

[DRAFT]

30 December 2008 Strictly private and confidential

 Project Horizon

 ROTHSCHILD

140
5/1

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[DRAFT]

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Government objectives

- Maintaining a functioning, stable banking system
- Unfreezing credit markets / increasing bank lending
 - To households, SMEs, larger corporates
 - Limiting the impact of the credit crisis on the real economy, e.g. bankruptcies
- Preference for private / market rather than state-forced solutions (e.g. nationalisation)
- Equality between banks
- For any Government investment there should be
 - A clear exit timescale and mechanism
 - Value for money for the taxpayer (appropriate upside for the Government's investment)
- Limited use of the Winding-up Company
- Compliance with EU State Aid guidelines
- Any program to be simple and understandable by stakeholders and the public

Issues

- [REDACTED]
- Most banks have difficult shareholder or mutual structures; equity held by the Government would be illiquid
- Banks need to be given choices rather than being forced down a certain route
- If an underwritten route were used, the Government would want to see some shareholders taking up their rights

It is understood that structuring a program which is fair and transparent but also accessible to the smaller and non-listed segment of the banking system in Denmark is a key objective

1. Executive summary

[DRAFT]

1.1 Executive Summary

This paper proposes a 'master scheme' for Government support to recapitalise the Danish banking system

- We have tried to meet as many of the Government's objectives (shown on the facing page) as possible – however not all can be reconciled
- The Danish banking system has a number of peculiarities compared to most European countries:
 - The dominance of Danske
 - Restrictions on the shareholder base in other listed banks
 - The number of small local banks and many mutual or foundation ownership structures where there are no existing shareholders
- [REDACTED]
- We therefore believe that the core instrument offered to banks who can demonstrate that they are fundamentally sound should be a [long dated] hybrid bond, the rate on which is set on a case-by-case basis but with reference to a matrix taking into account
 - capital adequacy
 - size of issue
 - CDS spread (if applicable)
 - credit rating or risk profile
- Note that the Government would be directly subscribing rather than underwriting but that this route gives Danske and other listed banks the opportunity to undertake a rights issue on their own at the same time or sequentially

I. Executive summary

1.1 Executive Summary (cont.)

- The rate on the hybrid bond would be reduced to the extent that a warrant is offered and is acceptable to the Government
 - We suggest that the Government only consider warrants into listed securities as it gives it liquidity: [REDACTED]
 - [REDACTED]
- In these circumstances we would expect [REDACTED] to be cash paying between (say) 7 to 9 % on the hybrid (plus the upside of a warrant) whereas [REDACTED] (say) 14% on the hybrid as they are riskier and cannot provide a suitable warrant
- However, as this may be an expensive option we also propose that the Government sets up and capitalises (with ordinary shares) a Master Co-operative Bank ("MCB") to give an alternative to the smaller banks. Any smaller bank which did not wish to take up the hybrid could request that they be acquired by the MCB in return for shares, based on an independent valuation at that time
 - E.g. if Foundation X owned Fynbank, that foundation would sell the assets and liabilities into MCB and hold shares in MCB instead. The objectives of Fynbank would be incorporated, where feasible, into MCB's objectives
 - The intention of MCB would be to list in (say) 5 to 7 years time at which stage the Government would intend to exit and participants such as Foundation X could decide whether to continue ownership or to sell.

Composition of total lending exposure (DKK bn 2007)

100%

80%

60%

40%

20%

0%

4

336

Group 1

5 banks

- Danske Bank
- FIH Erhvervsbank
- Jyske Bank
- Norddea Bank Danmark
- Sydbank

Group 2

12 banks

- Alm. Brand Bank A/S
- Amagerbanken Aktieselskab
- Arbejdernes Landsbank Aktieselskab
- Fioria Bank
- Forstadesernes Bank A/S (acquired by Nykredit)
- Nykredit Bank A/S
- Rindgjøbeling Landbobank, Aktieselskab
- Roskilde Bank, Aktieselskab (in liquidation)
- Sparbank A/S
- Sper Nord Bank A/S
- Sammenslutningen Danske Andetkasser
- Vestjysk Bank A/S

