

## **SUMMARY OF LEGAL INQUIRY INTO CERTAIN MATTERS AT ROSKILDE BANK**

By a terms of reference dated 12 February 2009, the board of directors of Roskilde Bank has requested that Mogens Skipper-Pedersen and Henrik Stenbjerre, attorneys-at-law, conduct an inquiry into certain matters at Roskilde Bank during the period from 1 January 2005 to August 2008.

The overall purpose of the inquiry was to report on the reasons for the financial collapse of Roskilde Bank in the summer of 2008 and to assess whether any criminal acts have been committed or if there is a basis for bringing actions for damages against and/or expressing criticism at members of the board of directors, the executive management, the management team or at the internal or the independent auditors. The assessments are based solely on written material.

The attorneys have submitted their report, and the board of directors has prepared this summary of the legal assessments of the matters referred to in the terms of reference.

### **1. Reasons for the collapse of Roskilde Bank**

The attorneys assess that in all material respects the collapse of Roskilde Bank was due to a combination of

- the bank's high risk profile (strong growth in lending, a high concentration and large focus on the property market and a modest excess capital adequacy ratio to act as a buffer against future losses),
- the bank's inadequate handling of credit cases and a poor credit culture,
- the negative trend on the property market, and
- the negative trends in the money market and the stock market.

Only the first two reasons concern the bank's internal conditions and these have consequently been the subject of assessment. These factors are believed to have caused a substantial part of the bank's overall losses.

#### Risk profile

The risk profile chosen by Roskilde Bank, characterised by very strong growth in lending relative to comparable banks (53% in 2005 and 59% in 2006), a high concentration (about 45%) in property investment and project development and the fixing of a modest excess

capital adequacy ratio, is primarily a choice made and implemented by the bank's prominent and strong CEO throughout many years, Niels Valentin Hansen. The CEO aimed to develop Roskilde Bank from being a local bank for the Roskilde area into a significant bank for the Zealand region. Given his significant assertiveness, he managed to implement his growth policy with the full support of his management team as well as branch managers and employees. The bank's board of directors also regularly acknowledged the growth policy.

The growth policy was implemented despite numerous and persistent reprimands from and examples of risks being pointed out by the Danish Financial Supervisory Authority (FSA). Roskilde Bank's written replies to the communications of the Danish FSA leave the impression that the bank did not take the warnings seriously. On the contrary, the bank maintained its chosen growth strategy relying on *the bank's capital resources and the high credit quality of the loan portfolio, the significant expertise within the property development sector and the heavy demand for this expertise in the market, the bank's special expertise in choosing the most suitable customers and projects, and the fact that the bank takes into account the building risk and the selling risk to the effect that the bank only takes a "marginal" risk.*

The bank's replies to the Danish FSA do not offer a realistic description of the situation. More likely, the situation was more along the lines that large and small property developers alike were *"queuing up"* at the bank, because it was quick and easy for them to borrow money from Roskilde Bank without having to meet the usual bank-related form requirements and document credit quality, etc. In addition, the bank had a sales-oriented credit culture and handled credit cases in a manner that was extremely careless and gave low priority to usual standards of credit approval. The guidelines for the handling of credit cases were not complied with, and the bank's central credit function, Team Kredit, neither had the power, the strength nor the resources to demand that the rules be observed.

#### Inadequate handling of credit cases and a poor credit culture

The handling of credit cases and the credit culture of Roskilde Bank were extremely inadequate and highly inappropriate, which, among other things, resulted in:

- A very large number of cases submitted to the board of directors for subsequent approval, classified as so-called *"urgent cases"*. This is the wrong use of the provision of the instructions to the executive management on *"pressing matters"*, and the *"urgent cases"* is a reflection of granting authorisations not having been complied with in a large number of cases.
- Widespread use of extending commitments to cover very substantial overdrafts, and quite often by exceeding the granting authorisations.
- Poor case processing in credit cases, including

- inadequate basis for granting large commitments
  - failure to regularly follow up on the financial situation, e.g. by procuring interim reports and budgets
  - failure to carry out perfections
  - failure to record relevant data
  - inadequate case files, etc.
- Bad credit standing of some of the large corporate customers and inadequate procedures to establish and verify of such standings.
  - Lacking overview, management and control of Group commitments, particularly project and construction funding.

