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DENMARK

REPORT ON OBSERVANCE OF STANDARDS AND CODES (ROSC)

December 2014

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REPORT ON THE OBSERVANCE OF STANDARDS AND CODES

November 13, 2014

Prepared By
Monetary and Capital Markets Department

This report was prepared in the context of a standards assessment mission in Denmark during March 2014, and overseen by the Monetary and Capital Markets Department, IMF.

CONTENTS

Glossary

AC	Additional Criteria
ALM	Asset Liability Management
AML/CFT	Anti-Money Laundering/Combating Financing of Terrorism
ASB	Accounting Standards Board
BCPs	Basel Core Principles
BoD	Board of Directors
BoM	Board of Management
BCBS	Basel Committee on Banking and Supervision
CAB	Commercial Appeals Board
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CEBS	Committee of European Banking Supervisors
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CFO	Chief Financial Officer
CoB	Conduct-of-Business
CPs	Core Principles
CRDIV	Capital Requirements Directive IV
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
DBA	Danish Business Authority
DFSA	Danish Financial Supervisory Authority
DGF	Danish Guarantee Fund
DIA	Danish Insurance Association
DKK	Danish Krone
DN	Danmarks Nationalbank (central bank)
DSA	Danish Society of Actuaries
D-SIBs	Domestic Systemically Important Banks
D-SIFI	Domestic Systemically Important Financial Institution
EBA	European Banking Authority
EC	Essential Criteria
EEA	European Economic Area
EFRAG	European Financial Reporting Advisory Group
EIOPA	European Insurance and Occupational Pensions Authority
EOs	Executive Orders
ERM	Enterprise Risk Management
ERSB	European Systemic Risk Board
ESMA	European Securities and Markets Authority
EU	European Union
FATF	Financial Action Task Force
FBA	Financial Business Act

FHCs	Financial Holding Companies
FIU	Financial Investigations Unit
FSC	Financial Stability Company
FTE	Full Time Equivalent
FX	Foreign Exchange
GDP	Gross Domestic Product
G-SIFI	Global Systemically Important Financial Institution
HQLA	High Quality Liquid Assets
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICAAP	Individual Capital Adequacy Assessment Process
ICP	Insurance Core Principles
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRB	Internal Ratings-Based
IRR	Interest Rate Risk
ISAs	International Standards on Auditing
ISN	Individual Solvency Need
JRAD	Joint Risk Assessment Decision
KPI	Key Performance Indicator
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value Ratio
MCIs	Mortgage Credit Institutions
MCR	Minimum Capital Requirement
MoBG	Ministry of Business and Growth
MoF	Ministry of Finance
MMoU	Multilateral Memorandum of Understanding
MoU	Memorandum of Understanding
NAO	National Audit Office
NIM	Net Interest Margin
NPLs	Non-performing loans
OECD	Organization for Economic Cooperation and Development
PCR	Prescribed Capital Requirement
RoE	Return on Equity
RWAs	Risk-Weighted assets
SIFIs	Systemically Important Financial Institutions
SRC	Systemic Risk Council
SREP	Supervisory Review and Evaluation Process
SRO	Self-Regulatory Organization
STRs	Suspicious Transaction Reports
UBO	Ultimate Beneficial Owners
VaR	Value at Risk

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Summary

1. **Denmark has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).** The Danish Financial Supervisory Authority (DFSA) has the appropriate legal authority to carry out supervision effectively and in its risk based approach has focused well on the key elements of risk within its banking system. Its powers and supervisory approach have evolved significantly since the recent global crisis and the DFSA emerged as a hands-on and proactive supervisor. Its overall supervisory approach is sound and the compliance with the credit-risk and capital adequacy related principles is uniformly high. The length of the examination cycle should be reduced through the use of additional resources. A more thorough and comprehensive approach to operational risk and market risk is warranted. Finally, the operational independence of the DFSA should be protected by retaining certain supervisory imperatives within the authority of the Director General, while strengthening the governance of the DFSA Board.

B. Introduction

2. **This Report on the Observance of Standards and Codes (ROSC) summarizes the findings and recommendations of the BCP assessment and should be read in the context of the accompanying FSAP documents.** The assessment mission took place from March 2-21, 2014.[1] The Financial System Stability Assessment (FSSA) and accompanying FSAP technical notes and ROSCs provide a comprehensive picture of the institutional setting, market structure, and financial sector risks in Denmark. Denmark is among the first countries to be assessed against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in September 2012.

C. Information and Methodology Used for Assessment

3. **The Danish authorities chose to be assessed and rated against both Essential Criteria (EC) and Additional Criteria (AC).** To assess compliance, the BCP Methodology uses a set of essential and additional criteria for each core principle (CP) and the assessment of compliance is made on a qualitative basis. It should be noted that the ratings assigned during this assessment are not directly comparable to the 2006 BCP assessment which was conducted under a previous version of the methodology (revised in 2006 and again in 2012). In particular, the revised BCPs have a heightened focus on risk management and strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks.

[1] The assessment team comprised Christopher Wilson (IMF) and William Rutledge (Consultant).

4. The assessment team reviewed the framework of laws, rules, and guidance and held meetings with officials and industry representatives. The authorities provided a comprehensive self-assessment of the CPs, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff, and systems. The team had extensive meetings with the DFSA, and additional meetings with the Ministry of Business and Growth (MoBG), auditing firms, and banking sector participants. The team received excellent cooperation from the authorities and extends its thanks to staff of the authorities, at a time when many other resource intensive projects related to domestic and global regulatory initiatives were underway.

5. The standards were assessed in the context of the Danish financial system's sophistication and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

D. Key Findings

6. Denmark has a high level of compliance with the BCPs. The DFSA has a risk-based approach to supervision which covers a total of 88 banks and 7 mortgage credit institutions (MCIs). The banking system is highly concentrated with the 5 largest banks accounting for 87 percent of total banking assets and the two largest banks accounting for approximately 70 percent. The DFSA prioritizes and concentrates resources in high risk areas and potential high-impact risks for the financial system. The onsite inspections involve a thorough and comprehensive assessment covering material risk areas such as capital, liquidity, governance, risk management, and Pillar 1 risks. This results in a supervisory cycle for onsite inspections ranging between one and six years (the extended examination cycle of six years is only used for small banks with low risks and a simple business model).

7. The regulatory architecture is well-developed, although structures in place have the potential to interfere with the DFSA's operational independence. Banking laws, regulations and prudential standards are regularly updated as necessary (e.g. in context of changes in the European Union legislative framework) to ensure that they remain effective and relevant. The decision-making process on significant matters—with a relatively low threshold of significance—faced by the DFSA currently requires the approval of the Financial Council, consisting of members appointed for up to four-year terms by the MoBG to represent designated stakeholder groups, including the financial industry. The replacement in July 2014 of the Financial Council with a Board of Directors will eliminate the issue of current industry representatives' casting votes on intended supervisory policy actions (a major governance weakness of the current system), but will in fact extend the range of issues on which the set of short-term appointees on the Board (two-year terms) will be authorized to decide. Not only will the Board act on numerous policy and individual institution matters, but it will have additional authority for setting the direction of the DFSA's operations.

