DANISH
SHIP FINANCE

RISK REPORT 2014

CVR NO. 27 49 26 49

INTRODUCTION

The purpose of this risk report is to provide a description of 1) risk and capital management and 2) the composition of the total capital and risks in relation thereto in accordance with the disclosure requirements set out in Part 8 to the Capital Requirements Regulation (CRR). In addition, the report includes a description of the various types of balance sheet and off-balance sheet risks that the company is exposed to.

The risk report is published in connection with the presentation of the annual report. The risk report is available on: www.shipfinance.dk/en/InvestorRelations/Risiko--og-kapitalstyring/Risikorapport

The company regularly assesses whether there is a need for publication more frequently than once a year.

There is no audit requirement in respect of the risk report, and it has been decided not to have the Risk Report for 2014 be subject to an audit.

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RISK MANAGEMENT

Risk management is given top priority because the various risks may have an adverse impact on financial performance and solvency and, by extension, weaken future business opportunities.

ALLOCATION OF RESPONSIBILITIES

The Board of Directors has the overall responsibility for ensuring appropriate risk management procedures. The risk policies established by the Board of Directors, including written guidelines for the Management Board, and the legislative framework govern the company's risk management.

The Management Board has the overall day-to-day responsibility for managing the company's risks and for reporting such risks to the Board of Directors. Risk management forms an integral part of the day-to-day operations and is pursued through policies and control measures prepared to retain an effective control environment. Based on regular reports about developments in the company's risks, the Management Board continuously assesses the company's exposures and resolve on any steps to mitigate identified risks.

Pursuant to the Executive Order on Governance, the company must appoint a Chief Risk Officer. The Chief Risk Officer is responsible for ensuring an adequate risk management process in the company and that an overview is established of the company's risk and total risk exposure. The Management Board has appointed a member of the Management Board as the company's Chief Risk Officer. The background is an assessment of the company's size and complexity, and the Management Board has found that it was unnecessary and inappropriate to appoint an employee with no other responsibilities than risk management.

In addition, the company has appointed a compliance manager, whose duties involve ensuring compliance with applicable legislation, market standards and internal rules and also ensuring that the company applies effective methods and procedures suitable for identifying and mitigating the risk of non-compliance.

REGULATION

Danish Ship Finance is governed by its own regulation 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). With the Act and the Executive Order, the company is governed by parts of the Danish Financial Business Act and the regulation on prudential requirements for credit institutions and investment firms (CRR). The company is also governed by:

- The Executive Order on Bond Issuance, the Balance Principle and Risk Management (the Bond Executive Order)
- The Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need
- The Executive Order on Governance, Risk Management, etc. for Financial Institutions (the Executive Order on Governance)
- The Executive Order on Financial Reports by Credit Institutions and Investment Companies, etc. (the Executive Order on Financial Reporting)

Like other financial enterprises, the company is supervised by the Danish Financial Supervisory Authority.

INTERNAL AUDIT

In accordance with applicable legislation, the Board of Directors, including the Audit Committee, regularly assesses the need for an internal audit function. The Board of Directors has decided that the combination of an internal control function, which regularly monitors compliance with the company's in-house business processes and control procedures in all significant areas and sharp attention by the external auditors helps to provide a satisfactory audit and control level. The work of the internal control function is planned by the external auditors.

WHISTLEBLOWER SCHEME

In accordance with the Danish Financial Business Act, the company has implemented an internal whistleblower scheme, which enables its employees to report any instances of non-compliance with the financial legislation to an independent third party. On receipt of such reports, the inde-

REPORTING TO THE BOARD OF DIRECTORS

Report	Frequency
Compliance reporting	Yearly
Report from Chief Risk Officer	Yearly
Authorisation list*	Each ordinary board meeting
Financial reporting	Quarterly
Internal financial reporting	Quarterly
Credit reports	Quarterly
Memorandum on weak credit exposures	Quarterly
Statement to be used for risk assessment	Yearly
Stress test	Quarterly
Annual asset review	Yearly

** Definition: "Loans or guarantees, increases, debtor replacements and other material changes to loans, including the granting of any breach of loan agreements granted by the Management Board".*

pendent third party will make a tentative screening of the report to assess whether the instance of non-compliance falls within the scope of the whistleblower scheme.

The company will regularly assess whether to expand the scheme so that the employees may also report any instances of economic crime.

REPORTING

The Board of Directors is provided with regular reports to ensure that its members have the necessary information about risk developments etc. On the basis of these reports, the Board of Directors assesses the overall policies, framework and principles for risk and capital management.

RISK TARGETS AND POLICIES

The company is exposed to different types of risk. On the basis of the company's business model and strategic goals, the Board of Directors defines risk policies and principles of risk and capital management. The purpose of the risk management policies is to define limits for the risks the company may undertake.

Credit risk represents the bulk of the overall risk exposure. Market risk and operational risk represent the other risks, whilst the company has limited liquidity exposure due to the rules of the Bond Executive Order.

The credit risk should be seen primarily as the risk associated with the borrower's inability to repay the loan with interest in due time. The company provides financing against a first mortgage in vessels and in special cases financing of the shipowner's payment of instalments to a shipyard. The company's credit policy defines overall targets to ensure a controllable lending risk. As part of the credit policy, in its loan portfolio the company seeks to ensure good credit quality and risk diversification in respect of borrowers and vessel types. When granting credit to new as well as existing customers, focus will be on vessel characteristics, the financial standing of the borrower, the terms of the loan and on the loan's contribution to compliance with the diversification rules. Credit risk associated with the company's financial counterparties is managed through a policy on managing counterparty risk. In this way, the company defines limits for the exposure to individual financial counterparties and the countries in which such counterparties are residents.

Market risk covers primarily interest rate, foreign exchange and liquidity risks, governed by lines defined in the Bond Executive Order and the Executive Order. The principal financial risks are centred on the securities portfolio. The overall goal is to avoid financial positions jeopardising the company's solvency or continued existence, and to make sure that interest rate and foreign exchange risks are managed by hedging or through intended open positions and that the company achieves the highest possible return with due consideration to the risk targets defined.

Liquidity risk represents a limited part of the overall risk exposure, as the company applies the specific balance principle in accordance with the Bond Executive Order. In addition, the liquidity policy defines liquidity risk limits in order to ensure consistently adequate liquidity. Liquidity management is generally carried out to ensure that the company's cost of funding does not become disproportionately high and to avoid that lack of funding prevents the company from retaining its business model. Ultimately, the purpose of the company's liquidity management is to ensure that it is consistently able to meet its payment obligations.

Operational risks primarily concern the credit area, the finance area, compliance and IT application. Operational risks are managed by way of a policy for operational risks, business procedures and internal controls issued by the Board of Directors. The policy defines the overall strategic goals for operational risks and instructions on how to achieve such goals. On an ongoing basis, the company registers losses and events deemed to be attributable to operational risks. The registration is used as a basis for assessing whether business procedures etc. should be adjusted in order to avoid or mitigate operational risks.

USE OF ECAIs

The company uses Standard & Poor's Ratings Services as its external credit assessment institution (ECAI).

The credit assessment classes used by Standard & Poor's Ratings Services are converted to credit quality steps using the Danish FSA's conversion table. Each credit quality step is designated a risk weighting to be used for the exposures at the individual credit quality steps when calculating the risk-weighted exposures under the standardised approach for credit risk.

The table below shows the Danish FSA's conversion of Standard & Poor's Ratings Services' credit assessment classes for credit quality steps for exposures to business entities, institutions, sovereigns and central banks.

Credit quality step	Standard & Poor's credit assessment classes	Exposures to business entities (corporates)	Exposures to institutions with a term to maturity of more than three months	Exposures to sovereigns 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 CREDIT ASSESSMENTS FROM STANDARD & POOR'S RATINGS SERVICES

Exposure class DKKm.	Exposure value before risk weighting	Exposure value after weighting with credit quality steps
Exposure to sovereigns and central banks	200	72
Exposure to public entities	0	0
Exposure to regional and local governments	0	0
Exposure to institutions	5,828	2,049
Exposure to business entities	36,838	36,880
Exposure by way of covered bonds and mortgage covered bonds	4,951	531

CAPITAL MANAGEMENT

Pursuant to the Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need, Danish Ship Finance must maintain a certain amount of capital relative to its activities, so that the total capital as a minimum matches the company's risk profile and complies with the legislative requirement.

There must be capital to cover the requirement at the existing and the expected level of activity in order to comply with the statutory rules and targets determined by the company itself.

The regulatory framework for capital management is defined in the Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need. The framework builds on three pillars:

- Pillar I contains a set of rules for calculating the total capital requirement, which is 8% of the total risk exposure amount for the three types of risk: Credit, Market and Operational risk.
- Pillar II contains a set of rules for how to calculate the adequate total capital, taking into consideration the company's individual characteristics, and all relevant risk types are included, irrespective of whether they are included in Pillar I or not.
- Pillar III sets forth rules on disclosure obligations, as a result of which the company, at least once annually, must disclose information on capital matters, its risk profile etc.

The Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need provides some freedom to choose methodology when calculating the adequate total capital. The reason is that companies must match their calculation methods to their risk profile. The company's management believes that the company has shown the necessary prudence.

CAPITAL TARGET

The capital target defined by the Board of Directors is based on a solvency that is sufficient for the company to continue its lending operations even in case of large cyclical fluctuations and difficult business conditions and to ensure compliance with statutory requirements.

At the end of 2014, the capital ratio was 16.4, against 17.0 at the end of 2013. The capital ratio is believed to be adequate to meet the above-mentioned target.

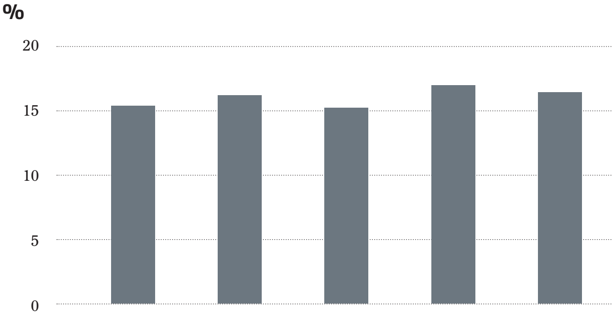
The increase in the total capital in 2014 was due to the consolidation after dividends for the year. The lower capital ratio was due to a higher percentage increase in the total risk exposure amount. The increase in the total risk exposure amount was primarily caused by an increase in the USD/DKK exchange rate and, to a lesser extent, by the fact that from 2014 a credit valuation adjustment charge (CVA charge) must be recognised for financial parties. The CVA charge reflects the market value of the counterparty credit risk for the company.

