CVR NO. 27 49 26 49

DANISH SHIP FINANCE

RISK REPORT 2013

INTRODUCTION

The purpose of this risk report is to provide a description of 1) risk and capital management and 2) the composition of the capital base and risks in relation thereto in accordance with the disclosure requirements set out in annex 20 to the Executive Order on Capital Adequacy. 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 once every year in connection with the presentation of the annual report. The risk report is available on www.shipfinance.dk/en/InvestorRelations/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 2013 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, materially 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 practical 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 risk manager. The risk manager 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 risk manager. 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). Pursuant to the Act and the Executive Order, the company is governed by parts of the Danish Financial Business Act. 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 Capital Adequacy (the Executive Order on Capital Adequacy), 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) and, like other financial enterprises, it is supervised by the Danish Financial Supervisory Authority.

Pursuant to the Bond Executive Order, the company must pursue a balance principle and has decided to pursue the specific balance principle. The balance principle entails fixed absolute limits for the size of allowable interest rate, foreign exchange and liquidity risks when there is a difference between payments on loans and funding. Under these rules, the company is prevented from assuming any noteworthy interest rate, foreign exchange or liquidity risk in connection with its lending operations.

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, whose efforts are supervised by the external auditors, 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.

WHISTLEBLOWER SCHEME

In accordance with the Danish Financial Business Act, the company is required no later than 31 March 2014 to implement an internal whistleblower scheme, which will enable its employees to report any instances of non-compliance with the financial legislation. The company will regularly assess whether to expand the scheme so that the employees may also report instances of economic crime.

REPORTING TO THE BOARD OF DIRECTORS

Report	Frequency
Compliance reporting	Yearly
CRO reporting	Yearly
Authorisation list*	Each ordinary board meeting
Financial reporting	Quarterly
Internal financial reporting	Quarterly
Credit reports	Quarterly
Memorandum on weak 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 changes to loans, including the granting of any breach of loan agreements granted by the Management Board"*

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 EXPOSURE

Danish Ship Finance's main business activity is to provide loans against a first mortgage in ships. 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 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. The 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. As a result of the company's focus on the security of the bond owners, 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.

As stated above, 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, the purpose of which is to ensure consistently adequate liquidity.

Operational risks primarily concern the credit area, the finance area, compliance and IT application. Operational risks are managed by way a policy for operational risks, business procedures and internal controls.

CAPITAL MANAGEMENT

Pursuant to the Executive Order on Capital Adequacy, Danish Ship Finance must maintain a certain amount of capital relative to its activities, so that the capital adequacy as a minimum matches the company's risk profile and complies with the legislative framework.

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 Capital Adequacy, which contains provisions implementing parts of the Capital Requirements Directive (CRD). The framework builds on three pillars:

- Pillar I contains a set of rules for calculating the solvency requirement, which is 8% of risk-weighted assets for the three types of risk – Credit, Market and Operational risk.
- Pillar II contains a set of rules for how to calculate the adequate capital base, 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.

Pursuant to the Executive Order on Capital Adequacy, companies have some freedom when selecting how to calculate their adequate capital base. 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.

NEW CAPITAL ADEQUACY RULES

The implementation of CRD IV brings stricter capital requirements and introduces two new liquidity requirements. The capital requirements are briefly described below, while the liquidity requirements are reviewed in "Cash management".

The CRD IV introduces stricter requirements on how much the tier 1 capital (excl. hybrid tier 1 capital) should represent of the capital base. In 2014, the requirement will be raised from 2 to 4%, equal to at least half of the capital requirement. In 2015, the requirement will be raised to 4.5%. In the period from 2016 to 2019, two buffers: a capital conservation buffer and a counter-cyclical buffer – will be introduced, increasing the required size of the capital base. The buffer requirements must be met using common equity tier 1 capital. Similarly, the solvency need supplement to the fixed statutory solvency requirement of 8% must be met using common equity tier 1 capital. The solvency need supplement is calculated when determining the individual solvency need, which is described later in the risk report.

Since the company's capital predominantly consists of common equity tier 1 capital in the form of tied-up reserve capital, the company already holds sufficient common equity tier 1 capital to comply with the future requirements. Furthermore, the company expects to comply with the capital requirement after the rules on buffers take effect.

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.

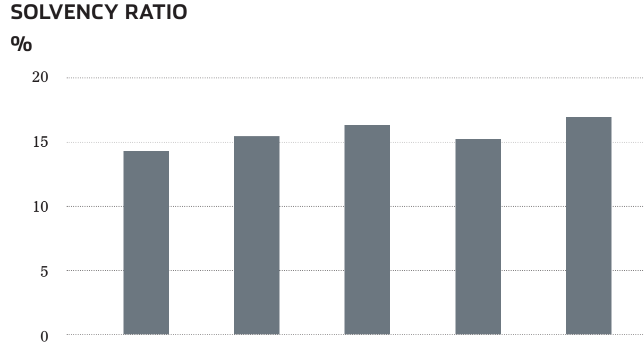
At the end of 2013, the solvency ratio was 17.0, against 15.2 at the end of 2012. The solvency ratio is believed to be adequate to meet the above-mentioned target.

Other than the consolidation after dividends, the increase of the capital base in 2013 driven by a reduction of deductions for deferred tax assets and reduced additional straining. The company maintains only moderate revaluation reserves which are included in the tier 2 capital. The reduction in risk-weighted items was due primarily to a decline in the loan portfolio and sale of unit trust certificates.