8. The supervisory intensity is broadly appropriate for large banks, but the examination cycle for smaller banks should be reduced. The DFSA has a good offsite framework for supervision. In particular, the Supervisory Diamond is used to detect signs of excessive risk-taking and allows early intervention. However, the very extended examination schedule limits the immediacy with which issues can be discerned from onsite work—an extremely clear problem for smaller well-capitalized banks (for which examinations can be scheduled beyond six years), but also relevant for larger banks as additional examinations work beyond the annual focused inspection is not typically performed during the annual cycle. For the onsite inspection tool to be most effective, it needs to be utilized on a more frequent basis, and in a more flexible way in order to incorporate additional reviews when for example, a change in the risk profile or a stress test result, indicates desirability of another onsite examination. The DFSA should seek approval for additional resources to be able to lessen significantly the time between examinations and enhance flexibility in responding to developments with additional onsite work. Staying on top of developments between inspections would also be aided by the receipt of audit and risk management reports on a flow basis (which the DFSA expects to address soon for systemically important financial institutions -SIFIs).

9. The DFSA collects a generally comprehensive set of financial and prudential information from banks on both a routine and ad hoc basis, but risk information should be expanded. Reporting instructions are fit for purpose and regularly reviewed and updated. On a routine basis, most banks submit a standardized suite of regulatory returns on a quarterly frequency and more often for certain types of information. Quarterly returns contain information to monitor bank performance and changes in business mix, especially credit risk. The data submitted by banks is subject to various statistical validations for data accuracy and quality and then analyzed by supervisors using cohort comparisons to detect outliers and discriminate risk profile. The DFSA does not provide reporting instructions for operational risk loss and related party lending, which should be enhanced in scope and granularity.

10. The DFSA has demonstrated the ability and willingness to act at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has exercised a range of supervisory tools to bring about timely corrective actions and occasionally revoked bank licenses. The DFSA has a wide range of options to intervene at an early stage and uses the Supervisory Diamond acts as an important tool for monitoring changes in risk profile. The DFSA took corrective actions even when the bank fulfilled the regulatory capital requirements. Since the global financial crisis struck, 19 banks were closed as part of a problem bank resolution.

11. The legal authority to carry out supervision is generally appropriate, but the DFSA does not have the power to reverse a change in control. The DFSA can withdraw the voting rights of the shareholder, but it cannot reverse the change in control. The powers—as spelled out in the Financial Business Act (FBA)—restrict the flexibility of DFSA to respond to a change in control if the shareholder acquires a shareholding without approval. If a transfer of significant ownership occurs, the supervisor has the power to review, reject, but not to impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties. In practice, the DFSA will reject the acquisition unless it is satisfied that all criteria are fulfilled.

12. The DFSA gives very strong focus to credit risk, with extended onsite examination activity and regulatory reporting. The ten largest exposures of the bank are reviewed annually (by the Board, by the external auditors, and by examiners). During credit inspections, the DFSA has a strong focus on a large number of specific credit risk exposures. The DFSA has taken a strong and conservative approach to impairment and provisioning policy, which was commended by the assessors. The DFSA sets prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties and the regulations provide detailed guidance to banks in determining connected counterparties when aggregating exposures. In general, however, banks typically have a risk appetite for large exposures lower than the 25 percent limit and the Supervisory Diamond encourages prudent management of aggregate credit concentration risk.

13. The regulatory definition of "related parties" and routine supervision need to be enhanced. The definition of "related parties" includes only the Board of Directors (BoD), the Board of Management (BoM) and intra-group transactions, but it does not extend to minor shareholders and key risk takers (i.e. credit officers). Therefore, the deficiencies in the definition of related party in the legislation limit the application of the DFSA's powers. From a routine supervision perspective, ongoing surveillance is not sufficiently frequent (i.e., no quarterly or semi-annually supervisory reporting is required) to track and monitor related party exposures. Supervision processes should be extended to actively monitor and assess related party exposures as part of the supervisory cycle.

14. The DFSA has a comprehensive set of market risk regulations that require banks to prudently manage market risk, but onsite and offsite processes should be strengthened. Banks are required to implement BoD approved policies and processes, which are regularly reviewed and adjusted according to macroeconomic conditions. Onsite reviews of risk management are performed routinely to verify compliance and assess risk profile. Currently offsite reporting of market risk information consists of data for specific categories: currency, interest rate, commodity, and equity products. While reporting requirements capture the majority of traded market instruments, the breakdown by instruments will not be captured by the reports. Therefore, an increase in the bank market risk exposure will be seen in the reporting, but the direct cause of the increase will not be visible. As a result, a build-up in some market risks, e.g. option risks or some concentration risks could occur in the absence of onsite examinations. Supervisory reporting of traded market risk could be expanded to capture a broader suite of risk information and results of stress testing.

15. The DFSA has made considerable progress increasing its supervision of banks' compliance with the AML/CFT regulations, but implementation efforts should be intensified. The DFSA actively liaises with the Financial Intelligence Unit (FIU) to share data and intelligence and ensure prosecution of AML/CFT cases. The DFSA has developed a risk-based onsite examination program to conduct assessments of banks' compliance with the obligations under AML/CFT Act. A self assessment questionnaire has to be completed by banks on an annual basis. As a result, the reporting of STRs has increased and there have been more cases of AML prosecution. The DFSA has commenced onsite examinations to the largest banks to assess the adequacy and effectiveness of internal processes and controls for AML/CFT. However, such onsite examinations should span across the larger population of banks.

16. Supervisory reporting is not sufficiently frequent and detailed to identify and monitor changes in operational risk profile. Onsite operational risk examinations are performed as a subset of credit and market risk reviews. The current focus of routine reporting should be expanded to include a broader suite of risk information—i.e., by loss event type and changes in business environment and internal control factors. Requirements for routine supervisory reporting do not require reporting of operational risk losses by event type and category which inhibits a meaningful offsite analysis of operational risk trends and changes in profile. The banks that use a standardized method for reporting operational risk will report Basel event type and category for the first quarter of 2014 in accordance with the new Common Reporting requirements.

17. Internal processes surrounding Pillar III disclosure requirements need to be systematized and aligned with the supervisory cycle. While the DFSA receives Pillar III reporting from banks, it does not review whether the disclosure requirements are met. Only the larger banks (Group 1 and 2) have such disclosures reviewed in detail, and typically reviews are performed for information purposes of the supervisors, not to assess completeness or accuracy of the filings. Accordingly, while there are provisions that could require republication or even the imposition of a fine, they have never come into play.

18. The DFSA maintains close cooperation with other supervisors. The largest banks have strong regional ties. The DFSA has hosted supervisory college meetings for Danske Bank since February 2009. It also actively participates in other supervisory colleges for the Nordic-Baltic as a host supervisor. The Nordic Baltic Macroprudential Forum offer country supervisory authorities the opportunity to cooperate and exchange information for the purposes of benchmarking in offsite supervision. Furthermore, a cooperation agreement exists on cross-border financial stability, crisis management and resolution between relevant Ministries, Central Banks and Financial Supervisory Authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden.