CALCULATION OF CAPITAL RATIO

DKKm/%	2014	2013
Total capital less deductions	9,682	9,312
Total risk exposure amount	58,883	54,817
Capital ratio	**16.4**	**17.0**

CAPITAL RATIO

%



TOTAL CAPITAL

The total capital is subordinated to ordinary creditors in the event that a financial undertaking goes bankrupt. The total capital can be composed of three different types of capital: core (tier 1) capital, hybrid tier 1 capital and tier 2 capital, and the relationship between total capital and total risk exposure amount is the capital ratio (previously the solvency ratio).

Tier 1 capital
Tier 1 capital is the capital that represents the core of the total capital of financial enterprises. The tier 1 capital primarily consists of paid-up share capital or guarantee capital and reserves in a credit institution.

Hybrid tier 1 capital
Hybrid tier 1 capital is a mixture of share capital and loan capital. There are special rules on how large a proportion of the hybrid tier 1 capital can be included as part of the tier 1 capital. The part of the hybrid tier 1 capital that cannot be included in tier 1 capital may instead be included in tier 2 capital.

Tier 2 capital
Tier 2 capital is the capital that supplements the tier 1 capital and the hybrid tier 1 capital in financial enterprises. Tier 2 capital consists, among other things, of subordinated loan capital subject to high risk exposure.

The total capital must consistently be higher than the adequate total capital.

Adequate total capital
The adequate total capital is calculated on the basis of a financial institution's risk profile. The calculation is made on the basis of the Danish FSA's 8+ approach, which is described later in this risk report.

Individual solvency need
The individual solvency need is expressed as the adequate total capital as a percentage of the total risk exposure amount. The individual solvency need must not be lower than 8% of the total risk exposure amount (total capital requirement). The individual solvency need is a "soft requirement", so as to give a non-complying institution time to restructure its total capital. When relevant, the FSA will order the institute to take the necessary steps.

Total capital requirement
The total capital requirement, or the Pillar I requirement, describes the statutory requirements for financial enterprises. For a credit institution, the total capital must represent at least 8% of the institution's total risk exposure amount. The total capital requirement is a hard requirement, which means that non-compliance will lead to withdrawal of the license.

Movements in the total capital are determined primarily by the profit/loss for the year and the company's dividend policy.

The company's total capital consists exclusively of common equity tier 1 capital in the form of share capital, tied-up reserve capital and retained earnings. The tied-up reserve capital may only be used to cover losses which cannot be covered by amounts available for dividend distribution. The tied-up reserve capital shall as far as possible be restored by advance transfer of the profit for the year, if, in prior years, it was wholly or partly used to cover losses. Hence, no dividends shall be paid and no distributions shall be made in connection with capital reductions until the tied-up reserve capital has been restored to the same nominal amount as the undistributable reserve had before being used wholly or partly to cover losses.

The tied-up reserve capital was established in connection with the conversion from a foundation into a limited liability company.

The company has not raised additional tier 1 capital or tier 2 capital.

The total capital less deductions amounted to DKK 9,682 million at 31 December 2014, against DKK 9,312 million in 2013.

CALCULATION OF TOTAL CAPITAL LESS DEDUCTIONS

DKKm	2014	2013
Common equity tier 1 capital		
Share capital	333	333
Tied-up reserve capital	8,343	8,343
Retained earnings	2,460	1,297
Revaluation reserve	10	10
Total common equity tier 1 capital	**11,146**	**9,983**
Deductions from common equity tier 1 capital		
Proposed dividends	1,181	405
Deferred tax assets	-	162
Additional straining pursuant to the Executive Order	85	104
Prudent valuation of trading portfolio	198	-
Total deductions from common equity tier 1 capital	**1,464**	**671**
Common equity tier 1 capital less statutory deductions	**9,682**	**9,312**
Total capital less deductions	**9,682**	**9,312**

TOTAL CAPITAL REQUIREMENT

Pursuant to legislation, a ship finance institute must have total capital which as a minimum amounts to the sum of the total capital requirement for credit risk, market risk and operational risk.

Because the Capital Requirement Directive has been implemented in Danish legislation, the company may choose between different methods for calculating its risk exposure amounts for each of the three overall types of risk included in the determination of the total capital requirement. The company has not applied for a permission from the Danish FSA to apply one of the internal methods. The company applies the standardised approach for calculating the total risk exposure amount and the total capital requirement for credit and market risks. When using the standardised approach, the risk weights are defined in the legislation. In addition, the company applies the basic indicator approach to calculate the risk-weighted exposures for operational risk.

The table below shows the company's risk-weighted exposures and total capital requirement for each exposure category. The total risk exposure amount at the end of 2014 was DKK 4,066 million higher than at the end of 2013. The risk exposure amount for assets outside the trading portfolio increased, primarily because of the higher USD/DKK exchange rate at the end of 2014. The risk exposure amount for off-balance sheet items also rose, primarily because of an increase in the portfolio of loan offers at the end of 2014. The risk exposure amount for counterparty risk rose considerably because a CVA charge on the financial counterparties must be recognised in 2014. The CVA charge amounts to DKK 651 million of the exposure amount for counterparties. The risk exposure amounts for market risk was on a level with 2013.

RISK EXPOSURE AMOUNT

	Risk exposure amount		Total capital requirement	
DKKm	**2014**	**2013**	**2014**	**2013**
Risk exposure amount for assets outside the trading portfolio	45,405	43,549	3,632	3,484
Risk exposure amount for off-balance sheet items	2,858	1,866	229	149
Risk exposure amount for counterparty risk	1,356	586	108	47
Risk exposure amount for market risk etc.	7,382	7,125	591	570
Risk exposure amount for operational risk	1,884	1,692	151	135
Average total risk exposure amount	**58,883**	**54,817**	**4,711**	**4,385**

AVERAGE VALUE FOR RISK EXPOSURE AMOUNTS

	Risk exposure amount		Total capital requirement	
DKKm	**2014**	**2013**	**2014**	**2013**
Risk exposure amount for assets outside the trading portfolio	42,147	46,685	3,372	3,735
Risk exposure amount for off-balance sheet items	3,000	2,468	240	197
Risk exposure amount for counterparty risk	1,449	734	116	59
Risk exposure amount for market risk etc.	7,832	5,633	627	451
Risk exposure amount for operational risk	1,708	1,710	137	137
Average total risk exposure amount	**56,136**	**57,229**	**4,491**	**4,578**

TOTAL CAPITAL REQUIREMENT – CREDIT RISK

The standardised approach is used to calculate the total capital requirement for credit risk, as a result of which all loans generally carry a weight of at least 100%. Under the standardised approach, the value of the ships' mortgages cannot be deducted, and in terms of solvency the loans are thus treated as unsecured loans.

The Executive Order sets out that the following loans or shares of loans each carry a weight of more than 100%:

- Pursuant to section 24 (3) of the Executive Order, construction loans carry a weight of 200% if the sum of construction loans does not exceed 125% of the solvency-related excess cover. If the sum of the construction loan exceeds 125%, the excess amount must be deducted from the tier 1 capital. Construction loans are secured through debtor's liability, assignment and subrogation in the building contract and assignment in the shipyard's collateral for payments under the building contract.
- Loans in which the loan exceeds 70% of the value of the mortgage at the date of grant must, in respect of the part that regularly exceeds 70%, result in a deduction ("additional straining") in the tier 1 capital. The maximum deduction is determined at the date of grant in Danish kroner.
- When the borrower either has an external rating corresponding to credit quality levels 5-6, or is domiciled in a country where the country risk calls for a higher weighting, the loan will have a weighting of 150%.

Construction loans amounted to DKK 41 million at 31 December 2014. The sum of the company's construction loans thus does not exceed 125% of the solvency-related excess cover. Deductions in the tier 1 capital concerning loans, which at the end of 2014 exceeded 70% of the value of the mortgage and which at the time of grant also exceeded 70% of the value of the mortgage, and which are thus subject to the rules on additional straining, amounted to DKK 85 million at 31 December

RISK EXPOSURE AMOUNT FOR CREDIT RISK

	Unweighted amount		Weighted amount		Total capital requirement	
DKKm	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Due from credit institutions	5,409	914	1,430	183	114	15
Loans and guarantees to shipowners	43,733	42,795	43,316	42,951	3,465	3,436
Mortgage bonds	4,951	4,048	495	405	40	32
Derivatives	2,420	1,004	1,356	586	108	47
Other balance sheet items with credit risk	406	459	430	422	34	34
Irrevocable credit commitments	4,942	2,907	2,471	1,453	198	116
Total risk exposure amount for credit risk	**61,861**	**52,126**	**49,498**	**45,999**	**3,960**	**3,680**

COUNTERPARTY RISK

Netting of exposure value:		
DKKm	**2014**	**2013**
The positive gross fair value of financial contracts after netting		
Counterparty with risk weight of 0%	0	0
Counterparty with risk weight of 20%	20	1,004
Counterparty with risk weight of 50%	800	0
Counterparty with risk weight of 100%	52	0
The value of the total counterparty risk calculated according to the market value method for counterparty risk		
Counterparty with risk weight of 0%	0	0
Counterparty with risk weight of 20%	40	2,303
Counterparty with risk weight of 50%	2,328	0
Counterparty with risk weight of 100%	51	0

2014.

COUNTERPARTY RISK ON DERIVATIVES AND CALCULATION OF CAPITAL

The company applies the market value method to calculate the size of the exposures for derivatives.

When determining the value of the exposure using the market value method for counterparty risk, the following method is applied:

1. Contracts are calculated at market value to obtain the current replacement cost for all contracts with a positive value.
2. In order to generate a figure for the potential future credit exposure, the nominal principal of the contracts or the underlying values are multiplied by percentages determined by the Danish Financial Supervisory Authority. Swaps based on two floating rates in the same currency are exempt, because only the current replacement cost needs to be calculated.
3. The sum of the applicable replacement costs and the potential future credit exposures represents the counterparty risk.

In its loan granting process and the ordinary monitoring of credit exposures, the company takes into consideration the calculated exposure value to ensure that this value does not exceed the granted credit line on the counterparty in question.