CALCULATION OF SOLVENCY RATIO

DKKm/%	2013	2012
Capital base less deductions	9,312	8,963
Risk-weighted items	54,817	59,128
Solvency ratio	**17.0**	**15.2**

SOLVENCY RATIO



CAPITAL BASE

The capital base is characterised by the fact that it is subordinated to ordinary creditors in the event that a financial undertaking goes bankrupt. The capital base can be composed of three different types of capital: core (tier 1) capital, hybrid tier 1 capital and supplementary (tier 2) capital, and the relationship between capital base and risk-weighted assets is the solvency ratio.

Tier 1 capital
Tier 1 capital is the capital that represents the core of the capital base 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 capital base must consistently be higher than both the adequate capital base and the capital requirement. Under the Danish Financial Business Act, the capital requirement is defined as the higher of the solvency requirement or the minimum capital requirement (EUR 5 million).

Adequate capital base
The adequate capital base 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 capital base as a percentage of the risk-weighted assets. The individual solvency need must not be lower than 8% of the risk-weighted assets (solvency requirement) or the minimum capital requirement. Unlike previously, the individual solvency need will henceforth be a "soft requirement", so as to give a non-complying institution more time to restructure its capital base. When relevant, the FSA will order the institute to take the necessary steps.

Solvency requirement
The solvency requirement, or the Pillar I requirement, describes the statutory requirements for financial enterprises. For a credit institution, the capital base must represent at least 8% of the institution's risk-weighted assets.

Minimum capital requirement
The minimum capital requirement is a capital base of at least EUR 5 million.

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

The company's capital base consists predominantly of core 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 capital base less deductions amounted to DKK 9,312 million at 31 December 2013, against DKK 8,963 million in 2012.

CALCULATION OF CAPITAL BASE LESS DEDUCTIONS

DKKm	2013	2012
Tier 1 capital		
Share capital	333	333
Tied-up reserve capital	8,343	8,343
Retained earnings	1,297	1,087
Total tier 1 capital	**9,973**	**9,763**
Deductions from tier 1 capital		
Proposed dividends	405	267
Deferred tax assets	162	330
Additional straining pursuant to the Executive Order on a Ship Finance Institute	104	213
Total deductions from tier 1 capital	**671**	**810**
Tier 1 capital less statutory deductions	**9,302**	**8,953**
Tier 2 capital		
Revaluation reserves	10	10
Total capital base less deductions	**9,312**	**8,963**

SOLVENCY REQUIREMENT

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

Because the CRD has been implemented in Danish legislation, the company may choose between different methods for calculating its risk-weighted items for each of the three overall types of risk, and thus also the solvency requirement. The company has not applied for a permission from the Danish FSA to apply one of the internal methods. The company applies the standard method for calculating risk-weighted assets and the solvency requirement concerning credit risk and market risk. When using the standard method, the risk weights are defined in the legislation. In addition, the company applies the basic indicator method to calculate the risk-weighted assets for operational risk.

The table below shows the company's risk-weighted exposures/assets and solvency requirement for each exposure category. The total weighted items at the end of 2013 were reduced by DKK 4,311 million relative to the end of 2012. Weighted assets outside the trading portfolio were reduced primarily because of a decline in the loan portfolio and sale of unit trust certificates. Weighted off-balance sheet items were also reduced, primarily on account of a decline in the portfolio of loan offers and revolving credit facilities at the end of 2013. Weighted items with a market risk increased primarily as a result of a small increase in the foreign currency position and positions in fixed-income derivatives and debt instruments which do not allow for netting between the currencies for solvency purposes.

RISK-WEIGHTED ASSETS/EXPOSURES

	Risk-weighted exposure		Solvency requirement	
DKKm	**2013**	**2012**	**2013**	**2012**
Weighted assets outside the trading portfolio	43,549	48,902	3,484	3,912
Weighted off-balance sheet items	1,866	2,953	149	236
Weighted items with counterparty risk outside the trading portfolio	586	780	47	62
Weighted items with a market risk	7,125	4,781	570	382
Operational risk	1,692	1,712	135	137
Total weighted items	**54,817**	**59,128**	**4,385**	**4,730**

AVERAGE VALUES OF RISK-WEIGHTED EXPOSURES

	Risk-weighted exposure		Solvency requirement	
DKKm	**2013**	**2012**	**2013**	**2012**
Weighted assets outside the trading portfolio	46,685	49,846	3,735	3,988
Weighted off-balance sheet items	2,468	2,995	197	240
Weighted items with counterparty risk outside the trading portfolio	734	759	59	61
Weighted items with a market risk	5,633	4,212	451	337
Operational risk	1,710	1,846	137	148
Total, average weighted items	**57,229**	**59,658**	**4,578**	**4,773**

SOLVENCY REQUIREMENT – CREDIT RISK

The standard method is used to calculate the solvency requirement for credit risk, as a result of which all loans generally carry a weight of at least 100%. Under the standard method, the values of the ships' mortgages cannot be deducted, and in terms of solvency the loans are 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 21(5) of the Executive Order, building loans carry a weight of 200% if the sum of building loans does not exceed 125% of the solvency-related excess cover. If the sum of the building loan exceeds 125%, the excess amount must be deducted from the tier 1 capital. Building 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 is domiciled in a country where the country risk calls for a higher weighting, the loan will have a weighting of 150%.

Building loans amounted to DKK 64 million at 31 December 2013. The sum of the company's building loans does not exceed 125% of the solvency-related excess cover. Deductions in the tier 1 capital concerning loans, which at the time of grant exceeded 70% of the value of the mortgage, amounted to DKK 104 million at 31 December 2013. Loans where the borrower is domiciled in a country where the country risk calls for a higher weighting amounted to DKK 821 million at 31 December 2013.