Table 1. Summary of Compliance with BCPs	
Core Principle	**Comment**
1. Responsibilities, objectives and powers	The DFSA has an appropriate overall set of legal authorities to carry out supervision of the Danish banking system. The responsibilities and objectives of each of the authorities involved in banking supervision are clearly defined in legislation. In addition to, and generally in support of, ongoing supervisory activities, the DFSA assists in drawing up financial legislation and prepares binding Executive Orders (EOs) for the financial sector area.
2. Independence, accountability, resourcing and legal protection for supervisors	The replacement in July of the Financial Council with a Board of Directors will eliminate the issue of current industry representatives' casting votes on intended supervisory policy actions (a major governance weakness of the current system), but will in fact extend the range of issues on which the set of short-term appointees on the Board will be authorized to decide. The Board will continue the current responsibilities of the Financial Council to act on numerous policy matters and individual institution matters, but will have additional authority for setting the direction of the DFSA's operations.
3. Cooperation and collaboration	There is a well-designed structure for supervisory coordination within Denmark simplified by the reality that essentially all domestic financial supervision is housed within the DFSA. Memoranda of Understanding (MoU) with the appropriate set of foreign supervisors are also in place. There is currently good operational cooperation between the DFSA and the DN. The two work closely together on stress testing and share data for analysis purposes and surveillance. There is broader cooperation between the DN, the MoF, the MoBG, and the DFSA for the coordination of financial stability matters. The cooperation is also codified in a MoU.
4. Permissible activities	Permissible activities are clearly defined in the regulations. The use of the word "bank" is clearly defined in the law (FBA), and controlled by the DFSA. Banks have the exclusive right to use the words "bank", "sparekasse" or "andelskasse" in their name and the list of banks licensed by the DFSA is published on their website. MCIs are licensed under the Mortgage Credit and Covered Bond Act and are not allowed to use the term "bank" or to take retail deposits. There are 8 licensed MCIs.
5. Licensing criteria	The DFSA has appropriate set of powers to set licensing criteria and reject applications. Over the course of the last five years the DFSA has received a limited number of new license applications and has applied a sound approach in applying license criteria. The licensing process is undertaken over the course of typically one year from the first meeting with the applicant to the actual time the license is granted, which gives the DFSA appropriate time to make a comprehensive assessment.
6. Transfer of significant ownership	In the event of a transfer of significant ownership occurs, the supervisor has the power to review and reject a proposed transfer of significant ownership or controlling interests held directly or indirectly in existing banks to other parties,

	but does not have a formal power to impose prudential conditions. The DFSA was nevertheless able to address this deficiency in certain circumstances to good effect. There is no definition of ultimate beneficial owners in the FBA.
7. Major acquisitions	According to legislation, prior notification and approval is required of the DFSA for a major acquisition. Although where a major acquisition involves a foreign undertaking, a lower threshold is applied of prior notification. The power to impose prudential conditions on an acquisition is not contained in the legislation, which is a gap in regards to this CP. In practice, when assessing a major acquisition, the DFSA will not approve an application unless it is satisfied that all criteria are fulfilled.
8. Supervisory approach	The DFSA has a good framework for supervision with a number of strengths – in particular the Supervisory Diamond that is used to constrain banks from adopting overly risky business models. There are some weaknesses, however, beginning with the generally very extended examination schedule (four years for the most well-capitalized medium sized banks, and up to six or even more years for smaller and most well-capitalized banks).
9. Supervisory techniques and tools	The DFSA has done a commendable job in putting in place a set of tools to enhance supervision coming out of the financial crisis. The assessors were impressed by the knowledge and commitment of the supervisors of the DFSA. Several areas of improvements have been identified. For the on-site inspection tool to be most effective, it needs to be utilized on a more frequent basis. Staying on top of developments between inspections would also be aided by the receipt of audit and risk management reports on a flow basis (which the DFSA expects to address on a later stage for SIFIs).
10. Supervisory reporting	The powers under the FBA allow the DFSA to collect a generally comprehensive set of financial and risk information from banks on both a routine and ad hoc basis. Reporting instructions are fit for purpose and regularly reviewed and updated. On a routine basis, most banks will submit a standardized suite of regulatory returns on a quarterly frequency and more often for certain types of information.
11. Corrective and sanctioning powers of supervisors	The DFSA has demonstrated an ability and willingness to intervene at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has exercised a range of supervisory tools to bring about timely corrective actions.
12. Consolidated supervision	The approach to consolidated supervision of the groups that have the bank as the ultimate parent (the predominant form within Denmark) appears sound. However, only selected requirements are applicable to financial holding companies (FHCs) where non-bank financial companies are the ultimate parent (solvency, reporting of large exposures and exposures to related parties) and requirements are not applicable even to the limited extent appropriate on a consolidated basis to groups where a non-financial company (e.g., grocery chain) is the ultimate parent.
13. Home-host relationships	The DFSA works very closely with other national supervisors in well-designed and implemented colleges. The DFSA has not established individual resolution

	plans for large banks, but issued an order requiring all banks to make a resolution assessment. In addition, the DFSA has a well functioning resolution planning regime for small and medium sized banks.
14. Corporate governance	The DFSA has a good overall approach to governance. The DFSA carried out a comprehensive horizontal review of the appropriateness of the composition of BoD and followed through to make sure necessary changes were made. There are a few gaps in governance requirements: not yet requiring the establishment of risk committees (to be required April 1, 2014); not requiring codes of conduct, and overall conflicts of interest polices; and not ensuing independence in the validation of models.
15. Risk management process	The DFSA has a generally well designed program for risk management, strongest in terms of credit risk (consistent with the risk profile of most Danish banks) and less well developed in terms of market and operational risk. There are some improvement opportunities, several of which are in train: updating the relevant EOs to require that the dismissal of the CRO will need to have the concurrence of the BoD, adding further requirements for SIFIs, and applying requirements more generally to FHCs. The latter has been implemented as of March 31, 2014.
16. Capital adequacy	DFSA has implemented the Basel II capital standards effectively. The supervisor sets prudent and appropriate capital adequacy requirements for banks which reflect the individual risk of the bank and incorporates considerations of the broader economic conditions. Pillar 2 arrangements are well developed and applied by supervisors through the annual ICAAP exercise which includes forward looking elements such as stress testing. There is an emphasis on quality of capital to absorb losses.
17. Credit risk	The DFSA gives very strong focus to credit risk, with much examination activity and regulatory reporting covering it. The ten largest exposures of the bank are reviewed annually (by the Board, by the external auditors, and by examiners). Furthermore, the DFSA's credit inspections have a strong focus on a large number of specific credit risk exposures. File reviews are a key feature of the onsite credit risk examination. The DFSA actively engages with bank representatives regarding the results of the file review where grades are evaluated for accuracy and valuations tested.
18. Problem assets, provisions, and reserves	The DFSA has taken a strong and conservative approach to impairment and provisioning, and the assessors commend them on that policy. Reports on asset quality are made regularly to the supervisors, and an annual review of exposures (addressing among other things the integrity of the classification system) is required to be presented to the BoD. Monitoring and managing on exposures, based on prompt and correct identification of weak exposures, is required under the relevant EO. The database of larger exposures that is used to check consistency of ratings could be broadened. In addition, the criteria for reversals of write-downs should be detailed in the relevant EO.

