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FINANCIAL SECTOR ASSESSMENT PROGRAM

December 2014

DETAILED ASSESSMENT OF OBSERVANCE OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision on Denmark was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on December 2014.

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BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

DETAILED ASSESSMENT OF OBSERVANCE

Prepared By
Monetary and Capital Markets Department

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in Denmark during March 2014, led by James Morsink and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx

CONTENTS

Glossary

AC	Additional Criteria
AML/CFT	Anti-Money Laundering/Countering Financing of Terrorism
BCPs	Basel Core Principles
BoD	Board of Directors
BoM	Board of Management
BCBS	Basel Committee on Banking and Supervision
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CEBS	Committee of European Banking Supervisors
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CPs	Core Principles
CFO	Chief Financial Officer
CRDIV	Capital Requirements Directive IV
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation
DFSA	Danish Financial Supervisory Authority
DGF	Danish Guarantee Fund
DN	Danmarks Nationalbank
D-SIB	Domestic Systemically Important Bank
D-SIFI	Domestic Systemically Important Financial Institution
EBA	European Banking Authority
EC	Essential Criteria
EO	Executive Order
ESRB	European Systemic Risk Board
EU	European Union
FATF	Financial Action Task Force
FBA	Financial Business Act
FHCs	Financial Holding Companies
FIU	Financial Investigations Unit
FSC	Financial Stability Company
FX	Foreign Exchange
GSIFI	Global Systemically Important Financial Institution
HQLA	High quality Liquid Assets
ICAAP	Individual Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IRB	Internal Ratings-Based
IRR	Interest Rate Risk
ISAs	International Standards on Auditing
JRAD	Joint Risk Assessment Decision
LCR	Liquidity Coverage Ratio

LTV	Loan-to-Value Ratio
MCIs	Mortgage credit institutions
MoBG	Ministry of Business and Growth
MoF	Ministry of Finance
MoU	Memorandum of Understanding
NIM	Net Interest Margin
NPLs	Nonperforming Loans
OECD	Organisation for Economic Co-operation and Development
RoE	Return on Equity
RWAs	Risk-Weighted Assets
SIFI	Systemically Important Financial Institutions
SRC	Systemic Risk Council
SREP	Supervisory Review and Evaluation Process
STRs	Suspicious Transaction Reports
UBO	Ultimate Beneficial Owners

SUMMARY, KEY FINDINGS AND RECOMMENDATIONS

A. Executive Summary

1. **The Danish banking system is mature and deep, supported by a stable economic and political infrastructure.** The business lines of banks provide customers with a full suite of products, including retail and commercial banking, capital markets, and asset management and pension products. Mortgage credit institutions (MCIs) play an important role by offering mortgage loans and issuing mortgage covered bonds. Banks and MCIs account together for 425 percent of the GDP, while the covered bonds market is one of the largest in the World. The banking sector experienced significant stress during the financial crisis, but intervention by the authorities was prompt and decisive. Since 2008, the sector has undergone consolidation, with the number of banks decreasing from 132 to 88 and total assets dropping by 10 percent.

2. **The banking sector is overseen by the Danish Financial Supervisory Authority (DFSA).** The DFSA is an integrated supervisor, with responsibilities spanning over banks, MCIs, insurance companies, pension funds, issuers of securities, and investors on the securities markets. The DFSA contributes to the preparation of financial legislation and issues Executive Orders (EOs) setting out the regulatory framework. As a European Union (EU) member, Denmark is subject to the overarching regulatory infrastructure provided by the EU Directives and Regulations, as well as by other standards issued by regional supervisory bodies. The EU legislation transposing Basel III (CRR/CRDIV) will be fully implemented on April 1, 2014. Furthermore, in October 2013, a political agreement has been reached on a Danish framework for domestic systemically important banks (D-SIBs), comprising—among others—better capital and higher liquidity standards.

3. **Denmark has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).** The 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 crisis and the DFSA emerged as a hands-on and proactive supervisor. Its compliance with the credit-risk related principles is uniformly high and the provisioning policies have been adequately enhanced. Its overall supervision is also considered sound, although resource constraints result in an extended supervision cycle and some risk areas receiving insufficient attention.