RISK-WEIGHTED ITEMS WITH CREDIT RISK

	Unweighted amount		Weighted amount		Solvency requirement	
DKKm	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**
Due from credit institutions	914	1,627	183	325	15	26
Loans and guarantees to shipowners	42,795	47,116	42,951	47,335	3,436	3,787
Mortgage bonds	4,048	9,010	405	901	32	72
Derivatives	1,004	1,646	586	780	47	62
Other balance sheet items with credit risk	459	585	422	467	34	37
Irrevocable credit commitments	2,907	4,400	1,453	2,200	116	176
Total risk-weighted items with credit risk	**52,126**	**64,383**	**45,999**	**52,008**	**3,680**	**4,161**

SOLVENCY REQUIREMENT – MARKET RISK

The standard method is used to calculate the solvency 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 solvency requirements for the risks in question.

SOLVENCY REQUIREMENT – OPERATIONAL RISK

The solvency 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 model to calculate its solvency requirement for operational risks. As a result, the risk-weighted items 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 solvency requirement for operational risks is performed regularly. If the solvency requirement is deemed to be higher than mentioned above, the company will make corresponding adjustments to its solvency requirement.

RISK-WEIGHTED ITEMS WITH MARKET RISK

	Unweighted amount		Weighted amount		Solvency requirement	
DKKm	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**
Debt instruments, specific risk						
Total specific risk *)	18,228	22,662	1,499	1,958	120	157
Debt instruments, general risk						
Total general risk	12,949	7,976	4,552	1,964	364	157
Shares, etc.						
Total shares, etc.	4	630	7	631	1	51
Currency positions						
Total long-term currency positions	1,067	853	1,067	853	85	68
Total risk-weighted items with market risk	**32,248**	**32,121**	**7,125**	**5,407**	**570**	**433**

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

RISK-WEIGHTED ITEMS WITH OPERATIONAL RISK

DKKm	2013	2012	2011	Average
Accounting items				
Interest income	2,401	2,825	3,028	2,751
Interest expenses	(1,510)	(1,939)	(2,204)	(1,884)
Dividends from shares, etc.	0	6	5	4
Fees and commission income	45	53	58	52
Fees and commissions paid	0	(5)	(2)	(2)
Market value adjustments	(25)	104	(135)	(19)
Sum of accounting items	**911**	**1,045**	**751**	**902**
Risk weight under the basic indicator model				
2013				1,692
2012				1,712

INDIVIDUAL SOLVENCY NEED AND ADEQUATE CAPITAL BASE

The Board of Directors and the Management Board ensure that the company maintains an adequate capital base. The considerations made by the Board of Directors and Management Board in this regard must lead to the determination of an individual solvency need. An adequate capital base 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.

The individual solvency need is calculated by dividing the adequate capital base with the risk-weighted assets.

INTERNAL PROCESS

The method used to calculate the adequate capital base 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 capital base 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 CAPITAL BASE

DKKm /%	2013
Total weighted items	54,817
Pillar I requirement (8 per cent of weighted items)	4,385
Earnings	**-**
Growth in lending	**-**
Credit risk	
- Credit risks for large customers in financial difficulty	247
- Other types of credit risk	-
- Concentration risks	46
Market risk and liquidity risks	-
Operational and control risks	**-**
Institution size	**-**
Settlement risk	**-**
Strategic risk	**-**
Reputational risks	**-**
Total adequate capital base	**4,679**
Individual solvency need, per cent	**8.5**

At the end of 2012, the internally calculated adequate capital base and the internally calculated individual solvency ratio amounted to DKK 3,464 million and 5.9%, respectively. The company's adequate capital base cannot be lower than the solvency requirement, equal to 8% of the risk-weighted items pursuant to the Danish Executive Order on Capital Adequacy. Against this background, the individual solvency ratio was fixed at 8% at 31 December 2012. At the end of 2013, the individual solvency ratio was 8.5%, or an increase of 0.5 of a percentage point.

The increase in the adequate capital base is due to a change in methodology based on the new FSA guidelines and not a change in the risk profile.

METHODOLOGY

Credit institutions are free to choose the methodology when calculating the adequate capital base provided the resulting solvency need provides a fair view and is prudent. The company follows the Danish FSA's "Guidelines on Adequate Capital Base and Solvency Needs for Credit Institutions", which contribute an interpretation of selected items in Schedule 1 to the Danish Executive Order on Capital Adequacy. The guidelines represent a new practice in calculating the adequate capital base, and stipulate a so-called 8+ approach based on a solvency 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 six risk areas that an institution would usually find relevant when determining its solvency need. In addition, the Executive Order on Capital Adequacy defines a number of aspects that should also be included. The institutions must assess whether there are other relevant risk elements they should consider when calculating their solvency need.

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 capital base builds on the following nine risk areas:

1. Earnings
2. Growth in lending
3. Credit risk
4. Market and liquidity risk
5. Operational and control risk
6. Institution size
7. Settlement risk
8. Strategic risk
9. Reputational risk

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 solvency requirement. In a number of areas, the FSA guidelines and the Executive Order on Capital Adequacy 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 capital base.

SPECIFICATION OF RISK AREAS:

This review describes the risk areas and the general considerations used by the company to determine the adequate capital base. The results of the calculation are shown in the table "Individual solvency need and adequate capital base" on page 11.

1. **Earnings.** 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 2.2% for 2013.

   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 and are expected to remain relatively stable going forward.

The reason is primarily that rising credit margins in the market for ship financing have had a positive effect on earnings, whereas higher funding costs have adversely impacted the financial performance. In other words, there has been a correlation between the price of funding and earnings from lending operations. This trend is expected to continue in the coming years, indicating low volatility in the future relative earnings.

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 2009, the company's lending growth has been between plus 2.1 and minus 8.6% pro anno, and the combined figure for the period 2009 to 2013 is minus 11.9%. 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 exposure. Large customers in financial difficulty are defined as customers whose total exposure accounts for more than 2% of the capital base 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 186 million (DKK 9,312 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 247.5 million at 31 December 2013.