Group 3

89 banks

- Lån og Spar Bank A/S, Sjælland, Sparekassen, Dragetholm Sparekasse, bankTrelteborg A/S, Fanejord Sparekasse, Sparekassen Lolland A/S, Middelfart Sparekasse, Faaborg A/S, Sparekassen, Svendborg Sparekasse, Saxo Bank A/S, E-TRADE Bank A/S, Basisbank A/S, Fransbanken A/S, Danske Andetkassers Bank A/S, DBa Bank A/S, Max Bank A/S, Skandinaviska Enskilda Banken A/S, Mars Bank A/S, Skissler Bank Aktieselskab, Vordingborg Bank A/S, Lokalbanken i Nordjylland a/s, Grenlandsbanken Aktieselskab, BIRF Bank A/S, Lollands Bank Aktieselskab, Løgmernes Pensjonsbank A/S, Vestfyns Bank A/S, Nordfyns Bank Aktieselskab, Totobanken A/S, Østjysk Bank A/S, Aarhus Lokalbank Aktieselskab, Djurslands Bank A/S, Morsø Bank Aktieselskab, A/S Narmourby Bank, Hvidbjerg Bank Aktieselskab, Pen-Sam Bank A/S, Rindgjøbeling Bank Aktieselskab, Bank Danmark A/S, Capinordic Bank A/S, FIH Kapital Bank A/S, Carmegle Bank A/S, Tandøer Bank A/S, Nordjyske Bank A/S, Gudme Raaschou Bank A/S, Dexia Vendeysse, eob bank a/s, Thy Sparekassen, Morsø Sparekasse A/S, Sparekassen Limfjorden, Freløvs-Møllerup Sparekasse, EkspresBank A/S, Sparekassen Spar Mors, Bank DnB Nord A/S, Farø Sparekassen, EK Bank Danmark A/S, Midtjyd Sparekassen, Hals Sparekasse, Himmerland A/S Sparekassen, Utsed Sparekasse, Sparekassen i Slags, Langå Sparekasse, Spar Salling Sparekasse, Sparekassen Bølling, Sparekassen Kronjylland, Sparekassen Høbro, Den lille Sparekasse, Sparekassen Djursland, Sparekassen Østjylland, Sparekassen for Nr. Nebel og Omegn, Farø Sparekasse, Den Jyske Sparekasse, Vortesse-Højnsvig Sparekasse, Branup Sparekasse, Fries Herreds Sparekasse, Broager Sparekasse, Sparekassen Legumkøster, Sparekassen Bredebro, Føllesparerkassen, Carlsbank, Frarup Andetkasse, Andetkassen Fælleskassen, Den Almennyttig Merkur

Group 4

41 banks

- Refsnæs Sparekasse, Sparekassen for Arns Herred, Sparekassen Den lille Blikube, Hårlev Sparekasse, Kongeald Sparekasse, Fiemelse Sparekasse, Rise Spare- og Lånekasse, Leasing Fyn og Factoring Bank Aktieselskab, Ø. Brønderslev Sparekasse, Sparekassen Nordmors, Boddum-Ydy Sparekasse, Sønderhå-Hersted Sparekasse, Kilm Sparekasse, Hunstrup-Esterild Sparekasse, St. Brøndum Sparekasse, Volelev Sogns Spare- og Lånekasse, Rønde og Omegns Sparekasse, Agri-Egens Sparekasse, Høigenæs Sparekasse, Vistoft Sparekasse, Tved Sparekasse, Søby-Skader-Halling Spare- og Lånekasse, Sparekassen Midtdjurs, Fruering-Viaved Sparekasse, Ulborg Sparekasse, Sladl Sogns Spare- og Lånekasse, Borbjerg Sparekasse, Fjalling-Trans Sparekasse, Lunde-Kyong Andetkasse, Ryfings Andetkasse, Fæster Andetkasse, København Andetkasse, Andetkassen OIKOS, J.A.K. Andetkassen Brøndrup, Andetkassen J.A.K. Ebeltoft, Andetkassen J.A.K. Slagelse, J.A.K. Andetkassen Østervraa, J.A.K. Andetkassen Vårde, Thisted Andetkasse, J.A.K. Andetkassen Rødding, Funder Fælleskasse Andetkasse

Groups

■ 1 ■ 2 ■ 3 ■ 4

Total: DKK 2,747 bn

Note includes lending activities abroad

Source Finansstatistik

2. Classification of the Danish banking sector [DRAFT]

2.1 Overview

Danish banks and mortgage institutions

- The Danish banking system is characterised by a high number of financial institutions. The majority of them are local savings banks
- The Danish FSA uses a four-tier classification of banks
 - Group 1: banks with capital in excess of DKK 50bn (5 banks)
 - Group 2: banks with capital between DKK 10bn and DKK 50bn (12 banks)
 - Group 3: banks with capital between DKK 250m and DKK 10bn (89 banks)
 - Group 4: banks with capital below DKK 250m (41 banks)
- In addition, there are 8 mortgage institutions in Denmark: BRFKredit, DLR Kredit, FIH Realkredit, LR Realkredit, Nordea Kredit Realkreditaktieselskab, Nykredit Realkredit, Realkredit Danmark and Totalkredit

