



Report on thematic inspection of market risk at Jyske Bank A/S (calculation of credit valuation adjustment for accounting purposes)

In December 2014 the Danish FSA conducted an inspection of Jyske Bank A/S' calculation of credit valuation adjustment for accounting purposes of derivatives. At the time of the inspection, the bank was working on a new method of calculation, and following the inspection the Danish FSA has received a description of the new method which was adopted in connection with the financial reporting for 2014.

Based on a risk assessment, the thematic inspection was carried out at selected major banks and was conducted over the period from December 2014 to February 2015 with follow-up as regards the banks' financial reporting for 2014 and for the first six months of 2015.

The reason for the thematic inspection is the increased focus on derivatives and their significance in respect of the financial crisis. As a result, focus on the credit valuation adjustment for accounting purposes of derivatives was strengthened.

Summary and risk assessment

Credit valuation adjustment for accounting purposes is an adjustment of the fair value of a derivative to cover the risk that the creditworthiness of counterparties deteriorates during the term of the agreement. Accordingly it is a function partly of the probability of a counterparty's default and the loss ratio in the event of default partly of the expected exposure.

The accounting rules are principles-based and consequently they do not specify methods to calculate credit valuation adjustment for accounting purposes of derivatives but only indicate that the risk premium requested by the market to assume the credit risk of the counterparties must to the greatest possible extent be included in the calculation.

In a letter concerning the financial reporting for 2014 of credit institutions etc., the Danish FSA pointed out that the market standard for the calculation of credit valuation adjustment for accounting purposes has moved in the direction of more extensive use of relevant credit information observable in the market.

The Danish FSA has assessed that the bank's choice of credit information that is observable in the market does not reflect the credit risk on the bank's specific counterparties. However the FSA appreciates the bank's challenges in finding relevant credit information about the bank's specific counterparties and takes note of the bank's assessment that the credit information used is not material to the financial reporting.

However, the FSA finds it important that, on a regular basis, the bank assesses and takes a critical stand as to whether the credit information used is the information that best reflects the credit risk of the bank's specific counterparties. In this connection, the bank must assess on a regular basis the materiality of the credit information to the financial reporting.

The bank has been ordered to prepare a business procedure for the calculation of credit valuation adjustment for accounting purposes of derivatives.