DANISH SHIP FINANCE 2021

› Risk Report

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SCOPE

This Risk Report is presented for the Danish Ship Finance Group (referred to as the Group) on a consolidated basis and for the subsidiary Danish Ship Finance A/S (referred to as DSF) on a standalone basis. The pronouns "we" and "our" are used to refer to DSF and the Group where the specific entity is not important.

All economic activity in the Group is carried out by DSF. The Group comprises DSF and the holding company, Danish Ship Finance Holding A/S (DSH). DSH has no business activity apart from its majority ownership of DSF.

This report describes the various risks to which the Group and DSF are exposed and the associated risk capital requirements. This report also details the composition of the capital base and the material risk and capital management methodologies employed by the Group.

Further information about risks and risk management can be found in the DSF Annual Report.

Reporting pursuant to statutory disclosure requirements is conducted annually in conjunction with the presentation of financial statements. A regulatory capital adequacy assessment is published quarterly.

As there is no audit requirement, the Risk Report 2021 is presented in unaudited form.

Additional Pillar 3 disclosures required under Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 (CRR) and the Danish Executive Order on Calculation of Risk Exposure, Own Funds and Solvency Need can be downloaded from:

→ **www.shipfinance.dk**

Legal framework

DSF is governed by its own dedicated legislation in the form of the Act on a Ship Finance Institute (the Act) and the Executive Order on a Ship Finance Institute (the Executive Order).

DSF is also governed by:

- The Executive Order on the Issue of Bonds, the balance principle and Risk Management (the Bond Executive Order)
- The Executive Order on Calculation of Risk Exposures, Own Funds and Solvency Need
- The Executive Order on Governance for Credit Institutions (the Executive Order on Governance)
- The Executive Order on Financial Reports for Credit Institutions and Investment Firms, etc. (the Executive Order on Financial Reports)

Pursuant to the Act and the Executive Order, the Group is governed by parts of the Danish Financial Business Act and the Regulation on prudential requirements for credit institutions and investment firms (CRR) via the Executive Order.

THE YEAR IN SUMMARY

The revised European Capital Requirements Directive and Regulation (often referred to as CRD V and CRR II) was adopted in May 2019 by the European Council and the European Parliament and published in the Official Journal of the European Union in June 2019.

The implemented changes in CRD V and CRR II include reporting under a revised market risk framework, a new standard approach for counterparty credit risk (SA-CCR), a revised large exposure framework, a revised leverage ratio requirement, a revised net stable funding ratio requirement, and revised disclosure requirements.

On 27 October 2021, the European Commission presented a first draft of CRR III, which will incorporate Basel IV into European legislation. The changes to the CRR will include revised standard approaches for credit risk, operational risk and market risk, and a revised counterparty valuation adjustment (CVA) framework. We do not expect new output floors for IRB models, implemented with CRR III, to impact capital calculations under the standard approach.

New European Union legislation on minimum loss coverage for non-performing loans (the NPL backstop) in the calculation of solvency became effective on 26 April 2021. We are in active dialogue with the Danish authorities regarding the specific mechanisms, ensuring appropriate capital calculation with respect to the collateral value of ship mortgages (as for real estate) across capital adequacy methodologies.

Development in key risk figures for DSF

DKK MILLION / %	2021	2020
Capital		
Own funds (less deductions)	9,131	9,156
Total risk exposure amount	45,477	41,042
Internal capital adequacy requirement, incl. buffers	11.6%	12.0%
Total capital ratio	20.1%	22.3%
Excess coverage	8.4%	10.3%
Leverage ratio	14.1%	13.8%
Funding and liquidity		
Liquidity coverage ratio (LCR)	449%	572%
Net stable funding (NSFR)	165%	165%
Issuer rating – S&P	BBB+ (Stable)	BBB+ (Stable)
Covered bond rating – S&P	A (Stable)	A (Stable)
Asset quality		
Annual loan impairment ratio	(0.1%)	0.3%
Accumulated loan impairment charges as % of loan book (year-end)	2.6%	3.9%
Net NPL ratio	3.0%	4.2%

DANISH SHIP FINANCE

RISK AND CAPITAL PROFILE

DSF is a leading provider of ship financing internationally and domestically and is among the 20 largest lenders to the shipping industry globally.

Financing to shipowners is only provided against first lien mortgages on vessels. Our lending to shipowners is in line with market practice, and mostly denominated in USD, and to a lesser extent in other currencies.

We fund our lending activity through the issuance of DKK-denominated ship mortgage bonds from the Capital Centre Institute in General and, since 2019, EUR-denominated CRR-compliant covered bonds (SDO) from the Capital Centre A. Although EUR bonds remain a smaller share of our overall funding compared to DKK bonds, we strive to ensure similar risk profiles and equally robust operating procedures and controls around Capital Centre A and Capital Centre Institute in General.

Bonds issued out of either capital centre are listed on Nasdaq Copenhagen and have been assigned ratings of "A (Stable)" by Standard & Poor's Global Ratings. Bonds are issued under Danish law.

Our business model naturally incurs foreign exchange mismatches between loans and bonds in different currencies. These mismatches are hedged with financial counterparties, subject to the strict requirements of the Danish specific balance principle.

Risk types

The Group is exposed to credit risk, market risk, liquidity risk, and various types of operational risk:

Credit risk, defined as the risk of losses arising from clients or financial counterparties failing to meet their payment obligations, is the primary risk related to the business model. Credit risk primarily stems from shipowners defaulting on their obligations towards us or, more remotely, defaults by financial counterparties with a credit exposure to the Group.

Market risk is the risk of losses due to factors that affect the overall performance of the financial market. Our exposure to market risk mainly stems from direct and indirect effects of changes in interest rates and USD/DKK, EUR/USD or DKK/NOK exchange rates on our loan book or capital reserves.

Liquidity risk is the risk of not being able to fulfil a payment obligation when due. Liquidity risk primarily arises from a maturity mismatch between the Group's payment obligations in DSF to e.g., bondholders, financial counterparties or lending clients and the amount of liquidity available at any one time. This risk is partly mitigated by a requirement to pre-fund all loans and commitments to clients under the Danish specific balance principle and is further managed subject to strict liquidity limit. Regular stress tests are carried out.

Operational risk is the risk arising from breakdowns in our internal procedures, or failures by people or systems. In this category, we also consider structural risks to our business model and the risk of material damage to our reputation.

RISK GOVERNANCE

We have a two-tier management structure, reflecting statutory requirements for listed Danish companies and the provisions laid down in the Danish Financial Business Act. The Board of Directors lays down overall policies, while the Executive Board is responsible for the day-to-day management of the Group.

The Board of Directors is responsible for ensuring that the Group has an appropriate organisational structure, and that risk policies and limits are established for all important risk categories, including the handling and monitoring of such risks. The Board of Directors has laid down guidelines for the Executive Board, clearly specifying the areas of responsibility and scope of action for management. In addition, new lending above certain limits must be submitted to the Board of Directors for approval.

The Board of Directors has appointed a Chief Risk Officer with responsibility for monitoring and reporting on the risk management processes of the Group. The Chief Risk Officer is a member of the Executive Board. The Executive Board has established a Risk Management function with the purpose of identifying, analysing and monitoring all risks except for credit risk. The Credit department is responsible for monitoring and reporting on credit risk arising from lending activities and financial counterparties.

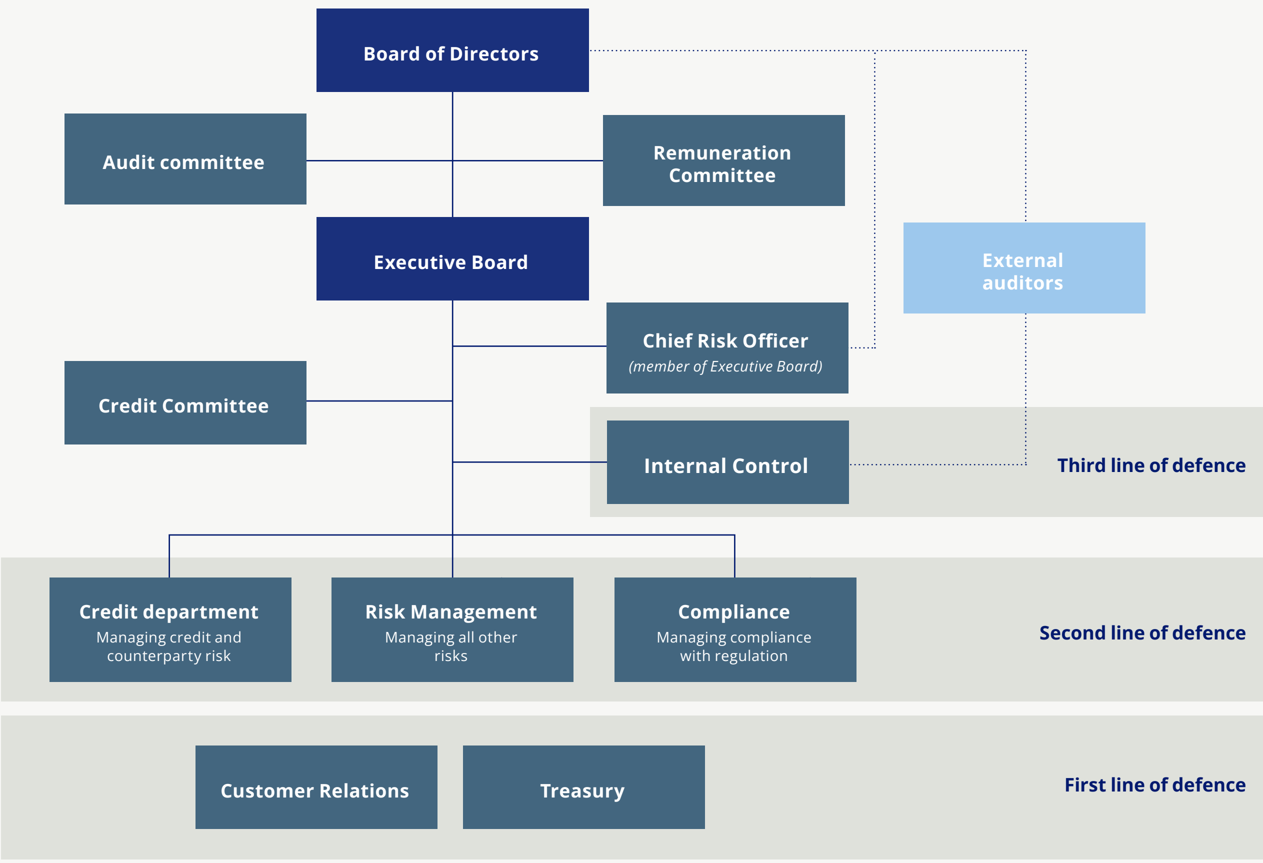
The Head of Compliance is responsible for monitoring compliance with applicable legislation, market standards and internal policies, and for ensuring that the Group applies effective techniques and procedures suitable for identifying and mitigating the risk of non-compliance. The Head of Compliance is also in charge of implementing, and ensuring management focus on, effective measures to prevent money laundering and terrorist financing.

Board committees

The Board of Directors has set up two committees: the Audit Committee and the Remuneration Committee. These committees are responsible for preparatory work and assist the Board of Directors in decision-making.

The Audit Committee is responsible for overseeing accounting and audit matters and for preparing accounting and audit-related topics for consideration by the Board of Directors. The Audit Committee comprises four members of the Board of Directors. The Chairman of the Board of Directors is not a member of the Audit Committee.

Risk governance structure



The Remuneration Committee assists the Board of Directors in preparing the Group's remuneration policy and remuneration proposals. The remuneration policy is adopted at the general meeting. The Chairman of the Board of Directors chairs the Remuneration Committee. The total remuneration of the Board of Directors, the Executive Board and employees whose activities are deemed to have a material impact on the company's risk profile is specified in Annex 9.

Internal audit

The Group is not required to have, and currently does not have, an internal audit function. To promote a robust control environment and support the work of the external auditors, an internal control function is in place. This function reports to the Executive Board.

In accordance with applicable legislation, the Board of Directors, including the Audit Committee, regularly assesses the need for establishing an internal audit function.

Reporting

The Board of Directors is provided with reports on a regular basis to ensure that its members possess the necessary information concerning risk levels and trends. Based on these reports, the Board of Directors assesses the adequacy of the overall policies, framework and principles for risk and capital management.

Overview of risk reports

Report	Frequency	Applicable legislation
Internal management report	Monthly	The Executive Order on Governance for Credit Institutions The Executive Order on Financial Reports
Treasury reporting	Quarterly	The Executive Order on Financial Reports
Stress test	Quarterly	The Executive Order on Governance for Credit Institutions
Credit reporting	Quarterly	The Executive Order on Governance for Credit Institutions
Loan impairment review	Semi-annually	The Executive Order on Governance for Credit Institutions
Compliance reporting	Annually	The Executive Order on Governance for Credit Institutions
Internal solvency, ICAAP	Annually	Guidelines on Adequate Capital Base and Solvency Needs for Credit Institutions
Internal solvency, ILAAP	Annually	Guidelines on Internal Liquidity Adequacy Assessment Process
Recovery plan	Annually	The Danish Financial Business Act
Report from the Chief Risk Officer	Annually	The Executive Order on Governance for Credit Institutions
Statement to be used for risk assessment	Annually	The Executive Order on Governance for Credit Institutions
Annual asset review	Annually	The Executive Order on Governance for Credit Institutions
IT risk assessment	Annually	The Executive Order on Governance for Credit Institutions
Sustainability report	Annually	The Executive Order on Financial Reports

Capital and risk management framework

We have a strong culture of risk awareness and long-term decision making coupled with stringent requirements for day-to-day monitoring and management of risks. We maintain strong capital and liquidity buffers well beyond regulatory minimum requirements. Prudent risk management is pivotal to our activities and shall ensure the long-term viability of our highly specialised business model.