CREDIT VALUE ADJUSTMENTS (CVA)

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

The company applies the CRR standardised approach. Based on the standardised approach, risk mitigation techniques such as netting and collateral may be used.

The company has entered into ISDA agreements that allow for netting, in part to control the level of credit valuation adjustments. Furthermore, CSA agreements have been signed with the largest financial counterparties, which entail that collateral is received automatically if the positive market values exceed a specified level.

The CVA charge amounted to DKK 651 million at 31 December 2014.

CVA-charge, DKKm	Exposure (un-weighted)	Exposure (weighted amount)	Total capital requirement
Standardised approach	2,367	651	52

FINANCIAL COLLATERAL

	Exposure		Collateral	
DKKm	**2014**	**2013**	**2014**	**2013**
Municipality and export guarantees	4	6	2	3
Deposited bonds and cash deposit	1,813	1,269	464	235
Total financial collateral	**1,816**	**1,275**	**466**	**238**

COLLATERAL AND GUARANTEES

The company does not apply netting, whether on or off the balance sheet.

The company receives financial collateral and guarantees (including re-guarantees from sovereign states and other public sector entities) in the following principal areas:

- Deposit funds
- Securities (bonds, unit trust certificates), primarily listed
- Government and credit institution guarantees

The company has business procedures in place for the management and valuation of collateral, and the procedures form an integral part of the ordinary risk monitoring process.

The company uses the simple credit risk-reducing method. This means that the capital charge on a credit exposure can be reduced when financial collateral is mortgaged. The CRR stipulates the financial collateral that may be used for risk mitigating purposes. According to the regulation, the financial collateral is issued by a company or country with a particularly good external rating.

In accordance with the rules of the CRR, the company uses financial collateral to hedge its credit and counterparty risk. The table above shows for each exposure category the coverage of the collateral, i.e. the fully adjusted size of the collateral within each exposure category.

CLEARING

Like the rest of the Danish financial sector, Danish Ship Finance is subject to the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as “EMIR”). The regulation 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. The company is characterised as a non-financial counterparty, which is below the clearing threshold, as EMIR defines financial counterparties as credit institutions approved pursuant to the credit institution directive. The company is exempt from this directive.

Non-financial counterparties will have a central clearing obligation only if certain threshold values for trading volumes are exceeded. As the company’s trading volumes do not exceed these clearing thresholds, it is not under an obligation to perform central clearing.

The company must ensure that it has appropriate procedures to measure, monitor and mitigate operational risk and counterparty risk for non-cleared OTC derivatives. In addition, all OTC derivative transactions must be reported to a trade depository, providing more specific details about the agreement.

RISK EXPOSURE AMOUNT FOR MARKET RISK

	Unweighted amount		Weighted amount		Total capital requirement	
DKKm	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Debt instruments, specific risk						
Total specific risk *)	10,350	18,228	1,604	1,499	128	120
Debt instruments, general risk						
Total general risk	13,412	12,949	4,937	4,552	395	364
Shares, etc.						
Total shares, etc.	17	4	17	7	1	1
Currency positions						
Total long-term currency positions	824	1,067	824	1,067	66	85
Total risk exposure amount for market risk	**24,604**	**32,248**	**7,382**	**7,125**	**591**	**570**

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

TOTAL CAPITAL REQUIREMENT – MARKET RISK

The standardised approach is used to calculate the total capital requirement for market risk. Positions with market risk are items in the trading portfolio and positions with foreign exchange risk outside the trading portfolio. Set out below is a table showing the total capital requirements for the risks in question.

TOTAL CAPITAL REQUIREMENT – OPERATIONAL RISK

The total capital requirement for the operational risks must cover the risk of losses as a result of inappropriate or insufficient internal processes, human error and system error or as a result of external events, including legal risks.

The company uses the basic indicator approach to calculate its total capital requirement for operational risks. As a result, the risk exposure amount for operational risks is calculated at 15% of a three-year average of net interest income and non-interest related net income.

An assessment of the total capital requirement for operational risks is performed regularly. If the total capital requirement is deemed to be higher than mentioned above, the company will make corresponding adjustments to its adequate total capital.

RISK EXPOSURE AMOUNT FOR OPERATIONAL RISK

Accounting items				
DKKm	**2014**	**2013**	**2012**	**Average**
Interest income	2,061	2,401	2,825	2,429
Interest expenses	(1,241)	(1,510)	(1,939)	(1,564)
Dividends from shares, etc.	0	0	6	2
Fees and commission income	114	45	53	71
Fees and commissions paid	0	0	(5)	(2)
Market value adjustments	123	(25)	104	68
Sum of accounting items	**1,057**	**911**	**1,045**	**1,005**
Risk exposure amount under the basic indicator approach				
2014				1,884
2013				1,692

INDIVIDUAL SOLVENCY NEED AND ADEQUATE TOTAL CAPITAL

The capital management is anchored in the so-called ICAAP (Internal Capital Adequacy Assessment Process), which is a review aimed at identifying risks and determining the individual solvency need.

The Board of Directors and the Management Board ensure that the company maintains adequate total capital. The considerations made by the Board of Directors and Management Board in this regard must lead to the determination of an individual solvency need. Adequate total capital covers the minimum amount of capital which, in the opinion of the Board of Directors, is required to ensure that the bondholders are only exposed to a minute risk of suffering a loss in case the company becomes insolvent during the next 12 months.

INTERNAL PROCESS

The method used to calculate the adequate total capital and the individual solvency need must, as a minimum, be approved by the Management Board and the Board of Directors once a year, whereas the calculations are made quarterly. The company has established segregation of duties to the effect that the adequate total capital and the individual solvency need are not calculated by the same persons who are in charge of the risk management process.

The table below shows the company's solvency need.

INDIVIDUAL SOLVENCY NEED AND ADEQUATE TOTAL CAPITAL

DKKm	2014
Total risk exposure amount	**58,883**
Pillar I requirement (8 per cent of total risk exposure amount)	**4,711**
Earnings	**-**
Growth in lending	**-**
Credit risk	
- Credit risks for large customers in financial difficulty	243
- Other types of credit risk	-
- Concentration risks	69
Market and liquidity risk	**-**
Operational and control risk	**-**
Leverage ratio	**-**
Adequate total capital	**5,023**
Solvency need ratio, per cent	**8.5**

At the end of 2013, the adequate total capital and the individual solvency need amounted to DKK 4,679 million and 8.5%, respectively.

METHODOLOGY

Credit institutions are free to choose the methodology when calculating the adequate total capital provided the calculated solvency need provides a fair view and is prudent. The company follows the Danish FSA's Guidelines on Adequate Total Capital and Solvency Needs for Credit Institutions, which contribute an interpretation of selected items in Annex 1 to the Danish Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need. The guidelines stipulate a so-called 8+ approach based on a total capital requirement of 8% (pillar I requirement), which is assessed to cover "normal" risks. Supplements are then added for "higher-than-normal" risks. In its guidelines, the Danish FSA has defined benchmarks for a large number of items with respect to expectations of "higher-than-normal" risks.

The guidelines define benchmarks and calculation methods within seven risk areas that an institution would usually find relevant when determining its adequate total capital. In addition, the Danish Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need sets out a number of additional factors that must be included in the assessment. The institutions must assess whether there are other relevant risk elements they should consider when calculating their adequate total capital.

The individual solvency need is calculated by dividing the adequate total capital with the total risk exposure amount.

Based on the risk areas defined by the executive order and the guidelines as well as other risk elements deemed relevant, the company's calculation of the adequate total capital base builds on the following seven risk areas:

1. Earnings
2. Growth in lending
3. Credit risk
4. Market risk
5. Liquidity risk
6. Operational and control risk
7. Leverage ratio

A capital requirement deemed to be adequate to cover the underlying risks is fixed for each risk area. The company has also stress-tested its operating results to demonstrate, among other things, whether it will require additional capital on a 12-month horizon.

The Board of Directors and the Management Board have defined the risks which the company should be able to withstand and thus also the factors that should be included in a calculation of the adequate total capital. In a number of areas, the FSA guidelines and the Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need stipulate that the company must perform stress tests (sensitivity analyses) indicating whether there is a need for additional capital. In the stress tests, the company's financial figures are tested for a number of adverse events in order to illustrate how the company would respond in such a scenario.

The company's combined stress test shows that it has a robust capital structure and liquidity buffer capable of withstanding a number of highly adverse events.

The company believes that the risk factors included in the calculation cover all the risk areas that, pursuant to legislation, the Board of Directors and Management Board must take into consideration when determining the adequate total capital.

SPECIFICATION OF RISK AREAS:

This review describes the risk areas and the general considerations used by the company to determine the adequate total capital. The results of the calculation are shown in the table "Individual solvency need and adequate total capital" on page 14.

1. **Earnings.** Mortgage credit institutions with core earnings representing less than 0.1% of loans and guarantees before impairment charges and market value adjustments should consider whether this gives rise to increasing the solvency need. The company's core earnings relative to loans and guarantees amounted to 1.9% for 2014.

   In addition to the level of earnings, earnings stability also forms part of the assessment of the solvency need. The company's core earnings have increased over the past few years but are henceforth expected to remain relatively stable around the level recorded in 2014.

   The company's earnings ability should also be assessed in relation to its dividend policy and capital procurement opportunities. Based on the results of the stress test of the operating profit, the company will, even in a severe stress scenario, not be facing a need for additional capital on a 12-month horizon.

   Based on the above, the company finds that the Pillar I requirement is sufficient to cover risks relating to earnings.

2. **Lending growth.** The Danish FSA defines that a combined year-on-year lending growth of 10% or more could expose an institution to higher-than-normal credit risk. Consequently, institutions must allocate additional capital.

   Since 2010, the company's lending growth has been below 10%. The average annual growth rate for the period 2010-2014 was (2.1)%. Against this background, the company believes that the Pillar I requirement is sufficient to cover risks resulting from lending growth.

3. **Credit risk.** In its guidelines, the Danish FSA divides credit risks into three sub-groups: credit risks for large customers in financial difficulty, other credit risks and credit risk concentration:

- **Credit risks for large customers in financial difficulty**
  For large customers in financial difficulty, an assessment should be made of a conservatively estimated loss on each loan. Large customers in financial difficulty are defined as customers whose total loans account for more than 2% of the total capital and where there is objective evidence of impairment of the exposure or material signs of weakness but no objective evidence of impairment (financial standing categories 1 and 2c). A detailed description of these financial standing categories is provided in the Appendix 8 of the Danish FSA's instructions for financial reporting in credit institutions and investment companies, etc.

