risk.

Eight percent of risk-weighted items with market risk

The table below shows the Bank's solvency requirement for market risks.

Solvency requirement for market risks

TDKK	Risk-weighted items	Capital requirement (8% of exposure)
Debt securities	905,336	72,427
Equity securities	85,758	6,861
Collective investment schemes	2,760	221
Foreign currency risk	35,812	2,865
Total weighted items	1,029,666	82,374

Solvency requirement for operational risk

vestjyskBANK uses the basic indicator approach for calculating the solvency requirement for operational risk.

Individual solvency need and individual solvency requirement

Further explanation of the methods used for calculating the adequate capital base and the solvency need

The Supervisory Board of vestjyskBANK holds discussions to determine the solvency need at least once every quarter. These discussions take as their starting point a proposal from the Executive Board which includes a proposal in respect of the size of the solvency need, including proposals for the choice of stress variables, stress levels, any risk areas and expected growth. On the basis of these discussions, the Supervisory Board makes a decision on the calculation of the Bank's solvency need, which must be sufficient to cover vestjyskBANK's risks, cf. section 124 (1) and (4) of the Danish Financial Business Act.

Furthermore, once a year, the Supervisory Board discusses at length the method for calculating vestjyskBANK's solvency need, including which risk areas and stress levels ought to be taken into account when calculating the solvency need.

The Management of vestjyskBANK has decided that the calculation of the Bank's solvency need should be based on a template drawn up by the Association of Local Banks, Savings Banks and Cooperative Banks in Denmark and on the Danish Financial Supervisory Authority's "Guidelines on Adequate Capital Base and the Solvency Need of Credit Institutions". It is the view of Management that vestjyskBANK, by taking this model and guidelines from the Danish Financial Supervisory Authority as its basis, is able to calculate a solvency need sufficient to cover the Bank's risks.

Under the method vestjyskBANK uses to calculate the solvency need, capital is allocated to four risk areas (credit risk, market risk, operational risk and other risks).

The first part of the model contains a number of stress tests. In these stress tests, the individual accounting/budget items are placed under "stress" using a number of variables. As a rule, the most recently presented financial report – the Annual Report or the Quarterly Report – is used as a basis.

On the basis of the Bank's specific situation as well as the requirements set out in the Executive Order on Capital Adequacy and "Guidelines on Adequate Capital Base and the Solvency Need of Credit Institutions" it is ascertained which risks vestjyskBANK should be able to withstand and consequently which variables and stress levels should be tested. Stress tests are basically an attempt to expose vestjyskBANK's accounting figures to a number of negative events in order to see how the Bank reacts in the given scenario.

Stress test used for determining solvency need

Capital for covering credit risks	Impairment of loans etc.: Customers with financial difficulties, and where the commitment exceeds 1% of the capital base, have been individually assessed. Other loans, guarantees and unused credit commitments: 3.69% Unused credit commitments have been included in the calculation with 10, 20 or 50% depending on the term of notice.
Capital for covering market risks	Fall in share price: 30%, but only 15% for shares in sector companies. Already deducted amounts in the capital base are deducted. Interest rate increase: 1.35% of the trading portfolio and 2.0% outside the trading portfolio. Interest structure risk is stressed by 0.7% in each direction. Foreign currency risk: For Euro: Exchange Rate Indicator 1 * 2.25% Other currencies: Exchange Rate Indicator 1 * 12%
Capital for covering other risks	Risk on derivative financial instruments: 8% of the positive market value
	General decrease in net interest income: 12% General decrease in net fee income: 17% Own properties: 18%

When calculating vestjyskBANK's solvency need, the point of departure is an economic depression scenario which, among other things, is reflected in the chosen stress levels, cf. the table above.

The results from the completed stress tests are included in the solvency need model, by the Bank holding a capital that would at least cover the result that would be obtained if the scenario in question were to occur. The combined effect of the stress tests on the solvency need is calculated by comparing the financial results with the overall effect on the weighted items. This produces a target for how much capital is required for the Bank to be able to survive the proposed scenario.

In addition to the risk areas addressed via stress tests, there are also a large number of risk areas which vestjyskBANK has found useful to take into account when assessing the solvency need.

