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# Responsible Banking
# - A Regulators Perspective

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# Financial supervision
## - Purpose and focus areas

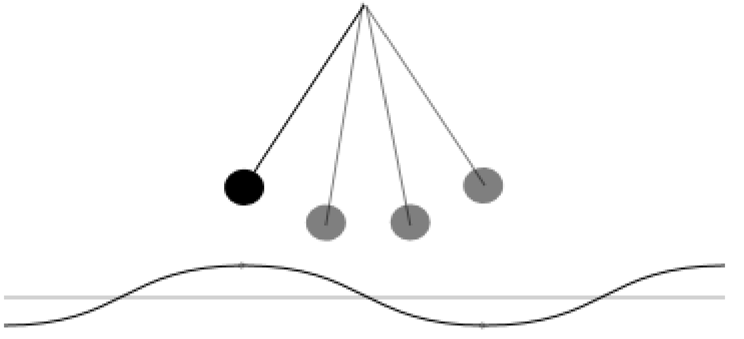
# The financial supervision

The overall purpose of the Danish FSA is to ensure:

- Financial stability
- Confidence in financial undertakings and markets
- Consumer protection
  - Bank customers – deposits
  - Pension customers – promises and guarantees
  - Investors – markets abuse
  - Code of conduct and general behavior

# Continued caution in good times …

- The pendulum will swing back and impairments will increase once more, regardless of prudent lending.



- We have yet to see the last crisis.
- But next time it should not be a bank crisis.

# Key focus areas

1. Viable business models

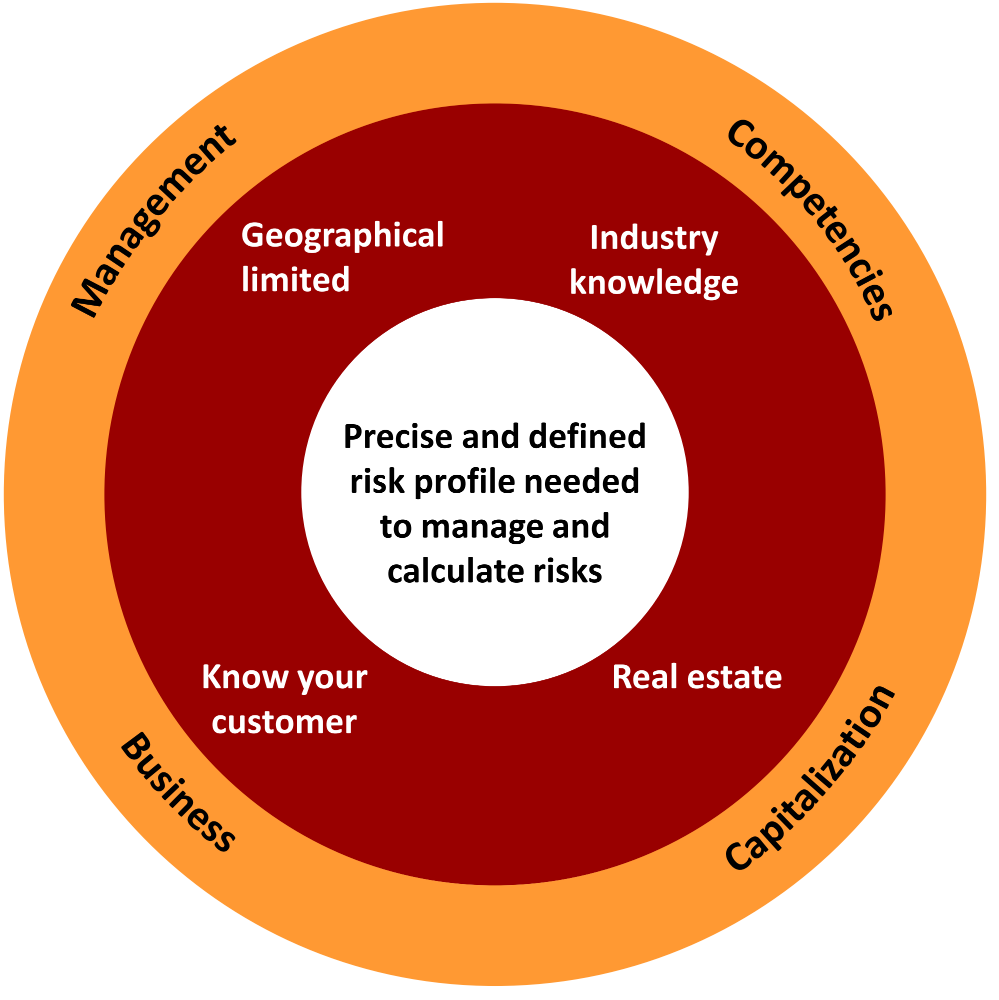
2. High capitalization and earnings

3. Governance and Fit & proper

4. Balanced risk appetite and risk taking – Sound Credit Standards

# Key focus areas in supervision

# 1. Viable business model …




… precise and well defined risk profile

# 1. Viable business model

Key is:

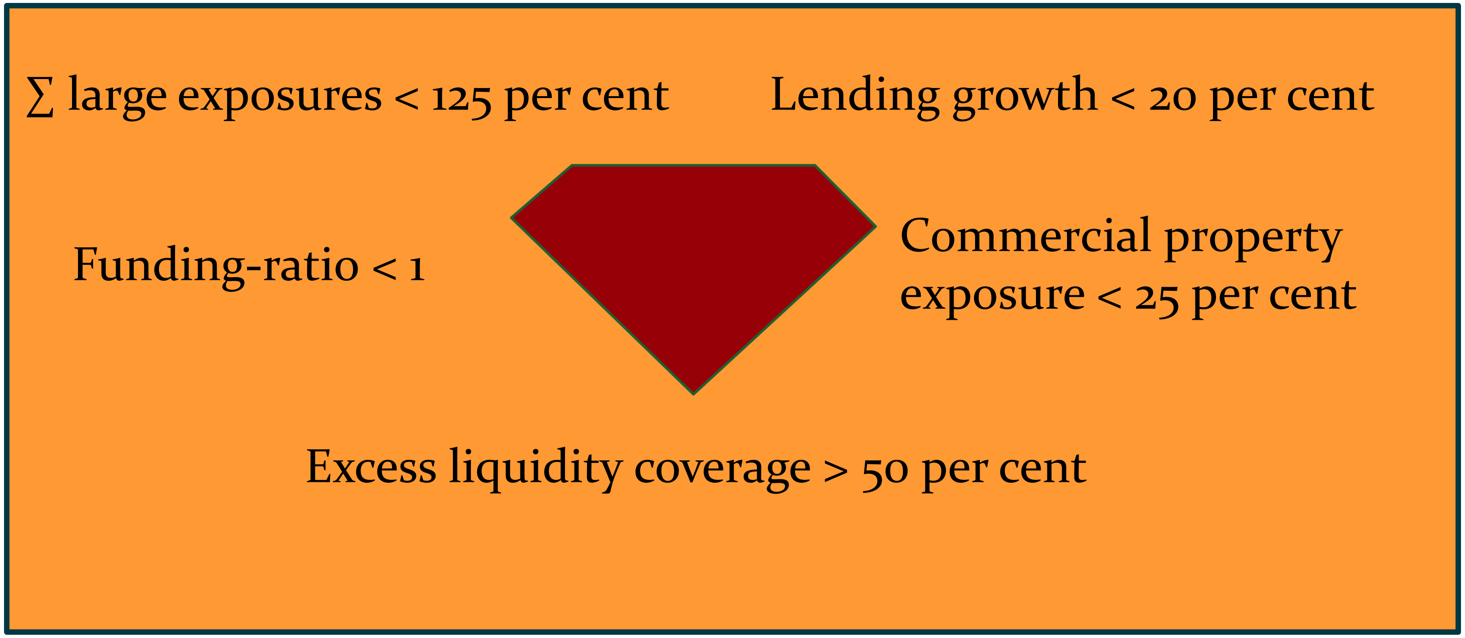
- Define appropriate risk profile in order to manage and calculate risks with adequate certainty
  - For example through geographical limitations and industry knowledge
- Ensures predictability and transparency

And also important to interact with

- *Business activity*
- *Competences*
- *Governance and operating management*
- *Capitalization*