  Based on the above, a large customer may be defined as a customer with a loan for more than DKK 193.6 million (DKK 9,682 million * 2%). Financial standing categories 1 and 2c will be equivalent to customers with a rating between 9 and 12 on the company's internal 12-point classification scale (12 being the lowest).

  Pursuant to the guideline method for calculating capital supplements for large customers in financial difficulty, the company's capital supplement amounted to DKK 243 million at 31 December 2014.

- **Other types of credit risk**
  Other credit risks primarily cover *"other risks in the loan portfolio" and "risks associated with financial counterparties".*

  In its assessment of "other risks in the loan portfolio", the company considers assessment areas laid down in the Guidelines on Adequate Total Capital and Solvency Needs for Credit Institutions and sensitivity analyses based on a number of scenarios and their importance for the need to make impairment charges.

  Based on the these assessments and sensitivity analyses, the company concludes that "other credit risks in the loan portfolio" are covered by the Pillar I requirement.

  The assessment of "*other credit risks associated with financial counterparties*" is based on an evaluation of the financial standing of the financial counterparties. The principal risks relate to the investment of the securities portfolio, the vast majority of which is placed in Danish mortgage bonds.

  The financial standing of financial counterparties and, by extension, the credit risk associated with the investment of the securities portfolio, interest rate and currency hedging etc. is monitored regularly, including an assessment of the capital required to hedge the exposures. Furthermore, bilateral collateral agreements (CSA) have been signed with a number of financial counterparties, which reduce the counterparty credit risk. Based on the current standing of its financial counterparties, the company concludes that the Pillar I requirement adequately covers the capital requirement concerning "other credit risks associated with financial counterparties".

- **Credit risk concentration**
  Concentration risks are calculated with respect to single name concentration and sector concentration. Pursuant to the Executive Order on Calculation of Risk Exposure Amount, Total Capital and Solvency Need, the capital requirement in an institution with a high risk diversification is generally lower than in an institution with a high risk concentration.

  In its guidelines, the Danish FSA notes that Danish mortgage credit institutions have a unique profile on account of their core business. Against this background, the calculation of sector concentration does not apply to mortgage credit institutions as per the guidelines. Meetings with the FSA have led to the conclusion that this also applies to Danish Ship Finance.

However, the guidelines stipulate that institutions exempt from these rules must consider the extent to which they have a concentration risk that should be addressed and for which capital should be allocated. Based among other things on the sensitivity analyses used in connection with the assessment of "other risks in the loan portfolio", the company has found that there is no material risk of loss in relation to sector concentration not covered by the Pillar I requirement.

In connection with single name concentration, the institution must consider imbalances in the distribution of loan sizes in its loan portfolio, irrespective of whether a customer has a good financial standing. The company applies the guideline calculation method with adjustments approved by the FSA. The company has calculated and assessed the capital supplement for single-name concentration at DKK 69 million.

4-5. Market and liquidity risk. Due to the specific balance principle, which caps the risk that the company may undertake, market and liquidity risks are considered limited. Furthermore, limits defined in the company's internal policies further mitigate the risks.

According to the FSA guidelines, mortgage credit institutions and similar institutions are exempt from making capital supplements with respect to market and liquidity risks. Nevertheless, the company makes a brief review of its market and liquidity risks on the basis of the guidelines, concluding that the market and liquidity risks are covered by the Pillar I requirement.

6. Operational and control risk. The capital reservation relating to operational risks based on the Pillar I requirement amounts to DKK 151 million. The company believes that adequate procedures are in place in relation to both internal and external matters to the effect that operational risks are covered by the Pillar I requirement.

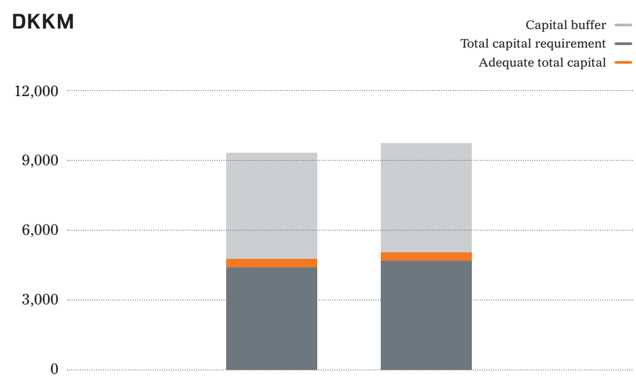
7. Leverage ratio. The leverage ratio is calculated as tier 1 capital relative to the institution's total exposure value (unweighted). The company's leverage ratio at 31 December 2014 has been calculated at 13.3%. According to the Basel Committee, the leverage ratio should not be lower than 3%. In other words, there is no need to determine a higher solvency requirement in order to reduce the gearing.

SOLVENCY NEED AND CAPITAL BUFFER

Danish Ship Finance's adequate total capital and total risk exposure amount were DKK 5,023 million and DKK 58,883 million, respectively, at 31 December 2014, corresponding to an individual solvency need of 8.5%. The total capital less deductions amounted to DKK 9,682 million at 31 December 2014, resulting in a capital ratio of 16.4%. This gives the company a capital buffer of DKK 4,660 million relative to the adequate total capital..

The company finds that the capital buffer is sufficient for the company to continue its lending activities during a period of difficult business conditions.

STATEMENT OF CAPITAL
DKKM



LIQUIDITY MANAGEMENT

Liquidity management is generally carried out to ensure that the company's cost of funding does not become disproportionately high and to avoid that lack of funding prevents the company from retaining the adopted business model. Ultimately, the purpose of the company's liquidity management is to ensure that it is consistently able to meet its payment obligations.

BALANCE PRINCIPLE

The specific balance principle permits a cash deficit between issued bonds and loans provided. A cash deficit – resulting from the future payments related to bonds issued by Danish Ship Finance, other funding and financial instruments which exceed the future incoming payments on loans, financial instruments and investments – may not exceed 100% of the total capital. Through in-house policies, the company has defined stricter requirements for any cash deficits between issued bonds and loans provided.

LIQUIDITY BUFFER

Bonds are typically issued in DKK, whereas most of the loans are disbursed in USD. The company has sourced USD for funding of USD loans disbursed via so-called basis swaps. The risk caused by lack of access to convert DKK funding into USD involves higher financing costs or the loss of business opportunities. The opportunities for sourcing USD liquidity rely on an efficient capital market. Through in-house policies, the company has defined in-house limits for the need for USD over time.

LIQUIDITY POLICY

Pursuant to the Executive Order on Governance, the company has prepared a policy for managing liquidity risk (liquidity policy). The purpose of the policy is to ensure that the company maintains a liquidity risk that matches the overall risk profile. The liquidity policy also serves to ensure adequate handling and management of liquidity, allowing the company at all times to meet its payment obligations, applicable legislation and plans for future activities and growth.

Pursuant to the company's liquidity policy, the company must have overall positive liquidity within the first-coming 18-month period. The calculation of the limit includes the securities portfolio at market value, and loan offers are included if they are expected to be disbursed during the period.

MANAGEMENT, MONITORING AND REPORTING

The company's liquidity management is anchored in the so-called ILAAP (Internal Liquidity Adequacy Assessment Process), which is a review aimed at identifying liquidity risks and determining liquidity targets.

The Board of Directors determines the overall guidelines for managing liquidity risk through the liquidity policy. The Management Board is responsible for ensuring that the guidelines established by the Board of Directors are laid down in business procedures that are regularly updated. The Management Board, the Chief Risk Officer and relevant department managers must approve any changes when the guidelines are updated.

Compliance with the liquidity policy is monitored by Middle Office. Each quarter, the company prepares a financial report on compliance with the policy framework that is submitted to the Board of Directors.
Moreover, a liquidity stress test is performed, consisting of the following components:

- An appreciating USD
- An increase in interest rates
- A widening of credit spreads
- Loan losses

The results of the liquidity stress test are used to manage and adjust in-house limits. Furthermore, the test is used to create an overview of the liquidity profile in an actual and in a stressed scenario.

CONTINGENCY PLANS

Pursuant to the Executive Order on Governance the company has prepared a liquidity contingency plan, which contains a catalogue of possible courses of action to strengthen the liquidity position in a critical situation. The liquidity contingency plan takes effect if pre-defined triggers are activated.

CREDIT RISK

CREDIT EXPOSURE BY MATURITY

	Credit institutions		Loans, advances and guarantees		Total credit exposure	
DKKm	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
On demand	61	26	0	0	61	26
0-3 months	5,348	888	1,624	1,383	6,972	2,271
3 months – 1 year	0	0	5,772	4,755	5,772	4,755
1 - 5 years	0	0	28,391	28,792	28,391	28,792
More than 5 years	0	0	7,560	7,453	7,560	7,453
Total	**5,409**	**914**	**43,347**	**42,383**	**48,756**	**43,297**

Credit risk reflects the risk of a loss due to default on the part of a counterparty. This applies to counterparties in the form of shipowners and financial institutions.

The limits for Head of Credit are stipulated in the company's credit policy and policy on counterparty management. The policies build on the provisions in the Act and the Executive Order. These provisions stipulate that the board of directors shall lay down risk diversification rules.

In its risk management activities, the company distinguishes between credit risk derived from lending operations and credit risks derived from transactions with financial counterparties. The day-to-day responsibility for the credit policy, the policy on counterparty management and for the periodical risk calculation and reporting of credit risk rests with the credit department.

LENDING

Ship financing is provided against a first mortgage in vessels. On a limited scale, the company also provides financing of the shipowner's payment of instalments to a shipyard. The company is a leading provider of ship financing in Denmark, and it focuses primarily on large, reputable shipowners in Denmark and abroad.

The most significant risk facing Danish Ship Finance is believed to be credit risk on the company's loans, which is the risk of losses when the mortgage cannot cover the residual debt if the customers default on their loans.

When considering potential loans, focus will be on vessel characteristics, the financial standing of the borrower, the terms of the loan and the loan's contribution to compliance with the diversification rules.

LOAN LIMITS AND ADDITIONAL STRAINING

The company may grant loans up to 70% of the value of the mortgaged vessel(s).

However, the company may, on certain conditions, grant loans beyond 70% of the value against other collateral and/ or against additional straining. The additional straining is maximised in Danish kroner, not later than when the loan offer is submitted.