The inadequate case processing in the bank's branches was the result of a combination of a poor credit culture and the fact that the bank's central credit function, Team Kredit, did not function satisfactorily. The bank lacked efficient credit management and compliance control in respect of its internal loan approval guidelines. At the same time, the credit department was not given sufficient resources to handle the bank's substantial lending growth, and the numerous other duties resting with this function, including the extensive work associated with the Danish FSA's many pressing inquiries. Thus, during the entire period, the credit function was unable *"to keep up with"* the branch sales team, including Team Erhverv, which may in itself have contributed to the large number of subsequent approvals at the bank.

## **2. Who was responsible for the collapse of Roskilde Bank?**

### Niels Valentin Hansen

The attorneys assess that Niels Valentin Hansen bears the main responsibility for the collapse of the bank, and that during the period until the effective date of his retirement on 30 April 2007 he grossly neglected his duties as CEO of Roskilde Bank, and that his acts and omissions imply **violation of section 54 of the Danish Public Companies Act and section 71 of the Danish Financial Business Act as well as a clear basis of liability towards the bank.**

In this connection, it should be emphasised that

- Niels Valentin Hansen implemented a growth strategy primarily through large loans within the property sector, including to property developers, some of which had caused other banks to collapse or suffer losses in the 1990s. This situation, in turn, warranted special caution, and it should be noted that Niels Valentin Hansen was already CEO of the bank at that time.

- Niels Valentin Hansen accepted and presumably in a number of cases directly approved very large loans, including a number of loans close to the 25% limit stipulated in section 145(1) of the Danish Financial Business Act, to property developers, often involving a substantial element of unsecured exposure.
- Niels Valentin Hansen accepted that the processing of credit cases in the bank's branches was not effected in accordance with the guidelines set out, and that this was a result of the bank's substantial growth.
- Niels Valentin Hansen accepted that the bank's central credit department was short-staffed and unable to conduct competent and usual bank-related risk management and control of the loans granted by the bank.
- Niels Valentin Hansen approved that the granting authority of the board of directors was to a high degree neglected through abuse of the exemption provision of the credit instructions in pressing cases since more than half of the loans that only the board of directors could approve were, in fact, approved by the executive management and the credit committee and only later presented to the board of directors for subsequent approval.
- Niels Valentin Hansen was aware that the bank's internal audit did not function adequately in 2005 and, in particular, 2006. By refraining from informing the board of directors of this situation, he contributed to increasing the bank's credit risk significantly, particularly considering the careless nature of the credit handling in the bank branches and the highly inadequate risk management conducted by Team Kredit. As a result, the board of directors had in fact lost its "watchdog" in the credit risk area, since the internal auditors, through the long-form audit report, have a duty to inform the board of directors of any material issues and as, pursuant to section 74(1) of the Danish Financial Business Act, the chief internal auditor is entitled to attend and speak at meetings of the board of directors.
- In the bank's replies to the Danish FSA, Niels Valentin Hansen left the mistaken impression with the Danish FSA and the board of directors that the high risk profile was justifiable on account of the lending customers' standing and a proper handling of credit cases and that, accordingly, the bank did not assume any unnecessary risks.

If Niels Valentin Hansen had seen to it at an earlier date that Roskilde Bank had established an independent and competent credit function with the necessary resources and with the powers to enforce the bank's credit policy and the approved guidelines for the handling of credit cases, the lending growth must be deemed to have been significantly lower and the credit quality of

the bank's lending portfolio to have been higher. Timely intervention in the inadequate work of the internal auditors would have improved the situation. It is possible that as a result of the crisis in the property market and the financial crisis the bank would still not have been able to survive as an independent bank in the long term, but presumably its losses would have been much smaller.