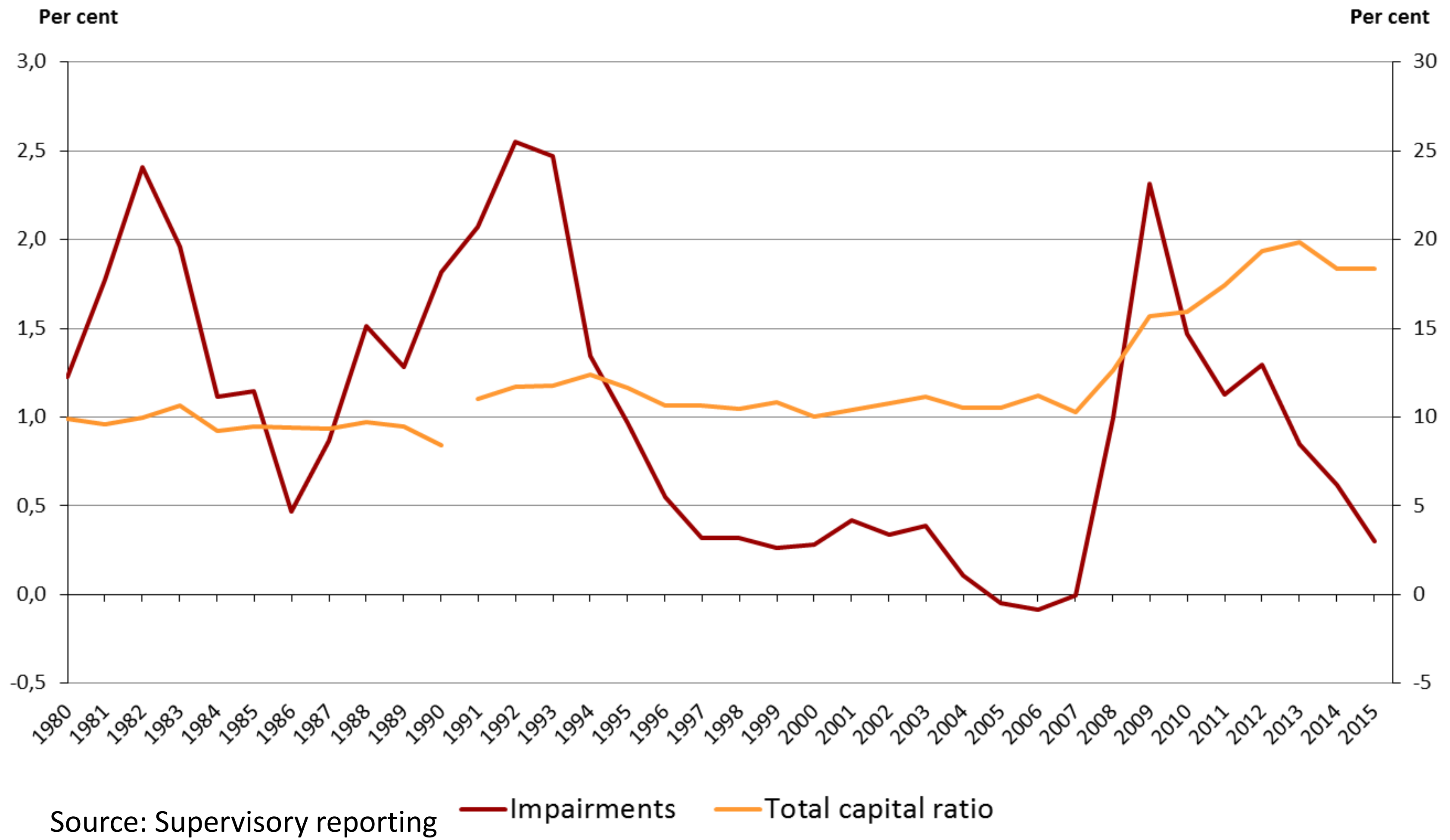
# 1. Viable business model

Supervisory Diamond for banks




- New benchmark for large exposures - changes 1 January 2018
- New benchmark for liquidity based on LCR - changes 30 June 2018
- Funding benchmark expected to be revised when the EU NSFR requirement enters into force