As a result of the additional straining, for this part of the lending operations a deduction is calculated in the company's tier 1 capital in connection with the solvency calculation. The deduction equals the part of loan in question that exceeds 70% of the mortgaged vessel(s) at the time of calculation, although capped by the maximum defined.

The calculation of the additional straining is made on the basis of an evaluation made or approved by the company on the basis of independent broker assessments of the market value of the mortgage.

In 2013 and 2014, the company did not grant any new loans with a loan-to-value ratio above 70% at the time of grant.

The company's weighted average loan-to-value ratio (LTV) after impairment charges at 31 December 2014 was 59%.

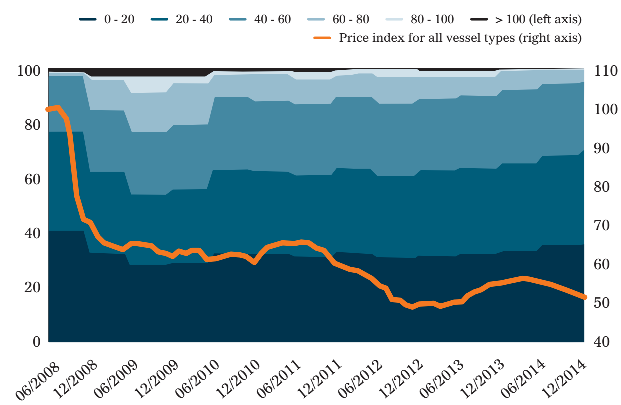
PERCENTAGE DISTRIBUTION OF LOANS INCLUDING GUARANTEES AFTER IMPAIRMENT CHARGES CALCULATED IN THE LTV RANGES (BY NOMINAL OUTSTANDING DEBT)

LTV range	Share of lending	
%	2014	2013
0-20	36	33
20-40	34	32
40-60	25	27
60-80	5	7
80-90	0	1
90-100	0	0
Above 100	0	0

PERCENTAGE DISTRIBUTION OF LOANS INCL. GUARANTEES WITH INDIVIDUAL CHARGES THE DISTRIBUTION IS MADE AFTER IMPAIRMENT CHARGES CALCULATED IN THE LTV RANGES (BY NOMINAL OUTSTANDING DEBT)

LTV range	Share of lending	
%	2014	2013
0-20	35	35
20-40	36	33
40-60	27	26
60-80	2	6
80-90	0	0
90-100	0	0
Above 100	0	0

LOAN TO VALUE INTERVALS VS. PRICE INDEX FOR ALL SHIPS INDEX/%



The chart above shows a breakdown of the loan portfolio into LTV (loan to value) ranges, which are calculated every six months. The LTV ranges show the proportion of the loans placed within a given range. For example, 95% of the loan amounts incl. guarantees and after impairments are secured by mortgages within 60% of the valuations at the end of 2014. The breakdown is compared with developments in ship prices based on a price index from Clarksons, showing price developments for all vessel types. The chart shows that even major declines in ship prices do not materially change the collateral for the loan. The reason is that instalments are regularly received and that a number of loan agreements include a right for the company to demand reduction and/or additional collateral if the value of the ship mortgage drops below a pre-arranged minimum threshold (MVC).

LARGE EXPOSURES

Danish Ship Finance is exempt from the EU's credit institution directive and any related directives. The most important consequence of this exception is that the company will not be subject to a limitation in respect of large customers and therefore is not subject to the CRR rules on large exposures. As a result, unlike other financial institutions the company is not bound by any statutory limits for maximum loans to an individual borrower. The Board of Directors shall instead lay down rules concerning risk diversification, including for its lending operations. However, the company has only one credit exposure that exceeds 25% of its adjusted total capital.

At 31 December 2014, the company had no financial counterparty exposures exceeding 25% of its adjusted total capital.

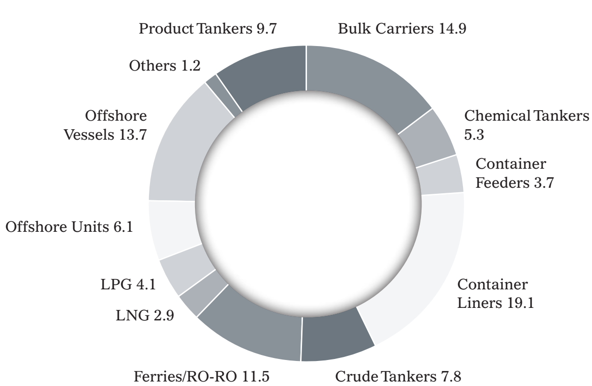
DIVERSIFICATION

The composition of the loan portfolio is governed by a set of diversification rules. The purpose of the diversification rules is to ensure adequate diversification by vessel type, borrower and country.

RISK DIVERSIFICATION ON VESSEL TYPES

Adequate loan portfolio diversification must be in place regarding vessel types. No single vessel type may be provided as security for more than 50% of the company's gross lending. Within each vessel type, no segment may be provided as security for more than 33% of the company's gross lending.

LOAN PORTFOLIO BY MORTGAGED VESSELS PERCENTAGE OF TOTAL LENDING



RISK DIVERSIFICATION ON BORROWERS

The composition of borrowers must be adequately diversified in the loan portfolio. The diversification rule is related to the objects clause in the articles of association:

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

For large loans, the company should seek to diversify the risk on vessel types within the individual account.

For financing as defined in the second sentence of the objects clause, the overall account per borrower may not, at a consolidated level, exceed 25% of the most recently calculated total capital. Thus, there are no formal limits on the size of individual exposures in respect of funding pursuant to the company's main objective (ship financing in Denmark).

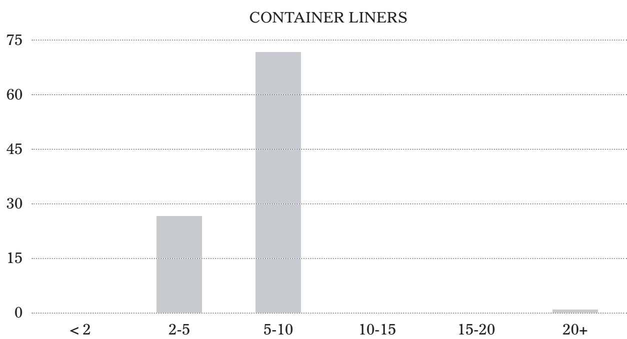
MOVEMENTS IN THE FIVE LARGEST EXPOSURES BEFORE IMPAIRMENT CHARGES

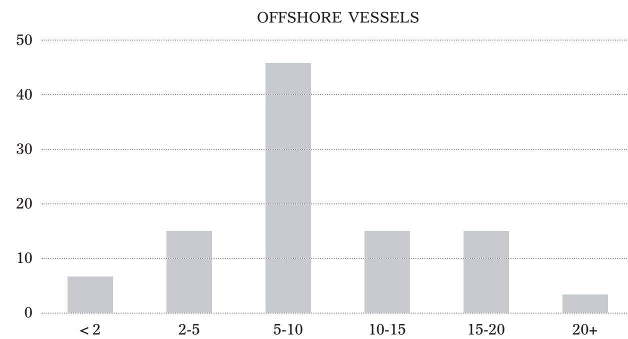
DKKm	2014	2013
Five largest exposures	16,533	20,241
Total loans and guarantees	45,912	46,012

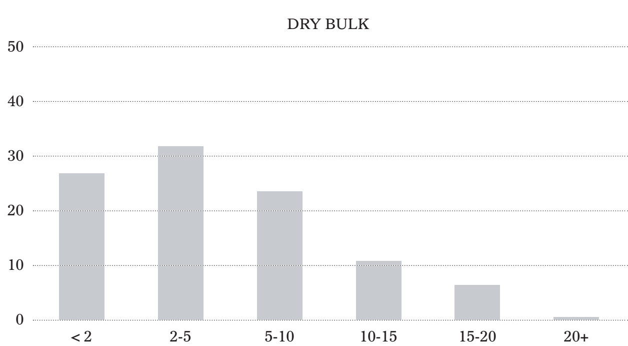
The five largest exposures at 31 December 2014 were secured by mortgages in 83 vessels comprising 8 vessel types. One exposure is substantially larger than the rest and represented less than 25% of total lending at 31 December 2014, against previously 35-40%.

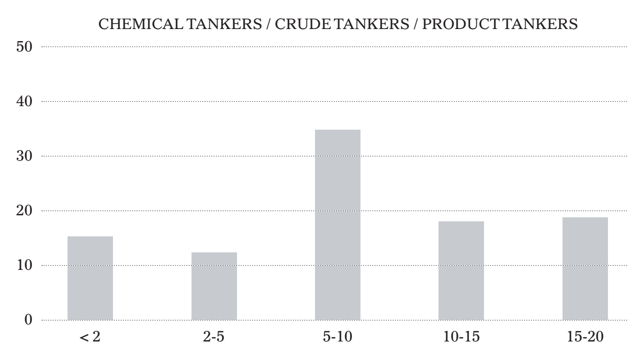
The risk diversification on borrowers focuses on diversification on vessel types in each loan. The largest loan was thus secured through mortgage on vessels distributed on three different vessel types (loans for Container Liners represent the majority, and loans for Offshore Units and Offshore Vessels the rest).