- **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 Executive Order on Capital Adequacy 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. 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 Capital Adequacy, 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 92 million. In 2013, the supplement for single-name concentration risk carries a weight of 50%, while the weighting will be 100% from 2014. This results in a capital supplement of DKK 46 million.

4. **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 has reviewed 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.

5. **Operational and control risk.** The capital reservation relating to operational risks based on the Pillar I requirement amounts to DKK 135 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.

6. **Institution size.** An institution should consider whether its size inherently gives rise to considerations about a supplement to the solvency need. It should also consider whether there are external risks such as legislative amendments, changes in economic conditions etc.

   Based on an assessment of factors such as the complexity of the company and the need to develop internal models, the company has not identified a need for a capital supplement because these matters are believed to be covered by the Pillar I requirement.

7. **Settlement risk.** Pursuant to the Executive Order on Capital Adequacy, the company must consider whether the extent of its settlement risks necessitates a capital reservation.

   The company believes that its settlement risks are covered by the Pillar I requirement.

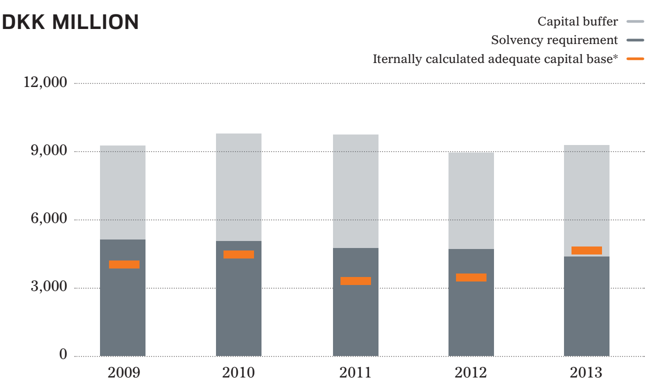
8. **Strategic risk.** An institution must consider its strategic risks. Strategic risks in this context are risks that may affect earnings or capital because of changes in the competitive environment, incorrect decisions, inadequate implementation of adopted resolutions or the inability to adjust to the competition.

   The company believes that its strategic risks are covered by the Pillar I requirement.

9. **Reputational risk.** Institutions must consider whether to allocate capital to cover reputational risk. Reputational risk is the risk of loss of earnings and capital because of the company's poor reputation among customers, investors, suppliers and public authorities.

The company believes that its reputational risks are covered by the Pillar I requirement.

STATEMENT OF CAPITAL
DKK MILLION



* The company's internally calculated adequate capital base must not be lower than the solvency requirement, equal to 8% of the risk-weighted items pursuant to the Danish Executive Order on Capital Adequacy, and in the preceding years, the individual solvency need was therefore fixed at 8%. For 2013, the internally calculated adequate capital base is calculated using the 8+ approach in accordance with section 124(5) of the Danish Financial Business Act and the Danish FSA's guidelines. Consequently, an individual supplement to the solvency requirement is included from 2013.

SOLVENCY NEED AND CAPITAL BUFFER

Danish Ship Finance's adequate capital base and risk-weighted items amounted to DKK 4,679 million and DKK 54,817 million, respectively, at 31 December 2013, corresponding to an individual solvency ratio of 8.5%. The capital base less deductions amounted to DKK 9,312 million at 31 December 2013, resulting in a solvency ratio of 17.0%. This gives the company a capital buffer of DKK 4,633 million.

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

CASH MANAGEMENT

The purpose of the company's cash management is to ensure that it maintains consistently adequate liquidity.

Through previous 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 further downgrade of the company's external rating would not change the company's robust liquidity situation, but it is expected to lead to higher funding costs in connection with new loans.

The cash management is consistent with the framework of the company's liquidity policy.

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
- Losses on customers

The results of the stress tests performed confirm that the company maintains a strong liquidity buffer.

REGULATION

Danish Ship Finance must comply with the balance principle, which entails defined absolute limits for the liquidity risk exposure a company may undertake when there is a difference between payments on lending and on funding.

CRD IV introduces two new liquidity requirements:

- a requirement on adequate short-term liquidity (LCR); and
- a requirement on adequate stable funding (NSFR).

The LCR requirement aims to ensure that the institutions have adequate liquidity to meet their payment obligations over a 30-day stressed period. A number of important technical standards still need to be adopted in connection with the LCR requirement, including the category of assets to be used when calculating the liquid assets.

The LCR requirement will be phased in from 2015 to 2018.

The NSFR requirement is intended to ensure that the institutions to a greater extent use medium and long-term funding for their loans, thus providing an appropriate liquidity level over a period of one year. As with the LCR requirement, a number of important technical standards have yet to be adopted for the NSFR requirement.

The NSFR will apply from 2018 at the earliest.

Like other institutions, Danish Ship Finance must report a large number of items in relation to LCR and NSFR to the Danish FSA. The LCR items are reported monthly, with 31 March 2014 as the reference date, while the NSFR items are reported quarterly, also with 31 March 2014 as the reference date.

Danish Ship Finance will still be subject to the balance principle, and the new requirements are not expected to lead to changes to the company's cash management processes.

CREDIT RISK

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 credit risk management 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.

LOANS

Danish Ship Finance provides ship financing against a first mortgage in ships and, on a limited scale, also 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 because 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

Danish Ship Finance 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, usually 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.