The Board of Directors defines risk policies and principles of risk and capital management. The purpose of the policies is to establish acceptable limits for risks.

Capital management

We shall at all time maintain sufficient own funds for the lending activity in DSF to continue, even in the event of large cyclical fluctuations in the shipping industry and adverse business conditions. Our capital is managed at a level deemed sufficient to underpin the credit rating of the issued bonds.

Credit and counterparty risk

In our credit risk management activities, we distinguish between credit risk relating to lending to clients and credit risk relating to transactions with financial counterparties.

Our efforts are founded on the limits set out in the credit risk and counterparty risk policies. The policies build on the provisions of the company's own Act and the Executive Order, stipulating, among other things, that the Board of Directors must lay down risk diversification rules.

Market risk

Market risk is governed by limits laid down in the Bond Executive Order and the Executive Order. Limits specified in our internal policy further mitigate market risk.

The overall objective is to safeguard our capital adequacy, to make sure that interest rate- and foreign exchange risks are managed either by hedging or through controlled open positions and to achieve an adequate financial return within the risk targets defined.

Liquidity risk

Liquidity risk is prudently managed under the specific balance principle in accordance with the Bond Executive Order. In addition, the liquidity risk policy defines risk limits to ensure adequate liquidity at all times.

Liquidity is managed with the objective of ensuring continued access to funding on adequate terms and to avoid any situation where lack of funding could challenge the business model. Ultimately, the aim of the liquidity management framework is to ensure that we are consistently able to meet our payment obligations even under stressed market conditions.

Operational risk

Operational risk is governed by the operational risk policy issued by the Board of Directors. The policy sets out the overall framework for identifying, evaluating and managing operational risk and is supplemented by operating procedures and internal controls.

On an ongoing basis, we register losses and potential loss events deemed to be attributable to operational risk. The registration is used as a basis for assessing the adequacy of controls, processes, operating procedures, etc. If required, these may from time to time be adjusted to increase the resilience to operational risks.

CAPITAL PROFILE

Key developments

The regulatory solvency ratio for DSF was 20.1% at year-end 2021 (22.3% at year-end 2020), mainly due to a larger loan book.

DSF's internal capital adequacy requirement, including buffers, amounted to 11.6% at year-end 2021 (12.0% at year-end 2020).

The Board of Directors and the Executive Board shall prudently manage capital such that adequate own funds are always maintained.

Adequate own funds are defined as the minimum capital required, in the assessment of the Board of Directors and the Executive Board, to ensure only a remote risk of the Group becoming distressed or insolvent during the following 12-month period such that bondholders could be exposed to a potential loss. Bondholders are subject to further protection under the specific balance principle.

The capital in both DSF holding and DSF is deemed adequate to meet the above-mentioned objective. As at 31 December 2021, the Group's total capital ratio was 17.6%.

AVAILABLE OWN FUNDS

The Group's own funds net of statutory deductions amounted to DKK 8,115 million as at 31 December 2021 (against DKK 7,731 million at year-end 2020). DSF's own funds net of statutory deductions amounted to DKK 9,131 million (against DKK 9,156 million in 2020).

The Group's own funds consist of Common Equity Tier 1 (CET1) capital in the form of share capital and tied-up reserve capital in DSF, retained earnings from previous years, and a subordinated Tier 2 debt instrument in DSH.

The development in available own funds is determined primarily by net profit for the year and the dividend policies of the Group companies DSH and DSF.

Definitions

Own funds

Own funds may be composed of three different types of capital: Common Equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital. Own funds are subordinated to the claims of ordinary creditors in the event of bankruptcy or other forms of financial restructuring.

The ratio of own funds to the total risk exposure amount is referred to as the total capital ratio.

Common equity Tier 1 capital

A firm's Common Equity Tier 1 capital (CET1) is the aggregate of the share capital, other reserves and retained earnings after certain statutory supplements and deductions.

Additional Tier 1 capital

Additional Tier 1 (AT1) capital consists of capital that form part of Tier 1 capital and is senior to shareholders' equity.

Tier 2 capital

Tier 2 capital consists of subordinated debt subject to certain restrictions. Tier 2 capital is senior to AT1.

Calculation of capital ratio

	Group		DSF	
DKK MILLION	**2021**	**2020**	**2021**	**2020**
Own funds less deductions	8,115	7,731	9,131	9,156
Total risk exposure amount	46,050	41,452	45,477	41,042
Total capital ratio	**17.6**	**18.6**	**20.1**	**22.3**

CAPITAL REQUIREMENTS

The internal capital adequacy requirement, including the combined capital buffer requirement, totalled 11.6% for DSF and 11.6% for the Group as at 31 December 2021. Own funds after statutory deductions totalled DKK 9,131 million for DSF and DKK 8,115 million for the Group, resulting in total capital ratios of 20.1% and 17.6%, respectively. This corresponds to excess coverage in the amount of DKK 3,819 million, or 8.4 percentage points, for DSF, and DKK 2,778 million, or 6.0 percentage points, for the Group.

Our capital requirement is calculated based on the 8+ approach and the Danish Financial Supervisory Authority's (FSA) guidelines on Adequate Capital Base and Solvency Needs for Credit Institutions.

Own funds shall at least equal to the sum of the own funds requirements associated with each of the risk types defined as Pillar 1 requirements, Pillar 2 requirements and the combined capital buffer requirement.

Adequate own funds and internal capital adequacy requirement

	Group		DSF	
DKK MILLION	**2021**	**2020**	**2021**	**2020**
Total capital less deductions	**8,115**	**7,731**	**9,131**	**9,156**
Pillar 1 requirements (8% of total risk exposure amount)	3,684	3,316	3.638	3,283
Pillar 2 requirements	455	532	455	532
Capital conservation buffer	1,151	1,036	1,141	1.026
Countercyclical capital buffer	65	66	65	65
Excess capital	2,778	2,781	3.839	4.249
Solvency ratio (%)	17.6	18.6	20.1	22.3
Internal capital adequacy requirement, including combined capital buffer requirement (%)	11.6	11.9	11.6	12.0
Excess capital (%)	6.0	6.6	8.4	10.3

CREDIT RISK MANAGEMENT

Key developments in 2021

In 2021, the credit quality of the loan book strengthened, positively impacted by increased freight rates in several shipping segments and successful work-outs of some legacy non-performing loans. In line with this, the average DSF Rating of the loan book and its collateral coverage improved. Non-performing loans (NPL) were further reduced, resulting in a DKK 39 million reversal of loan impairment charges. The net NPL ratio improved to 3.0% at year-end 2021, down from 4.2% the year before.

Credit risk is the risk of incurring losses because of clients or financial counterparties failing to meet their payment obligations towards us. We are mainly exposed to the credit risk of clients (shipping companies) through loans collateralised by vessels. We are also exposed to the credit risk of financial counterparties (financial institutions) through the high-quality bonds we hold in our portfolio and the financial contracts we have entered into with those counterparties.

Credit risk is managed pursuant to the credit policy approved by the Board of Directors, containing specific guidelines for credit risk appetite, risk-taking and the ongoing risk management carried out in relation to lending activities.

Standard operating procedures are in place, ensuring a consistent approach to credit assessment and credit risk management.

Counterparty risk is managed pursuant to the counterparty risk policy approved by the Board of Directors, containing guidelines for credit risk appetite and risk management carried out in relation to counterparty risk exposure.

GOVERNANCE STRUCTURE

The credit governance structure rests upon the three lines of defence principle, which ensures organisational separation of loan origination, credit risk management and control functions.

The Credit department has day-to-day responsibility for the credit policy, the counterparty risk policy, credit risk monitoring, loan impairment reviews and reporting of credit risk.

CLIENT SELECTION AND DIVERSIFICATION

We strive to maintain a conservative risk profile when structuring and originating loans, focusing on clients' credit quality through the shipping cycle while at the same time ensuring adequate diversification by country and vessel type. Thus, clients' financial standing and robustness, market position, track record in stressed markets, sustainability efforts, and reputation are criteria we consider when assessing loan requests.

In addition, the composition of clients in the loan book (total loans and guarantees) must be adequately diversified. The diversification rule is related to the objective clause in DSF's Articles of Association.

Objective clause

The objective of the company is to provide ship financing in Denmark. In addition, the company may provide ship financing in the international market if such activities do not unnecessarily limit the company's Danish operations.

Credit exposure to any non-Danish client may not exceed 25% of eligible capital in DSF.

Five largest credit exposures

DKK MILLION	2021	2020
Five largest credit exposures	11,467	10,141
Loan book	37,544	33,576

At year-end 2021, the five largest credit exposures were secured by mortgages on 75 vessels split between nine vessel types.

Credit exposure to one client group was substantially larger than the rest and represented approximately 13% of the loan book at year-end 2021. This is the only client where the aggregated exposure exceeds 25% of the eligible capital. This credit exposure is secured by mortgages on 34 vessels split between three different vessel types: Container Liners, Product Tankers and Offshore Units.

LOAN-TO-VALUE

We grant loans with an initial loan-to-value (LTV) of up to 70%, subject to a first priority mortgage on the financed vessels.

We may, under certain conditions, grant loans above the 70% LTV limit against supplementary collateral and/or subject to an additional capital charge. The additional capital charge is maximised to an amount in DKK determined on the date of granting the loan or at disbursement of the loan at the latest.

The additional capital charge is a deduction from Tier 1 capital equal to the part of the loan that exceeds 70% of the value of the mortgaged vessel(s) at the time of calculation, but not exceeding the maximum defined.

We have not granted loans with an initial LTV exceeding 70% for several years.

Loans held in Capital Centre A are subject to a maximum LTV of 60% after including any additional collateral posted for the benefit of the bondholders.

In 2021, we did not grant any loans for the financing of clients' payments of instalments to shipyards.

The loan book after loan impairment charges was on average secured by mortgages within 44% of the market valuation of the financed vessels.

LOAN DOCUMENTATION

The lending activity involve the use of extensive loan and security documentation. The purpose of the loan documentation is to set out the contractual terms of the loan and the rights and obligations of both parties.

If a client defaults on its representations, warranties or undertakings (payment or otherwise) and work-out proceedings fail, the loan documentation provides for legal remedies whereby we can reduce our exposure to the client.

Ultimately, if the client defaults on its payment obligations pursuant to the loan documentation and such default continues, a first priority mortgage on vessels gives us the right to apply for the issue of a warrant of arrest by way of levy of execution against the mortgaged vessel with the local enforcement court.

The execution lien gives us the right to apply for a forced sale of the mortgaged vessel with the enforcement court or in a private sale, if permitted pursuant to the relevant arrest jurisdiction, and apply the auction/sales proceeds against the defaulted loan. Such enforcement action takes time and is costly. Use of this action will vary depending on the choice of arrest jurisdiction. The last time we arrested a vessel was in 2011.

Most of our loan and security documentation uses "one-sided exclusive jurisdiction clauses", which allows us to take up proceedings against the client in any court of competent jurisdiction to ensure that any legal disputes are resolved in an orderly fashion and in a jurisdiction favourable to us.

We also participate in syndicated and club deal loans to shipowners together with other lenders. Standard Loan Market Association documentation is typically applied in adapted form in these transactions.

RISK MITIGATION

In addition to first priority mortgages on the financed vessels and assignment of each vessel's primary insurances, the composition of the loan book adheres to a set of diversification rules. The purpose of the diversification rules is to ensure adequate diversification by client, vessel type and country.

VESSEL TYPE DIVERSIFICATION

The loan book shall be adequately diversified across vessel types. No single vessel type may be provided as security for more than 50% of the loan book. Within any vessel type, no segment may account for more than 33% of the loan book.

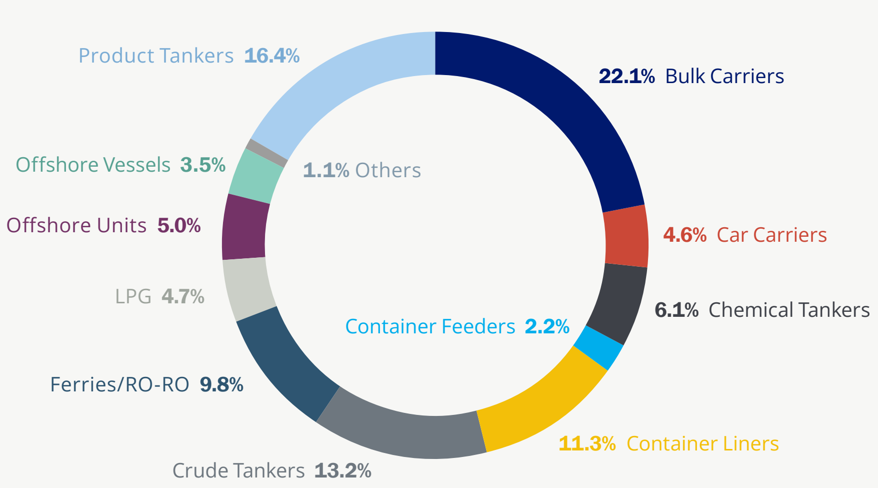
COUNTRY RISK DIVERSIFICATION

The loan book shall be adequately diversified by country. The country risk is monitored in terms of both country of ultimate risk and operational head office, and the latter is used for regulatory purposes such as solvency calculations.