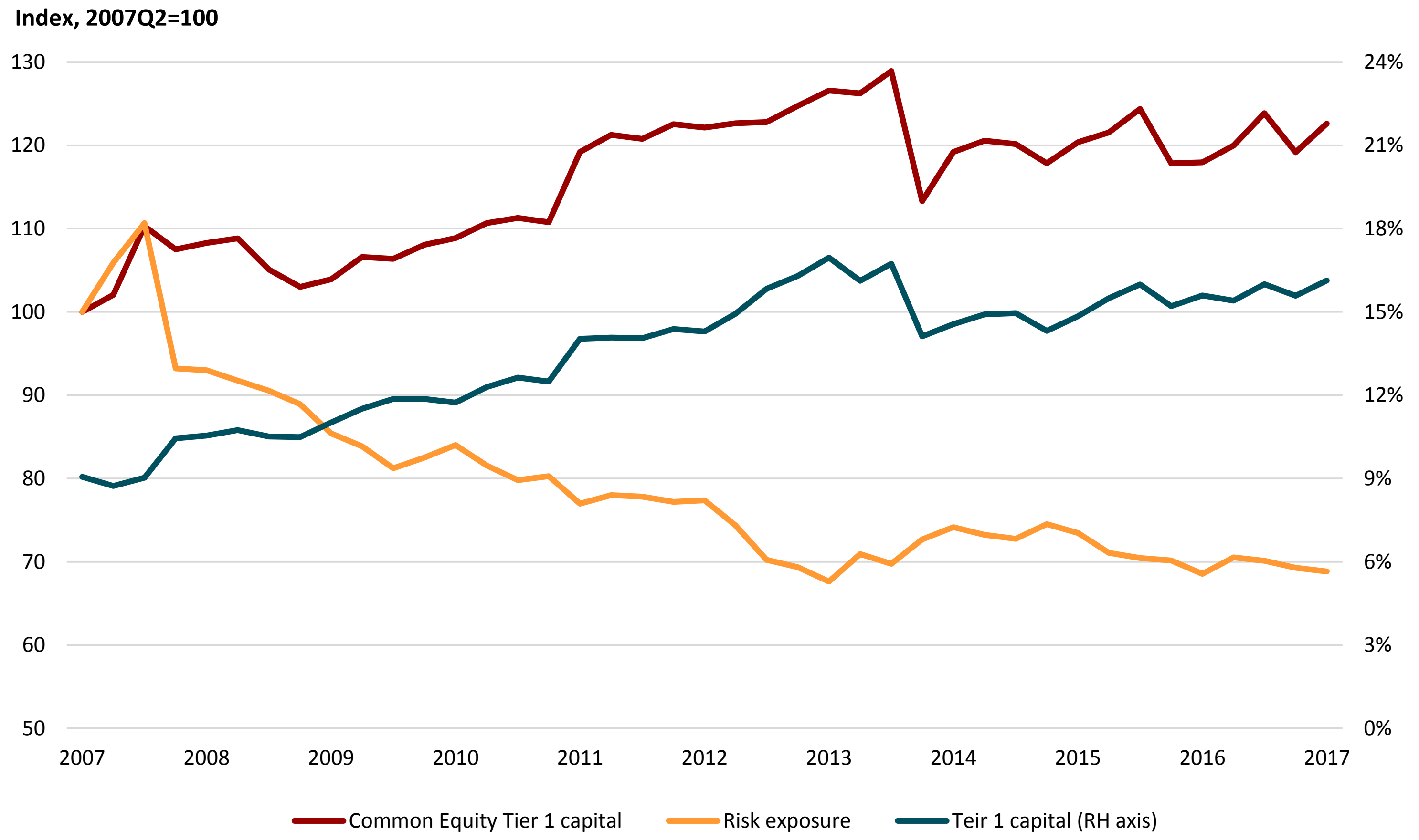
# 2. High capitalization




Source: Supervisory reporting

... Build up buffers during good times ... not in bad times

# 2. Bank capitalization has improved since the financial crisis




Source. Reports to the Danish FSA

# More capital and decreasing risk exposures for banks

# 2. High capitalization

Recently we have seen increasing dividend payouts and share buy back programs

- Timing is important
  - Capital should be build up in good times, not in bad times
- High dividend pay outs must not be on the expense of economic robustness
- Dividend policy should be set within capital objectives

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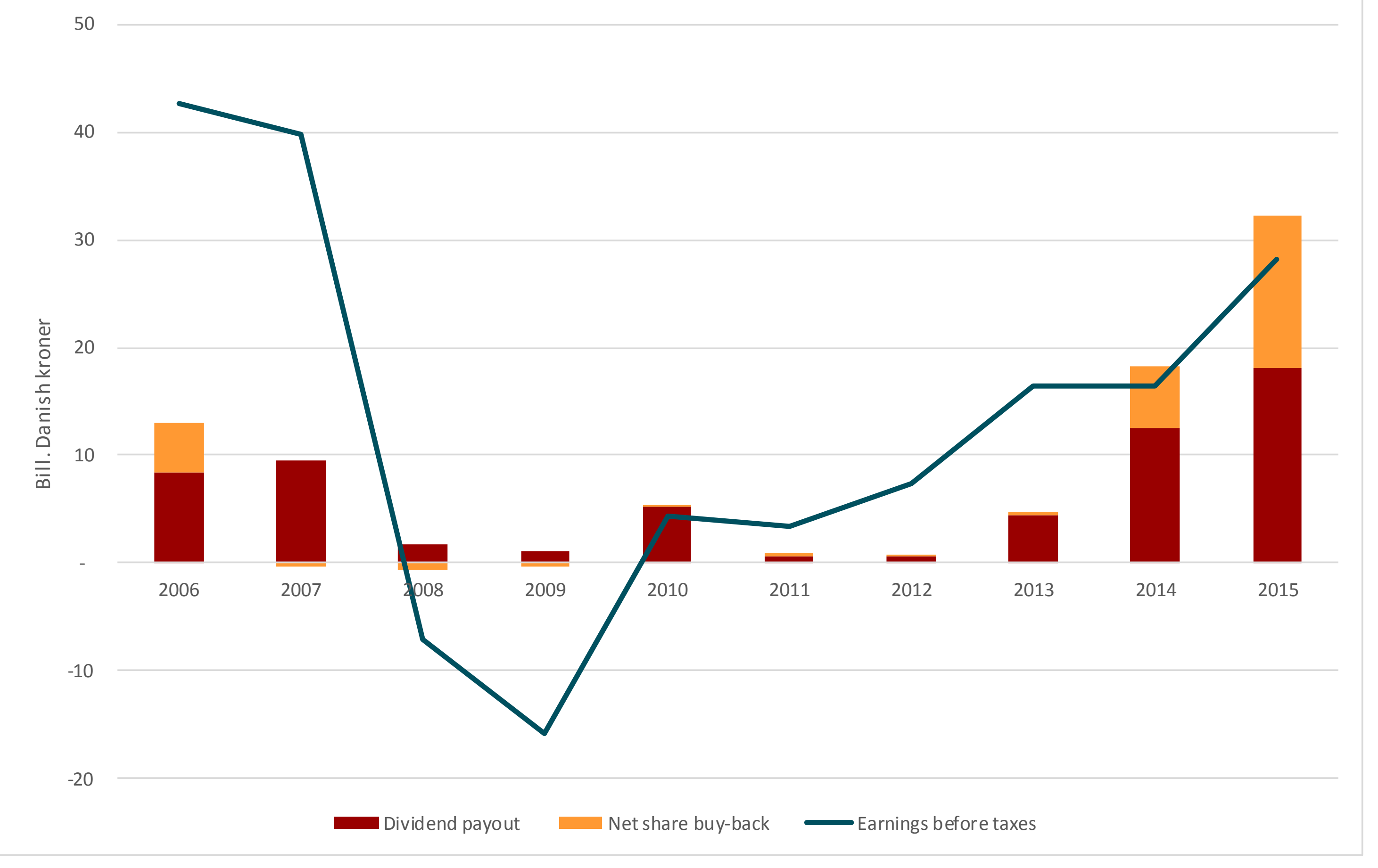
# 2. Earnings, dividend pay-out and capital buy-back