CREDIT EXPOSURE BY MATURITY

	Credit institutions		Shipowners		Total credit exposure	
DKKm	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**
On demand	26	63	0	0	26	63
0-3 months	888	1,564	1,383	1,875	2,271	3,439
3 months – 1 year	0	0	4,755	5,117	4,755	5,117
1 – 5 years	0	0	28,792	26,649	28,792	26,649
More than 5 years	0	0	7,453	12,723	7,453	12,723
Total	**914**	**1,627**	**42,383**	**46,364**	**43,297**	**47,991**

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 2012 and 2013, the company did not grant any loans with a loan-to-value ratio above 70%.

The company's weighted average loan-to-value ratio (LTV) after impairment charges at 31 December 2013 was 62%.

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

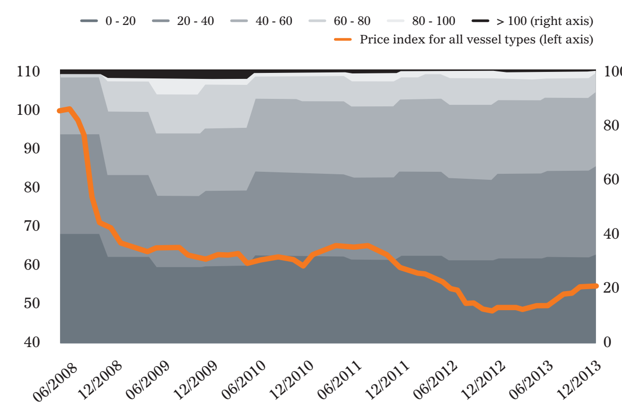
LTV range	Share of lending	
%	2013	2012
0-20	33	31
20-40	32	31
40-60	27	27
60-80	7	8
80-90	1	1
90-100	0	1
Above 100	0	1

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

LTV range	Share of lending	
%	2013	2012
0-20	35	28
20-40	33	27
40-60	26	25
60-80	6	16
80-90	0	4
90-100	0	0
Above 100	0	0

LOAN TO VALUE INTERVALS VS. PRICE INDEX FOR ALL SHIPS

INDEX/%



Source: Clarksons, Danish Ship Finance

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. It can be deduced from the chart that 92% of the loan amounts incl. guarantees and after impairments, are secured by mortgages within 60% of the valuations at this time. 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 securing 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.

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 executive order 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.

At 31 December 2013, the company had no financial counterparties exceeding 25% of its capital base. The company thus has no financial counterparty that would have exceeded the limit under the calculation method applied in the regulations.

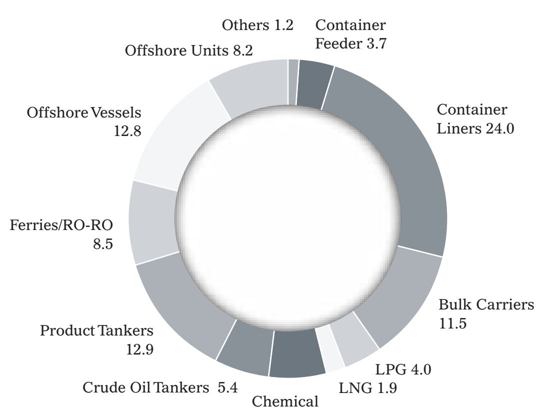
DIVERSIFICATION

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.

RISK DIVERSIFICATION ON VESSEL TYPES

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

LOAN PORTFOLIO BY MORTGAGED VESSELS, ETC. 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 capital base. Thus, there are no formal limits on the size of individual loans in respect of funding pursuant to the company's main objective (ship financing in Denmark).

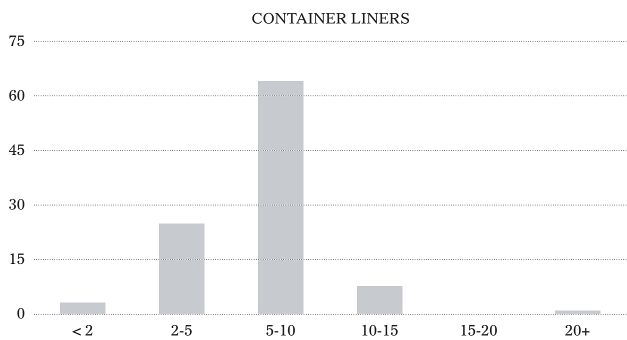
MOVEMENTS IN THE FIVE LARGEST DEBTORS BEFORE IMPAIRMENT CHARGES

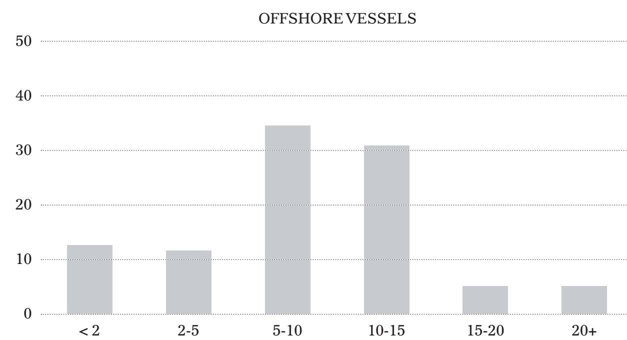
DKKm	2013	2012
Five largest debtors	20,241	24,052
Total loans and guarantees	46,012	50,131

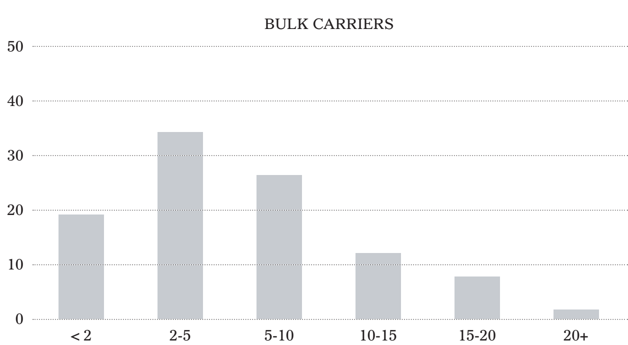
The five largest loans at 31 December 2013 were secured by mortgages in 123 vessels comprising 10 vessel types. One loan is substantially larger than the rest and typically represents 35-40% of total lending. At the end of the year, however, the share was somewhat below the usual level.