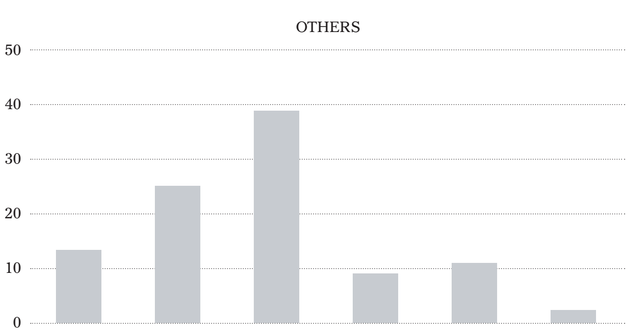
AGE DISTRIBUTION OF MORTGAGED VESSELS
(AS A PERCENTAGE OF TOTAL LENDING TO THE VESSEL TYPE)

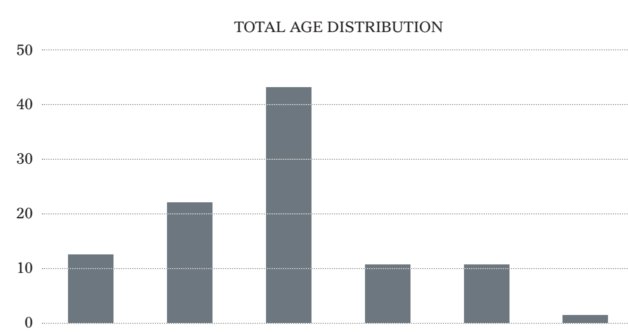








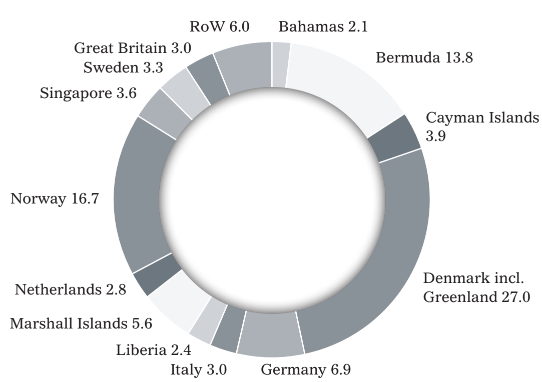




RISK DIVERSIFICATION ON COUNTRIES

The loan portfolio must be adequately diversified on countries. The country risk is calculated on the basis of the borrower's home country, or, in the case of guarantees, the guarantor's home country. If there is only a guarantee for part of the loan, the country risk is distributed proportionally. Loans to borrowers in Norway, Switzerland and the USA and in certain EU countries are not subject to restrictions as to country risk. For loans to borrowers in other countries, the company has defined an overall limit per country of up to 20% of its gross lending.

DEBTOR DISTRIBUTION BY COUNTRY OF ULTIMATE RISK (PERCENTAGE OF TOTAL LENDING)



Countries with a share of at least 2% are shown separately. Other countries are grouped into 'Rest of world'.

The risk calculation method was selected on the basis of a wish to calculate and control the company's overall risk exposure using the legal system of a single country in case the need for a court order arises. The situation typically occurs in connection with default of an exposure in which the mortgaged vessels and any other collateral have been realised and the company must seek to collect a residual claim.

The company endeavours to mitigate the risk that may be associated with having to obtain a local court order by incorporating venue agreements into the loan documentation to the effect that any disputes must be settled in a court outside the debtor's home country. Denmark, Norway, Germany or the UK are often used as venues.

The company has deliberately avoided using the flag states of the vessels as an expression of the country risk, as the risk of loss associated with having to arrest and subsequently effect a forced sale of a vessel relies more on which jurisdiction the vessel is arrested in than the flag under which the vessel is sailing.

CREDIT RISK ON SHIPOWNERS

The credit policy contains specific guidelines for the ongoing risk management in the loan portfolio. A number of predefined procedures are used in the ongoing credit risk management process, the most important of which are described below.

GRANTING OF LOANS

The Management Board and the credit manager have been allocated authorities by the Board of Directors allowing them to grant loans up to pre-determined limits. The granting of loans must be disclosed at the subsequent ordinary board meeting.

If the Management Board authorises loans involving a significant increase of the risk on existing loans, such authorisation must be approved by the Board of Directors.

As in previous years, the Board of Directors was the authorising body in the majority of all loans granted in 2014.

ONGOING MONITORING

As part of the risk management process, all loans are assessed at least twice a year. All loans are assessed, and the current credit risk is assessed on the basis of current market valuations of the financed vessels and the most recent accounting data from the borrower.

In addition, the portfolio is monitored in an ongoing process in relation to the borrowers' fulfilment of the individual loan agreement, comprising:

- Half-yearly updating of the market values of all financed vessels and verification that any agreed requirements on maximum loan-to-value ratios are complied with.
- Verification that any other collateral meets the specified minimum requirements.
- Verification the existence of adequate insurance cover on financed vessels.
- Verification compliance with all other material loan covenants.

If a loan is deemed to entail increased risk, the monitoring will be intensified to safeguard the company's interests to the best possible extent.

INSURANCE OF SHIP'S MORTGAGES

All vessels mortgaged as collateral for loans must be insured. Insurance is taken out by the borrower. Borrowers' insurances concerning financed vessels are assigned to Danish Ship Finance.

As a general rule, the insurance includes:

- Hull and machinery insurance, which covers damage to the vessel or total loss.
- P&I (Protection & Indemnity) insurance, which is a third party liability insurance to cover damage against persons or equipment.
- War Risks, which covers damage to the vessel, potential total loss and retention, etc. caused by war or war-like conditions.

In addition, most of the loans are covered by Mortgage Interest Insurance and Mortgagee Additional Perils Pollution Insurance. This insurance covers the risk in most situations which the primary insurance policies do not cover, for example due to shortcomings in relation to the ship's seaworthiness.

INSPECTION OF VESSELS

As a supplement to the half-yearly market valuations, physical inspections of the financed vessels are made on a spot-check basis. The inspection may be performed both during the loan period or prior to submitting a financing offer.

MARKET VALUATIONS

The company values each vessel twice annually. The valuation is generally made by an external broker, who estimates a price for the financed vessels on the basis of supply and demand. The company may also determine the value itself, for example on the basis of a specific independent market price or if external assessments have been received for similar vessels.

Market valuations are used to determine the loan-to-value ratio on the company's loans and for control purposes in connection with the half-yearly impairment charges on loans, advances and receivables.

LOSSES AND LOAN IMPAIRMENT CHARGES

Twice a year, all exposures are reviewed in order to re-assess the current need for impairment charges. The assessment of any impairment on the individual loans is based on the borrower's present and expected future financial position and on the value of the ship's mortgage and any other collateral.

The overall guidelines for the company's impairment charges are laid down in the Executive Order on Financial Reporting. It appears from the executive order that, in addition to individual impairment charges, the company must also make collective impairment charges.

The Danish Financial Supervisory Authority has accepted that Danish Ship Finance may omit to make collective impairment charges provided that the assessment of the individual loans be planned in such a manner that the assessment in practice covers an assessment consistent with that which would take place in a collective assessment and that impairment charges be made accordingly for each loan. Furthermore, it is a precondition that the assessment of any impairment of the individual loans be made on the basis of a probability weighting of the expected outcome in respect of payments from the borrowers.

The Danish Financial Supervisory Authority's guidelines for the company's impairment charges thus assume:

1) that all loans are subjected to an individual assessment;
2) that the criteria for objective evidence of impairment at the individual assessment in addition to the individually conditioned criteria comprise all external developments, factors and events (observable data) that increase the likelihood of losses on the type of loans that the specific loan belongs to; and
3) that each loan is tested for impairment for all the identified criteria for objective evidence of impairment based on the likelihood with which they are expected to reduce the cash flow from the loan.

Based on the FSA guidelines, all loans are reviewed in order to identify any objective evidence of impairment or objective evidence of impairment within each vessel type.

In addition, all loans have been reviewed to evaluate whether the existing classification and pertaining impairment ratio still provides the best estimate of the cash flows due from the specific borrower. Where this is estimated not to be the case, the loan is reclassified.

Objective evidence of impairment

Objective evidence of impairment ("OEI") is a concept used to express that a loan entails a higher probability of default. The concept is used for calculating individual impairment charges pursuant to Annex 10 of the Executive Order on Financial Reporting and the Danish FSA guidelines.

OEI exists if at least one of the following events has occurred:

- Default, cf. below
- The borrower is experiencing significant financial difficulty
- Overdrafts/arrears, unless the problem is short-term and the amounts concerned are small by comparison to the borrower's financial situation or if due to errors or technical problems
- Loans with more lenient repayment terms, including respite, which the company, for reasons relating to the borrower's financial difficulty, would not otherwise have granted

If OEI is established for credit exposures, including loans/receivables without impairment, the borrower will be downgraded on the company's internal classification scale (12-point scale with 12 being the lowest) to risk category 11 (or risk category 12 if the credit exposure is also in default) with a PD (probability of default) of 100%.

When reconstruction, including agreements for composition or conversion of a loan/receivable into share capital/subordinated loan capital has been completed, the OEI period will run for at least 12 months. Subsequently, a new impairment test will be performed on the credit exposure.

CREDIT EXPOSURES – DEFAULT

A loan/receivable is deemed to be in default if the borrower is not expected to be able to meet his obligations. That will be the case, if at least one of the following situations has occurred:

- A loss is deemed inevitable
- Bankruptcy or other financial reconstruction
- Overdrafts/arrears for more than 90 days
- Cancelled loans
- Interest resetting to zero

If a credit exposure is in default, the borrower will be downgraded to risk category 12 with a PD of 100%.

Calculation of loan impairment charges at credit exposure level

The company makes individual impairment charges on loans with objective evidence of impairment and also charges with a collective component on loans to customers operating in shipping segments in which the earnings prospects give rise to expect future losses but on which loans no objective evidence of impairment has been found.

The technical calculation model, which is the same for both impairment models, looks as follows:

Loan impairment = (loss given default (i.e. a stressed LGD) x probability of default (PD)) – potentially dividends (prudent estimate).

The individual customer's PD is determined on the basis of an internal classification system (rating) and it reflects a conservatively estimated likelihood of the customer defaulting on his payment obligations within the next 12 months.

LGD is calculated in the following manner:
LGD = Balance on the loan (B) – NV of the mortgage value under the mortgage (Sx) – value of other collateral (Ø).

For customers where individual objective evidence of impairment is established due to financial difficulty on the part of the customer, the PD is set at 100%. For impairment with a collective component, the customer's current PD is used.

The following serves to illustrate the calculation method for impairment with a collective component.

Customer's PD = 25%
Loans (B) = DKK 100 million
Market value of vessel = DKK 125 million
PV of stressed value of vessel (Sx) = DKK 70 million
Other collateral (Ø) = DKK 0 million
Dividends (D) = DKK 0 million
LGD = B – Sx – Ø = DKK 100 million – DKK 70 million – 0= DKK 30 million
Impairment = (LGD x PD) – D = (DKK 30 million x 0.25) – 0 = DKK 7.5 million

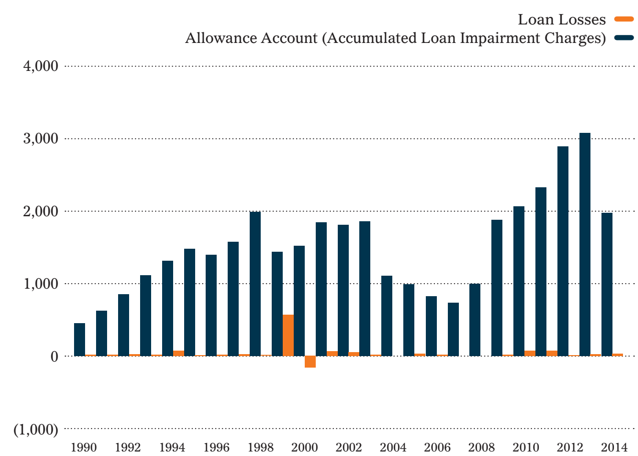
If the customer had individual objective evidence of impairment (a PD of 100%) in the above example, the impairment charge would instead have been DKK 30 million.