19. Concentration risk and large exposure limits	Notification requirements for large exposures need to be tightened. Currently, the DFSA will be notified at the end of each quarter. In general, however, banks typically have a risk appetite for large exposures lower than the 25 percent limit and the Supervisory Diamond enforces the management of aggregate credit concentration risk. As mentioned in CP17, there is generally a strong focus on credit risk by the supervisor which includes credit concentration risk.
20. Transactions with related parties	Regulations for related party transactions include only BoD, BoM and intra-group transactions. This narrow definition does not cover the broader definition of related parties contemplated by this CP. For example, the definition of related party does not extend to minority shareholders and key risk takers such as credit officers. The deficiencies in the definition of related party contained in the legislation limit the application of the DFSA's powers to mitigate the risks from related party lending. From a routine supervision perspective, ongoing surveillance is not sufficiently frequent.
21. Country and transfer risks	The two largest banks in Denmark have extensive cross-border exposures, the majority of which are within the Nordic countries (Sweden, Norway, and Finland). In addition, banks take on country risk through trade finance in commercial portfolios and extension of foreign currency lending (mainly Euro and Swedish Krona). Through on-site examinations, supervisors will assess the adequacy of the risk management framework to identify and manage country and transfer risk. There was evidence to suggest this process was effective. Country risk is assessed on an ad hoc basis and as such will occur when macroeconomic conditions indicate that country risk can pose a risk to banks.
22. Market risk	The DFSA has a comprehensive set of market risk regulations that require banks to prudently manage market risk. The majority of traded market risk activity is customer driven (flow) and the typical instruments include Danish mortgage bonds, equities, FX derivatives, and commodities. While the reporting requirements capture the majority of traded market instruments, more exotic instruments are not captured by the reporting requirements. As a result, a build-up in market risk could occur in the absence of onsite examinations.
23. Interest rate risk in the banking book	Laws and regulations stipulate minimum obligations of banks to manage and mitigate interest rate risk (IRR). For the larger banks, onsite inspections are conducted at minimum once every four years. Banks with SIFI-status will, however, be assessed annually beginning in 2014. While a risk-based approach is applied to onsite examinations, the supervision cycle for medium and smaller banks of once every four to six years is considered too long in light of the limited offsite reporting obtained for quarterly monitoring and risk profiling.
24. Liquidity risk	The FBA prescribes two quantitative liquidity requirements that banks need to meet at all times and which are reported to the DFSA on a monthly basis for the majority of banks (very small banks are exempted to quarterly reporting). These liquidity ratios are designed to restrict an over-reliance on unstable funding sources and to ensure a sufficient liquidity buffer is in place at all times. The systemic banks are also subject to reporting LCR and NSFR on a monthly basis. The DFSA requires banks to submit results of liquidity stress tests on a monthly frequency. Due to their business model, which is by regulation restricted to

	lending based on issuing covered bonds within tight limits on the risk profile in all aspects, MCIs have very high levels of encumbrance.
25. Operational risk	Onsite operational risk examinations are performed as a subset of credit and market risk reviews. Supervisory reporting is not sufficiently frequent and detailed to identify and monitor changes in operational risk profile. The current focus of routine reporting should be expanded to include a broader suite of risk information i.e. by loss event type and changes in business environment and internal control factors. Requirements for routine supervisory reporting should be expanded to allow meaningful analysis of operational risk trends and changes in profile.
26. Internal control and audit	There is a gap in the relevant EO in not directing that internal auditors of banks must review risk management, compliance, and control function. From their review of audit books and discussions with bankers, the assessors saw evidence that some reviews are done (at least for the largest banks), but it is important that the EO be appropriately updated.
27. Financial reporting and external audit	The overall program for external auditors appears sound. The DFSA has been thoughtful in looking to extract particular value from the work of external auditors through requirements to review in detail the largest exposures of a bank. There are some shortcomings however, there are no requirements that fair value estimates are subject to independent verification and validation, and the DFSA does not have access to the work papers of external auditors.
28. Disclosure and transparency	While the disclosure requirements look adequate on paper, from responses to assessors' questions, the DFSA does not review whether any of these disclosure requirements are met. The assessors were advised that only Group 1 and 2 banks have such disclosures read for information purposes of the supervisors, but not to assess completeness or accuracy of the filings. Accordingly, while there are provisions in the EO that could require republication or even the imposition of a fine, these provisions have never come into play.
29. Abuse of financial services	Since 2006, the DFSA has made considerable progress increasing its supervision of banks' compliance with the AML/CFT Act. The DFSA has developed a risk-based onsite examination program to conduct assessments of banks' compliance with the obligations under AML/CFT Act. As a result of the DFSA's actions, the reporting of STRs has increased and there have been more cases of AML prosecution. Despite this progress, work remains to effectively implement AML/CFT supervision.

E. Recommendations

Table 2. Recommendations to Improve Observance of the BCPs

Reference Principle	Recommended Action
2. Independence, accountability, resourcing and legal protection for supervisors	• Seek to secure increased operational independence through revisiting the threshold of significance for Financial Council and Board decision-making, and by establishing a set of supervisory imperatives (e.g., setting the inspection schedule and establishing the approach to impairments and provisioning) that should be wholly within the authority of the Director General. • Look to mitigate concerns with the new Board structure by seeking legislative change on the currently very short terms of appointees and the absence of a formal vetting process for nominees.
6. Transfer of significant ownership	• Expand powers in relation to significant ownership (qualifying ownership) to be able to reverse a change of control. • Explicitly define the term "ultimate beneficial owners" in the law. • Amend the FBA to require a written demand for the banks to notify DFSA about any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
8. Supervisory approach	• Seek to get the necessary budgetary approval to be able to lessen significantly the length of time between examinations. • Require the submission of comprehensive recovery and resolution plans for all banks.
9. Supervisory techniques and tools	• With additional budgetary resources, use the tool of the onsite examinations more flexibly to respond to findings from offsite processes and external events. • Require the submission of audit and risk management reports on a flow basis.
12. Consolidated supervision	• Apply prudential rules more generally to financial holding companies. • Seek authority to do fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies.
14. Corporate Governance	• Require the establishment of risk committees, and the issuance of codes of conduct, and overall conflicts of interest polices. • Modify regulations to ensure independence in the validation of models.
15. Risk management process	• Update requirements to require that the dismissal of the CRO will need to have the concurrence of the BoD (this has been implemented as of March 31, 2014), add further requirements for SIFIs, and apply requirements more generally to financial holding companies. • Ensure that liquidity and other risks are factored into internal pricing of financial products, new product approval, and performance measurements. • Clarify the rules/guidance on independence of the units doing validation of models.
18. Problem assets, provisions, and reserves	• Broaden the data base of larger exposures that is used to check consistency of ratings.

20. Transactions with related parties	• Revise regulations to incorporate a broader definition of related parties. • Enhance routine disclosures to include related party exposures with detailed information for offsite analysis.
22. Market risk	• Expand the suite of data used in routine offsite supervision. • Expand onsite market risk examinations in a risk-based approach to include a broader set of banks (this might be achieved through the proposed SIFI recommendations).
23. Interest rate risk in the banking book	• Formalize procedures for netting.
25. Operational risk	• The current focus of routine reporting should be expanded to include a broader suite of risk information, i.e., by loss event type. • Establish a stand-alone onsite examination program for operational risk to achieve a comprehensive view of risk bank-wide. • Formal notification requirements should be agreed to allow supervisors to remain apprised of developments at a bank in the event of operational risk incident.
26. Internal Audit and control	• Modify regulations to direct internal auditors of banks to review risk management, compliance and control functions. • Include provisions related to dual control and to the protection of assets
27. External Audit	• Require that fair value estimates are subject to independent verification and validation. • Seek authority for the DFSA to have access to work papers of external auditors.
28. Regulatory reporting	• Change internal policies of the DFSA to ensure there is a systematic review of Pillar III disclosures to assess completeness and accuracy of the filings.
29. Anti-money laundering and Counter-terrorist financing	• Expand the self assessment program to all include banks as part of annual offsite surveillance. • Expand the onsite examination program within the risk-based approach to a broader number of banks.