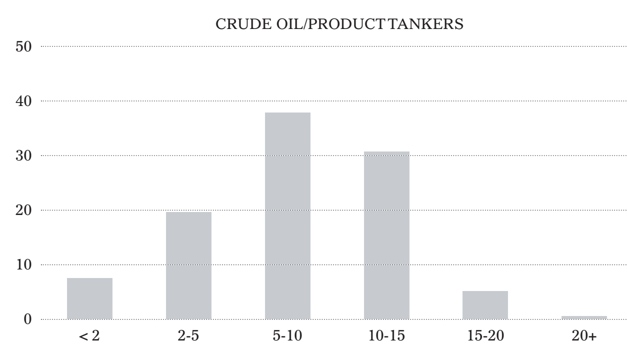
The risk diversification on borrowers focuses on diversification on vessel types in each loan. The largest loan was thus secured through mortgage on vessels distributed on five different vessel types (loans for Container Feeder and Container Liners accounted for 69%, Offshore Units 26% and Offshore Vessels 5%). The other four loans were secured through mortgages in 9 different vessel types.

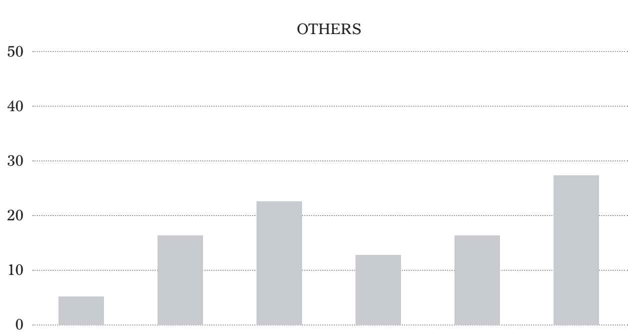
AGE DISTRIBUTION OF MORTGAGED VESSELS
AS A PERCENTAGE OF TOTAL LENDING TO THE VESSEL TYPE

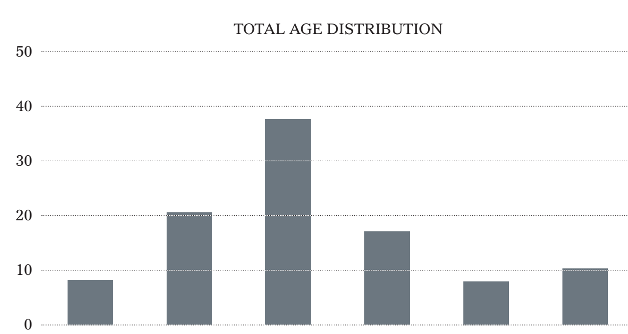








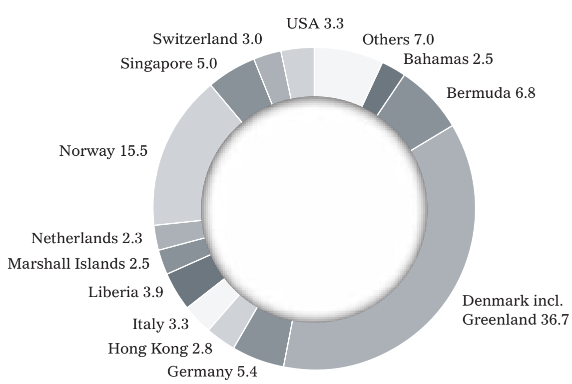




RISK DIVERSIFICATION ON COUNTRIES

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 between the countries. 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 10% 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 'Others'.

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 a loan in which the mortgaged collateral – usually vessels – have been realised and the company must seek to collect a residual claim. In such situations, it is important for the company's risk of loss that the local court recognises the claim put forward by the company as being legally valid.

The company endeavours to eliminate the risk that may be associated with having to obtain a local court order by incorporating venue agreements into the loan documentation.

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 an 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 2013.

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 verifying that any agreed requirements on maximum loan-to-value ratios are complied with.
- Verifying that any other collateral meets the specified minimum requirements.
- Verifying the existence of adequate insurance cover on financed vessels.
- Verifying 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 SHIPS

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 fixed by an external broker, who fixes 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 for example 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 loans 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 above guidelines, all loans are reviewed in order to identify any objective evidence of impairment or expectations of 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.

Calculation of loan impairment charges at 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 stressed shipping segments 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).

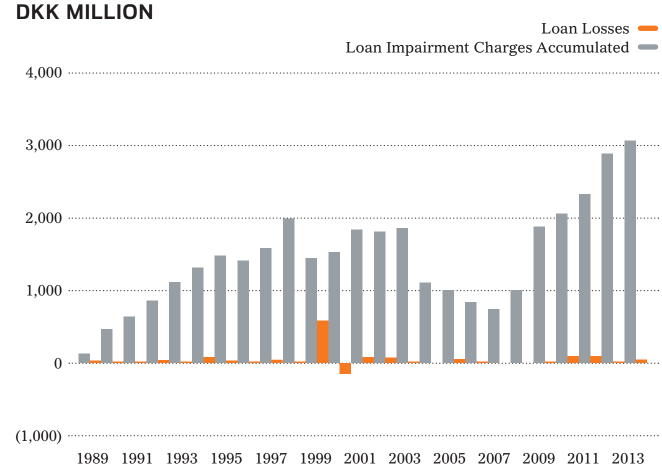
For customers where individual objective evidence of impairment is established due to financial difficulty on the part of the customer, the PD is set at 100%. For impairment with a collective component, the customer's current PD is used.