According to the attorneys' assessment, Niels Valentin Hansen's acts and omissions show gross negligence on his part, for which reason he is **liable in damages to the bank for the losses suffered by the bank as a result thereof. See section 140 of the Danish Public Companies Act.**

Violation of section 54 of the Danish Public Companies Act is punishable if gross negligence can be proven.

The attorneys draw attention to section 373(6) and (7) of the Danish Financial Business Act pursuant to which acts of members of the board of directors and the executive management of a bank or a financial undertaking are punishable if they i.a.

- (i) omit to take the necessary steps in the event of losses or imminent danger of material losses,
- (ii) submit incorrect information on matters pertaining to the undertaking to a public authority or the general public,
- (iii) are guilty of gross or frequent negligence or carelessness which may entail losses for the undertaking or the depositors or other investors of the financial undertaking.

In light of the written material on which the inquiry is based, the attorneys are **not in a position to assess whether these provisions have been violated in a manner that in a subjective assessment could be deemed to be one of gross negligence.**

The attorneys also draw attention to section 280 of the Danish Criminal Code on breach of trust, which reads:

*"Any person who, for the purpose of obtaining for himself or others an unlawful gain, involves some other person in a loss of property 1) by abusing an authority conferred on him to act with legal effect on behalf of the latter 2) by acting against the interests of the person concerned in respect of property held in trust by him on behalf of that person, shall, provided the case is not covered by sections 276-279a of this Act, be guilty of breach of trust."*

Acts fitting the elements of the crime described are only punishable if they can be proved to be the result of wilful conduct.

The attorneys do **not find that they can assess on the basis of the written material available to them whether section 280 of the Danish Criminal Code has been violated.**

#### Arne Wilhelmsen

As a member of the executive management since 1 November 2006, Arne Wilhelmsen is, in the attorneys' assessment, **co-responsible for the collapse of the bank**, since he had a duty to notify the board of directors of the inadequate handling of credit cases, Team Kredit's failure to conduct risk management and its resource problems as well as the noted weaknesses in internal audit.

#### Søren Kaare-Andersen

Søren Kaare-Andersen joined the bank as CEO on 1 July 2007 and quickly – through the Danish FSA's letters and internal audit reports – became aware that the handling of credit cases did not live up to usual standards within the banking sector. He launched a number of initiatives among other things for the purpose of stopping the use of "*urgent cases*" and the incorrect treatment of overdrafts. He introduced a new independent credit organisation, separately from Team Erhverv, and consolidated the bank's risk management in a new department, Team Risikostyring.

In the same way, a new set of rules was prepared for the handling of credit cases, information meetings were held and circular letters were sent to the branch managers specifying that the guidelines were now to be followed. In the event of violations discovered in 2008, warnings were issued and regular and summary dismissals were carried out.

According to the attorney's assessment, Søren Kaare-Andersen did not realise the extent of the inadequate case handling and the credit culture until early 2008. They do **not find that a basis of liability exists in the case of Søren Kaare-Andersen.**

#### Allan H. Christensen

The attorneys express criticism of the fact that the head of the credit committee, Allan H. Christensen, signed reports to the Danish FSA, giving the impression of a much better credit case handling and assessment of credit quality than was actually the case. They also express criticism of the fact that Allan H. Christensen, who was a member of the bank's management council until 21 January 2008 participating in his capacity as responsible for credit and presenting credit cases and other matters to the bank's board of directors and who

undoubtedly must have had full knowledge of the poor and risky handling of credit cases, the reasons for the many urgent cases and the resource situation of Team Kredit, did not in a clear and explicit manner inform the board of directors of these conditions, and of the very significant credit risks associated with them. A manager at this level must be expected to provide such information and to actively make proposals for a change of the inappropriate conditions surrounding the handling of credit cases. The attorneys find that Allan H. Christensen's omissions are **actionable vis-à-vis the bank**.