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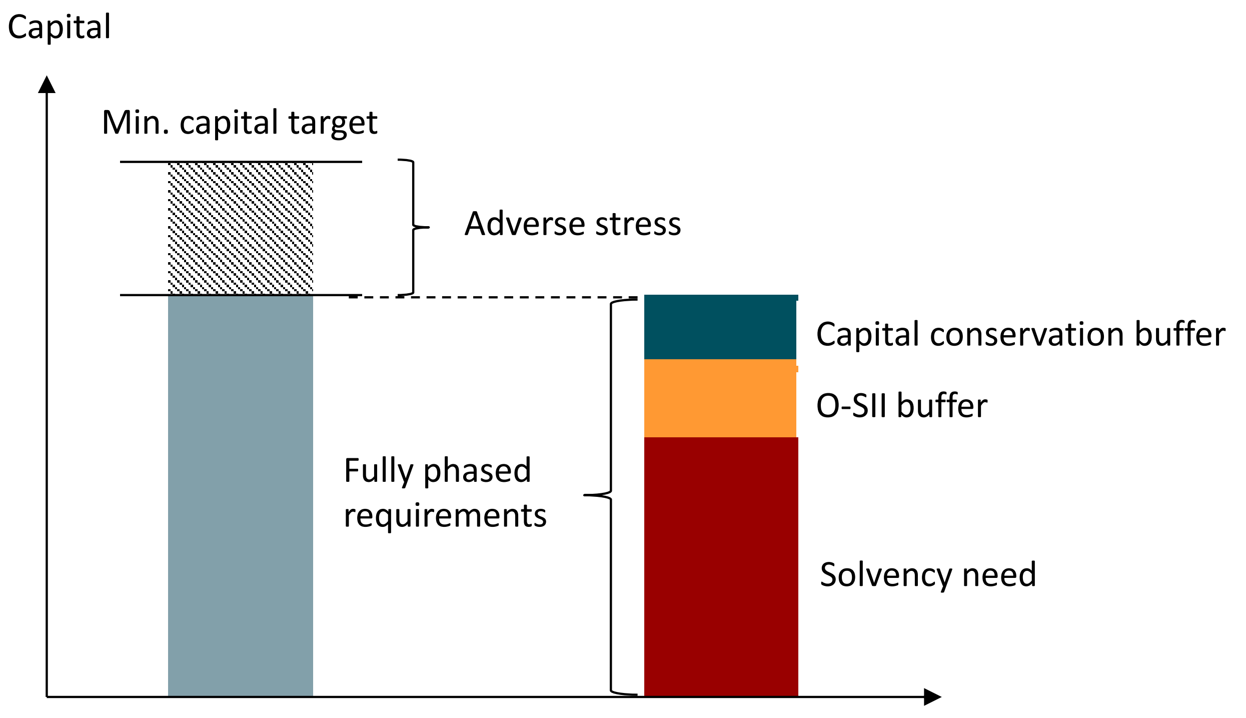
# 2. High capitalization and capital target




Most banks have capital positions well above their announced capital target in order to mitigate unforeseen events

# 2. High capitalization and capital target

There has to be a sound connection between capital, capital requirements and capital targets

- Capital targets should be well above the requirements to address a risk of conflict with requirements in case of unforeseen events

This rationale is also based on the fact that Denmark has chosen a model with lower total capital requirements than our Nordic neighbors

- Norway has gearing requirements and a hard Basel-floor
- Sweden has a higher O-SII buffer

We therefore expect banks to have a higher capital target margin than their Nordic peers

# 3. Governance - Fit & proper

Capital and liquidity is not enough

- Leasons learned from recent financial crisis

A strong board with collective competences is also vital. Such a board will ensure:

- Defining business model and key requirements
- Appropriate operations monitoring and sufficient reporting


The Danish FSA will in time ahead put even more focus on these competencies and the boards interaction with senior management