Key issues and recent events

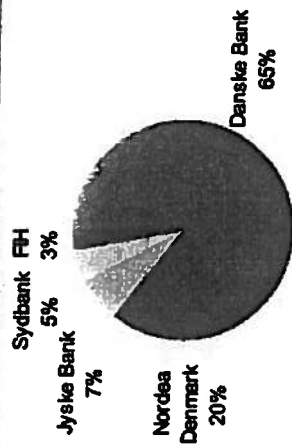
- Recent problems across Groups 1 and 2
 - Quality of loan portfolios is worsening; increasing loan losses expected in 2009-10
 - Issues with funding and capital, the current bank rescue scheme is thought to be unlikely to adequately address the wider problems
 - Risk of banks becoming insolvent – Roskilde bank has been the largest casualty so far, also FIH's parent Kaupthing was nationalised
- Covered bond markets are difficult to access at the moment. These have been widely utilised, in order to sustain the high loans-to-deposits ratios across the banking system. Danish banks are now facing funding problems as debt falls due for refinancing. Nevertheless, access is still open for better quality issues – e.g. Nykredit bonds were rated AAA by S&P in November
- Banks in Groups 3 and 4 have broadly adopted a savings bank model. It is understood that potential future funding problems and large exposures pose a threat to these Groups

Concentration by total loan exposure within the Groups (2007 data)

Around 90% of the country's lending base can be accounted for by 25 banks:

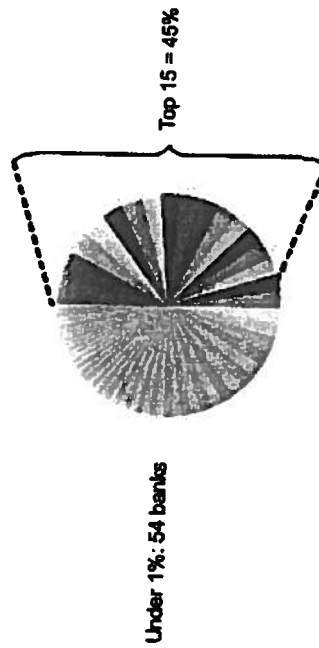
- All of Group 1
- Top 5 Group 2 banks
- Top 15 Group 3 banks

Group 1 (Total: DKK 2,061 bn)

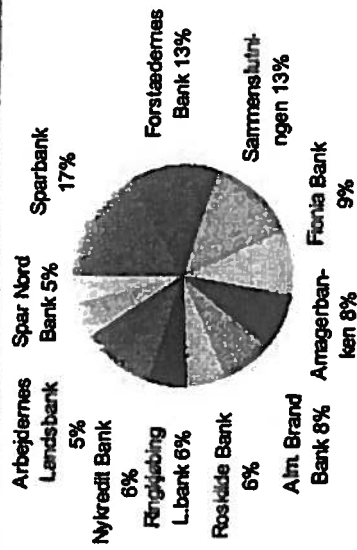


Note Danske Bank numbers include lending outside Denmark

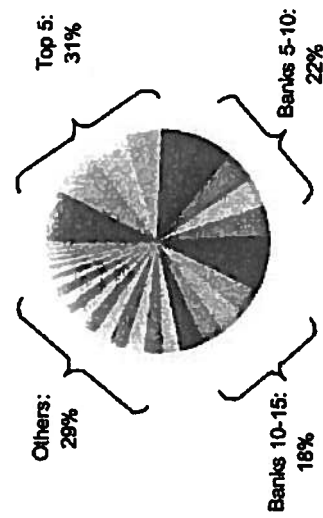
Group 3 (Total: DKK 3,380 bn)



Group 2 (Total: DKK 3,440 bn)



Group 4 (Total: DKK 4 bn)



Source Finansstatistik, Company information

[DRAFT]

2. Classification of the Danish banking sector

2.2 Key metrics and loan exposure of the Groups

Average key metrics by group (30 Jun 2008)