> 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
> NV 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.

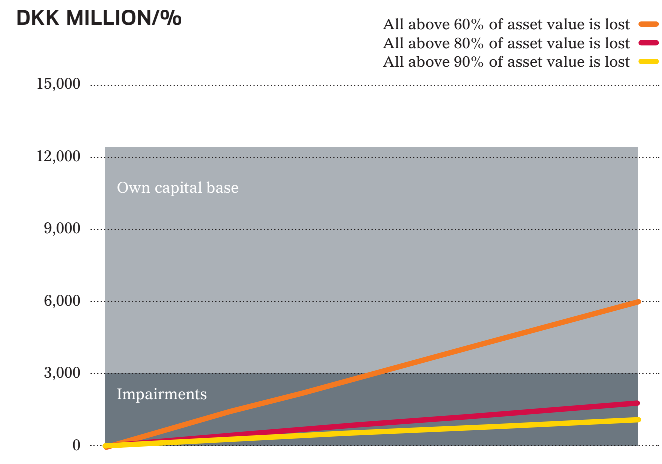
The company's accumulated impairment charges amounted to DKK 3,071 million at 31 December 2013 against DKK 2,884 million last year. This represented an increase of DKK 187 million.

The accumulated impairment charges accounted for 6.7% of the company's total loans and guarantees, which was 0.9 percentage point higher than the year before. The increase in the impairment ratio was due to reduced lending and adverse trends in the financial standing of a small number of borrowers in 2013 triggered by the crisis in parts of the shipping industry. Danish Ship Finance incurred losses of DKK 28 million in 2013, against DKK 1 million in 2012. Losses actually incurred thus remain at a very low level.

LOAN IMPAIRMENT CHARGES AND CREDIT LOSSES
DKK MILLION



LOAN LOSSES AT GIVEN DEFAULT RATES
DKK MILLION/%

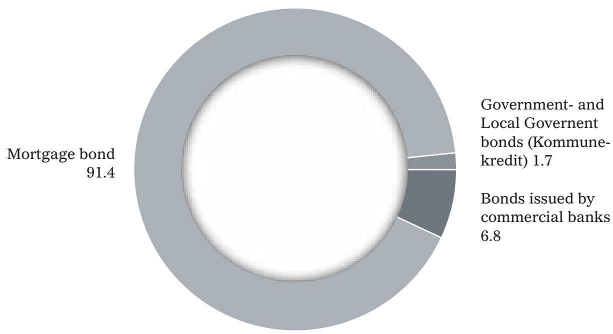


Accumulated losses since the company was established in 1961 were DKK 890 million at 31 December 2013. This corresponded to 2.0% of total gross lending at 31 December 2013.

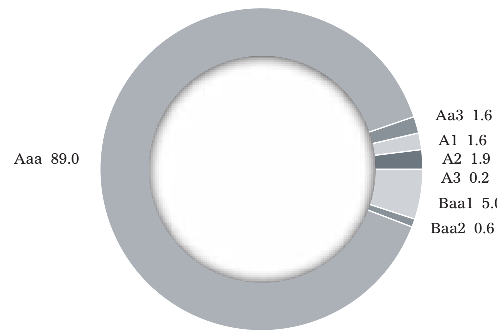
DEVELOPMENTS IN IMPAIRED CLAIMS DUE TO VALUE ADJUSTMENT AND IMPAIRMENT CHARGES

At 31 december 2013	Loans		Financial counterparties	
DKKm	**2013**	**2012**	**2013**	**2012**
Individual impairment charges/provisions				
Impairment charges/provisions for loans and counterparties, 1 January	2,003	1,209	0	0
Impairment charges/provisions during the year	492	792	0	0
Reversal of impairment charges/provisions made in previous financial years, where there is no longer any objective evidence of impairment or the impairment is reduced	471	302	0	0
Other movements	379	306	0	0
Final loss (written off) on previous impairment charges/provisions	28	1	0	0
Accumulated impairment charges/provisions for loans and financial counterparties, 31 December	2,375	2,003	0	0
Sum of loans and financial counterparties where individual impairment charges/provisions have been made (calculated before impairment charges/provisions)	6,885	6,756	0	0
Impairment charges with collective component/provisions				
Accumulated impairment charges/provisions for loans and financial counterparties, 1 January	881	1,119	0	0
Impairment charges/provisions during the year	509	468	0	0
Reversal of impairment charges/provisions, where there is no longer any objective evidence of impairment or the impairment is reduced	315	401	0	0
Other movements	(379)	(306)	0	0
Accumulated impairment charges/provisions for loans and financial counterparties, 31 December	695	881	0	0
Final loss (written off)	0	0	0	0
Sum of loans and financial counterparties where collective impairment charges/provisions have been made (calculated before impairment charges/provisions)	13,541	15,479	0	0
Final loss				
Final loss with no previous individual impairment charges	0	0	0	0
Sale of acquired assets	5	0	0	0
Received on claims previously written off	0	0	0	0

DISTRIBUTION OF SECURITIES PORTFOLIO
%



EXPOSURE ON FINANCIAL COUNTERPARTIES BY CREDIT RATING
%



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 capital base requirement must be invested in investment grade assets. At 31 December 2013, the company had invested DKK 12,507 million in investment grade securities, corresponding to 446% 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 – both in relation to compliance with the company's policies for managing market risk and liquidity risk, respectively, and in connection with receivables 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.

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.

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. Twice a year and when the creditworthiness of the counterparty changes, the allocated lines are re-assessed.

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, CSA agreements have been concluded with some of the company's financial counterparties.