... a strong board

# 3. Governance - Fit & proper

There has been a general tightening in the Fit & proper requirements and in the Danish FSA's toolbox to intervene

capinordic

A responsible and effective management is key to

- Financial stability
- Confidence in the financial sector
- Consumer protection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# 4. Balanced risk appetite and risk taking

- It is essential to ensure sound credit standards
- The Danish FSA has several focus areas in this regard:

- **Private banking**
  - Any signs of higher risks in this area of business?
- **Property project financing**
  - Any signs of unsound lending practices?
  - Leasons learned from the recent crisis?
- **Commercial credit**
  - Will competition weakens credit standards?
  - Is an increased risk taking decided on a responsible and informed basis?
- **New branch openings and new business areas**
  - Are growing customer base and new business areas properly aligned with the overall business model?
  - Are decisions taken on a sufficiently informed basis?

Foundation for losses in times of crisis is often laid in good times

# 4. Balanced risk appetite and risk taking

## Private banking – increased risks?

The Danish FSA has conducted investigations of wealthy private banking customers in a number of banks

- Focus: Basis for informed decision making, reporting, business procedures and number of fundings
- Learnings from recent crisis: Credit risk can be significant if knowledge about the customers financial position is not sufficient
- Volume of investment credits are lower than pre crisis level
  - At present not an increased risk in this business area
  - But easing in a growing market brings new risks

# 4. Balanced risk appetite and risk taking

## Real estate project financing

- That is Residential or Commercial properties

Systemic important institutions

- Investigation in early 2016
  - High growth over the last 3-4 years and high competition in the big cities
  - Projects are often expensive apartments
  - No present signs of unsound lending

Medium sized financial institutions

- Investigation in the fall of 2016
  - Lending to real estate projects to a limited extent
  - Institutions do not follow own business procedures and/or have imprecise procedures
  - Some signs of increased risk taking

… Deja vu?

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# 4. Balanced risk appetite and risk taking

## Commercial credit, business lending

- Investigation on new lending to commercial customers

- Increased risk taking in order to attract new lending:
  - Relaxed credit terms regarding collateral
  - … and lending margins
  - Unsound credit granting; cases of insufficient customer knowledge or vulnerable customers
  - Deviations from main guidelines set by the board
  - … and examples of insufficient basis for decision making

➢ That is increased loss potential in case of negative changes to macro economic environment

… competition potentially compromises credit standards

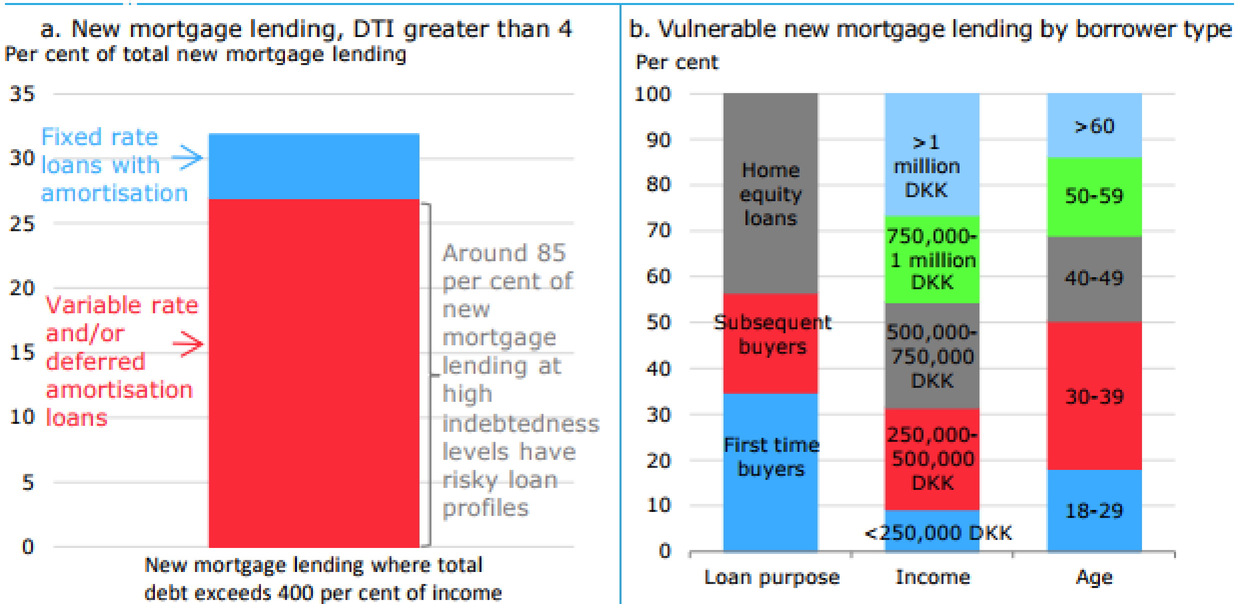
Finanstilsynet

# Responsible Banking

# Good Business Practice

# Rising house prices and a higher number of highly indebted households may entail systemic risk

In Copenhagen, environs and Aarhus every fourth household opts for vulnerable indebtedness. 2015 Chart 1