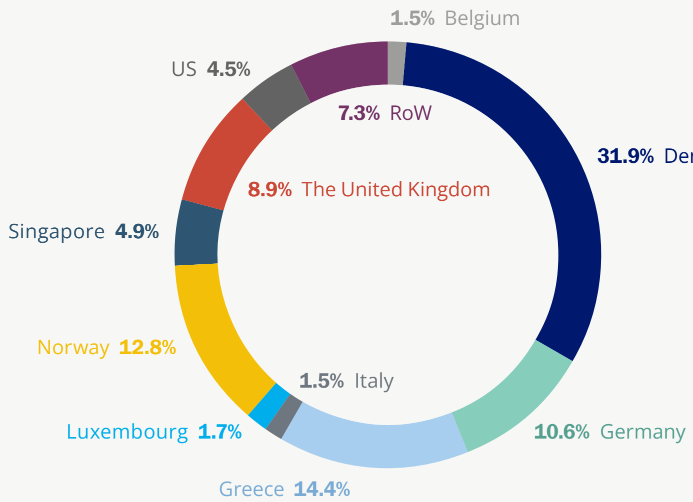
Lending to clients in most EU countries, Norway, the United Kingdom, Switzerland and the US is not subject to any restrictions. For lending to clients in other countries, we have set an overall limit per country of 25% of the loan book.

Countries accounting for a share of 1.5% or more of the loan book are shown individually. Other countries are grouped into the rest of the world (RoW).

Loan book broken down by mortgaged vessel type as at 31.12.2021
DKK 37,544 million



Debtor distribution by customers' operational head office as at 31.12.2021



MITIGATION OF COLLATERAL RISK ON MORTGAGED VESSELS

Market value of mortgaged vessels

We obtain valuations for all vessels at least semi-annually. The valuations are generally carried out by an external broker, which determines fair market values for the financed vessels. We may in some cases self-assess the values based on, for example, specific independent market values or external valuations of similar vessels.

Among other things, market valuations of vessels are used to determine the LTV ratios on loans and for control purposes when reassessing the collateral value of mortgaged vessels (after haircuts) as part of our semi-annual loan impairment review. The valuations are also used to monitor compliance with the 60% LTV limit in Capital Centre A.

Inspection of mortgaged vessels

As a supplement to the semi-annual market valuations, physical inspections of the financed vessels are made on a spot-check basis. An inspection may be performed both during the loan maturity period or prior to a loan offer being submitted. Due to continued Covid-19 restrictions in many countries, we made fewer physical inspections in 2021 than in the preceding years.

Insurance of mortgaged vessels

All vessels mortgaged as security for a credit exposure must be insured. Insurances are taken out by the client and assigned to us.

Generally, the following primary insurances are required:

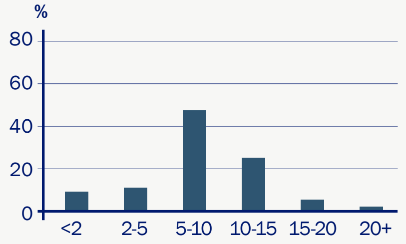
- Hull and machinery insurance, which covers damage to or total loss of the vessel;
- P&I (protection and indemnity) insurance, which covers oil pollution caused by the financed vessel, damage to equipment and injuries to seamen. This insurance is also a third-party liability insurance covering collision with another vessel;
- War risk insurance, which covers damage to the vessel, potential total loss and retention, etc. caused by war or war-like conditions.

In addition, most credit exposures are covered by a mortgagee's interest insurance (MII) and a mortgagee's additional perils pollution insurance (MAPP). These insurances cover our risks in various situations where the primary insurances do not provide cover, for example if the vessel is not seaworthy at the time of the claim.

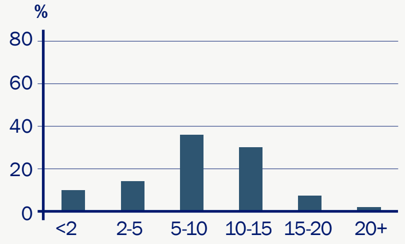
Age distribution of mortgaged vessels

The following charts display the age distribution of all mortgaged vessels as well as the age distribution of the largest vessel types in the loan book.

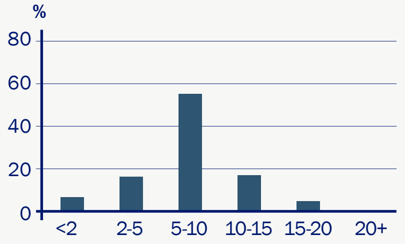
Age distribution of total ship portfolio



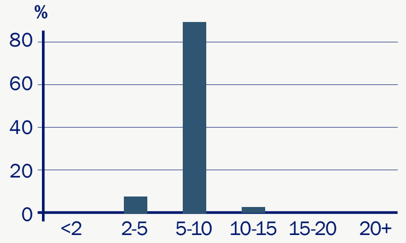
Chemical Tankers / Crude Tankers / Product Tankers



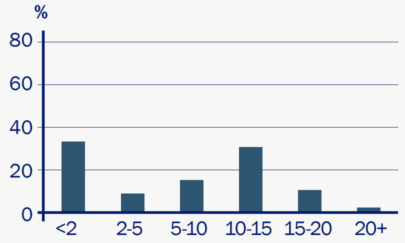
Bulk Carriers



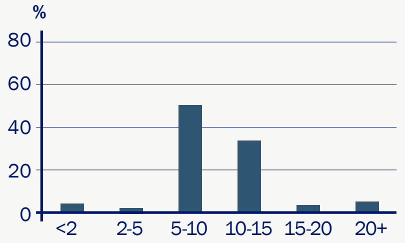
Container Liners



Ferries / Ro-Ro



Others



LOAN BOOK DEVELOPMENTS

At year-end 2021, the loan book amounted to DKK 37,544 million, up from DKK 33,576 million the year before.

The table below shows the loan book after loan impairment charges, broken down by net LTV intervals.

Net LTV intervals

%	2021	2020
0-20	49	39
20-40	37	37
40-60	13	22
60-80	1	2
80-90	0	0
90-100	0	0
Over 100	0	0

At year-end 2021, 99% of the loan book after loan impairment charges was secured by mortgages within 60% of the market valuation of vessels.

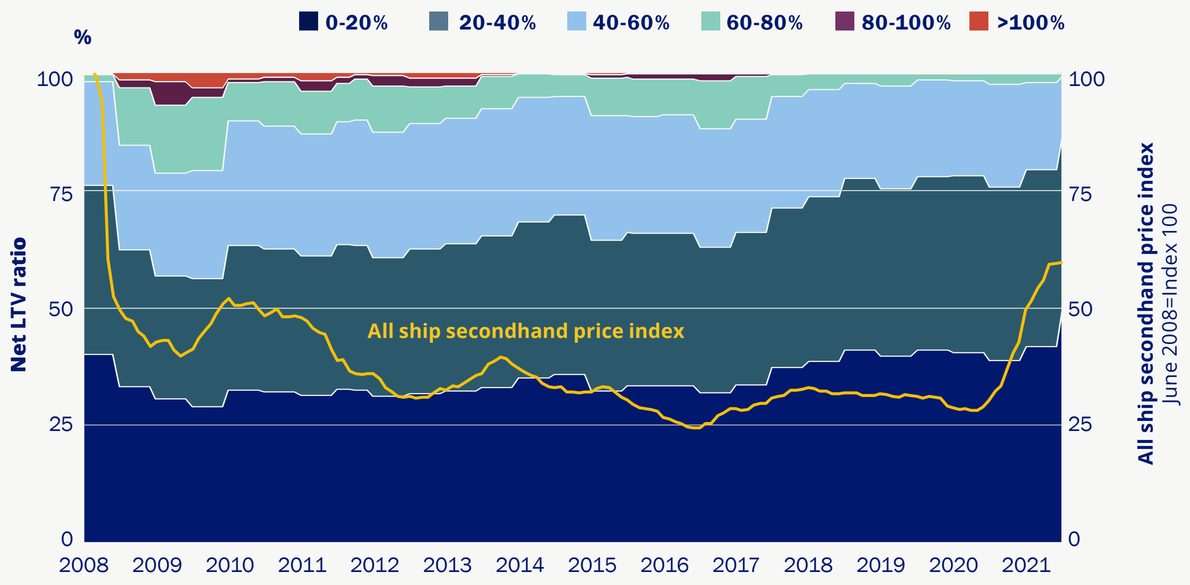
The chart illustrates the development in net LTVs over time and during periods of significant changes in the market values of vessels.

It is noteworthy that even major declines in vessel prices have not adversely affected the collateral coverage of the loan book.

This is due to the positive effect of regular loan repayment schedules and the benefit of minimum value clauses included in most loan agreements, where we have the right to demand partial prepayment and/or additional collateral if the market values of the mortgaged vessels fall below an agreed threshold.

The net LTV intervals are shown together with the development in vessel prices based on a price index for all vessel types (the solid line).

Net LTV vs price index for all vessel types



Sources: *Clarksons, Danish Ship Finance*

DANISH SHIP FINANCE

COLLATERAL VALUE OF MORTGAGED VESSELS (AFTER HAIRCUTS)

We have prudent methodologies in place for calculating the expected minimum realisation value of a vessel in a low market net of realisation costs (Sx value).

The Sx value is calculated by discounting the expected earnings per day in a low market for each of the subsegments of the relevant vessel types. The calculation is based on fixed low earnings throughout the estimated residual life of the vessel and an expected sale of the vessel within 12 months. The interest rate originally agreed on the loan is used as the discount rate. Estimated selling costs are deducted from the value.

The estimated earnings per day of a mortgaged vessel are expected to gradually fall throughout the residual life of the vessel due to increasing maintenance costs and decreasing operational performance, etc. The value of earnings per day in a low market is thus adjusted over the estimated lifetime.

This method for calculating the collateral value of the mortgaged vessels resulted in an average haircut of 59% to the current market value (ranging from 43% to 89% depending on the shipping segment) at year-end 2021. The method is monitored on an ongoing basis and is recalibrated when deemed prudent.

A client's unsecured credit exposure is calculated as the total credit exposure less (i) the Sx value of mortgaged vessel(s) and (ii) the value of any other collateral. Any such positive amount is applied in the calculation of loan impairment charges.

Rating

A DSF Rating is assigned to all clients. The development in the DSF Rating since initial recognition and the related stage development are monitored using a stage migration matrix. The actual stage depends on the state of the established credit risk.

In the table below, the DSF Ratings are mapped to the credit risk ratings determined by the FSA and to external ratings determined by the external credit rating.

Rating scale

DSF Rating	External rating	
	Standard & Poor´s	Danish FSA
1 2	AAA/AA A	3
3 4 5 6	BBB BB	2A
7 8	B	2B
9 10	CCC	2C
11 12	CC/C D	1

If the DSF Rating is 1 to 4 based on the mapping, the client or financial counterparty is considered to have low credit risk. Such a rating is equivalent to an investment grade rating from external credit rating agencies.

NON-PERFORMING LOANS

Non-performing loans (NPL) encompass all credit-impaired and defaulted loans. This includes loans for which no loan impairment charges have been recognised, for example because adequate collateral has been provided.

As at 31 December 2021, gross NPL amounted to DKK 1,911 million, down from DKK 2,407 million the year before. NPL after loan impairment charges (net NPL) improved from DKK 1,356 million at year-end 2020 to DKK 1,111 million at year-end 2021. The development in key NPL figures is displayed below.

Non-performing loans

DKK MILLION / %	2021	2020
Loan book	37,544	33,576
Gross NPL	1,911	2,407
Gross NPL ratio (%)	5.1	7.2
Net NPL	1,111	1,357
Net NPL ratio (%)	3.0	4.2

A loan is considered credit impaired if one of the following events occurs, and hence is assigned a DSF Rating 11:

- The client is experiencing significant financial difficulty and the risk of incurring a credit loss is larger than not incurring a credit loss; or
- The credit exposure has lenient repayment terms, which could include forbearance measures, which we, for reasons relating to the financial difficulty, would not otherwise have granted.

A loan is in default if the client is subject to one of the following events, and hence is assigned a DSF Rating 12:

- Bankruptcy or another in-court restructuring;
- Arrears/past due for 90 days or more, unless the problem is short term and the amount concerned is limited in comparison to the client's financial situation, or if this is due to errors or technical problems;
- A loss is deemed inevitable;
- Non-accrual interest; or
- Foreclosure

NPL prudential backstop

Legislation has been implemented by the European Union (EU) aimed at reducing non-performing loans (NPL) on balance sheets across the European banking sector. This includes an amendment to CRR regulation no. 575/2013 as regards minimum loss coverage for non-performing exposures (NPL backstop), subject to which new or modified NPLs from 26 April 2019 – after two years – will require a deduction from the CET1 capital if not sufficiently covered by loan impairment charges. We have implemented this legislation in our credit risk management systems and are in active dialogue with the Danish authorities regarding the specific mechanisms ensuring appropriate capital calculation with respect to the collateral value of ship mortgages (as for real estate) across capital adequacy methodologies.