#### Board of directors

The overall assessment is that the individual members of the bank's board of directors have, in a manner which is **unlawful and actionable** in relation to the bank, omitted:

- to conduct adequate supervision of the bank's executive management
- to actively consider the bank's high risk profile and assess the necessity of fixing limits for the bank's maximum exposure to the property sector, to single commitments within property development and to the total exposure to large commitments
- to cause the long-term practice of urgent cases to be stopped
- to actively clarify the resource requirements of the bank's central credit function, Team Kredit, with a view to ensuring the addition of the necessary resources for performing proper credit control of large credit grants and control of the branch compliance with the internal guidelines for good credit case handling.

The omissions mentioned imply **violation of section 54 of the Danish Public Companies Act and section 71 of the Danish Financial Business Act and possibly section 373(6) and (7) of the latter Act**.

The attorneys assess that active earlier intervention on the part of the board of directors in each area concerned could have contributed to limiting the bank's overall losses.

The attorneys do not find sufficient basis for assuming that the board of directors was aware of the inadequate handling of credit cases, Team Kredit's insufficient credit control or the inadequacy of the internal auditors' work performed during 2005-06.

### **3. Do the internal auditors share in the responsibility?**

Inger Pedersen was head of internal audit until she retired due to illness on 31 January 2007. According to the information available, she passed away in April 2007.

Birgit Schledermann has been head of internal audit since 1 February 2007.

As per the 2005 financial year

The attorneys find that the work performed in 2005 was not satisfactory.

They express particular criticism of the fact that a number of audit reports were available in draft form only and were not forwarded to the relevant recipients, and that in a number of areas and in a number of instances the audit work was not performed and reported with due care.

Their assessment is, however, that there **is not a fully sufficient basis on which to conclude that generally accepted auditing principles have been violated.**

As per the 2006 financial year

The attorneys find that the internal audit department did not function satisfactorily in 2006 and that conditions worsened considerably relative to 2005.

The attorneys express particular criticism

- that all audit reports but one were only available in undated draft versions,
- that in a number of areas and in a number of instances the audit work was not performed and reported with due care, including in the quarterly reports. This was particularly unsatisfactory, given the material objections that were subsequently uncovered in the credit area.
- that the long-form audit report of 9 February 2007 in respect of the 2006 financial year did not adequately reveal the material shortcomings of the work conducted by internal audit.

It is the attorneys' assessment that the former chief internal auditor violated generally accepted auditing principles.

It is also their assessment that **chief internal auditor Birgit Schledermann violated generally accepted auditing principles** by having signed the long-form audit report of 9 February 2007 in respect of the 2006 financial year without qualifications, through which action she – who was not responsible for the internal audit in 2006 – contributed to legitimising vis-à-vis the board of directors the inadequate work conducted, and that **there is a basis for liability towards the bank.** However, the board of directors of Roskilde Bank

believes that the new head of internal audit – having served in the position for only nine days at the time – was under extraordinary pressure to sign the long-form audit report from the executive management, the board of directors and the independent auditors, all of whom must have realised that her signature could not have been based on any in-depth investigation. Accordingly, the board of directors does **not intend to take further action** in respect of Birgit Schledermann.

#### As per the 2007 financial year

Internal audit's reporting on the work conducted in 2007 leaves the impression that substantial progress was made to the audit work relative to the previous year. In certain areas, however, the auditors could have conveyed messages more clearly to the board of directors. For example, the many credit-related comments made in the 14 audit reports comprising 33% of the sub-exposures reviewed, should have been mentioned in the long-form audit report, as this would have directed the board's attention to these matters.

It is the attorneys' assessment that there **is no basis on which to conclude that there was a violation of generally accepted auditing principles**. The same applies to the period 1 January – August 2008.