Group	Tier 1 ratio (%)	Total capital ratio (%)	Loans to deposits ratio (%)	Loans to equity ratio (x)	Cost-income ratio
Group 1	10.5	13.7	127.1	10.9	61%
Group 2	9.9	11.6	154.7	8.4	132%*
Group 3	16.6	19.2	120.3	5.8	75%
Group 4	22.4	22.8	84.3	3.9	104%

Note: Group 4 Tier 1 and Total Capital ratios shown as at 30 Jun 2008

Note * Cost-income ratio inflated in H1 2008 due to inclusion of Roskilde in official statistics

Data as of 30 Jun 2008

Loans and deposits exposure by group (30 Jun 2008)

	Group 1 DKKbn %	Group 2 DKKbn %	Group 3 DKKbn %	Group 4 DKKbn %	Total DKKbn %
Public authorities	64.4 3%	1.7 1%	1.6 0%	0.0 0%	67.7 2%
Business					
Agriculture and forestry	50.5 2%	19.0 6%	23.6 7%	0.4 0%	93.8 3%
Fishing	4.1 0%	0.8 0%	1.3 0%	0.0 0%	6.2 0%
Manufacturing, utilities and energy	194.3 9%	17.6 5%	17.5 5%	0.1 2%	229.7 8%
Construction	35.1 2%	16.3 5%	14.6 4%	0.2 5%	66.3 2%
Retail and leisure	124.0 6%	20.4 6%	20.4 6%	0.3 7%	165.3 6%
Transport and telecoms	68.4 3%	5.4 2%	5.6 2%	0.1 2%	79.6 3%
Financial institutions	667.5 32%	45.7 1%	20.2 6%	0.1 1%	733.9 27%
Property	297.8 14%	76.9 22%	62.3 18%	0.2 6%	437.9 16%
Other	45.3 2%	23.3 7%	30.8 9%	0.2 5%	99.6 4%
Total	1,487.1	225.5	186.3	1.6	1,910.5
Private customers	508.7 25%	116.5 34%	140.6 42%	2.7 63%	770.5 28%
Total	2,061.1	343.7	338.5	4.3	2,747.6

Source: Finansstatistik

One of the key areas of concern in both Groups 2 and 3 is their significant exposure to the property and, to an extent, also the construction sector

Benchmarking the key players

Size metrics (RWAs as at 30 Sep 2008)

Name	Loan exposure (2007, DKKm)	RWAs (30 Sep 08, DKKm)	Largest sector exposures
Group 1			
Danske Bank A/S	1,344,122	646,741	Financial institutions, Property
FH Erhvervsbank A/S	64,313	69,297	Property, Manufacturing
Jyske Bank A/S	144,444	91,935	Financial institutions, Property
Nordea Bank Danmark A/S	414,326	290,065	Financial institutions, Property
Sydbank A/S	93,915	58,994	Property, Financial institutions
Group 2			
Alm Brand Bank A/S	25,980	16,443	Property, Financial institutions
Amagerbanken Aktieselskab	27,246	25,132	Property, Financial institutions
Arbejdernes Landsbank, Aktieselskab	18,524	15,820	Financial institutions, Property
Floria Bank A/S	32,226	20,408	Property
Forstædernes Bank A/S	44,972	26,469	Property, Financial institutions
Nykredit Bank A/S	19,226	64,471	Agriculture and forestry
Fingylabing Landbobank, Aktieselskab	20,057	14,135	Financial institutions, Property
Roskilde Bank, Aktieselskab (in liquidation)	20,179	n/a	Property, Agriculture and forestry
Sammenslutningen Danske Andelskasser	44,728	12,623	Financial institutions, Property
Spar Nord Bank A/S	17,389	38,132	Property
Sparbank A/S	58,514	15,024	Property, Financial institutions
Vestjysk Bank A/S	14,656	18,199	Agriculture and forestry, Retail and Leisure

Source: Finansstatistiknet

2. Classification of the Danish banking sector [DRAFT]

2.3 Benchmarking the key players

Quality metrics (30 Sep 2008)