Other risk areas that have been considered in relation to establishing the solvency need

Additional capital for covering credit risks	Including: Customers with financial problems Major commitments Commercial concentration Geographical concentration Concentration of securities
Additional capital for covering market risks	
Capital for covering operational risks	
Capital for covering other risks	Including: Strategic risks Reputation risks Risks in relation to the size of the financial institution Property risks Group risks Funding Liquidity risks Settlement risks Other conditions

Determination of the influence of these areas on the solvency need ratio is either calculated directly by means of supplementary calculations or by Management having assessed the capital needs relating to these risk areas.

The risk factors included in the model are, in vestjyskBANK's view, applicable to all risk areas which the law requires that the Bank's Management should consider when determining the solvency need and the risks that Management finds the Bank has taken on.

In addition, the Supervisory Board and the Executive Board must consider whether the capital base is sufficient to support future activities. At vestjyskBANK, this assessment forms part of the general process of ascertaining the solvency need. Management therefore undertakes on-going assessments of how anticipated growth will affect the determination of the solvency need.

Adequate capital base and solvency need

vestjyskBANK's solvency need distributed by risk areas

	Adequate capital base MDKK	Solvency need (as a percentage)
Credit risks	2,222	8.7%
Market risks	390	1.5%
Operational risks	181	0.7%
Other risks	-44	-0.2%
Adequate capital base/solvency need	2,749	10.7%

vestjyskBANK's surplus/capital situation

	MDKK
Capital base after deductions	3,194
Adequate capital base	2,749
	Percentage
Solvency	12.4
Solvency need	10.7
Surplus solvency	1.7

Solvency need

vestjyskBANK has reported its individual solvency need as being 10.7 percent.

Note on specifications for measurements set out under "Adequate capital base and solvency need"

Solvency need and surplus solvency

vestjyskBANK has calculated its surplus solvency as 1.7 percentage points on the basis of a solvency need of 10.7 percent and an actual solvency ratio of 12.4. The surplus solvency is regarded as being weak, but in light of the published capital plan, cf. company announcement of 25 January 2012, the surplus solvency is regarded as satisfactory.

Credit risk

The credit risk is the Bank's largest risk area which is why the bulk of the solvency need can be attributed to this. Therefore, vestjyskBANK focuses intensely on this risk area in particular. The bulk of the allocated capital coming under the area of credit risks can be attributed to the stress test conducted.

Market risk

The capital allocated to market risks can primarily be attributed to the interest rate risk on the Bank's fixed interest rate assets and liabilities, equity risk and foreign currency risk. The market risk is calculated primarily via the stress test.

Operational risk

Under this category, capital has been allocated to cover the value at risk derived from internal and external circumstances caused by insufficient or defective internal procedures, human or system errors as well as external influences, including legal risks.

Other risks

Other risks are included in the solvency need stress test as a deduction. This is due to the fact that, even under the most stringent stress test, the Bank will accrue considerable earnings from its business operations. This consolidation is included in the solvency need model as a deduction. In addition, "Other risks" includes allocated capital for a decrease in price for owner-occupied property.

Reference should also be made to the description of the applied solvency need model in the section "Further explanation of the methods used for calculating the adequate capital base and the solvency need" for a more detailed description of which risks are attributed to the various categories.

Disclosure relating to adequate capital base and solvency need is determined on the basis of legal requirements

The adequate capital base and solvency need are not determined on the basis of legal requirements.

Capital base after deductions and solvency ratio

The capital base stands at DKK 3,194 million, and the solvency ratio stands at 12.4 percent. The specification is outlined in the section "Capital base".

Extension of adequate capital base and solvency need resulting from legally stipulated requirements

There has been no extension as a result of legally stipulated requirements.

Counterparty risk

vestjyskBANK's policy is to manage tightly any and all counterparty risks while entering into the transactions necessary to maintain a sound operating environment.

vestjyskBANK uses the market value method for counterparty risk to calculate the exposures' size and risk weighting for derivative financial instruments. The market value method is described in the following.

In the market value method, the market value of contracts with a positive market value and principal amounts of all contracts are included in the capital adequacy statement. The market value of the contracts is included with the weighting of the relevant contracts' remaining maturities and with the weighting for the relevant counterparties.