Forbearance measures

We focus on having a credit risk management framework that ensures consistency between the credit risk profile, credit risk appetite and current legislation, and on having a robust capital structure. Risk management should ensure financial solutions that are viable in the short, medium and long term.

Forbearance plans may be adopted to assist clients in temporary financial difficulty. Given the cyclical nature of shipping, temporary forbearance measures are common in ship finance.

Concessions granted to clients include temporary partial payment deferrals, interest-only schedules and term extensions. Forbearance plans are granted solely in accordance with the credit policy with the aim of reducing the long-term risk of credit losses. As at 31 December 2021, forbearance measures had been granted on a limited number of loans.

Covid-19 concessions

Forbearance practices continue to be able to cater for clients materially affected by the Covid-19 pandemic.

In 2021, we did not receive any client requests for Covid-19 concessions.

Loan impairment charges

Loan impairment charges are made subject to the International Financial Reporting Standard 9 (IFRS 9), which provides rules for classification and impairment of financial assets, including loans.

We comply with the Executive Order on Financial Reports, according to which the IFRS 9 principles, particularly Annex 10, have been implemented, and guidelines published by the Danish Financial Supervisory Authority (FSA).

This includes stage recognition of all loans in Stages 1, 2 and 3 and provides the overall rules and guidelines for calculating loan impairment charges for expected credit losses (ECL), based on a forward-looking approach.

We recognise 12-month ECL on initial recognition of loans. If a loan is subject to either significantly increased credit risk, significant signs of weakness or credit impairment since initial recognition, lifetime ECL are recognised.

All credit exposures are reviewed semi-annually to reassess the applicable stage of loans and the size of loan impairment charges. In addition, defaulted credit exposures are reviewed for partial or full write-off if a credit loss is considered unavoidable.

As part of this process and when obtaining relevant new information, it is evaluated whether the existing DSF Rating still provides the best estimate of the credit risk of the client and the loan. Where this is considered not to be the case, the client and the loan are reclassified accordingly.

Individual loan impairment charges are made based on the ECL impairment model. The size of ECL for individual credit exposures is based on the calculation of ECL, which may be supplemented by management judgment, as described below.

Loan impairment charges for 2021 amounted to an income of DKK 39 million compared to an expense of DKK 100 million the year before.

Stage recognition

All our credit exposures are subject to stage recognition in Stages 1, 2 or 3 based on the principles set out in the table below.

Stage recognition, PD & ECL

Stage	Recognition	ECL
Stage 1	No increase in credit risk since initial recognition	12-month PD
Stage 2	The credit risk has increased significantly since initial recognition and/or loans are showing significant signs of weakness	Lifetime PD
Stage 3	Credit impaired and/or defaulted loans (NPL)	Lifetime PD

The subsequent calculation of loan impairment charges in the form of ECL includes, depending on the stage of the loan in question, either the 12-month probability of default (PD) or the lifetime PD.

When determining the PD, the remaining duration of a loan is evaluated for credit exposures in Stage 2. Loans in arrears/past due for 30 days or more (but less than 90 days) are generally showing significant signs of weakness, and they are classified as Stage 2 for calculating ECL. Loans in arrears/past due for 90 days or more are in default, and they are classified as Stage 3 for the purpose of calculating ECL.

At year-end 2021, no performing loans were in arrears/past due. Thus, all loans recognised as being in Stage 2 were assigned DSF Ratings, reflecting significantly increased credit risk since initial recognition or showing signs of weakness, rather than arrears/past due.

ECL impairment model

ECL is calculated as a function of PD, exposure at default (EAD) and loss given default (LGD), adjusted for forward-looking information using a macroeconomic factor (MEF) for each shipping segment.

ECL = PD * EAD * LGD * MEF

Scenario testing forms part of the ECL calculation, including the MEF, and is based on the following scenarios:

- Base-case scenario
- Worst-case scenario
- Best-case scenario

The calculation of the MEF is described in more detail below.

Macroeconomic factor (MEF)

The MEF, which is used as a parameter in the calculation of ECL, is based on a semi-annual internal assessment.

The model consists of eight market indicators, which are considered for each vessel type.

Scenario testing is carried out based on three scenarios, their probability and an MEF effect. Based on this, a score of 0 or 1 per market indicator is provided and accumulated, with an aggregate score close to 8 indicating elevated risk.

For each client, the PD is adjusted for the MEF to reflect the outlook for the segment to which the client is primarily exposed. The PD for each client can thus be below, at or above the standard PD. The MEF parameter may range from 0.90 to 1.27 as at 31 December 2021.

At year-end 2021, an accumulated MEF effect of minus DKK 2 million, down from plus DKK 16 million the year before, was included in the total ECL allowance account.

Write-offs

A credit exposure is written off, in whole or in part, when we have exhausted all practical recovery and restructuring efforts and have concluded that there is no reasonable expectation of full recovery. A corresponding amount is then written off.

Indications that there is no reasonable expectation of full recovery include:

- Ceasing of enforcement activity; or
- The value of the collateral is such that there are no reasonable expectations for recovering the loan in full.

We may write off credit exposures that are still subject to enforcement activity. Amounts which are legally owed in full, but which have been partially written off, are still subject to full recovery initiatives.

Net write-offs amounted to DKK 284 million in 2021, compared to DKK 805 million in 2020. Write-offs were well within the total ECL allowance account provided for in previous years.

DANISH SHIP FINANCE

Total ECL allowance account

The total ECL allowance account amounted to DKK 1,007 million as at 31 December 2021, down from DKK 1,330 million the year before, primarily affected by write-offs in the legacy Offshore portfolio.

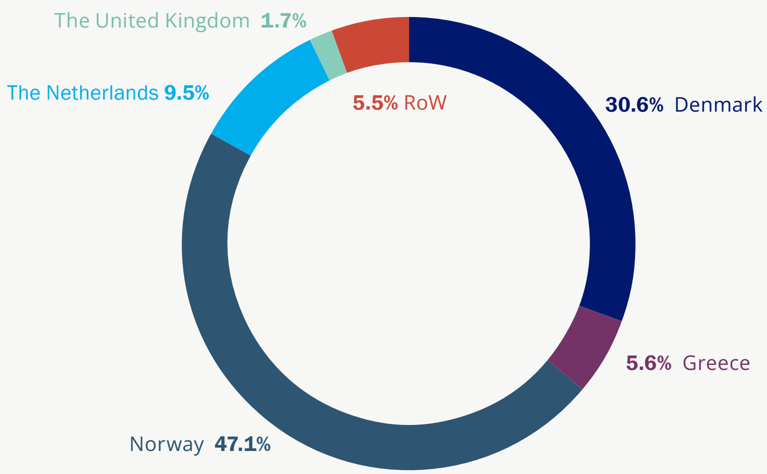
The following table displays key figures related to the total ECL allowance account:

Key figures

DKK MILLION	2021	2020
Loan book	37,544	33,576
Total ECL allowance account	1,007	1,330
Net write-offs	284	805
Loan impairment charges (minus = reversal)	(39)	100

At year-end 2021, the geographical distribution (based on operational head office) of the total ECL allowance account was as shown in the graph:

Total ECL allowance account broken down by operational head office as at 31.12.2021



Management judgment

Management judgments are carried out on the individual client level as an add-on or reduction to the individual loan impairment charges suggested by the ECL impairment model.

At year-end 2021, accumulated management judgments of DKK 75 million, down from DKK 100 million the year before, were included in the total ECL allowance account to cover potential uncertainties in the estimated value of collateral (after haircuts) in the Offshore segments.

Sensitivity analysis

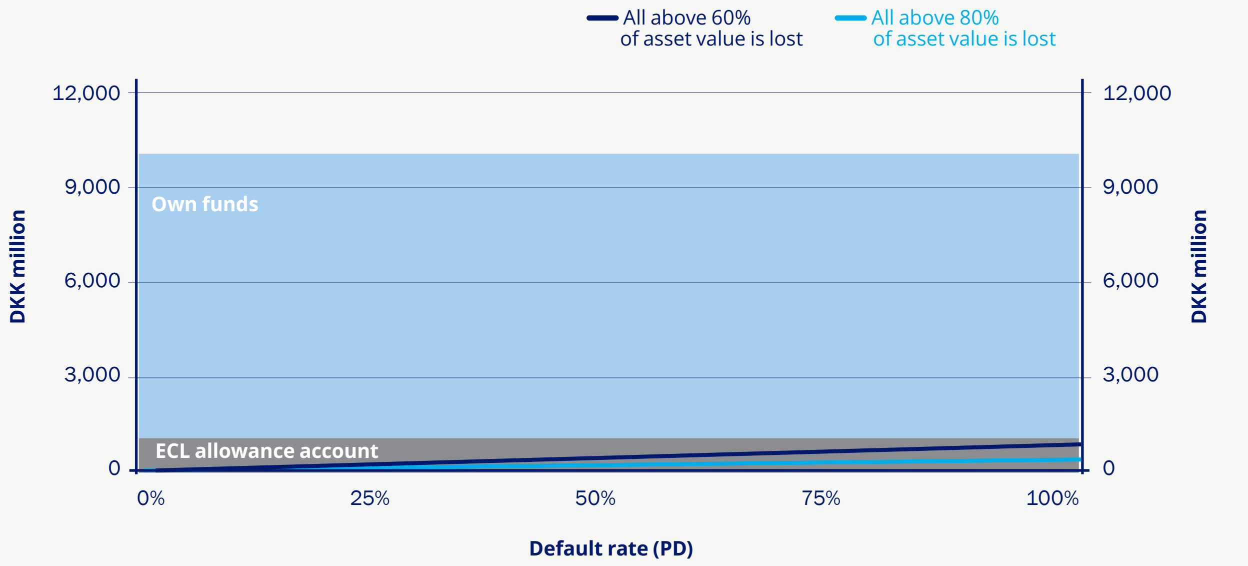
The loan impairment charges are sensitive to, among other things, changes to Sx values and the MEF. If Sx values were to decrease by 10% (in addition to the conservative 59% average haircut already applied) across the loan book, loan impairment charges would increase by about DKK 230 million. If the maximum MEF were to be applied across all shipping segments, loan impairment charges would increase by about DKK 119 million.

Loan losses at given default rates

The graph illustrates our strong ability to absorb loan losses in the rather unlikely scenario where all or a certain percentage of the client's default, and the mortgaged vessels are subsequently sold.

In the extreme event of all clients defaulting, the loan impairment charges alone would be almost sufficient to cover shortfalls if the mortgaged vessels were sold with haircuts of 40% to current market values.

Loan losses at given default rates



Development in the total ECL allowance account

DKK MILLION	Clients 2021	Clients 2020	Financial counterparties 2021	Financial counterparties 2020
Individual loan impairment charges				
Total ECL allowance account as at 1 January	1,330	2,035	0	0
New loan impairment charges/loss allowances during the year	277	760	0	0
Reversal of loan impairment charges/loss allowances made in previous years	307	(648)	0	0
Gross write-offs debited to the ECL allowance account	293	(817)	0	0
Total ECL allowance account as at 31 December	1,007	1,330	0	0

FINANCIAL COUNTERPARTIES

Credit exposure to financial counterparties, which may be credit institutions, export guarantee agencies and insurance companies, is entered into according to the counterparty risk policy. The policy sets out certain criteria, including a requirement for financial counterparties to have an investment grade rating from a recognised ECAI.

The counterparty risk policy quantifies and defines the principles for credit exposure to be granted to individual financial counterparties. The counterparty risk policy is also applied in the management of market and liquidity risks and sets out maximum risk limits for financial counterparties.

Furthermore, we prioritise financial counterparties that are global systemically important banks (G-SIB) or systemically important financial institutions (SIFI).

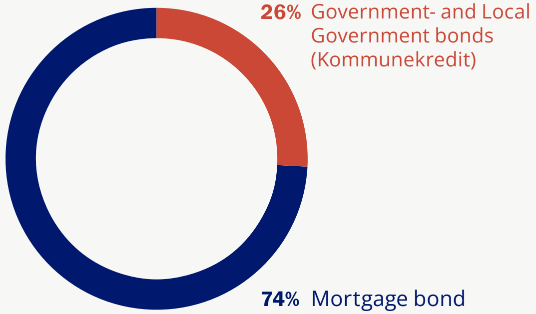
We carry out transactions, such as purchase of securities, with financial counterparties when investing our own funds or placing temporary excess liquidity from bond issuances.

Our investment portfolio, comprising high-grade government and mortgage bonds, and occasionally money market deposits and interest-sensitive financial instruments, represents a significant share of our assets.