Name	Tier 1 ratio (%)	Total capital ratio (%)	Loans to deposits ratio (%)	Loans to equity ratio	Cost-income ratio (%)
Group 1					
Danske Bank A/S	12.3	16.6	147.0	10.5x	59.9
FH Erhvervsbank A/S	10.7	14.1	697.0	7.6x	48.3
Jyske Bank A/S	10.1	11.5	113.6	12.2x	61.7
Nordea Bank Danmark A/S	8.0	10.8	114.2	11.7x	64.1
Sydbank A/S	11.2	15.6	133.5	13.1x	61.0
Group 2					
Alm. Brand Bank A/S	7.4	10.2	159.5	14.2x	156.3
Arbejdsbanken Aktieselskab	7.7	11.6	226.5	10.5x	55.6
Arbejdernes Landsbank, Aktieselskab	11.5	11.5	102.6	4.9x	88.5
Floria Bank A/S	7.6	10.2	178.4	10.5x	95.2
Forstødernes Bank A/S	7.1	10.7	178.6	11.1x	90.9
Nykredit Bank A/S	7.7	10.4	184.1	9.5x	64.5
Ringkjøbing Landbobank, Aktieselskab	12.6	15.7	158.6	7.8x	32.4
Roskilde Bank, Aktieselskab (in liquidation)	n/m	n/m	n/a	n/m	n/m
Sammenslutningen Danske Andelskasser	13.7	13.7	100.1	4.7x	104.2
Spar Nord Bank A/S	10.2	11.8	119.4	9.7x	66.2
Sparbank A/S	9.5	11.1	134.9	7.8x	76.3
Vestlysk Bank A/S	7.3	10.3	158.4	9.0x	61.0

Source: Finanstilsynet

Data as of 30 Jun 2008

Tier 1 ratios across Groups 1 and 2 are widely distributed

However, higher Tier 1 ratios (especially so for smaller lenders) may actually be misrepresentative of the absolute impact of potential loan losses on their portfolios

[DRAFT] 2. Classification of the Danish banking sector

2.3 Benchmarking the key players (cont.)

Market metrics (30 Sep 2008)

Name	RWAs (DKKm)	Mkt cap (DKKm)	P/BK ratio	Ownership type	Voting restrictions	Key shareholders
Group 1						
Danske Bank A/S	648,741	35,639	0.34x	Public		A.P. Møller-Mærsk, Realdanmark
FH Erhvervsbank A/S	69,297	nm	nm	Public subsidiary		Kaupthing / Liquidator
Jyske Bank A/S	91,935	6,642	0.64x	Public	Max 4,000 votes	Foreningen Nykredit
Nordea Bank Danmark A/S	290,065	nm	nm	Public subsidiary		Nordea
Sydbank A/S	58,994	4,371	0.61x	Public	Max 5,000 votes	ATP, Foreningen Nykredit
Group 2						
Alm. Brand Bank A/S	16,443	1,227	0.26x	Public	None - access to capital?	Alm. Brand af 1972 (policy holders)
Amagerbanken Aktieselskab	25,132	184	n/a	Public	Max votes 1/1,000 of capital	FFA Pension, Foreningen Nykr.
Arbejdernes Landsbank, Aktieselskab	15,820	nm	nm	Cooperative		Unions
Floria Bank A/S	20,408	343	0.20x	Public	Max 10,000 votes / 10% cap.	Foundation (Floria Aktiefond)
Forstædernes Bank A/S	26,469	nm	nm	Private subsidiary		Nykredit
Nykredit Bank A/S	64,471	nm	nm	Cooperative		Foreningen Nykredit (policy holders)
Ringjæbing Landbobank, Aktieselskab	14,135	1,512	0.82x	Public	Max 2 votes	ATP
Roskilde Bank, Aktieselskab (in liquidation)	n/a	nm	nm	In liquidation		No major private shareholders
Sammenslutningen Danske Andelskasser	12,623	nm	nm	Cooperative		23 cooperative banks
Spar Nord Bank A/S	38,132	2,448	0.58x	Public	Shareholder regions / delegates	Spar Nord Fonden, Nykredit
Sparbank A/S	15,024	434	0.27x	Public	Max 1,000 votes / 10% cap.	Spar Vest Fonden
Vestjysk Bank A/S	18,199	443	0.25x	Public	Max 3% of capital	Pakler Helm, ATP

Note * Denotes banks for which estimated potential loan losses applied to 2007 RWAs under a 95% confidence interval (official estimates of 2.85% of RWAs for Group 1; 3.36% for Group 2) would exceed the market capitalisation

Source Factset, Company Information, L1onshares, Finansstatistiknet

The depressed market values of most listed Danish banks imply that in some cases the potential estimated loan losses exceed the current market capitalisation under a stress scenario (e.g. 5% likelihood)