In vestjyskBANK's authorisation process and in the general monitoring of commitments, the calculated exposure value is taken into account, thus ensuring that this does not exceed the authorised credit limit for the counterparty.

Positive gross current value

The positive gross current value of financial contracts after netting, cf. Annex 17 of the Executive Order on Capital Adequacy, is TDKK 526,519. The value of the Bank's total counterparty risk, calculated in accordance with the market value method for counterparty risk, cf. Annex 16, points 9-16 of the Executive Order on Capital Adequacy is TDKK 349,045.

Risk coverage by means of credit derivatives

vestjyskBANK does not use credit derivatives to cover the part of the credit risk that relates to counterparties. Therefore the Bank does not carry out any transactions in the area.

Credit risk and risk of dilution

For the purpose of assessing vestjyskBANK's credit risk, an account is given below of the various ways in which the Bank calculates the distribution of its exposures, and how the Bank deals with defaulted and impaired accounts receivable. It also describes the movements in impairments/provisions in 2010, as well as the distribution of impairment/provisions amongst industries.

Guidelines for adjusting the value of loans

The Bank ascertains the value of defaulted accounts receivable and impaired accounts receivable in accordance with the rules in sections 50-55 of the Executive Order on Financial Reporting for Credit Institutions and Investment Companies, etc.

Exposure after impairment

The Bank's total exposure after impairment amounts to TDKK 36,200,701.

Geographic distribution of exposures

Since the Bank has more than 95 percent of its exposures in Denmark, the Bank is permitted, under Annex 20, sec 12(d) of the Executive order on capital adequacy, to omit listing exposures by geography, and therefore no further geographic division has been performed.

Distribution of exposures by term to maturity

Items recognised in the Bank's Statement of Financial Position by term to maturity	On demand	0-3 months	3 months-1 year	1-5 years	More than 5 years
TDKK					
Exposures to central government or central banks	570,609	249,990	0	0	0
Exposures to regional or local government authorities	32,055	3	2,605	9,970	1,343
Exposures to public entities	1,328	0	0	0	0
Exposures to multilateral development banks	0	0	0	0	0
Exposures to international organisations	0	0	0	0	0
Exposures to institutes	633,416	200,262	8,127	82,908	0
Exposures to business enterprises etc.	7,241,722	295,762	1,326,911	2,660,614	1,757,049
Exposures to retail customers	2,683,880	268,840	836,562	2,478,380	1,259,438
Exposures secured with mortgages in real property	389,282	61,592	152,576	298,905	191,101
Exposures which are in arrears or overdrawn	199	0	11,844	60,388	7,135
Covered debt securities	0	0	0	0	0
Exposures to business enterprises etc. with short-term credit reviews	0	0	0	0	0
Exposures to collective investment plans	0	0	0	0	0
Exposures under other items, including assets without counterparties	897,276	0	0	0	0

Distribution of exposures by industry segment

1.000 kr.	Exposures to central government or central banks	Exposures to regional or local government authorities	Exposures to public entities	Exposures to multilateral development banks	Exposures to international organisations	Exposures to institutes	Exposures to business enterprises etc.	Exposures to retail customers	Exposures secured with mortgages in real property	Exposures which are in arrears or overdrawn	Covered debt securities	Exposures to business enterprises etc. with short-term credit reviews	Exposures to collective investment plans	Exposures to other items, including assets without counterparties
Public authorities	0	28,169	0	0	0	0	225,890	403,838	55,170	0	0	0	0	0
Agriculture, hunting, forestry and fishery	0	0	0	0	0	0	3,927,547	1,585,054	170,120	21,052	0	0	0	0
Manufacturing industry, raw material extraction, public service utilities	0	30,000	0	0	0	0	4,150,175	578,288	111,078	2,012	0	0	0	0
Construction and civil engineering contractors	0	0	0	0	0	0	628,508	563,598	112,206	1,252	0	0	0	0
Trade, restaurant and hotel businesses	0	0	0	0	0	0	1,814,549	1,221,007	368,489	0	0	0	0	0
Transport, mail and telecommunications	0	15,000	0	0	0	0	298,065	158,837	19,822	852	0	0	0	0
Credit and financing companies and insurance companies	820,599	0	0	0	0	1,558,343	555,656	173,359	37,114	12,586	0	0	0	85,270
Property administration and real estate, business services	0	0	0	0	0	0	4,137,638	1,210,293	635,908	20,334	0	0	0	0
Other industry segments	0	10,000	0	0	0	0	791,067	362,105	56,345	1,049	0	0	0	0
Retail	0	0	0	0	0	0	653,916	6,851,745	625,771	40,706	0	0	0	812,006
Industry category not available or unknown	0	0	0	0	0	0	258,290	23	0	0	0	0	0	0