COUNTERPARTY RISK

DKKm	2013	2012
Netting of exposure value:		
The positive gross fair value of financial contracts after netting, cf. schedule 17 to the Executive Order on Capital Adequacy		
Counterparty with risk weight of 0%	0	0
Counterparty with risk weight of 20%	1,004	1,691
Counterparty with risk weight of 100%	0	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%	2,303	3,362
Counterparty with risk weight of 100%	0	0

COUNTERPARTY RISK ON DERIVATIVE FINANCIAL INSTRUMENTS AND CALCULATION OF CAPITAL

The company applies the market value method of the Executive Order on Capital Adequacy for counterparty risk 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 loans, 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.

Collateral

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

The company receives financial collateral in the following principal areas:

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

FINANCIAL COLLATERAL

	Exposure		Collateral	
DKKm	**2013**	**2012**	**2013**	**2012**
Municipality and export guarantees	6	18	3	6
Bank guarantees	0	0	0	0
Deposited bonds and cash deposit	1,269	1,824	235	500
Total financial collateral	**1,275**	**1,842**	**238**	**506**

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 an exposure can be reduced when financial collateral is mortgaged. Appendix 7 of the Executive Order on Capital Adequacy sets out the financial collateral that may be used under the simple credit risk-reducing method. In this connection, it should be noted that the executive order includes a requirement that the financial collateral used must be issued by a business or country holding a premium rating.

In accordance with the rules of the Executive Order on Capital Adequacy, the company uses financial collateral to hedge its credit risk exposure. 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.

The Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as “EMIR”) entered into force in 2012. Like the rest of the Danish financial sector, Danish Ship Finance is subject to the regulation. 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. Danish Ship Finance 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. Danish Ship Finance 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 thresholds, it is not under an obligation to perform central clearing.

As for the financial counterparties, 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 of the company’s OTC derivative transactions must be reported to a trade depository, providing more specific details about the agreement.

Derivative transactions not cleared through a central counterparty will from 31 March 2014 generally be subject to a separate capital requirement (CVA requirement) to hedge the risk of losses due to impairment of the counterparty’s creditworthiness. The company may partly reduce the CVA requirement by entering into agreements on mutual collateral for the value of derivative contracts (referred to as CSA contracts).

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 rules.

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 capital base. 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 capital base. 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 has been restricted to six years. Danish Ship Finance has calculated the option-adjusted duration at approximately 1.2 years at 31 December 2013. 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 495 million at 31 December 2013, corresponding to 5.3% of the capital base, against DKK 224 million in 2012.

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 years	2 years	5 years	10 years	15 years	30 years
2013	0	65	20	21	12	19
2012	40	138	(13)	(16)	(15)	(30)

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 capital base.

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 cash 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 2013: DKK 1,066 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 loan 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

Liquidity risk is the risk that the company is unable to meet its payment obligations as they fall due.

Pursuant to the Bond Executive Order, the company must pursue a balance principle. The company has decided to pursue the specific balance principle. The balance principle entails fixed absolute limits for the size of allowable interest rate, foreign exchange and liquidity risks when there is a difference between payments on loans and funding.

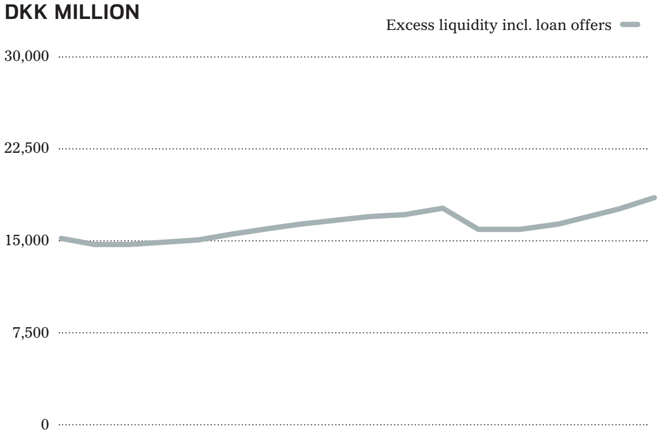
The specific balance principle permits a cash deficit between issued bonds and loans provided. Such a cash deficit – resulting from the future payments related to bonds issued by Danish Ship Finance, other funding and financial instruments which exceed the future incoming payments on loans, financial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

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.

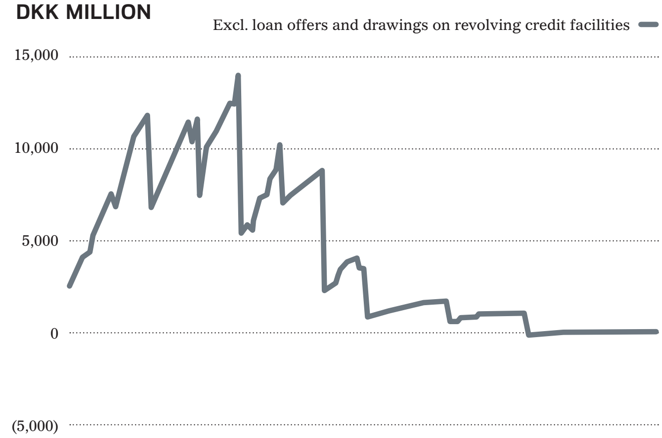
Bonds are typically issued in DKK, whereas most of the loans are disbursed in USD. The company has sourced USD for funding of all loans disbursed via so-called base swaps. The risk caused by lack of access to convert DKK funding into USD involves higher financing costs or the loss of business opportunities. 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.

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

SHORT-TERM LIQUIDITY
DKK MILLION



LONG-TERM LIQUDITY BETWEEN FUNDING AND LENDING
DKK MILLION



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 ship's mortgages which it proves necessary to take over in case the borrower defaults on his loan.

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 customer 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.

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