3. Structuring a solution

3.1 Government key investment criteria

- We assume the Government will wish to ensure that any investment into the financial system, where taxpayers money is put at risk, will be priced to reflect the nature of the investment / entity. Key criteria in structuring any scheme will include:
 - Application of market terms
 - Preference for liquid instruments or instruments that are as liquid as practicable in the circumstances; or availability of alternative exit routes
 - Securing voting rights in the investee entity where the type of investment being made reasonably requires such rights to be obtained

- In addition, we understand that it is the Government's objective to follow a system that ensures, as far as possible, equality between the banks, transparency of process and creation of clear audit trails

- Given the significant differences in type of entity in the Danish banking system, the Government's objectives cannot be achieved through a "one size fits all" policy. However, the approach suggested overleaf attempts to reflect an equitable and consistent program but one which is flexible enough to meet the different circumstances of the banks

Significant differences within the Danish Banking sector pose a challenge for a "one size fits all" solution – but do not necessarily prevent a consistent policy approach

3. Structuring a solution

3.2 Program outline (1/2)



- Banks filtered into those which are "fundamentally sound" and those which are "distressed"**
- Distressed banks to be dealt with by the Winding-up Company – possibly as a precursor to entry to the "Master Cooperative Bank" (MCB) if appropriate (see overleaf)
 - For fundamentally sound banks, to provide consistency / equality, the program could follow a number of key principles
 - Banks applying for assistance would need to demonstrate they are fundamentally sound by complying with set criteria in a pro forma application



- Hybrid instrument with to form the core of the program for all banks (e.g. detachable warrants)**
- Consistent with Government preference not to invest in ordinary shares
 - Direct equity investment not suitable in any case for entities without ordinary shares in issue, limited free float or too small a market capitalisation (the Government stake is so large that it *de facto* becomes a take-over). Banks with limited free float could (if they chose) change the nature of their listing to allow warrants and so benefit from a lower coupon



- Warrants provide a mechanism for delivery of upside to the Government**
- Where unsuitable / unable to provide warrants (e.g. where limitation on voting rights in the entity and/or size of market capitalisation), the banks would:
 - Be required to pay a higher coupon on the hybrid; and
 - if the resulting coupon does not appear to be supported by a stress-tested business plan, consideration to be given whether entity must in any event fall into either Winding-up Company or the MCB as appropriate

3. Structuring a solution

3.2 Program outline (2/2)

Coupon to be paid before ordinary dividends

- Dividend-linked step-up provisions on the coupon / call price step-up to encourage redemption; where not practical to link to increase in the ordinary dividend (such as for mutuals), consider ability to link to an alternative metric such as increase in retained profits

In addition, Government to create and capitalise (through ordinary shares) a new co-operative bank - Government's "Master Cooperative Bank" (MCB)

- Fundamentally sound savings banks may apply for the MCB to acquire their businesses in return for shares to be issued to policy holders or newly established charitable foundations (i.e. Fionia Fondation model)
- On each acquisition, an independent valuation at the time to determine a) if the bank is fundamentally sound and b) the number of shares to issue to the owner
- State has medium term (say, 5-7 years) intention to IPO the MCB so Government, and members, can realise value
- Given the nature of the smaller non-public or heavily protected listed banks, the market terms for hybrid instruments are likely to be so expensive that the MCB is an attractive alternative. It gives fair credit to the value of the institution / franchise while allowing for continued service of customer / geographic markets (MCB assumed to continue to operate acquired operations / branches). The option to sell assets into the MCB may also be considered

3. Structuring a solution

3.3 Application of the criteria

Banks divided into four groups reflecting their circumstances, with the outlined general criteria applied:

Listed banks capable of implementing their own market solution

- Hybrid investment with warrants

Subsidiaries of overseas banks

- Hybrid invested at the country level
- Provisions to ensure that the capital retained at the level invested and not channelled up to the parent
- Warrants for ordinary shares at the parent / listed company level if available (would reduce coupon)

Other Danish listed banks

- Following the general principles (hybrid instrument with warrants) but with higher coupon where offering warrants would be impractical
- Option to also be available to sell into the MCB

Unlisted banks

- As with option 3, with ability to sell into the MCB
- It is envisaged that all participating institutions will be given the option to "upgrade" to a cheaper coupon when steps are taken to address voting and liquidity issues (e.g. abolishment of voting restrictions and dilution of foundation holdings blocking market solutions, capital raisings or mergers)

Pricing

- To follow EC / ECB guidelines
- Negotiations bank by bank (or at least by category of bank) to reflect circumstances
- Base coupon on hybrid with warrants to be [at least 9% - to be adjusted for voting restrictions and lack of liquidity]