#### **4. Do the independent auditors share in the responsibility?**

Ernst & Young served as independent auditors during the period 1 January 2005 – February 2008.

#### As per the 2005 financial year

The attorneys find that the work conducted by the independent auditors in 2005 was not satisfactory.

For example, the attorneys express criticism of the fact

- that the required supervision was not performed, including the ongoing quality control of the work performed by internal audit,
- that the necessary measures were not taken in respect of the distinct indications of weakness apparent in both internal audit and the credit area.

The assessment is, however, that there **is not a fully sufficient basis on which to conclude that there was a violation of generally accepted auditing principles**.

As per the 2006 financial year

The attorneys find that the work conducted by the independent auditors was not satisfactory.

For example, the attorneys express criticism of the fact

- that the required supervision was not performed, including the ongoing quality control of the work performed by internal audit and that timely measures were not taken to rectify the unacceptable situation.
- that the independent auditors gave their sign of approval to the work performed by the internal auditors in the long-form audit report on the annual report, as it must have been, or should have been, apparent to the auditors that the work performed was inadequate,
- that the independent auditors failed to consider, in their long-form audit report, the lack of information in the annual report about the change in the management's option programme from being funded to being unfunded.
- that the independent auditors pointed out the shortage of resources in the credit department, but only concluded that no misstatements were ascertained in the annual report as a result thereof, which served to debase the serious nature of this information vis-à-vis the board of directors.
- that the independent auditors did not take into account in the long-form audit report the fact that the newly-appointed head of internal audit signed the long-form audit report of 9 February 2007 without qualifications thereby contributing to giving the board of directors an inaccurate impression of the work conducted by internal audit.

It is the attorneys' assessment that the **independent auditors did not conduct their audit in accordance with generally accepted auditing principles and that there is a basis for liability towards the bank.**

As per the 2007 financial year

It is the attorneys' assessment that there **is no basis on which to conclude that there was a violation of generally accepted auditing principles in respect of the 2007 financial year.**

KPMG was appointed as new independent auditors at the general meeting held on 27 February 2008. The attorneys have not found reason to investigate and assess possible liability on the part of KPMG.

## **5. Did the financial statements give a true and fair view?**

The audited interim report for Roskilde Bank for the six months to 30 June 2008 revealed an operating loss of DKK 5,142 million and negative equity of DKK 2,525 million after total impairment charges on loans and guarantees of DKK 3,578 million. This led to the bank's collapse and discontinuation as an independent bank.

The very large write-downs at 30 June 2008 raise the question of whether part of these write-downs should have been objectively ascertainable prior to 1 January 2008. Against this background, the attorneys have assessed the bank's need for write-downs in the 2007 annual report, but they have not found reason to consider the need for write-downs at 31 December 2005 or 31 December 2006.

It is the attorneys' assessment that there is **no basis on which to conclude that objectively ascertainable value impairments had arisen on individual exposures requiring write-downs to such an extent and at such time that would cause the 2007 annual report and the interim report for the period ended 31 March 2008 to contain with material misstatements.**

This conclusion considers, among other things, the fact that banks became subject to new accounting rules at 1 January 2005, under which provisions for likely future losses could no longer be made and that, instead, write-downs on loans could only be made on the basis of objectively ascertainable criteria, and the fact that the Danish FSA conducted a thorough review of the bank's exposures in December 2007 without criticising the timing with which the bank recorded OIV (Objective Indications of Value impairment), or requiring that write-downs be made in excess of the two write-downs on large exposures which were the result of the FSA's review. In their audit of the 2007 annual report, the independent auditors reviewed write-downs of DKK 389 million, corresponding to 87% of the write-downs made at 31 December 2007 without indicating a need for additional write-downs on the exposures reviewed or other exposures.