The company's accumulated impairment charges amounted to DKK 1,974 million at 31 December 2014 against DKK 3,071 million last year. This represented a decline of DKK 1,097 million.

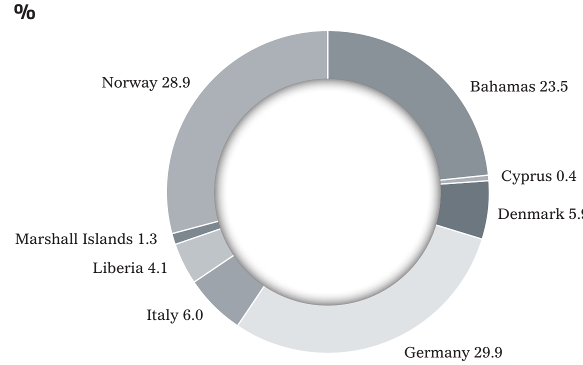
The accumulated impairment charges accounted for 4.3% of the company's total loans and guarantees, which was 2.4 percentage points lower than the year before. The lower impairment ratio was due to full or partial reduction of credit exposures for which impairment had been recognised. Danish Ship Finance incurred losses of DKK 32 million in 2014, against DKK 28 million in 2013. Losses actually incurred thus remain at a very low level.

Accumulated losses since the company was established in 1961 were DKK 921 million at 31 December 2014. This corresponded to 2.0% of total gross lending at 31 December 2014.

LOAN IMPAIRMENT CHARGES AND CREDIT LOSSES
DKK MILLION

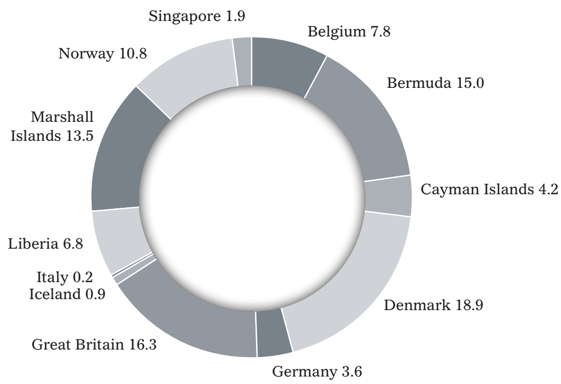


GEOGRAPHICAL DISTRIBUTION RELATIVE TO INDIVIDUAL IMPAIRMENT CHARGES
%



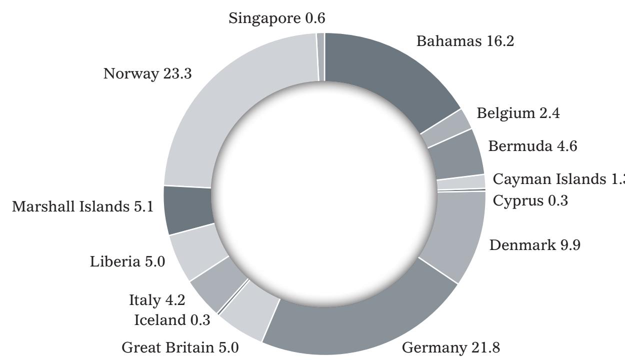
GEOGRAPHICAL DISTRIBUTION RELATIVE TO COLLECTIVE IMPAIRMENT CHARGES

%



GEOGRAPHICAL DISTRIBUTION RELATIVE TO TOTAL IMPAIRMENT CHARGES

%

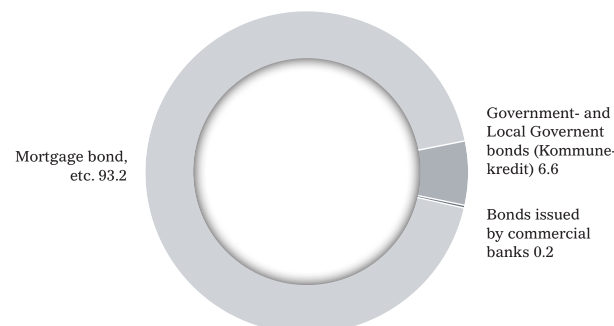


Developments in impaired claims due to value adjustment and impairment charges

At 31. december 2014	Loans		Financial counterparties	
DKKm	**2014**	**2013**	**2014**	**2013**
Individual impairment losses				
Impairment charges for loans and counterparties, 1 January	2,375	2,003	0	0
Impairment charges during the year	137	492	0	0
Reversal of impairment charges made in previous financial years, where there is no longer any objective evidence of impairment or the impairment is reduced	1,116	471	0	0
Other movements	0	379	0	0
Final loss (written off) on previous impairment charges	32	28	0	0
Accumulated impairment charges for loans and financial counterparties, 31 December	1,364	2,375	0	0
Sum of loans and financial counterparties where individual impairment charges have been made (calculated before impairment charges)	3,948	6,885	0	0
Impairment charges with collective component				
Accumulated impairment charges for loans and financial counterparties, 1 January	695	881	0	0
Impairment charges during the year	191	509	0	0
Reversal of impairment charges, where there is no longer any objective evidence of impairment or the impairment is reduced	277	315	0	0
Other movements	0	(379)	0	0
Accumulated impairment charges for loans and financial counterparties, 31 December	610	695	0	0
Final loss (written off)	0	0	0	0
Sum of loans and financial counterparties where collective impairment charges have been made (calculated before impairment charges)	16,777	13,541	0	0

LOAN LOSSES AT GIVEN DEFAULT RATES
DKK MILLION/%.

DISTRIBUTION OF SECURITIES PORTFOLIO
%



FINANCIAL COUNTERPARTIES

In addition to loans, the company's securities portfolio also represents a significant part of the assets. The securities portfolio comprises government and mortgage bonds, money market transactions and interest-sensitive financial instruments.

Most of the portfolio consists of mortgage bonds, which leads to an excess cover relative to the statutory requirement that at least 60% of the total capital requirement must be invested in high grade assets. At 31 December 2014, the company had invested DKK 13,138 million in high grade securities, corresponding to 439% of the statutory requirement.

Transactions with financial counterparties are made in connection with investing own funds as well as excess liquidity from issued bonds. These transactions involve cash deposits, securities and financial instruments.

Financial contracts may entail a risk of losses if the contract has a positive market value to the company, and the financial counterparty cannot fulfil his part of the agreement. This type of risk also includes settlement risk.

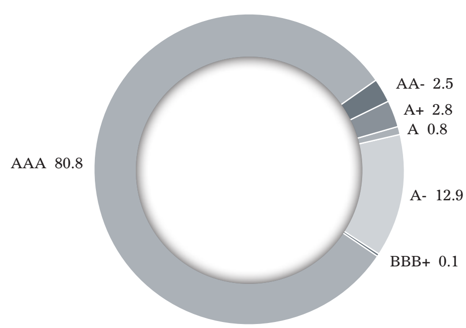
The policy for managing counterparty risk quantifies and defines limits for the exposure to individual financial counterparties and the countries in which such counterparties are residents. The policy is used in connection with the management of market risk and liquidity risk defines limits for maximum receivables (lines) under loans to and guarantees from credit institutions, export guarantee institutions and insurance companies. The policy also includes the Management Board's guidelines and options for delegating granting authorities.

Emphasis is on financial counterparties having high credit ratings, as a substantial proportion of business transactions with the counterparties involves long-term contracts with a potentially large increase in market value. Bilateral collateral agreements (CSA) have been signed with a number of financial counterparties, which reduce the credit risk.

GRANTING OF LINES

Financial counterparties are granted lines on the basis of defined criteria. Such grants are made on the basis of, among other things, ratings assigned by recognised international rating agencies, when such ratings are available. Once a year and when the creditworthiness of the counterparty changes, the allocated lines are re-assessed.

EXPOSURE ON FINANCIAL COUNTERPARTIES BY CREDIT RATING
%



The Management Board and the credit manager have been allocated authorities by the Board of Directors allowing them to grant lines to financial counterparties within certain limits. The granting of such lines must be disclosed at the subsequent board meeting. Credit grants over and above the predefined limits are decided by the Board of Directors.

CONTRACTUAL BASIS

The contractual basis for transactions with financial counterparties is based primarily on market standards such as ISDA and GMRA agreements, which allow netting in the case of default on the part of the financial counterparty. Furthermore, Danish Ship Finance has entered into agreements on market-value adjustments or collateral (CSA agreements) with a number of its counterparties in connection with derivative trading.

ONGOING MONITORING

Exposures to each counterparty are monitored in an ongoing process, partly to ensure that the financial counterparties consistently comply with the requirements, partly to ensure compliance with the granted lines. The responsibility for ongoing monitoring is independent of the executing departments.

MARKET RISK

Market risk is the risk of losses caused by changes in the market value of assets and liabilities as a result of changing market conditions. The overall market risk is calculated as the sum of fixed income and exchange rate positions. The most significant market risks are associated with the securities portfolio, as the company is governed by the limits of the Bond Executive Order, which includes restrictions on interest rate, exchange rate and liquidity risk between the bond issues (funding) and the loans.

The company pursues a market risk policy to manage its market risks. The policy lays down clear and measurable limits for interest rate and exchange rate risks and builds on the provisions of the Bond Executive Order, among other things. The guidelines for market risks may be stricter than such external provisions.

The company's treasury department has the day-to-day responsibility for the market risk policy, while the responsibility for the current calculation and reporting of market risks lies with a function outside the treasury department. Market risks are monitored in an ongoing process and reported to the Board of Directors on a quarterly basis. In case of breach of the limits defined in the market risk policy, the Management Board must be informed immediately and the Board of Directors not later than at the next board meeting.

INTEREST RATE RISKS

Interest rate risk is the risk that the company will incur a loss as a result of a change in interest rates. Rising interest rates have an adverse impact on the market value of the securities portfolio.