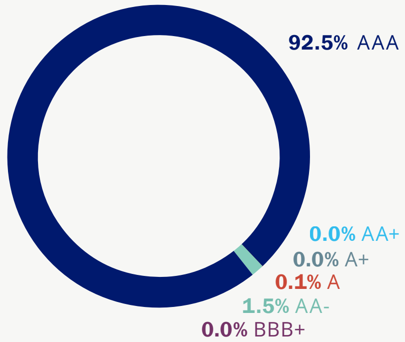
Contractual framework

A financial contract may entail risk of loss if it has a positive market value, and the financial counterparty does not perform on its part of the contract. This type of risk also includes settlement risk.

Distribution of securities portfolio



Exposure on financial counterparties by credit rating



The contractual framework for transactions with financial counterparties is based primarily on market standards such as the International Swaps and Derivatives Association (ISDA) and the International Capital Market Association (ICMA) agreements, which allow netting in the event of default of the financial counterparty. Furthermore, we have agreements on market-value adjustments or collateral (CSAs) for derivatives trading with various financial counterparties.

We are subject to the European regulation on OTC derivatives, central counterparties and trade repositories (known as EMIR). EMIR stipulates an obligation to clear certain types of derivatives via a central counterparty. This obligation applies to financial counterparties and non-financial counterparties that exceed the clearing threshold.

EMIR defines financial counterparties as credit institutions approved pursuant to the Credit Institutions Directive. We are exempt from this directive and are defined as a non-financial counterparty (NFC). NFCs only have a central clearing obligation if their trading volumes exceed certain thresholds. As our trading volumes do not currently exceed these clearing thresholds, we are not required to perform central clearing.

Ongoing monitoring

We continuously monitor our credit exposure to financial counterparties to ensure that the financial counterparty consistently complies with our requirements and to ensure compliance with approved lines. The ongoing monitoring is carried out independently of the executing entities.

EXTERNAL CREDIT ASSESSMENT (ECAI)

We use Standard & Poor's Global Ratings (S&P) as our external credit assessment institution (ECAI).

The credit rating categories defined by S&P are converted into credit quality steps using the FSA's conversion table. To calculate the risk-weighted exposure amounts under the standardised approach for credit risk, each credit quality step is designated a risk weight to be applied to the exposures graded at this credit quality step.

The table shows the FSA's conversion table, which translates S&P's credit rating categories to credit quality steps for exposures to corporates, institutions, central governments and central banks.

Credit quality step	S&P's credit rating category	Exposures to corporates	Exposures to institutions with terms to maturity > three months	Exposures to central governments or central banks
1	AAA to AA-	20%	20%	0%
2	A+ to A-	50%	50%	20%
3	BBB+ to BBB-	100%	50%	50%
4	BB+ to BB-	100%	100%	100%
5	B+ to B-	150%	100%	100%
6	CCC+ and below	150%	150%	150%

Exposure classes using S&P credit assessments

EXPOSURE CLASS DKK MILLION	**Group** *Exposure (unweighted)*	**DSF** *Exposure (unweighted)*
Exposures to central governments or central banks	x	x
Exposures to public sector entities	0	0
Exposures to regional governments or local authorities	0	0
Exposures to institutions	x	x
Exposures to corporates	x	x
Exposures in the form of covered bonds and mortgage bonds	x	x
Exposures in default	x	x
Exposures associated with particularly high risk	0	0
Exposures to institutions and corporates with a short-term credit assessment	0	0
Exposures in the form of units or shares in collective investment undertakings (CIUs)	0	0
Equity exposures	0	0
Other items	x	x
Total	**x**	**x**

MARKET RISK MANAGEMENT

Key developments in 2021

Actual levels of market risk at the end of the year remained well within the allowed boundaries. There were no breaches of market risk policy limits in 2021.

Market risk is the risk of loss on financial assets because of movements in financial market prices, including interest rates, yield spreads, foreign exchange rates and costs for hedging volatility, etc.

Bond issuances (funding) and lending are subject to restrictions on interest rate, foreign exchange and liquidity risk between the bond issues and the loans under the Danish balance principle. Hence, the main market risks are interest rate and yield spreads associated with the investment portfolio.

RISK GOVERNANCE AND RESPONSIBILITIES

The risk profile and the framework for market risk management are laid out in our market risk policy, which is set by the Board of Directors.

The market risk policy sets limits and specific guidelines for the ongoing management of risks relating to changes in financial risk factors, and lays down clear and measurable limits on, inter alia, interest rate and foreign exchange risks, building on the Bond Executive Order and other provisions. Our internal market risk limits are more stringent than external regulatory requirements.

The Treasury department has day-to-day responsibility for complying with the limits laid down in the market risk policy, and the Risk Management department has day-to-day responsibility for the monitoring and reporting of adherence to the limits set out in the market risk policy.

If a limit is breached, the Treasury department is responsible for documenting the cause and for submitting a plan of action to resolve the breach. The Executive Board is informed immediately, and the Board of Directors informed no later than at the next board meeting. If required, the relevant authorities will be informed immediately.

The Risk Management department provides a full market risk report to the Board of Directors, and to the Executive Board members on a regular basis. The Risk Management department provides relevant data for internal and external reports in which market risk is reported.

INTEREST RATE RISK

Interest rate risk is the risk of incurring a loss due to a change in interest rates. Generally, rising interest rates have an adverse impact on the market value of the investment portfolio. Interest rate risk can also be created by a mismatch between assets and liabilities, client behaviour and optionality in the investment portfolio.

We adhere to the specific balance principle and the Bond Executive Order, which stipulates that interest rate risk in the banking book must not exceed 1% of own funds.

As at 31 December 2021, the interest rate exposure in the banking book stood at DKK 21 million, against DKK 20 million as at 31 December 2020, corresponding to 0.2% of own funds.

The Bond Executive Order also stipulates that the interest rate risk on assets, liabilities and off-balance sheet items must not exceed 8% of own funds. Based on the FSA guidelines for calculating interest rate risk in the trading book, the interest rate exposure was DKK 185 million as at 31 December 2021, corresponding to 2.0% of own funds, against DKK 164 million as at December 2020. According to the guidelines in the Bond Executive Order, it is not permitted to offset (net) risk between currencies in this statement. Netting substantially reduces the risk, to DKK 1 million as at 31 December 2021.

Furthermore, the interest rate risk appetite is limited by setting a minimum and a maximum for the option-adjusted duration. The option-adjusted duration of the investment portfolio in the trading book, including financial instruments, is currently limited to +/- two years. The option-adjusted duration was calculated at approximately 0.0 years as at 31 December 2021.

DANISH SHIP FINANCE

IBOR reform

The Financial Conduct Authority (FCA) confirmed on 5 March 2021 that all LIBOR settings will either cease to be provided by any administrator or will no longer be representative, effective immediately after 31 December 2021 in the case of GBP settings, and after 30 June 2023 in the case of USD settings. Other IBORs are, in the same context, expected to be replaced by risk-free rate (RFR) reference benchmarks in the near future. RFRs are based on rates agreed in actual market transactions, as opposed to rates that are expected to be achievable in market transactions.

We are exposed to IBORs through cash products in our loan book, bonds held and derivatives traded. Relevant systems, processes and documentation are in place and the Board of Directors has approved the use of RFRs. We are thereby today able to formally grant loans and trade derivatives based on RFR indices.

CREDIT SPREAD RISK

Credit spread risk arises from differences in yield either between different securities with the same issuer or between securities of the same type and maturity. The credit spread usually correlates with the creditworthiness of the issuer but can also be an expression of differences in liquidity, seniority of the securities, or other attributes.

Spread risk is typically measured as a decrease in market value caused by an increase in the spread of 100 bps on mortgage bonds, government bonds and other secured and unsecured bonds. Spread risk on callable bonds is calculated on the basis of option-adjusted interest rate sensitivities.

Our market risk policy limits the accepted maximum spread risk for the trading book. As at 31 December 2021, the actual total credit spread risk was DKK 512 million, against DKK 361 million as at December 2020.

FOREIGN EXCHANGE RISK

Foreign exchange risk is the risk of financial impact from exchange rate fluctuations.

The Group's business activities involve a natural flow of different currencies, primarily related to the lending activities. The Bond Executive Order does not allow for foreign exchange risk arising from a mismatch between funding and lending on principal amounts, under the specific balance principle. However, foreign exchange risk does exist outside the banking book in relation to net earnings, which are typically in USD.

A modest amount of foreign exchange risk is allowed in the investment portfolio. The market risk policy limits this risk to a maximum of 0.3% of own funds and only in currencies that are included in the FSA's exchange rate indicator 2.

The Group's total net exposure to foreign currency across all balance sheet items is calculated using the FSA guidelines for exchange rate indicator 1. As at 31 December 2021, the total foreign exchange risk was DKK 284 million, equal to 3.1% of own funds.

EQUITY RISK

Equity risk is the risk involved in the changing prices of stock investments. At year-end 2021, we held no positions in equities or equity instruments, and therefore had no equity risk.

FINANCIAL DERIVATIVES

We use derivatives according to the market risk policy, which limits the types of derivatives that may be used and for what purposes. Financial instruments may be applied to hedge risks between funding and lending and in relation to investment activities.

LIQUIDITY RISK MANAGEMENT

Key developments in 2021

The CRR II regulatory framework was adopted in the liquidity risk policy and in daily risk management. Our available liquidity remains well above the minimum required level as set out for both LCR and NSFR.

Liquidity risk is the risk of loss arising from the inability to fulfil immediate and short-term payment obligations.

RISK GOVERNANCE AND RESPONSIBILITY

Liquidity risk management is anchored in the internal liquidity adequacy assessment process (ILAAP), which is a review aimed at identifying liquidity risk exposures and determining liquidity targets. The risk profile and the framework are laid out in our liquidity risk policy, which is set by our Board of Directors.

Liquidity risk is managed in each of the applicable currencies and is subject to strict limits and stress tests. Our liquidity risk policy determines our overall liquidity risks and funding structure and contains specific guidelines for the ongoing management of liquidity risk.

Daily liquidity management is carried out by the Treasury department with the objective of ensuring that we are consistently able to meet our payment obligations and maintain our business model, which includes supporting planned lending activities, and ensuring that our funding costs remain competitive.

The Risk Management department has day-to-day responsibility for the monitoring and reporting of adherence to the limits set out in the liquidity risk policy.

If a limit is breached, the Treasury department will be responsible for documenting the cause and submit an action plan to resolve the breach. The Executive Board is informed immediately and the Board of Directors at the next board meeting, or earlier if required. If required, the relevant authorities will be informed immediately.

BALANCE PRINCIPLE

The specific balance principle laid out in the Bond Executive Order permits a future liquidity deficit between issued bonds and loans provided of up to 100% of own funds.

A deficit occurs if future payments related to bond issuances, financial instruments and other funding instruments exceed future incoming payments on loans, financial instruments and liquidity positions.

Our internal policies define strict requirements for any liquidity deficits between issued bonds and loans provided. We pre-fund all credit commitments well in advance of disbursement.

Surplus funds from pre-funding and proceeds from unscheduled prepayments of loans are placed in secure and liquid securities or as short-term money market deposits with credit institutions which qualify for credit quality step 2 or better.

FUNDING

We issue bonds in DKK and EUR, whereas most loans are disbursed in USD. To cover the currency mismatch, we source USD and hedge currency risks via basis swaps.

The opportunities for sourcing USD liquidity rely on an efficient capital market. Our ability to convert DKK or EUR funding into USD entails a risk of temporarily higher financing costs or a loss of business opportunities in the event of a market disruption.

The liquidity policy set limits for USD liquidity requirements over time.

ENCUMBERED ASSETS

Funding and lending activities are ringfenced by law to ensure timely payments to bond investors. Due to this setup, the ringfenced assets are subject to encumbrance, as per the European Banking Authority’s (EBA) guidelines on disclosure of encumbered and unencumbered assets.

Apart from ringfenced assets, the primary sources of asset encumbrance are supplementary collateral under Capital Centre A (SDO) and collateral under CSA agreements. Encumbered assets accounted for 87% of total assets plus any collateral received that may be subject to encumbrance.

The information disclosed on encumbered assets and collateral received is based on data as at 31 December 2021. Encumbered assets are specified in Annex XXXV.

DANISH SHIP FINANCE

According to the regulatory technical standards on disclosure of encumbered and unencumbered assets issued by the EBA in March 2017, credit institutions with less than EUR 30 billion in total assets or an encumbrance level below 15% are exempt from the disclosure requirements for high-quality liquid assets (HQLA) and extremely high-quality liquid assets (EHQLA), and thus these are not specified in Annex 7.