The distribution by industry segment does not conform with the Danish Financial Supervisory Authority's newest model for grouping industry segments, as the Bank lacks the requisite system-level support.

Average value of exposures over the course of the period

Statement of risk-weighted items:

TDKK	**31/12/2011**	**Average for the year**
The Bank's total risk-weighted exposures calculated by applying the standardised approach:		
Exposures to central governments or central banks	0	0
Exposures to regional or local authorities	0	0
Exposures to public entities	266	143
Exposures to multilateral development banks	0	0
Exposures to international organisations	0	0
Exposures to institutes	502,865	544,670
Exposures to business enterprises etc.	14,554,992	14,731,559
Exposures to retail customers	6,372,652	6,567,750
Exposures secured with mortgages in real estate	924,917	942,230
Exposures which are in arrears or overdrawn	139,431	744,176
Covered debt securities	0	0
Exposures to business enterprises etc. with short-term credit reviews	0	0
Exposures to collective investment plans	0	0
Exposures under other items, including assets without counterparties	376,894	390,202
Weighted items with credit risk, total	22,872,017	23,920,729

Distribution of defaulted and impaired accounts receivable by industry segment

Impaired loans and guarantees, with subdivision into defaulted accounts receivable and accounts receivable that are impaired, impairment/provisions and also expenses relating to value adjustments and impairments, treated both individually and as a group, are divided among the following industries:

TDKK	Loans and guarantees on which there has been impairment/provisions		Impairment/ provisions at end of 2011	Effect on operations re. value adjustments and impairment during 2011
	Defaulted	Impaired		
Public authorities	0	0	0	0
Agriculture, hunting, forestry and fisheries	140,929	2,895,762	656,415	-497,390
Industry and raw material extraction	86,222	650,983	89,241	-34,411
Energy supply	49,446	256,993	10,298	-8,972
Building and construction	105,467	594,239	124,359	-38,454
Trade	62,772	601,061	90,117	-19,392
Transportation, hotels and restaurants	80,918	464,025	67,115	-17,422
Information and communications	7,135	10,998	8,204	-1,353
Financing and insurance	404,480	1,415,254	500,443	-223,180
Real property	222,150	3,508,310	354,197	-117,780
Other business	107,082	733,748	92,322	23,152
Business, total	1,266,601	11,131,373	1,992,711	-935,202
Retail	182,441	2,250,189	217,205	-49,667
Total	1,449,042	13,381,562	2,209,916	-984,869

The effect on operations with regard to value adjustment of impairment during the year is calculated as: Impairment/provisions at the end of 2010 less Impairment/provisions at the end of 2011 less Final loss (written off) in 2011 plus Entered into previously written off accounts receivable.

Geographic distribution of defaulted and impaired accounts receivable

Since the Bank has more than 95 percent of its exposures in Denmark, the Bank is permitted, under Annex 20, sec 12(h) of the Executive order on capital adequacy, to omit listing exposures by geography, and therefore no further geographic division has been performed.

Movements in impaired accounts receivable

In 2011, the Bank had the following movements in value adjustment and impairments:

TDKK	Individual impairments/provisions		Impairments in groups
	Loans	Guarantee debtors and unused credit commitments	Loans
Cumulative impairment/provisions at the beginning of the year	1,416,918	10,710	69,912
Movements over the year:			
1. Exchange rate adjustment	0	0	0
2. Impairments/provisions over the year	1,139,347	31,882	15,910
3. Reversal of impairment/provisions made during previous financial years, where there is no longer any objective indication of impairment, or the impairment has been reduced	208,282	6,549	37,153
4. Other movements	19,258	0	2,635
5. Value adjustment of acquired assets	0	0	0
6. Final loss (written off) of previously individually impaired/allocated	245,752	0	0
Accumulated impairment/provisions at end of year	2,121,489	36,043	51,304
Total loans and guarantees, on which there has/have been impairment/provisions (calculated before impairment/provisions made)	4,870,947	266,485	9,693,172
Loss not previously individually impaired/allocated	54,456	0	0
Entered into on previously written off accounts receivable	5,410	0	0

Credit rating agencies

This part of the reporting is not relevant to vestjyskBANK.