F. Authorities' Response

19. **The Danish authorities welcome the assessment of the regulation and supervision of the Danish banking sector.** We look forward to using the observations and recommendations in the assessment report to further improve our approach to regulation and supervision of the banking sector in Denmark.

20. **In general we share the views expressed in the assessment report as well as the grading of most of the Basel Core Principles.** We think they overall reflect the complexity of the matter in a very balanced and thoughtful manner.

21. **With this in mind we would like to add a more general remark on the operational independence of the DFSA.** We understand the underlying reasons for your concerns. We would, however, like to emphasize that it has not materialized as a problem to us in the past. Also in

relation to the high level of transparency of the DFSA's findings we understand the concerns mentioned; the transparency has however turned out to be more positive than negative.

22. We also have a few remarks regarding the intensity of the examination schedule, conform the assessment of Basel Core Principle 8:

- Whereas we acknowledge that the intensity of the DFSA's inspections could be increased with shorter time periods between inspections, we would however like to stress once again that the examination schedule is based on the DFSA's ongoing risk assessment of banks. This implies that only small banks with low risks and a simple business model are covered by the extended examination schedule of six years.

- Furthermore, the DFSA regularly makes changes to the examination schedule to accommodate changes in the risk assessment of individual banks. A change in the risk assessment could come about from the ongoing outlier surveillance which is based on both regular reporting from the banks and the results of the DFSA's semi-annual stress-test model. Or it could be the result of solvency meetings with banks or from various written material such as the auditor's protocol.

- The point of the ongoing risk assessment is to prioritize the banks that the DFSA deems to be the riskiest. We do acknowledge that this means that the low risk banks are visited significantly less often but we see this mainly as a by-effect of a truly risk based approach.

INSURANCE CORE PRINCIPLES

A. Summary

23. Insurance regulation in Denmark has a good level of compliance with the Insurance Core Principles (ICPs). The DFSA regulates insurance and pension funds for prudential and market conduct purposes. A strength of its approach is the focus on key risks and its readiness to require action by insurers to address vulnerabilities. There is comprehensive oversight of reinsurance. Solvency standards are robust and already well-aligned to the EU Solvency II regime, but DFSA would benefit from a clear legally-set solvency level below which companies may not operate. The DFSA does not require all insurers to have functions responsible for risk, compliance, internal audit and actuarial work, but will do so as it implements Solvency II.

24. There is a need to increase attention to market conduct supervision. Insurers are required to adopt good business practices and to act honestly and loyally with customers, but there is scope to extend their work to product design. The supervision of intermediaries suffers from a lack of powers for onsite inspections and low resources. The DFSA would benefit from powers to impose administrative penalties and should have an explicit policyholder protection objective in legislation.

25. Offsite supervision is well-developed as is international cooperation, but the frequency of onsite inspections should be increased. Offsite monitoring is based on extensive reporting and stress tests. The frequency of onsite inspections for firms not seen as high risk is nevertheless low. The DFSA should develop its risk-based framework better to integrate offsite analysis with the assessment of governance, management, and controls. There is a need to extend group supervision to insurance holding companies and to increase supervision of insurance fraud issues and AML/CFT.

26. There is scope to strengthen the institutional framework. The composition and governance of the Financial Council create risks to the independence of supervisory decision-making from undue political or industry influence. The DFSA is subject to government budgetary procedures and salary constraints that can hamper its ability to raise extra resources. The MoBG has responsibility for some decisions, although they are currently delegated to DFSA. There is no provision for internal audit at the DFSA. Given the breadth of its responsibilities and key tasks, the DFSA's resources should be increased.

B. Introduction and Scope

27. Denmark's regulatory regime and supervisory practices were assessed[2] against the standards of the International Association of Insurance Supervisors (IAIS). The assessment was undertaken against the IAIS ICPs issued in October 2011, as revised in October 2013. Specific

[2] The assessment team comprised Mala Nag (IMF) and Ian Tower (Consultant).

principles apply to the supervision of intermediaries. The scope of the assessment covers the prudential and market conduct supervision exercised by the DFSA.

28. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that were in place at the time of the assessment in March 2014. The authorities provided a self-assessment and provided the assessors with examples of actual supervisory practices and assessments, which enhanced the assessment process. Technical discussions with and briefings by officials from the DFSA, Consumer Ombudsman, and the MoBG also enriched this report; as did discussions with industry participants.

C. Market and Institutional Setting

29. As an integrated regulator, the DFSA supervises the whole financial sector. DFSA is responsible for prudential and market conduct supervision. It assists the MoBG in drawing up legislation and issues its own EOs and guidelines. The MoBG is responsible for the general business environment in Denmark, including the financial sector, and competition policy. Life insurance companies and pension funds are covered by a single legislative framework. The DFSA acts as secretariat for the Financial Council[3] which makes decisions on matters of principle or of far reaching significance for individual companies. In 2013, the Danish government also setup a Systemic Risk Council to enhance monitoring of systemic financial risks.

30. There has been consolidation in the insurance sector and technical provisions have increased since the financial crisis. At the end of 2013, there were 115 insurance companies, down from 174 in 2008. There have been no life insurance failures and the last nonlife failure was in 2002. Technical provisions held by the insurance sector have increased from DKK 1.37 trillion in 2008 to DKK 2.06 trillion in 2013. Unit-linked life insurance provisions have grown six fold since 2008. Profitability has been maintained with positive returns on equity throughout 2009 to 2013. Solvency ratios (328 percent in life insurance and 292 percent in nonlife in 2013) have recovered from their 2011 lows. The DFSA and industry are preparing for the implementation of Solvency II in 2016.

D. Key Findings

31. Insurance regulation in Denmark has a good level of compliance with the ICPs. A particular strength of the DFSA's approach is its close focus on key risks in the sector and its readiness to require action by companies to address vulnerabilities. The industry has a high regard for the professionalism of the DFSA supervisors.

32. The DFSA's solvency standards are robust and already well-aligned to the EU Solvency II regime. For some years, DFSA has required the use of current market prices in the valuation of assets and liabilities and since 2007 has required companies to assess their individual solvency

[3] As of July 2014, the Financial Council has been replaced by a Board.

needs. Solvency regulation has been overhauled with effect from 2014 as part of the transition to Solvency II. The regime is well-developed, although full implementation will take time. DFSA's approach in practice is to intervene early; but it would benefit from a clear solvency level below which companies may not operate. Further, the DFSA does not yet require all insurers to have functions responsible for risk, compliance and internal audit, while only for life companies is there a requirement for specific actuarial capacity.