The attorneys have also assessed whether the management reports contained in the 2005, 2006 and 2007 annual reports provided sufficient information about matters that are normally relevant for users of financial statements, or whether they fail to provide a true and fair view as required under sections 185–187 of the Danish Financial Business Act. They express criticism of the fact that the management reports contained insufficient information in some

areas, but have **not found sufficient basis on which to conclude that for this reason the 2005, 2006 and 2007 annual reports did not give a true and fair view.**

## **6. Dealings in own shares**

The attorneys have reviewed the bank's transactions with Glitnir at around the turn of the year 2006/2007. Their assessment is that the circumstances of the transactions with Glitnir are such that there is no need for any further investigation.

They have also reviewed the bank's transactions with large corporate clients. Considering the fact that the Danish FSA informed the bank in April 2009 that an investigation into these transactions had been initiated, they have **not found reason to conduct an independent assessment of this matter.**

The attorneys have taken note that the bank, in connection with the bank's capital increase in March and April 2007, subscribed shares for an amount of approximately DKK 77 million using the bank's own subscription rights, equalling about 22% of the share issue.

By doing so, the bank was **in violation of section 48h (1) of the Danish Companies Act which prohibits the subscription of own shares, and might also have been in violation of section 296(1) (iii) of the Danish Criminal Code or, in the alternative, of section 373(7) of the Danish Financial Business Act.**

Pursuant to section 48h(3) of the Danish Companies Act, shares subscribed in violation of section 48h(1) are considered to be subscribed by all members of the board of directors and the executive management, who will be jointly and severally liable for paying the subscription amount. However, this does not apply to members of the board and/or the executive management who are able to prove that they did not realise or ought not to have realised that the subscription for shares was unlawful.

The attorneys also find that **Ernst & Young was in violation of generally accepted auditing principles and the statutory order on statements made by state-authorized and registered public accountants by not making any mention of this matter in the long-form audit report on the 2007 annual report and by not including an emphasis of matter in their report.**

## **7. Share options in favour of management**

When introduced in 2003, the option programme was consistent with similar incentive schemes of other banks. The granting of options equal to 5% of the bank's share capital, of

which 2% was granted to Niels Valentin Hansen and 1% to each of the three other members of management, the programme was at the high end and it proved to have the potential to become very attractive to the option holders.

The options were exercised in the spring of 2008 (one of them was exercised in 2006 due to retirement) and in accordance with the option agreements, with the exception that the matters set out below were not mentioned:

- Funding of the purchase of shares when the options were exercised was approved by the bank, according to the information available, on the bank's ordinary terms.
- The board of directors allowed the bank to buy back the shares at market price in order to redeem the bank credit relating to the share purchase.
- When one of the option holders subsequently received a claim from the tax authorities, the bank approved a credit of DKK 34 million in February 2008 against security in shares in the bank with a market value of DKK 20.7 million.

It is the attorneys' assessment

- that there is **no sufficient basis to conclude that the option grants in 2003 were not reasonable**
- that there is **no sufficient basis to conclude that the exercise of the options in 2006 and 2008 did not take place in a reasonable manner**
- that **criticism should be expressed of the fact that the bank subsequently approved a credit of DKK 34 million against insufficient collateral in cover of tax relating to the option agreement.**

## **8. Conclusion**

The board of directors of Roskilde Bank hereby considers the inquiry into certain matters at Roskilde Bank during the period from 1 January 2005 to August 2008 to be concluded.

The board of directors believes that the inquiry provides an adequate report on the reasons for the financial collapse of Roskilde Bank in the summer of 2008 and an assessment of whether any criminal acts were committed or if there is a basis for bringing actions for damages against and/or expressing criticism at members of the board of directors, the executive management, the management team or at the internal or the external auditors.

Accordingly, the board of directors of Roskilde Bank has resolved to take legal action against Niels Valentin Hansen, Arne Wilhelmsen, Allan H. Christensen, the individual members of the bank's then board of directors as well as the bank's former auditors, Ernst & Young.

5 August 2009

The board of directors of Roskilde Bank.