Disclosure relating to calculating credit risk using the IRB method

This part of the reporting is not relevant to vestjyskBANK.

Market risk

The Executive Order on Capital Adequacy contains a requirement to the effect that the Bank must provide disclosure relating to the solvency requirements for a number of risks stated under the market risk area. The following table shows a statement of the solvency requirements for the risks in question.

Statement of solvency requirements in the market risk area

TDKK	Risk-weighted items	Capital requirement 8%
Items with position risk:		
Debt securities	905,336	72,427
Equity securities, etc. (incl. collective investment schemes)	88,518	7,081
Total foreign currency position	35,812	2,865

Disclosure relating to internal models (VaR models)

vestjyskBANK does not use internal models (VaR models) to calculate the risk on positions in its trading portfolio.

Operational risk

vestjyskBANK uses the basic indicator approach, cf. Annex 18 of the Executive Order on Capital Adequacy for calculating the capital requirement for operational risks. This means that the capital requirement is calculated as 15 percent of the average core income for the previous three years. The core income is the total of the net interest income and non-interest-related net income.

vestjyskBANK also continuously assesses the capital requirement for its operational risks. If the requirement is considered to be greater than what is stated above, this will be taken into account when the Bank calculates the solvency need.

Exposures in the form of shares etc. not included in the trading portfolio

vestjyskBANK, in collaboration with other banks, has acquired shares in a number of sector companies. The aim of these companies is to support the banks' mortgage credit transactions, payment services, IT, unit trusts, etc. vestjyskBANK has no plans to sell these shares, since participation in these sector companies is considered necessary for operating a local bank. The shares are therefore not considered part of the trading portfolio. vestjyskBANK has published a capital plan, comprising divestiture of sector shares cf. the Bank's company announcement of 25 January 2012 (see below).

In many of the sector companies, the shares are redistributed so that the banks' share of the participation at all times reflects the individual banks' business volumes with the sector companies. Redistribution is typically done on the basis of the sector company's equity value. On the basis of this, vestjyskBANK regulates the book value of these shares quarterly, half-yearly or yearly – depending on the frequency of new information received from the individual sector companies. This continuous regulation is entered in the income statement in accordance with the rules.

In other sector companies the shares are not redistributed, but are instead usually valued on the basis of the last known trade, or the value is calculated using a recognised valuation method. Adjustments to the booked values of the shares in these companies are also entered in the income statement.

Positions in listed shares, unlisted share positions and other exposures

	TDKK
Beginning of 2011	486,409
Additions	11,118
Outflow	505
Unrealised profit	-825
End of 2011	496,197

Realised and non-realised profit or loss 2011

	TDKK
Realised profit or loss resulting from sales and liquidation	207
Non-realised profit or loss, latent profit and loss	-825

Non-realised profit or loss is included in the Bank's core capital and the supplementary capital.

Exposures for interest rate risk in positions outside the trading portfolio

vestjyskBANK's exposures to interest rate risk in positions outside its trading portfolio are primarily in the form of fixed-interest loans, mortgages, deposits and subordinated debt.

The Bank's policy is to apply the rules set out in Executive Order on Accounting Principles to the interest rate risk pertaining to positions not included in the trading portfolio. This allows the Bank to hedge fixed-rate assets (loans and mortgages) and fixed-rate liabilities (funding) using swaps and other derivatives, so that any interest rate risk is hedged optimally. The Bank complies with the accounting rules for measurement of effective hedging; there is therefore constant focus on maintaining an interest rate risk and value adjustment that remain neutral.