33. Market conduct supervision should receive increased attention. The DFSA requires insurers to adopt good business practices and to act honestly and loyally with customers. The powers of the Consumer Ombudsman to take cases to the Court add strength to the consumer protection framework, but at the cost of some regulatory uncertainty given scope overlap with DFSA. The regulation of intermediaries suffers from a lack of powers for onsite inspection and, in common with market conduct regulation, from low resources. The DFSA also needs powers to impose administrative penalties. Giving the DFSA an explicit policyholder protection objective in the legislation, as required by the ICPs, would underpin an increased emphasis on market conduct work, adding to the existing focus on fairness issues in financial supervision.

34. Offsite supervision is well-developed, but there is scope to increase the frequency of onsite inspections. The DFSA takes a risk-based approach that takes account of business model sustainability. The frequency of onsite inspections for firms not seen as high risk is long at four years. The planned more frequent inspections of larger life companies (reflecting Solvency II) are appropriate. The DFSA should develop its risk-based framework better to integrate offsite analysis with the assessment of governance, management and controls. There is also a need to extend the scope of group supervision to insurance holding companies and to raise the priority of supervision work in relation to market conduct, insurance fraud issues and AML/CFT.

35. International cooperation is well-developed. The DFSA is an active member of EU supervisory colleges and has implemented relevant guidelines in respect of its role as group and host supervisor and for crisis preparedness. There are no barriers to the exchange of information with relevant authorities and the DFSA exchanges information readily where required. The authorities are encouraged to expedite the Denmark access to the IAIS multilateral MoU which will facilitate cooperation with countries outside the European Economic Area.

36. There is scope to strengthen the institutional framework. The composition, method of appointment and significant scope of the Financial Council in relation to supervisory decisions creates some risks to the independence of supervisory decision-making from undue political or industry influence. The DFSA is subject to government budgetary procedures and salary constraints that can hamper its ability to raise extra resources and recruit and retain high value skills. There is no internal audit at the DFSA. Given the breadth of its responsibilities and key tasks, in relation to Solvency II and market conduct challenges, the DFSA's insurance resources are insufficient.

37. While DFSA has an appreciation of the major sources of vulnerability for the insurance sector, there is no specific framework for macroprudential surveillance. There is scope for taking a more formal approach (following the examples of Canada, Australia, or Belgium), including occasional assessment of individual companies' systemic significance, and for developing cross-sectoral analysis, covering linkages between insurance and the banking sector, for example through the covered bond market. Extending the work of the financial stability experts at the DN to the insurance sector would bring another perspective to macroprudential oversight of insurance.

Table 3. Summary of Compliance with the ICPs

Insurance Core Principle	Overall Comments
1. Objectives, Powers and Responsibilities of the Supervisor	The FBA is the primary legislation and lays out the objectives of supervision, but does not explicitly include policyholder protection. There is scope to improve clarity over differing responsibilities of DFSA, the Council, the MoBG, and the Consumer Ombudsman. The MoBG retains certain powers, including approval of mergers and acquisitions. Currently, these powers are delegated to the DFSA as part of a contract subject to annual review.
2. Supervisor	The DFSA is directly accountable to the Minister and, through the Minister, to the Danish Parliament. There are risks arising from its agency status to its operational independence from undue industry and political influence. The, DFSA will need additional resources to ensure robust supervision to fulfill its broad mandate. Explicit procedures regarding appointment and dismissal of the governing body should be in writing and publicly disclosed. There are no internal audit arrangements within the DFSA.
3. Information Exchange and Confidentiality Requirements	Within Denmark, DFSA exchanges information with other relevant authorities, subject to confidentiality agreements. The DFSA shares information with non-EEA supervisors where reciprocity and cooperation agreements are generally required. However, it is also prepared to exchange information where requested on a case-by-case basis where it is satisfied on supervisory purpose and protection of confidentiality.
4. Licensing	Licensing processes for insurance companies and foreign subsidiaries are clear. Although key persons in control functions are not explicitly covered in the licensing requirements, licensees may be subject to a requirement to have an internal auditor and responsible actuary for life insurers.
5. Suitability of Persons	The DFSA reviews fitness and propriety on a continuous basis. Supervisory focus on suitability has increased since the financial crisis and DFSA has exercised its power to require members of the BoD and BoM to step down. DFSA has published such orders on an anonymized basis. There are no regulations on suitability requirements for Key Persons in Control Functions, but comprehensive requirements for risk management, compliance, actuarial and internal audit functions are scheduled to be introduced in 2014, to be followed by related suitability requirements in 2015.
6. Changes in Control and Portfolio Transfers	There is a clear and comprehensive set of regulatory requirements for changes in significant interest, control, conversions of legal structure, amalgamations and portfolio transfers. The DFSA's review focuses on understanding the proposed business model and the financial soundness of the continuing company. In practice, DFSA does not grant approval in cases where the interests and rights of the policyholders are adversely affected.
7. Corporate Governance	There is a wide range of general and specific oversight responsibilities on the board of directors, with an emphasis on risk management, including the

	establishment of a risk appetite. The DFSA has focused on ensuring that boards have appropriate expertise and taken action at several firms to improve board effectiveness through enhanced levels of expertise. The absence of requirements on the composition of the board of management creates a wide divergence in practice on board of management composition. There are no requirements in relation to the role of control functions in the governance structure.
8. Risk Management and Internal Controls	The DFSA's supervisory work includes evaluation of the effectiveness of the risk management and control framework and it has taken action to require improved effectiveness of risk management or controls. However, there are no requirements for functions responsible for risk and compliance. Internal audit functions are not required of all companies and, where mandatory, are not required to be engaged in internal control, if the BoD decides that the function should be involved in the audit of financial statements.
9. Supervisory Review and Reporting	The DFSA takes a risk-based approach to supervision and pays close attention to the sustainability of the business model. The DFSA uses a system of specific stress and scenarios (the Traffic Light tests and Supervisory Diamond for nonlife companies) to rate the insurers and plan the onsite inspections. The gap between onsite inspections for many insurance companies can be long. The DFSA should consider having a risk-based supervisory framework to better integrate the quantitative and qualitative aspects of the risk assessment in its ongoing supervisory review and reporting methodology. The DFSA would benefit from having additional conduct of business monitoring requirements.
10. Preventive and Corrective Measures	The DFSA has adequate powers to initiate timely and proportionate preventive and corrective measures.Supervisors use moral suasion and enter into a dialogue with insurers before taking the preventive and corrective actions. DFSA is reviewing requirements to gauge whether a supervisory intervention ladder would be appropriate for life companies. Given DFSA's prudential and market conduct mandate, it would be appropriate to broaden the early intervention mechanisms to also include preventive measures for fraud risks and consumer protection issues.
11. Enforcement	The DFSA and the Consumer Ombudsman have a range of powers of enforcement, covering both financial matters and conduct of business requirements. The DFSA's powers are relatively limited and administrative penalties are not available. The DFSA's powers in relation to breaches of minimum solvency and other prudential requirements are more extensive and while untested in some areas, have been used as part of the DFSA's early intervention in case of emerging risk of financial weakness.
12. Winding-up and Exit from the Market	The legislation provides for exit from the market and insolvency in ways which safeguard the interests of policyholders. The requirement for a special register of assets, which are to be equal to technical provisions and to be used exclusively for the benefit of insured parties, is central to ensuring that assets will be available for policyholders whatever the financial situation of the company, providing in effect for policyholder preference.
13. Reinsurance and Other Forms of Risk Transfer	The DFSA exercises particularly close supervision of reinsurance cover of nonlife insurance companies. There are, however, limited regulatory requirements on reinsurance which could be extended to include an explicit