Pursuant to the Bond Executive Order, the interest rate risk between funding and lending must not exceed 1% of the total capital. The company seeks to minimise the interest rate risk between funding and lending by applying conservative principles, but a loss or a gain may arise due to changes in interest rates.

The Bond Executive Order also stipulates that the interest rate risk on the company's assets, liabilities and off-balance sheet items must not exceed 8% of the company's total capital. Interest rate risks are adjusted using a minimum and a maximum for the option-adjusted duration. The current maximum option-adjusted duration on the securities portfolio, including financial instruments, has been restricted to four years. Danish Ship Finance has calculated the option-adjusted duration at approximately 0.5 years at 31 December 2014. Furthermore, there are restrictions for interest rate risk distributed on maturities between 0.5 years and 30 years. The table below shows the interest rate risk broken down by maturities.

Using the Danish FSA's guidelines for calculating interest rate risks, the risk was calculated at DKK 539 million at 31 December 2014, corresponding to 5.6% of the total capital, against DKK 495 million in 2013.

As the company is governed by the rules of the Bond Executive Order, it only has limited exposure to interest rate risk outside the trading portfolio.

INTEREST RATE RISK BY MATURITIES

DKKm	0.5 year	2 years	5 years	10 years	15 years	30 years
2014	37	94	60	(6)	(69)	(47)
2013	0	65	20	21	12	19

EXCHANGE RATE RISK

The Bond Executive Order stipulates that the combined foreign exchange risk on assets, liabilities and off-balance sheet items must not exceed 2% of the total capital.

The market risk policy does not accept currency risks arising due to mismatch of funding and lending except for inevitable, limited foreign exchange risks resulting from the ongoing liquidity management. The company's lending margin is collected in the same currency in which the loan was granted. Accordingly, net interest income from lending operations is affected by exchange rate fluctuations. The primary impact derives from the USD, which is the currency in which the vessels primarily generate earnings and are valued, and therefore also the preferred lending currency.

Exchange rate indicator 1 at 31 December 2014: DKK 824 million. Exchange rate indicator 1 corresponds to the company's overall net exposure in foreign currency on the total balance sheet items, calculated according to the guidelines of the Danish Financial Supervisory Authority.

EQUITY RISK

Apart from small holdings of sector shares and shares received in connection with the reconstruction of credit exposures, the company had no shareholding interests in other companies.

DERIVATIVES

Danish Ship Finance uses derivatives in specific areas. The market risk policy specifies which derivatives the company may use and for which purposes. These are transactions made to hedge risks between funding and lending and in connection with investment activities.

LIQUIDITY RISK

The company's liquidity management efforts and the liquidity requirements defined by law are aimed at reducing the liquidity risk to the greatest extent possible.

Liquidity risk involves the risk of:

- a disproportionate rise in the cost of funding
- lack of funding which prevents the company from maintaining its current business model
- the company ultimately not being able to meet its payment obligations due to lack of funding

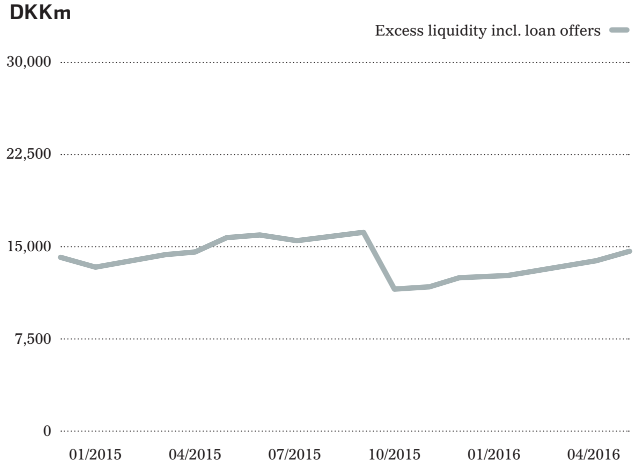
Through bond issues and the existence of a liquid portfolio of bonds, the company has secured ample liquidity coverage for all existing loans and loan offers until expiry. The company is therefore not exposed to any refinancing risk. A potential downgrade of the company's external rating would not change its robust liquidity situation, but it is expected to lead to higher funding costs in connection with new loans.

Shown below are charts of:

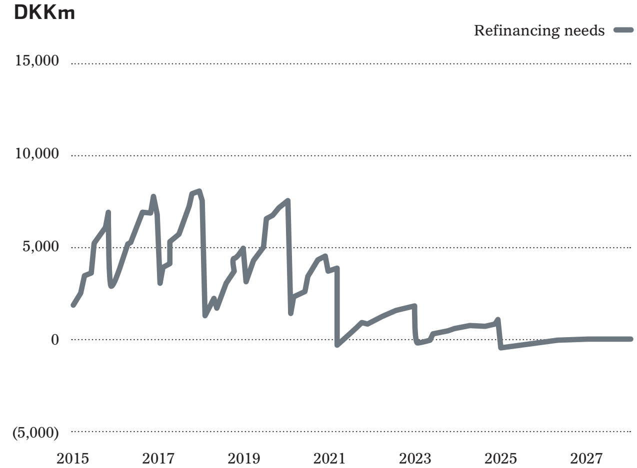
- Short-term excess liquidity incl. the market value of the securities portfolio
- The liquidity mismatch between funding and lending

The average maturity of issued bonds exceeds the average maturity of the loans.

SHORT TERM LIQUIDITY
DKKm



LIQUIDITY MISMATCH BETWEEN FUNDING AND LENDING
DKKm



LIQUIDITY COVERAGE RATIO

In accordance with the CRR, in 2015 a requirement will be introduced on adequate liquidity over a period of 30 days in a stressed scenario (LCR requirement). The LCR requirement will be phased in over a number of years.

Shown below is the LCR requirement for 2015:

The company's LCR at 31 December 2014 has been calculated at 85%.

In the calculation of liquid assets, covered bonds may not account for more than 70%, and at least 30 percentage points thereof must be covered bonds with a rating corresponding to credit category 1, which corresponds to Standard & Poor's AAA to AA- rating.

$$\text{Liquidity Coverage Ratio} = \frac{\text{Liquid assets}}{\text{Net cash outflows for a 30 - day period}} \geq 60\%$$

The 70% cap on covered bonds entails that the company has a substantial volume of mortgage bonds which are not eligible for inclusion as liquid assets. If these mortgage bonds are sold and government bonds are purchased instead, it would significantly increase the LCR.

OPERATIONAL RISK

Operational risk is the risk of direct or indirect losses caused by deficient or faulty internal procedures and processes, human errors, system errors or losses prompted by external events or incidents. Operational risk is often associated with specific and one-off events.

The Executive Order on Governance, which has entered into force, contains rules on the management of operational risks. Against this background, the company has defined a policy in this area. The Board of Directors will update the policy at least once a year. In addition, operational risks are managed through business procedures and internal controls. The control is performed, among others, by the company's internal control function, which is independent of the executing departments.

The key operational risks relate to credit and finance functions, compliance and the use of information technology.

In the credit function, the risk relates to the handling of agreements and security documents and regular follow-up on loan covenants. In addition, the risk relates to the handling of any non-performing credit exposures.

In the finance function, the risk relates to the conclusion and implementation of financial contracts, deposits and general money transfers.

In the compliance area, there is a risk that sanctions will be imposed on the company, a risk of loss of reputation or that the company or its stakeholders suffer material financial losses due to lack of compliance with applicable legislation, market standards or internal rules.

In the area of information technology, the risk relates to the derived consequences of a system breakdown or serious system errors.

CALCULATION OF OPERATIONAL RISK

DKKm	Weighted exposure
2014	1,884
2013	1,692

REMUNERATION POLICY

The Board of Directors has adopted a shareholder-approved remuneration policy. The company does not provide variable pay components to the members of the Board of Directors, the Management Board or material risk takers.

Through this remuneration policy, the company aims to promote a remuneration practice which is consistent with and promotes sound and effective risk management and discourages excessive risk-taking and which is also aligned with the business strategy, values and long-term goals, including a sustainable business model.

Information about all quantitative disclosures relating to remuneration, divided into Board of Directors, Management Board and employees designated as material risk takers is set out below:

No persons received a salary in excess of EUR 1 million in the financial year.

DKK'000	Fixed salary/ remuneration	Variable salary	Salary/ remuneration total	No. of recipients
Board of Directors	2,011	-	2,011	10
Management Board	6,131	-	6,131	2
Other employees whose activities have a material impact on the company's risk profile	3,695	-	3,695	2
Total	**11,837**	**-**	**11,837**	

MANAGEMENT'S STATEMENT

The Board of Directors of Danish Ship Finance A/S approved the risk report for 2014 on 27 February 2015.

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

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

The Board made its assessment on the basis of its adopted business model/strategy, material and reports presented to the Board by the Management Board, internal controls, Chief Risk Officer and Head of Compliance and on the basis of any supplementary information or reports obtained by the Board.

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 company is focused on the most creditworthy part of the shipping industry. The company seeks to obtain profitable earnings by pricing its products to reflect the risk and the working capital assumed by the company in combination with an overall assessment of the business volume with customers and counterparties. The company seeks to ensure it has an appropriate and robust capital base supporting its business model.

The maximum risk tolerance defined by the Board is managed via limits set out in the individual policies. Shown below are a number of key figures that provide external players with an overview of the company's risk management.

RATIOS

	Regulatory requirement	Compliance at 31/12 2014
Capital requirement		
Capital ratio	>8 %	16.4 %
Tier 1 capital ratio	>6 %	16.4 %
Common equity tier 1 capital ratio	>4.5 %	16.4 %
Pillar II requirement		
Individual solvency need	<capital ratio	7.9 % point excess cover
Total pillar II requirement	<capital ratio	7.9 % point excess cover
Liquidity		
Liquidity Coverage Ratio (LCR)	>60 %	85 %
Gearing		
Leverage ratio	>3 % (Basel III recommendation)	13.3 %
Loss percentage		
Realised losses on loans	N/A	Realised losses represent < 0.10 % of lending

Copenhagen, 27 February 2015

Peter Lybecker
Chairman

Hugo F. Jensen
Deputy Chairman

Fatiha Benali

Jenny N. Braat

Marcus F. Christensen

Christopher Rex

Glenn Söderholm

Henrik R. Søgaard

Trond Ø. Westlie

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