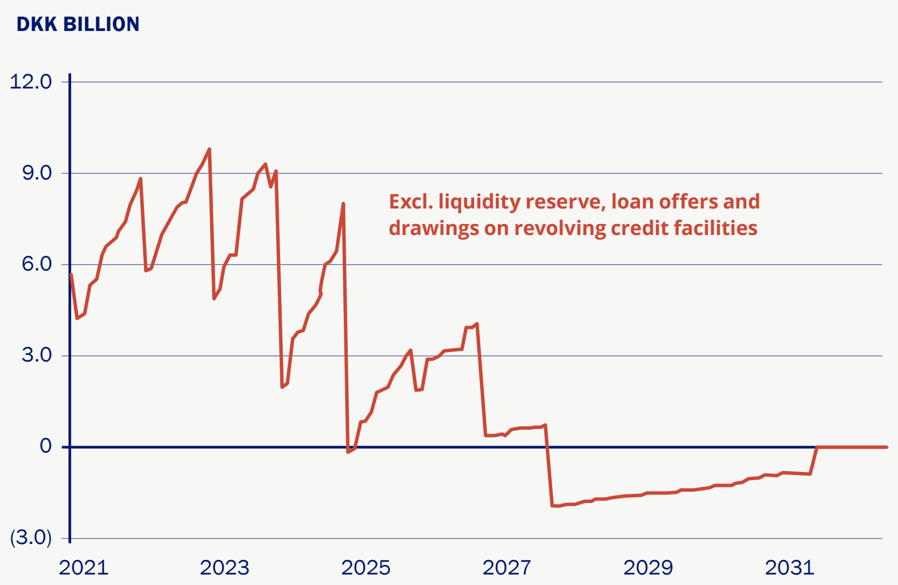
REFINANCING RISK

Through bond issues and a portfolio of liquid bonds, we ensure sufficient liquidity coverage for all existing loans and credit commitments until expiry. We are therefore not exposed to any refinancing risk.

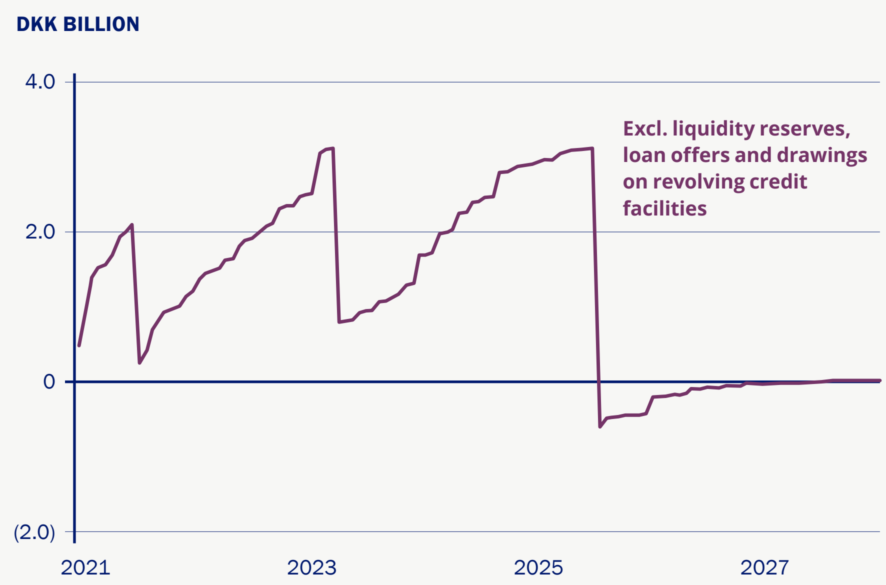
A potential downgrade of our external rating would not change our robust liquidity situation but could lead to higher funding costs for new loans not yet offered.

The charts show the primary liquidity mismatch between currently outstanding funding and lending, before considering our DKK 9.1 billion liquidity reserve.

Net liquidity in Capital Centre Institute in General



Net liquidity in Capital Centre A



STRESS TESTING

We have developed a stress test programme in accordance with the guidelines set out by the EBA on institution stress testing. As part of the programme, a liquidity stress test is performed on a monthly basis to ensure that there is enough liquidity to maintain the business model and meet our total payment obligations.

The liquidity stress test identifies the resilience of our short-term liquidity position in a stressed scenario in which we have no access to our usual funding sources. The liquidity stress test focuses on the effects of simultaneous shocks to several interrelated risk factors, such as currency exchange rates, interest rates, credit spreads and loan losses. The results of the liquidity stress test are used to manage and adjust internal liquidity limits.

Our stress testing confirms that the current limit structure is adequately robust in relation to these risk exposures.

We have recently reviewed the market stresses observed during the Covid-19 pandemic in relation to the assumptions in our stress-testing framework. We found the current framework to be adequately conservative.

OTHER LIQUIDITY RISK INDICATORS

In combination with our liquidity stress test, we use regulatory indicators in the form of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). Both are used as tools for asset liability management.

In the liquidity risk policy, our Board of Directors has set minimum limits for both the LCR and the NSFR requirements that are higher than the regulatory requirements.

The daily management of the LCR is carried out by the Treasury department, while the Risk Management department has day-to-day responsibility for the monitoring and reporting of adherence to the limits in the liquidity risk policy. Risk Management reports on indicators to the FSA on a monthly (LCR) and quarterly (NSFR) basis.

The LCR is a key regulatory requirement. According to the CRR regulation, liquidity is required to ensure that credit institutions have adequate unencumbered high-quality liquid assets (HQLA), consisting of cash or assets that can be converted into cash at little or no loss of value in private markets, to meet liquidity needs for a 30-calendar-day liquidity stress scenario.

Our own funds investment portfolio represents a significant share of the liquid assets. The investment portfolio consists of government and mortgage bonds, money market transactions and interest-sensitive financial instruments.

Furthermore, a running three-month-forecast of the LCR is calculated as part of the daily monitoring.

Another regulatory indicator in the CRR regulation is the NSFR requirement. While the LCR focuses on short-term liquidity risk, the NSFR addresses the balance between funding needs and the stability of funding sources. This ensures that institutions use stable medium- and long-term funding to support their lending operations and ensures an appropriate liquidity level over a full calendar year.

Due to our business model, we by default maintain a high and stable NSFR level.

Annex XIII provides a more detailed description of the LCR and the NSFR.

As at 31 December 2021, the LCR was calculated at 449% and the NSFR was calculated at 159%.

CONTINGENCY PLANS

In accordance with the Executive Order on Governance for Credit Institutions, we have prepared a liquidity contingency plan containing a catalogue of possible initiatives with which to strengthen the liquidity position in a critical situation. The liquidity contingency plan takes effect if predefined triggers are activated.

$$\textbf{Liquidity coverage ratio} = \frac{\textit{HQLA}}{\textit{Net liquidity outflow over a 30 day stress period}} \geq 100\%$$

$$\textbf{Net stable funding ratio (NSFR) formula} = \frac{\textit{Available amount of stable funding}}{\textit{Required amount of stable funding}} \geq 100\%$$

OPERATIONAL RISK MANAGEMENT

Key developments in 2021

Our Operational Excellence programme continued to markedly improve the robustness of our operating environment.

Operational risk is the risk arising from breakdowns in our internal procedures, or failures of people or systems. In this category, we also consider structural risks to our business model and the risk of material damage to our reputation.

GOVERNANCE AND RESPONSIBILITIES

Our operational risk policy stipulates that operational risk shall be kept low. Operational risk is assessed on the basis of the probability of a given event occurring and the potential loss resulting from such an event.

Given its nature and characteristics, operational risk is best mitigated and managed as part of day-to-day business conduct. Responsibility for the day-to-day management of operational risk lies with the individual business areas. Operational risk management activities are coordinated by Risk Management to ensure coherence, consistency and effectiveness across the Group.

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

As part of operational risk management, operational risk events are systematically recorded, categorised and reported. Operational errors are divided into three main groups by potential or actual loss:

- Small errors (<DKK 25,000)
- Medium-sized errors (<DKK 5 million)
- Large errors (>DKK 5 million)

Errors can be upgraded to a more severe category according to management judgment. We make regular use of this option, including in 2021.

Small errors are reported to the relevant head of department. Medium-sized and large errors are reported to the Executive Board. The Board of Directors is notified of large errors.

The recording of operational risk events must include information about the type of product, process and risk concerned and a plan of action for more severe events.

COMPLIANCE

Operational risk includes compliance risk, which is subject to separate guidelines. This area is managed by the Head of Compliance. An assessment of the level of compliance risk is reported annually to the Board of Directors and the Executive Board.

The Compliance department is an independent function which serves to assess and report the implementation of applicable legislation, practice and market standards, and any non-compliance with these. This helps mitigate the risk of sanctions being imposed on the Group, the risk of loss of reputation or the risk of the Group or its clients suffering material financial losses.

The Compliance department takes a risk-based approach when identifying areas for review.

MONEY-LAUNDERING RISK

In relation to anti-money laundering (AML), we have laid down specific policies, business procedures and controls. Furthermore, extensive efforts are made to ensure compliance with requirements pertaining to proof of client identity (know-your-customer procedures). The prevention of money laundering and terrorist financing is a high priority. The business model in itself severely limits the risk of DSF being used for such purposes.

The AML function is responsible for ensuring that we comply with the Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism, the EU Funds Transfer Regulation and EU anti-terrorism regulations. The AML function is anchored in the Compliance department and reports directly to the Executive Board and Board of Directors.

IT SECURITY

Information and information systems are vital to our business, and IT security is therefore essential to our credibility and continued existence. The IT department reports on IT security measures to the Executive Board and the Board of Directors, which regularly review these.

The IT department works to a defined security- and risk tolerance level aimed at ensuring that our day-to-day business and activities are consistently supported by a secure and reliable IT infrastructure. The IT department is responsible for complying with the adopted IT security level and IT contingency plan. The IT department contributes to ensuring and monitoring that our IT activities to the best possible extent are protected against internal and external threats and responsible for ensuring compliance with legislative and internal requirements.

Our priorities in the IT security area are based on regulatory requirements as well as considerations about the necessary robustness of day-to-day operations. Our operations must be secure and stable, a requirement fulfilled through automation and ongoing capacity adjustments. Our IT security efforts include the preparation of contingency plans and recovery procedures and periodic testing of such measures aimed at ensuring our continued operation at a satisfactory level should extraordinary events occur.

In our assessment of IT risk, we have revised and described all our systems. For each single risk event, requirements for support and error handling have been included in the description. Levels for system availability and stability are determined and revised regularly and the IT security is frequently tested.

We consider cyber security to be the most important aspect of IT security that cannot be fully mitigated. To mitigate the exposure to cyber risk, we constantly keep our knowledge of cyber threats up to date. We also use the knowledge we gather to inform employees of pending cyber security threats and thereby heighten inhouse awareness. We have engaged several external partners to monitor and periodically test our cyber security defences, to ensure that we keep our infrastructure protected against the prevailing cyber security threat level.

CAPITAL MANAGEMENT

Key developments in 2021

The capital ratio for DSF decreased to 20.1% at year-end 2021 (from 22.3% the year before), mainly due to a larger loan book in 2021. DSF's internal capital adequacy requirement, including buffers, amounted to 11.6% at year-end 2021 (compared to 12.0% the year before).

Adequate own funds are defined as the minimum amount of capital required to ensure only a remote risk of the Group becoming distressed or insolvent during a 12-month period such that bondholders could be exposed to a potential loss. Bondholders are, however, subject to further protection ensured by law, as non-acceleration clauses apply in the event of bankruptcy.

AVAILABLE OWN FUNDS

The Group's own funds net of deductions amounted to DKK 8,115 million as at 31 December 2021 (against DKK 7,731 million in 2020). DSF's own funds amounted to DKK 9,131 million (against DKK 9,156 million in 2020).

The Group's own funds consist of Common Equity Tier 1 capital (CET1) in the form of share capital and tied-up reserve capital in DSF, retained earnings from previous years, and a subordinated Tier 2 debt instrument in DSH.

The tied-up reserve capital was established in 2005 when DSF was converted from a foundation into a limited liability company. The amount has remained unchanged at DKK 8,343 million.

Tied-up reserve capital in DSH was recognised in own funds at DKK 4,735 million as at 31 December 2021 (against DKK 4,413 million in 2020). The recognition of tied-up reserve capital in DSH is calculated according to the FSA's ruling as an amount corresponding to the tied-up reserve capital's proportionate share of DSF's capital requirement.

The tied-up reserve capital was established in 2005 when DSF was converted from a foundation into a limited liability company. The amount has remained unchanged at DKK 8,343 million.

The tied-up reserve capital may only be used to cover losses that cannot be covered by the amounts available for dividend distribution. In the event the tied-up reserve capital is used to cover losses, the tied-up reserve capital must be restored by a priority claim on profit in the subsequent years. Hence, no dividends may be paid, and no distributions made in connection with capital reductions, until the tied-up reserve capital has been restored to the original nominal amount.

DSH has issued Tier 2 capital on terms and conditions that meet the requirements for inclusion in the Group's own funds as a Tier 2 instrument under the CRR. The Group's Tier 2 capital, amounting to a nominal sum of DKK 2 billion, is provided by the pension fund PFA and pension funds under management by PKA. These pension funds are shareholders of DSH. Annex 2 details the terms and conditions of the Tier 2 capital.

The FSA has ruled that tied-up reserve capital shall be included in the determination of consolidated capital adequacy at an amount corresponding to the tied-up reserve capital's proportionate share of the capital requirement.