Hedging for fixed-rate loans and mortgages occurs at portfolio level and is checked monthly. Effective hedging is ensured by means of a requirement for interest rate matching within defined terms and term bands. The hedged portfolio is rebalanced and adjusted quarterly.

Hedging fixed-rate liabilities such as subordinated debt is done on a one-to-one basis, so that there is zero net interest rate exposure on these positions.

At 31 December 2011, vestjyskBANK had a total interest rate risk exposure not included in the trading portfolio of DKK -155 million.

Disclosure relating to securitisations

vestjyskBANK does not use securitisations.

Disclosure relating to calculating credit risk in IRB institutions

vestjyskBANK does not use the internal ratings based approach for calculating credit risk, cf. section 19 of the Executive Order on Capital Adequacy.

Disclosure relating to methods for reducing credit risk

vestjyskBANK uses the standard method for reducing credit risk for the 2011 financial year.

Disclosure relating to advanced measuring method for calculating operational risk

vestjyskBANK does not use the advanced measuring method for calculating operational risk. Instead, it uses the basic indicator method.

Capital plan, cf. company announcement of 25 January 2012

In its company announcement of 25 January 2012, vestjyskBANK and Aarhus Lokalbank announced that the two banks were planning a merger and implementation of a capital plan that will strengthen the Bank's business platform as well as ensure the long-term funding and capital structure. The announced capital plan comprises (1) a voluntary conversion of a Danish capital injection of approximately DKK 297 million, (2) a rights issue of between DKK 250 and 300 million, (3) raising of subordinated loans in the amount of DKK 200 million, as well as (4) divestiture of sector shares in the amount of DKK 175 million. It is part of the capital plan that the continuing bank is assumed to receive new individual government guarantees with maturities of up to three years, which in the long term might be able to replace the banks' existing individual government guarantees with maturities in 2012 and 2013.

One of the purposes of the capital plan is to address vestjyskBANK's funding challenge and form an improved basis for a future successive repayment of the government guaranteed loans with the objective that the Bank will no longer need government guarantees after 2016. Together with greater earning power, this improved funding situation will improve the merged Bank's capacity to weather the financial crisis.

The execution of the capital plan is predicated upon a number of formal and factual conditions, including conditions outside the control of vestjyskBANK. There is therefore an element of uncertainty as to whether the capital plan will be executed. Among other things, the Bank must (1) obtain new individual government guarantees, (2) raise the new subordinated loan capital of DKK 200 million, and (3) divest industry sector shares for DKK 175 million to Danmarks Nationalbank for the merger to occur as planned, and it is a condition that all the capital plan's components, including the execution of a rights issue with proceeds in the range DKK 250–300 million, be executed. In addition to this general condition, the merger and the capital plan's components are, among other things, subject to the following conditions:

- The merger can solely be executed, if the participating companies enter into a final merger plan, which will subsequently need to be approved by both parties' annual general meetings, and approval is obtained from the relevant government agencies.
- The issue can solely be executed with the planned proceeds, if the Annual General Meeting approves the required capital increase, and the company obtains issue commitments and deposits in an amount corresponding to proceeds of DKK 250 million. The capital expansion is not guaranteed, and at the present time, there is no guarantee that vestjyskBANK will be able to raise the minimum proceeds of DKK 250 million assumed in the capital plan.
- Obtaining new individual government guarantees is, among other things, conditional upon the provision of the requisite authority, that the relevant government agencies grant their approval, and that a number of other terms and conditions are met and complied with in the commitment of new individual government guarantees.
- The execution of the divestiture of industry sector shares is subject to governing body approval of the divestiture by the industry sector companies in question.

Market conditions or developments in the activities of Vestjysk Bank A/S or Aarhus Lokalbank Aktieselskabs may generally cause the execution of the merger or one or more of the capital plan's components no longer to be sound, or that it can no longer be executed in practice, resulting in the inability to execute other components of the capital plan.

On 20 February 2012 the Bank executed the voluntary conversion of a government capital injection, cf. company announcement of 20 February 2012.


Thisted
Thyborøn
Lemvig
Struer
Holstebro
Randers
Viborg
Århus
Ringkøbing
Ikast
Herning
Silkeborg
Hvide Sande
Lem
Videbæk
Horsens
Skjern
Esbjerg
Kolding
Odense