	requirement that cedants have reinsurance and risk transfer strategies appropriate to the nature, scale and complexity of their business.
14. Valuation	While the valuation requirements for life insurance have since 2008 moved away from using current risk free rates across the yield curve, valuation continues to be carried out on an economic basis and is now closely aligned with the expected EU Solvency II approach. The DFSA's initiative to establish a longevity benchmark has led to stronger valuation standards in this area. While there is no peer review requirement for actuarial work, as in some other countries, the role of the responsible actuary in life insurance, with reporting obligations to the BoD and DFSA, provides for a balance between the responsibilities of actuary and board.
15. Investment	Detailed regulations on investments held against technical provisions are supported by obligations on BoDs for prudent management of investment risk, regular reporting to the DFSA, obligations on auditors and DFSA oversight through on-site supervision. The requirements apply to individual insurers and pension funds rather than directly, on an aggregate basis, to groups. Some additional reporting should be considered where risks have been identified from thematic work, such as that on alternative investments.
16. Enterprise Risk Management for Solvency Purposes	There is an extensive framework of requirements in relation to risk management for solvency purposes and a process of own risk and solvency assessment. The requirements make clear that it is for the Board of Directors to carry out the risk assessment and to make the key decisions on the calculation of the Individual Solvency Need. The overall approach has been introduced only at the start of 2014 and will take time to embed, while the DFSA has not reviewed any risk assessments as yet. Some detailed aspects of the ICP standards are not reflected in the DFSA approach, including the requirement for an explicit ALM policy.
17. Capital Adequacy	The capital adequacy requirements were substantially revised at the start of 2014 but will take time to embed. The framework has been substantially strengthened, particularly the calculation of the Individual Solvency Need through the addition of a standard model based on the most recent draft Solvency II requirements and a target protection level corresponding to VaR with a confidence level of 99.5% over 12 months. In addition, the recent development of holding company regulation with the recognition of insurance holding companies has strengthened group supervision of capital adequacy. There is no prior approval requirement for use of internal models, though there is limited appetite for model use. The absence of a full framework of solvency control levels, for solo entities or groups, places a premium on the readiness of supervisors to follow up concerns promptly.
18. Intermediaries	The insurance industry mainly distributes via agents, but broker sales are gaining momentum. Due to changes in broker remuneration regulations, brokers are primarily serving corporate clients. DFSA is able to monitor insurance agents through the normal supervision processes for insurance companies for whom they act as agent. Ongoing review of brokers could be improved. The DFSA's review of intermediaries focuses mainly on checking compliance with registration requirements, consideration of complaints from consumers and some good practice cases taken up from thematic supervisory work. There is scope for some improvements in this regard.

19. Conduct of Business	DFSA's focus has been on good business practices and regulations requiring insurers to '*act honestly and loyally*' with their customers, on product information, disclosures and on the marketing of products to consumers. However, there is no equivalent regulation obliging intermediaries to set up written policies and procedures to ensure compliance with good practices. The DFSA should have a process in place to determine whether insurers are taking the interests of different types of customers into account when developing and marketing products. There is a particular need to address the presentation of costs and benefits to policyholders and pension scheme members when they are offered the opportunity to exchange a product with a guaranteed interest rate for a unit linked product. The DFSA should consider additional resources to provide appropriate oversight of brokers and legislative power to be able to conduct on-site risk-based supervision of broker intermediaries.
20. Public Disclosure	Insurers are subject to an extensive set of disclosure requirements set by the DFSA under its authority to set accounting and disclosure standards for all regulated financial undertakings. These apply at both solo and group consolidated levels. The requirements focus on measurement standards and there are gaps in disclosure requirements in relation to qualitative information, for example corporate governance (except for the few listed companies). Financial information is readily available to policyholders and other market participants, on individual companies and groups, from the Danish Business Authority and to an extent from the DFSA website.
21. Countering Fraud in Insurance	Fraud is a criminal offence under the Danish Criminal Code, but the DFSA takes no measures at present to assess fraud risk or to require insurers and intermediaries to take effective measures to address those risks, except for the requirement on insurers to monitor transactions or relationships (including those with intermediaries) that are not in line with the good practices policy.
22. Anti-Money Laundering and Combating the Financing of Terrorism	The DFSA is active in AML/CFT fora within Denmark and externally and has the necessary powers, if not the resources, to enforce compliance and exchange information with other authorities. There are plans to intensify supervision of life insurance and pensions, informed by a new, near-complete study of the risks and exposures. However, no supervisory work is taking place and there is a risk, evidenced also by the low level of suspicious transactions reporting, that life insurers and pension funds do not adequately address compliance with AML/CFT requirements.
23. Group-wide Supervision	The supervision of insurance groups in Denmark follows the EU Directive. The DFSA has adequate powers and flexibility to determine the scope of insurance groups as well as supervise and take appropriate measures against both regulated and non-regulated entities. To ensure intra-group transactions are captured and monitored at an aggregate level, it is recommended that DFSA require appropriate group reporting systems to measure and monitor such aggregate risk exposures. The review of group risks, including intra-group transactions, at the holding company level will provide better insights to risk management of the solo entity as well. With banking/insurance conglomerates, the authorities are encouraged to commence joint on-site supervision with focus on intra-group exposures, and market conduct inspections.

24. Macroprudential Surveillance and Insurance Supervision	While there is no specific framework at DFSA for macroprudential surveillance, DFSA does have a clear appreciation of the major sources of vulnerability for the insurance sector and targets its collection of information and intelligence, and its supervisory efforts, towards addressing them. The DFSA does have a clear view of the risks to financial stability arising in the insurance sector. However, a more formal approach to occasional assessment of individual companies' systemic significance would help validate its view. Extending the work of the financial stability experts at the DN to the insurance sector would bring another perspective to macroprudential oversight of insurance, while furthering the development of cross-sector analysis.
25. Supervisory Cooperation and Coordination	For insurance groups with international operations or part of international groups, the supervisory colleges have been operating in line with the EIOPA's templates and guidelines. The level of engagement bilaterally with other supervisors is high, at regional level (with other Nordic supervisors), within the EU and at wider international level. Nationally, the DFSA cooperates and coordinates with relevant agencies from other sectors, including the Consumer Ombudsman, DN and other government ministries as required.
26. Cross-border Cooperation and Coordination on Crisis Management	The DFSA's coordination arrangements and emergency plans, based on the EIOPA template, are in place for all colleges in which the DFSA participates. It has not been necessary for the DFSA, as group supervisor or as a host supervisory authority, to manage a full solvency crisis to date. To that extent, its processes remain untested, but it has cooperated with other supervisors in the management of significant weakness at some firms.