The share of the tied-up capital that may be included is calculated according to the following formula:

$$\textit{Share} = \frac{\textit{Tied-up reserve capital}}{\textit{Total CET1 capital}} * (\textit{Capital requirement} * \textit{total exposure})$$

Calculation of available own funds less deductions

DKK MILLION / %	Group 2021	Group 2020	DSF 2021	DSF 2020
Common equity Tier 1 capital				
Share capital	1,224	1,224	333	333
Tied-up reserve capital	4,735	4,413	8,343	8,343
Retained earnings	189	133	579	529
Revaluation reserve	-	-	70	70
Total common equity Tier 1 capital before deductions	**6,148**	**5,770**	**9,325**	**9,275**
Deduction from common equity Tier 1 capital				
Proposed dividends	-	-	128	59
Deferred tax assets	-	-	-	-
Position of own shares	1	2	-	-
Additional capital charge pursuant to the Executive Order	0	0	-	-
Non-performing exposure	8	-	8	-
Prudent valuation of trading portfolio	24	28	24	28
Deductions pursuant to transitional rules	-	-	33	33
Total deductions from common equity Tier 1 capital	**34**	**30**	**194**	**119**
Common equity Tier 1 capital less statutory deductions	**6,115**	**5,740**	**9,131**	**9,156**
Tier 2 capital	2,000	1,990	-	-
Own funds less deductions	**8,115**	**7,731**	**9,131**	**9,156**

Definitions

Own funds

Own funds can be composed of three different types of capital: Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. Own funds are subordinated to the claims of ordinary creditors in the event of bankruptcy or other forms of financial restructuring.

The ratio of own funds to the total risk exposure amount is referred to as the total capital ratio.

Common equity Tier 1 capital

A firm's Common Equity Tier 1 capital (CET1) is the aggregate of the share capital, other reserves and retained earnings after certain statutory supplements and deductions.

Additional Tier 1 capital

Additional Tier 1 (AT1) capital consists of loans that form part of Tier 1 capital and is senior to shareholders' equity.

Tier 2 capital

Tier 2 capital consists of subordinated debt subject to certain restrictions. Tier 2 capital is senior to AT1.

DANISH SHIP FINANCE

CAPITAL REQUIREMENTS

CAPITAL REQUIREMENTS

PILLAR 1 | **PILLAR 2** | **COMBINED CAPITAL BUFFERS**

Our capital requirement is calculated based on the 8+ approach and the Danish Financial Supervisory Authority's (FSA) guidelines on Adequate Capital Base and Solvency Needs for Credit Institutions.

The guidelines issued by the FSA contain benchmarks for stress tests, etc. These benchmarks define the limits within which the FSA assesses an institution's risks as being covered by 8% of the total risk exposure amount. If these limits are exceeded, the institution is required to increase its adequate own funds.

The Group shall have own funds at least equal to the sum of the own funds requirements associated with each of the risk types defined as Pillar 1 requirements, Pillar 2 requirements and the combined capital buffer requirement.

Adequate own funds and internal capital adequacy requirement

	Group		DSF	
DKK MILLION / %	**2021**	**2020**	**2021**	**2020**
Total risk exposure amount	**46,050**	**41,453**	**45,477**	**41,042**
Pillar 1 requirements (8% of total risk exposure amount)	**3,684**	**3,316**	**3,638**	**3,283**
Pillar 2 requirements				
Earnings	-	-	-	-
Growth in lending	-	-	-	-
Credit risks				
- Credit risks for large clients in financial difficulty	34	31	34	31
- Other types of credit risk	34	24	34	24
- Concentration risks	29	116	29	116
Market and liquidity risks	358	361	358	361
Operational and control risks	0	0	0	0
Leverage risk	-	-	-	-
Other risks	-	-	-	-
Total adequate own funds	**4,139**	**3,848**	**4,093**	**3,815**
Total capital less deductions	8,115	7,731	9,131	9,156
Total adequate own funds	4,139	3,848	4,093	3,815
Capital conservation buffer	1,151	1,036	1,137	1,026
Countercyclical capital buffer	63	66	62	65
Excess capital	**2,778**	**2,781**	**3,839**	**4,249**
Solvency ratio (%)	17.6	18.6	20.1	22.3
Internal capital adequacy requirement	9.0	9.3	9.0	9.3
Capital conservation buffer	2.5	2.5	2.5	2.5
Countercyclical capital buffer requirement	0.14	0.16	0.14	0.16
Internal capital adequacy requirement, including combined capital buffer requirement	**11.6**	**11.9**	**11.6**	**12.0**
Excess capital	**6.0**	**6.6**	**8.4**	**10.3**

Pillar 1 requirements

PILLAR 1	PILLAR 2	COMBINED CAPITAL BUFFERS

Pillar 1 requirements

The Pillar 1 own funds requirement is a regulatory requirement for financial institutions. Own funds must represent at least 8% of an institution's total risk exposure amount (risk-weighted assets). Non-compliance with the own funds requirement will lead to withdrawal of the institution's licence.

We apply the standardised approach for the calculation of the total risk exposure amount and the own funds requirement for credit and market risks. When using the standardised approach, the risk weights are predefined. In addition, we apply the basic indicator approach to calculate the risk exposure amount for operational risk.

Credit risk

According to the standardised approach, all loans generally carry a weight of at least 100%. In addition, the value of the ship mortgages cannot be deducted, and for capital adequacy purposes the loans are thus treated as unsecured loans.

The table shows that the majority of our risk exposures have a risk weight of 100%.

Credit risk exposure by risk weight

Risk weight	**Group** Credit risk exposure (weighted)	**Group** Own funds requirement
DKK MILLION	**2021**	**2021**
0	-	-
10	502	40
20	298	24
50	1,195	96
100	38,101	3,048
150	416	33
200	-	-
250	580	46
Total credit risk exposure	**41,090**	**3,287**

Pursuant to the Executive Order, the following loans or shares of loans each carry a risk weight of more than 100%:

- Pursuant to section 24(3) of the Executive Order, construction loans carry a risk weight of 200% if total construction loans do not exceed 125% of the excess capital coverage. If total construction loans exceed 125%, the excess amount must be deducted from Tier 1 capital. Construction loans are secured through the client's liability, assignment and subrogation in the construction contract and assignment of the shipyard's collateral for payments according to the construction contract.
- Pursuant to the definition in Article 178 of CRR, loans in default (equivalent to internal DSF Ratings 11 and 12) carry a risk weight of 150%.
- Under certain conditions, we may grant loans exceeding 70% of the value against other collateral and/or against additional reservations of our own funds. The maximum deduction is determined in DKK at the date of approval.
- Where the client either has an external rating corresponding to credit quality steps 5 and 6 or is unrated and is headquartered in a country where the country risk calls for a higher weighting, the loan carries a risk weight of 150%.

As at 31 December 2021, no construction loans were present in the portfolio.

Counterparty risk on derivatives and calculation of capital

We apply the new standard approach under CRR II, SA-CCR, to calculate derivative exposures. We use the SA-CCR method to determine the exposure value for counterparty risk.

The Group counterparty credit risk is calculated at DKK 1,163 million as at 31 December 2021.

Pursuant to the CRR, institutions shall calculate a credit valuation adjustment (CVA) charge. The CVA charge is a separate capital requirement for OTC derivatives to cover the risk of loss due to a value adjustment caused by a deterioration of a counterparty's credit quality.

Credit valuation adjustment (CVA)

We use the standardised approach for calculating the CVA charge, which allows the use of risk mitigation techniques such as netting and collateral.

The counterparty risk on financial derivatives is reduced through netting agreements as well as through margin calls and collateral provided in accordance with standard documentation from the ISDA and the ICMA. Bilateral collateral agreements (CSAs) have been signed with the largest financial counterparties, which means that collateral is received or posted automatically if the positive market values exceed a specified minimum threshold.

The CVA charge for the Group amounted to DKK 772 million as at 31 December 2021.

CVA charge - Standardised approach

DKK MILLION	2021
Exposure – unweighted	2,674
Exposure – weighted	772
Own funds requirement	62

Collateral and guarantees

We may receive the following types of financial collateral and guarantees:

- Deposit funds;
- Securities (debt instruments, investment fund units), primarily listed; or
- Government and credit institution guarantees

Funded credit protection

	Group Exposure (weighted)	
DKK MILLION	**2021**	**2020**
Deposits in cash or cash assimilated instruments	319	475
Debt securities issued by central governments or central banks	-	-
Debt securities issued by institutions	-	-
Total financial collateral	**319**	**475**

We have operating procedures in place for the management and valuation of collateral. These procedures form an integral part of the regular risk monitoring process.

We use the simple method for valuing financial collateral in our credit risk mitigation assessment. This means that the capital charge on a credit exposure can be reduced by means of collateralisation. The CRR specifies the financial collateral eligible for credit risk mitigation purposes.

In accordance with the rules of the CRR, we use financial collateral and guarantees to hedge credit and counterparty risk. The table on funded credit protection shows the level of protection in each exposure category, i.e. the fully adjusted size of the collateral within each exposure category.

Market risk

According to the CRR II requirements, we started reporting on FRTB (Fundamental Review of the Trading Book) as at 30 September 2021. We applied the new standardised approach (FRTB SA). The final implementation of FRTB is set to follow the CCR III regulation.

We use the standardised approach to calculate the own funds requirement for market risk. Positions involving market risk are instruments in the trading book and positions involving foreign exchange risk are outside the trading book.

Risk exposure amount and own funds requirement

DKK MILLION	Group Exposure (weighted) 2021	Group Own funds requirement 2020
Debt instruments, specific risk		
Total specific risk *)	785	63
Debt instruments, general risk		
Total general risk	2,259	181
Shares, etc.		
Total shares, etc.	18	1
Foreign currency positions		
Total long foreign currency positions	284	23
Total amounts for market risk	**3,736**	**299**

**) Specific risk for debt instruments is calculated for all debt instruments in the trading book, including unweighted and weighted amounts for repo transactions.*

Operational risk

We apply the basic indicator approach to calculate the own funds requirement for operational risk. The risk exposure amount for operational risk is calculated at 15% of a three-year average of net interest income and non-interest-related net income.

An assessment of the own funds requirement for operational risk is performed quarterly. If the own funds requirement is deemed to be higher than the level mentioned below, we adjust the own funds reservation accordingly.

Risk exposure amount for operational risk

DSF DKK MILLION	2021	2020	2019	Average
Accounting items	783	820	941	848
Interest income	(279)	(279)	(310)	(289)
Interest expenses	-	0	-	-
Dividends on equity investments	32	21	26	26
Fee and commission income	-	-	-	-
Fee and commission expenses	(82)	(150)	(197)	(143)
Market value adjustments				
Sum of accounting items	**454**	**411**	**460**	**442**
Risk exposure amount (weighted) under the basic indicator approach	**829**	**880**	**1,056**	

Summary of Pillar 1 requirements

The following table details the risk exposure amounts and own funds requirements for each exposure category.

Risk exposure amount

	Group Risk exposure amount (weighted)		Group Own funds requirement		DSF Risk exposure amount (weighted)		DSF Own funds requirement	
DKK MILLION	**2021**	**2020**	**2021**	**2020**	**2021**	**2020**	**2021**	**2020**
Credit risk								
- Central governments or central banks	580	377	46	30	18	28	1	2
- Regional governments or local authorities	0	0	0	0	0	0	0	0
- Public sector entities	-	-	-	-	-	-	-	-
- Institutions	1,492	1,149	119	92	1,492	1,055	119	84
- Corporates	36,681	32,331	2,934	2,586	36,681	32,140	2,934	2,571
- Covered bonds and mortgage bonds	502	699	40	56	502	699	40	56
- Exposures in default	1,274	1,476	102	118	1,274	1,476	120	118
- High-risk exposures	-	-	-	-	-	-	-	-
- Exposures with short-term credit assessment	-	-	-	-	-	-	-	-
- Equity exposures	-	-	-	-	-	-	-	-
- Other items	562	527	45	42	562	527	45	42
Total credit risk	**41,090**	**36,559**	**3,287**	**2,925**	**40,529**	**35,924**	**3,242**	**2,874**
Of which, Counterparty risk	1,163	827	93	66	1,163	826	93	66
Market risk								
- Debt instruments	3,045	3,454	244	276	3,045	3,454	244	276
- Shares, etc.	18	18	1	1	18	18	1	1
- Foreign exchange risk	284	265	23	21	284	265	23	21
- Commodity risk	-	-	-	-	-	-	-	-
Total market risk	**3,346**	**3,736**	**268**	**299**	**3,346**	**3,736**	**268**	**299**
Credit valuation adjustment (CVA)	**772**	**501**	**52**	**40**	**772**	**501**	**62**	**40**
Total operational risk	**829**	**880**	**66**	**70**	**829**	**880**	**66**	**70**
Total risk exposure amount	**46,038**	**41,678**	**3,683**	**3,334**	**45,477**	**41,042**	**3,638**	**3,283**

DANISH SHIP FINANCE

Pillar 2 requirements

PILLAR 1	PILLAR 2	COMBINED CAPITAL BUFFERS

Pillar 2 requirements

While Pillar 1 entails the calculation of risks and capital requirements on the basis of uniform rules for all credit institutions, Pillar 2 considers the individual characteristics of a given institution and covers all relevant risk types, including risks not addressed under Pillar 1.

Own funds requirements for specific risk areas

We base our calculations for the Pillar 2 requirement and our total adequate own funds on a number of predefined risk areas and other relevant risk elements:

1. Credit risk including counterparty risk
2. Market risk
3. Liquidity risk
4. Operational and control risk
5. Leverage risk
6. Earnings
7. Growth in lending
8. Other risks

A capital requirement deemed adequate to cover the underlying risks is determined for each risk area. Institutions must decide whether other elements of risk should be considered when calculating adequate own funds. Additionally, the Group's operating results are stress tested to determine, among other things, whether it will require additional capital within the next 12 months.