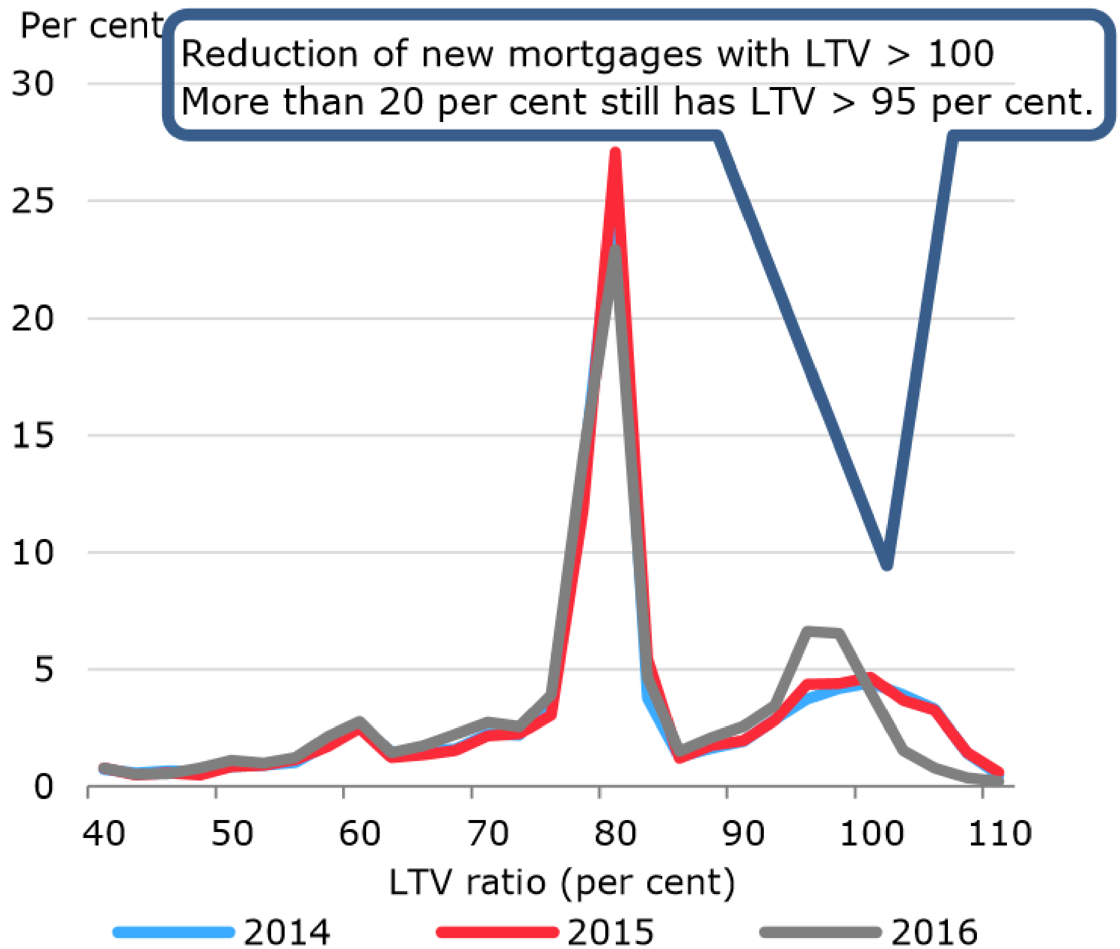



Note: New mortgage lending defined on the basis of remaining cash debt reported by mortgage banks. High indebtedness is defined as borrowers with a total ratio of debt to income before tax of more than 400 per cent.

Source: Own calculations on the basis of microdata from Statistics Denmark.

# Share of housing loans with high LTV slightly reduced

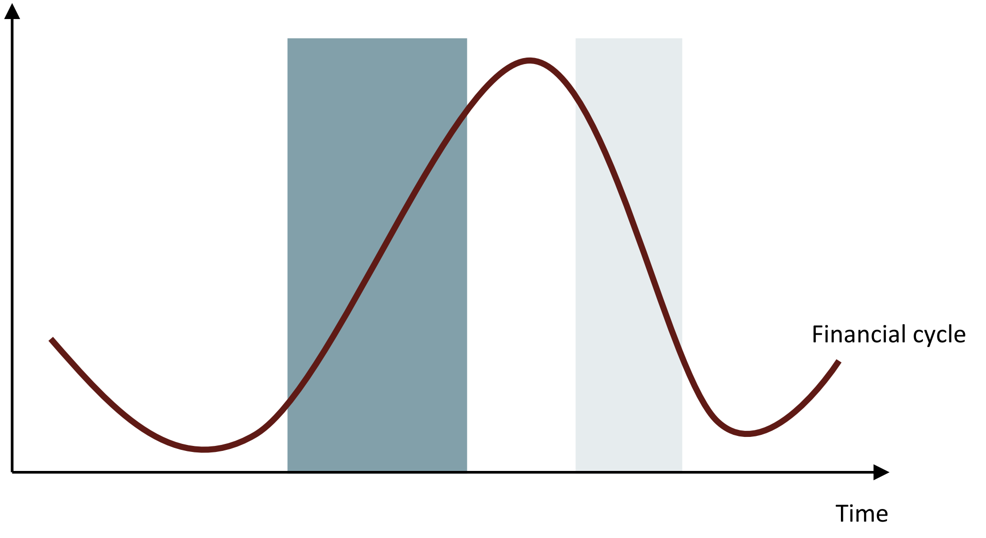
**LTV ratios for debt-financed home purchases**