E. Recommendations

Table 4. Recommendations to Improve Observance of the ICPs

Insurance Core Principle	Recommendations
1. Objectives, Powers and Responsibilities of the Supervisor	• Consider explicit legislative requirement in the DFSA's objectives to include the maintenance of a fair and safe insurance sector for the protection of policyholders; and • Consider amendments to the legislation to improve clarity in the powers of DFSA as the primary authority responsible for the supervision and regulation of individual financial institutions.
2. Supervisor	• Consider instituting an internal audit unit within the DFSA for auditing supervisory processes and internal controls; • Consider exempting the DFSA from the government's administrative rules, as in the case of the DN, to strengthen DFSA's financial and operational autonomy. Also consider setting DFSA as a legal statutory body responsible for the supervision of the financial sector; • Review the adequacy of supervisory resources, training plans, succession planning of DFSA and how DFSA could be exempted from collective agreements and salary controls set by the Danish

	government in order to attract supervisors with industry experience; and • Establish explicit provisions on public disclosure of the reasons for removal of the head of DFSA and future governing Board before the end of the statutory period of appointment.
5. Suitability of Persons	• Expedite the implementation of the key control functions and suitability requirements; and • Review the application of the suitability requirements to senior management to ensure that they cover senior managers in all relevant positions.
7. Corporate Governance	• Review the FBA and Executive Order 1575 to clarify expectations on BoDs and BoMs in relation to protection of policyholders' interests; • Amend the governance requirements to include provisions requiring directors to act in the best interests of the insurer and policyholders and requiring boards to carry out succession planning; and • Review its expectations of the composition of the BoM and whether to set requirements in this area.
8. Risk management and Internal Controls	• Expedite the introduction of requirements for control functions at all insurers; • Clarify in regulations that internal audit functions must carry out a minimum of work auditing the internal controls; and • Undertake cross-firm/thematic work at an early stage to benchmark major companies against the new requirements.
9. Supervisory Review and Reporting	• Review the strategy on supervisory cycles for insurers; • Consider having a risk-based supervisory framework to better integrate the quantitative and qualitative aspects of the risk assessment in its ongoing supervisory review and reporting methodology; • Include conduct of business monitoring requirements for full on-site inspections of large insurers; and • Equip DFSA with adequate supervisory resources to shorten the supervisory cycle and to provide better oversight of risks in the system.
15. Investment	• Extend reporting requirements to cover group-wide aggregate investments and consider closer supervisory review of the security of custodial services for insurers' investment portfolios; and • Carry out periodic updates to surveys of insurers' and pension funds' investments so as to monitor and respond to developments in risk profiles, for example as companies increase their unit-linked business.
16. Enterprise Risk Management for Solvency Purposes	• Introduce a requirement for an ALM policy; • Review the application of its requirements on risk management for solvency purposes and own risk and solvency assessments to groups and extend the framework as necessary.
17. Capital Adequacy	• Strengthen their capital adequacy requirements further by establishing

	solvency control levels, including a minimum capital requirement below which an insurer is regarded as no longer viable and must close or have its insurance business transferred; and • Set a requirement for prior approval before a model may be used.
18. Intermediaries	• Review and promote appropriate regulatory framework and supervisory practices with respect to intermediaries' good conduct and to improve broker licensing and ongoing review requirements; • Establish proportionate governance expectations tailored for broker intermediaries, focusing on fair treatment outcome for policyholders; • Ensure that DFSA has adequate resources for effective supervision of intermediaries, including brokers.
19. Conduct of Business	• Closer attention is needed for disclosure requirements so that customers are cognizant of the inherent risks of the product and a process to review the appropriateness of the financial products offered. • Empower DFSA with additional resources to conduct on-site risk-based supervision of broker intermediaries and conduct more proactive CoB supervision.
20. Public Disclosure	• Review and revise financial reporting requirements from the perspective of effective disclosure to ensure that companies present complete information, including a full set of qualitative information such as the nature of the companies' products and their corporate governance; and • Extend to annual reports the requirement applying now only to interim reports that insurers make the report available to the public, for example on their websites.
21. Countering Fraud in Insurance	• Change the legislative framework to empower DFSA to issue enforceable rules requiring insurers and intermediaries to report insurance frauds. DFSA should have a supervisory process in place to review fraud related reports received from insurance companies and broker intermediaries.
22. Anti-Money Laundering and Combating the Financing of Terrorism	• The DFSA, in conjunction with the FIU and Danish Industry Association, should expedite completion of the National Risk Assessment Report on AML/CFT risks in life insurance and pension funds; • The DFSA should use this, as planned, as the basis for an enhanced supervision plan for 2014, augmenting its staffing in this area as necessary.
23. Group-wide Supervision	• Consider increasing supervisory intensity on groups beyond solvency and ownership review to include all key control functions and group risks; • Review the supervisory cycle to ensure the smaller domestic insurance groups are not left unsupervised on a group basis. • Provide group supervisory oversight to market conduct and consumer

	protection matters, in a group context, including in bancassurance models; • Require appropriate group reporting systems to measure and monitor aggregate risk exposures to ensure intra-group transactions are captured and monitored at an aggregate level; • Commence joint onsite supervision for financial conglomerates.
24. Macroprudential Surveillance and Insurance Supervision	• Establish a process to consider macroprudential issues more formally on a regular basis, including an occasional review of the potential systemic significance of large insurers, using the IAIS's assessment methodology; • Supplement work on assessing vulnerabilities in insurance companies with periodic macroeconomic stress tests; • The DN should extend its financial stability analysis to cover the insurance sector, starting with cross-sector linkages.
25. Supervisory Cooperation and Coordination	• Expedite Denmark's accession to the IAIS multilateral MoU which will facilitate other cross-border cooperation with non-EEA signatories to MMoU, in case this becomes necessary to a fuller extent than at present.
26. Cross-border Cooperation and Coordination on Crisis Management	• Seek opportunities for further testing of its arrangements and plans in line with the 2012 EIOPA test; • Review the requirements DFSA places on insurers for crisis management and contingency plans to ensure that these provide for an appropriately wide range of crisis events and include operational procedures for handling information provision and communications to the DFSA and college of supervisors.

F. Authorities' Response

38. The DFSA welcomes the assessment of the regulation and supervision of the Danish insurance sector. We look forward to use the observations and recommendations contained in the assessment report to further improve regulation and supervision of the insurance sector in Denmark.

39. Generally, we share the views expressed in the assessment as well as the level of fulfillment of the Insurance Core Principles in Denmark. In our view, it supports the Danish FSA's ambition of being an effective risk based supervisor given the available resources. This being said, the DFSA has a few remarks regarding Risk Management and Internal Controls, Conduct of Business and Macroprudential Surveillance and Insurance Supervision.

40. Firstly, the DFSA agrees that insurers should have sufficient control functions in line with the thinking in ICP 8 and Solvency II. As a consequence, the Danish insurers were informed in 2009 through the first Solvency II preparedness letter, that future requirements of the four control functions would be embedded in the Danish financial regulation. With the delay of Solvency II original time plans for implementation have been modified and currently the Danish FSA is working on having the four functions formally implemented through regulation during fall 2014.

41. On market conduct, the current legislation does contain regulation of "fairness" supported by more specific regulation on the contribution principle which regulates fair treatment of customers with profit sharing products. In the supervision of life insurance and pension undertakings, this principle plays a key role of market conduct supervision. The regulation is backed up by requirements on the insurers to submit the products technical basis continuously. The technical basis is assessed and published by the DFSA. The regulation on fairness is not covered in the ICPs, but has substantial economical impact on policyholders.

42. In relation to the macroprudential surveillance of the Danish insurance sector, it should be noted that the DFSA has carried out several thematic analysis with a broader view than just microprudential supervision. For example, analysis covering many aspects connected with the use of derivatives, the use of liquidity swaps and repos and an assessment of alternative investments.