Credit risk

In its guidelines, the FSA divides credit risk into three subgroups: credit risk exposure to large clients in financial difficulty, other credit risk and credit risk concentration.

Credit risk exposure to large clients in financial difficulty

For large clients in financial difficulty, a conservative loss estimate should be made for each loan. A large client is for this purpose defined as a client whose total credit risk exposure accounts for more than 2% of own funds. Financial difficulty is defined as being either credit impaired (Stage 3) or showing significant signs of weakness since initial recognition without being credit impaired (Stage 2), corresponding to rating steps 1 and 2c on the FSA rating scale.

A large client is defined as a client with a credit exposure of more than DKK 183 million (corresponding to 2% of DKK 9,156 million).

FSA rating steps 1 and 2c refer to clients with a DSF Rating between 9 and 12 on our 12-point internal scale (12 being the weakest, denoting that a client is in default). A detailed description of the FSA rating steps is provided in Appendix 7 of the FSA's instructions for financial reports for credit institutions, etc.

Pursuant to the guideline method for calculating capital charges for large clients in financial difficulty, our Pillar 2 add-on amounted to DKK 34 million as at 31 December 2021.

Other credit risk

Other credit risk primarily covers "other credit risk in the loan portfolio" and "other credit risk associated with financial counterparties".

In our assessment of "other credit risk in the loan portfolio", we consider areas laid down in the guidelines on adequate own funds and internal capital adequacy requirements for credit institutions and sensitivity analyses based on scenarios, and their importance for the need to make loan impairment charges.

In 2020, based on assessments and sensitivity analyses, we made a Pillar 2 reservation of DKK 100 million to absorb potential credit risk impacts arising from Covid-19-related effects. In 2021, this reservation was reassessed and removed, as we no longer view the risk of Covid-19-related loss as elevated given the strong recovery in shipping markets in several segments.

Pursuant to the Executive Order on a Ship Finance Institute, additional capital is required in the event that the LTV exceeds 60% at the time the loan is added to Capital Centre A. In 2021, the Pillar 2 capital reservation was DKK 34 million.

The assessment of "other credit risk associated with financial counterparties" is based on an evaluation of the financial standings of the financial counterparties. The principal risks relate to the investment of the trading book, the majority of which is placed in Danish covered bonds.

The financial standings of financial counterparties and thereby the credit risk associated with the investment of the trading book, and interest rate and exchange rate hedging, etc., are monitored continuously, including an assessment of the capital required to hedge the exposures. Furthermore, bilateral collateral agreements (CSAs) have been signed with financial counterparties to reduce the counterparty credit risk.

Based on the current financial standings of our financial counterparties, we conclude that the Pillar 1 requirement adequately covers the capital requirement concerning “other credit risk associated with financial counterparties”.

Credit risk concentration

Concentration risk is calculated with respect to single-name concentration and sector concentration pursuant to the Executive Order on Calculation of Risk Exposures, Own Funds and Solvency Need.

In its guidelines, the FSA notes that Danish mortgage lenders have a unique profile due to the nature of their core business. Against this background, the assessment of sector concentration does not apply to mortgage lenders, as per the guidelines.

However, the guidelines stipulate that those institutions exempt from these rules must consider the extent to which they have concentration risk that should be addressed and for which capital should be allocated. Based on the sensitivity analyses used in the assessment of “Other credit risk in the loan portfolio”, we find that there is no material risk of loss as a result of sector concentration not covered by the Pillar 1 requirement.

With respect to single-name concentration, we must consider any imbalances in the distribution of exposure sizes in the loan portfolio, irrespective of credit quality. We apply the calculation method stipulated in the guidelines with adjustments approved by the FSA. The Pillar 2 add-on for client concentration has been calculated at DKK 29 million.

Market risk

According to the FSA guidelines, mortgage banks and similar institutions are exempt from Pillar 2 add-ons with respect to market risk. We have nonetheless assessed our market risk based on the guidelines and have adjusted the Pillar 2 add-on for interest rate risk and spread risk accordingly.

Interest rate risk is the risk of incurring a loss due to a change in interest rates. The Pillar 2 add-on for interest risk in the banking book as at 31 December 2021 was calculated at DKK 69 million.

Spread risk arises from rising spreads between individual bonds and the general level of near-risk-free interest rates. The Pillar 2 add-on for spread risk as at 31 December 2021 was calculated at DKK 361 million.

Liquidity risk

The specific balance principle limits the risk that we may assume. Limits specified in our internal policies further mitigate the risk.

Collateral obligations to derivative counterparties do impose a need for liquidity. These are carefully managed and evaluated through risk management tools including stress tests.

Mortgage banks and similar institutions are exempt from Pillar 2 add-ons with respect to liquidity risk. We nevertheless assess our liquidity risk based on the guidelines and conclude that the is covered by the Pillar 1 requirement.

Operational and control risk

Operational risk and control risk under Pillar 2 include business risk, i.e. external factors negatively influencing the business model.

In DSF, business risk would most likely arise from lower credit margins following increased competition or the risk of new regulatory requirements that jeopardise the covered bond status, LCR eligibility or repo access of our bonds. These risks are considered to be adequately monitored and managed.

Reputational risk can affect the size of the risk premium related to issuance of the bonds. We manage this risk by applying an overall conservative approach and holding substantial capital and liquidity reserves.

Leverage

The leverage ratio is calculated as Tier 1 capital relative to the institution’s total exposure value (unweighted). As at 31 December 2021, the leverage ratio was calculated at 9.6% for the Group and 14.1% for DSF.

Pursuant to Article 451(1) of the CRR, institutions must disclose whether they use Tier 1 capital to measure capital, cf. Article 499(1)(a) of the CRR, and whether the leverage ratio is calculated at the end of the quarter.

According to the Basel Committee, the leverage ratio should not be lower than 3%. Therefore, there is no need for the Group to increase the internal capital adequacy requirement to reduce leverage.

Further information on the leverage ratio is provided in Annex 9.

DANISH SHIP FINANCE

Earnings risk

Mortgage lenders with core earnings representing less than 0.1% of loans and guarantees before loan impairment charges and market value adjustments must consider whether this gives rise to an increase in the internal capital adequacy requirement. Core earnings relative to loans and guarantees amounted to 1.0% for 2021.

In addition to the level of earnings, earnings stability also forms part of the internal capital adequacy assessment. Our earning capacity should be assessed in relation to our dividend policy and access to capital. The results of the stress test show that we will not, even in a severe stress scenario, require additional capital within the next 12 months.

We find that the Pillar 1 requirement is sufficient to cover risk relating to our earnings.

Risk from growth in lending

The FSA defines total year-on-year lending growth of 10% or more as potentially exposing an institution to higher-than-normal credit risk. Consequently, institutions with lending growth at this level or above must allocate additional capital. Our annual rate of growth in lending from 2020 to 2021 was 13.6%, which reflects a catch up after a reduction in recent years. From 2019 to 2021, lending has been reduced by 7%.

Other risks

Institutions must assess whether there is a need for a Pillar 2 add-on in respect of strategic risk, group risk and external risk.

No substantial external risks have been identified that may challenge the business model. Therefore, no additional capital has been allocated to cover such risks.

Combined capital buffer requirement

PILLAR 1	PILLAR 2	COMBINED CAPITAL BUFFERS

Pursuant to the Danish Financial Business Act, the combined buffer requirement is an addition to the capital adequacy requirements described on the previous pages. Institutions must have sufficient regulatory capital available to cover the sum of the Pillar 1 and Pillar 2 requirements and the combined capital buffer requirement. If a credit institution does not meet this total capital requirement, it will only be permitted to make distributions, disburse variable pay and make payments relating to AT1 capital instruments if certain conditions are met.

The combined capital buffer requirement consists of:

- **Capital conservation buffer**
  In 2021, the capital conservation buffer was 2.5% of the total risk exposure amount.
- **Systemic risk buffer**
  The systemic risk buffer only applies to SIFI institutions in Denmark.
- **Countercyclical capital buffer**
  The institution-specific countercyclical capital buffer may be applied by the authorities if lending growth results in higher macroprudential risk. This buffer may be between 0% and 2.5% of the total risk exposure amount.

Based on the geographical distribution of credit risk exposures, the capital requirement for the countercyclical capital buffer was calculated at DKK 65 million as at 31 December 2021. The capital requirement pertains to exposures to clients domiciled in Chile, Norway, Hong Kong and Luxembourg, which have set the following countercyclical capital buffer rates:

- Chile: 0.625%
- Norway: 1.00%
- Hong Kong: 1.00%
- Luxembourg: 0.50%

Institution-specific countercyclical capital buffer, DSF

DKK MILLION	2021	2020
Total risk exposure amount	45,477	41,042
Institution-specific countercyclical buffer requirement, DKK million	62	65
Institution-specific countercyclical buffer requirement, %	0.1	0.2

The geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer is provided in Annex 10.

All EU member states can implement a systemic risk buffer applying to domestic exposures. The requirement may apply to the entire sector or to individual subsectors.

The systemic risk buffer is aimed at preventing and mitigating long-term, non-cyclical systemic or macroprudential risks not covered by the Capital Requirements Regulation (CRR). Since the Danish systemic risk buffer rate is only applied to systemically important financial institutions, it is not relevant for DSF.

In accordance with the Executive Order on Management and Control of Banks, etc., we have prepared a capital contingency plan as part of the recovery plan, containing a catalogue of possible courses of action to strengthen our capital position in a critical situation.

The capital contingency plan would take effect in the unlikely event of predefined triggers being activated.

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LEVERAGE RATIO

The leverage ratio is defined as the relationship between Tier 1 capital and the balance sheet total (including off-balance sheet items). The ratio does not factor in any collateral.

The intention is to reduce the risk of excessive leverage and to allow for the potential uncertainty in the determination of capital requirements resulting from the internal models or the standardised approach.

All the Groups material risks and Tier 1 capital are in DSF. The leverage ratio for DSF is 14.1%. In DSH, the leverage ratio is 41.8% and at the Group level it is 9.6%.

The reason that the ratio is significantly lower for the Group than for DSF and DSH alone is the consolidation technique stipulated by the FSA whereby the tied-up reserve capital is included in the determination of consolidated capital adequacy at an amount corresponding to the tied-up reserve capital's proportionate share of the capital requirement. For further information, please refer to the section on "Available own funds".

According to the FSA, policies that contain a total leverage ratio target are a requirement when the leverage ratio is less than 10%. However, for the reasons described above, the Group does not have a policy regarding a target for the total consolidated leverage ratio.

SUPPLEMENTARY COLLATERAL AND OVER COLLATERALIZATION

Pursuant to the Executive Order, the issuance of covered bonds in Capital Centre A requires DSF to post supplementary collateral for loans exceeding an LTV limit of 60% in the event of declining ship values.

The LTV ratios are closely monitored, and the capital centre maintains a collateral buffer should ship values decline.

The general need for supplementary collateral for Capital Centre A was low throughout the year and increased slightly towards the end of the year, averaging 2.6% of issued bonds.

At the end of 2021, the requirement for supplementary capital amounted to DKK 248 million or 3.1% of issued bonds.

The capital requirement for Capital Centre A consists of the mandatory 8% requirement plus the additional capital adequacy requirement and the combined capital buffer.

As at 31 December 2021, Capital Centre A had a cover pool ratio of 21.2%, which is well above the combined capital requirement of 11.6%.

The securities placed in the cover pool can be used for supplementary collateral to cover any breaches of the LTV ratio.

MANAGEMENT DECLARATION

The Board of Directors of both Danish Ship Finance A/S (Danmarks Skibskredit A/S) and Danish Ship Finance Holding A/S (Danmarks Skibskredit Holding A/S) approved the Risk and Capital Management report for 2021 on 28 February 2022.

The Board of Directors finds that the Group's risk management procedures are adequate and provide assurance that the risk management systems in place are adequate in relation to the Group's risk profile and strategy.

The Board of Directors also finds that the Group's overall risk profile in relation to its business strategy, business model and key figures provides a relevant and comprehensive picture of the Group's risk governance, including how the risk profile and the risk tolerance defined by the Board of Directors affect each other.

The Board of Directors made its assessment on the basis of the adopted business model, the latest strategy report, material and reports presented to the Board of Directors by the Executive Board, risk managers and compliance officers, internal controls and any supplementary information or reports obtained. A review of the business model and policies shows that the overall requirements set out in the model for specific risk areas are fully reflected in the more specific limits of the individual policies.

The Group maintains solvency and liquidity well in excess of minimum requirements and seeks to ensure it has an appropriate and robust capital base supporting its business model.

The risk tolerance defined by the Board of Directors is managed via applicable policies and limits.

Copenhagen, 28 February 2022

Board of Directors

Eivind Drachmann Kolding
(Chairman)

Peter Nyegaard
(Vice Chairman)

Marcus Freuchen Christensen

Anders Damgaard*

Povl Christian Lütken Frigast*

Thor Jørgen Guttormsen

Anna-Berit Koertz

Ninna Møller Kristensen

Jacob Meldgaard

Michael Nellemann Pedersen*

Christopher Rex

Henrik Sjøgreen

**) also signed in the capacity of board member of Danmarks Skibskredit Holding A/S*

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DANISH SHIP FINANCE A/S (DANMARKS SKIBSKREDIT A/S)

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