Effect from down payment requirement

# Risks build up in good times ...

- Initiatives have been implemented but asset prices keep rising




... How and when to act?

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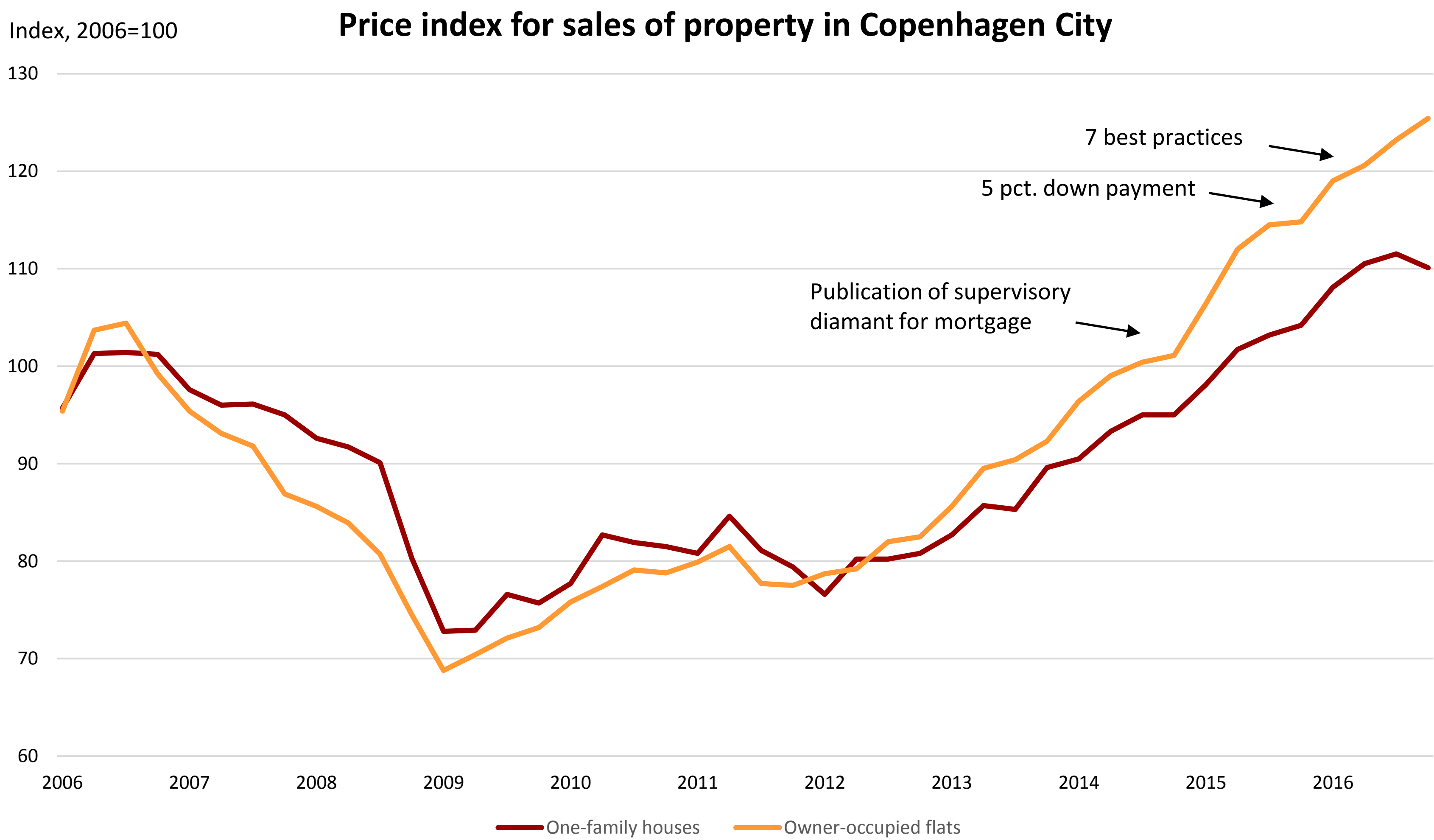
# By example, Housing prices ... addressed by several initiatives




Source: Statistics Denmark

... but housing prices keep rising