4. **The operational independence of the DFSA is an issue.** 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 appointees from designated stakeholder groups, including the financial industry. While the replacement in July 2014 of the Financial Council with a Board of Directors (BoD) will eliminate the issue of current industry representatives, the latter (whose members will have shorter two-year terms) will not only act on numerous policy and individual institution matters, but on setting the strategic direction of the DFSA's operations. The Director General should establish a set of supervisory imperatives that are wholly within his

authority. Law changes should be sought to lengthen the terms of the Board members and establish a formal vetting process for the nominees.

5. The DFSA employs a risk-based approach to supervision. The DFSA prioritizes and concentrates resources in high risk areas and potential high-impact risks for the financial system. This results in a supervisory cycle for onsite inspections that can be changed 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). The onsite inspections involve a thorough and comprehensive assessment covering material risk areas such as capital, liquidity, governance, risk management and the Pillar I risks. However, the very extended examination schedule limits the immediacy with which issues can be discerned from onsite work and the timeliness of addressing through onsite reviews, concerns that develop from the monitoring process. This becomes extremely problematic for smaller banks (but also relevant for larger banks), as additional onsite examinations work beyond the annual focused inspection is not generally done, issues are generally handled more informally, or deferred to the next scheduled 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.

6. The DFSA has implemented a sound overall approach to governance and risk management. The DFSA's regulatory framework places very strong responsibilities on the BoD to ensure appropriateness of the business model and to put in place and enforce limits on overall risk taking. The DFSA uses the onsite supervisory process to evaluate critically the effectiveness of the governance and risk management processes. The DFSA has also focused strongly on the composition of Boards, highlighted by its recent horizontal review and effective supervisory follow-up to ensure that sufficient financial expertise was present for all Boards. Regulations regarding internal models should be updated to stipulate the need for sound governance and independent validation.

7. The Supervisory Diamond for banks (introduced in 2010) is a key tool used by the DFSA to detect early signs of higher risk activities. The Supervisory Diamond (hereafter "the Diamond") contains five criteria: (i) credit concentration risk; (ii) funding risk; (iii) liquidity risk; (iv) exposures to commercial real estate; and (v) excessive loan growth. The Diamond is used by the DFSA to detect signs of excessive risk-taking and allows early detection and intervention. Breaches of the Diamond are published on its website to encourage prudent behavior. To complement the criteria in the Diamond, the DFSA should expand the depth and breadth of data used in offsite supervision to more effectively monitor and track changes in risk profile especially in relation to market risk and operational risk. The DFSA has proposed a separate Supervisory Diamond for MCIs which would provide supervisory guidance in key risk areas (lending growth, loans with short term funding, borrower's interest-rate risk, interest-only loans, and large exposures).

8. 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.

B. Information on the Methodology Used for Assessment

9. This assessment of the Basel Core Principles for Effective Supervision (BCP) is part of the 2014 FSAP Update for Denmark. The assessment was conducted during an IMF mission that visited Denmark from March 4–21, 2014.[1] 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. In their self-assessment, the authorities requested to be graded against both essential and additional criteria and the assessors based their conclusions on compliance with both criteria. The last BCP assessment was conducted in 2006.

10. It should be noted that the ratings assigned during this assessment are not directly comparable to previous assessments. Gradings cannot be compared between this assessment and former assessments as each has taken place under a separate iteration of the methodology, which was revised in 2006 and again in 2012. In revising the Core Principles (CPs) to reflect the lessons from the recent financial sector crisis, the BCBS has sought to raise the bar for sound supervision and to update the principles on the basis of emerging supervisory best practices. New principles have been added to the methodology along with new essential criteria (EC) for each principle that provide more detail and additional criteria (AC) that raise the bar even higher. Altogether, the revised CPs now contain 247 separate essential and additional criteria against which a supervisory agency may now be assessed. In particular, the revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. While the BCPs set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

11. The assessment team reviewed the framework of laws, rules, and guidance and held meetings with officials and industry representatives. 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 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.

12. The team appreciated the very high quality of cooperation received from the authorities. The team extends its thanks to staff of the authorities, who provided excellent cooperation, including extensive provision of documentation and technical support, at a time when many other initiatives related to domestic and global regulatory initiatives were in progress.

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

13. The standards were evaluated 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.

14. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the crisis, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Danish authorities with an internationally consistent measure of the quality of its banking supervision in relation to the revised CPs, which are internationally acknowledged as minimum standards.

15. To determine the observation of each principle, the assessment has made use of five categories: (i) compliant; (ii) largely compliant; (iii) materially noncompliant; (iv) noncompliant; and (v) non-applicable. An assessment of "compliant" is given when all EC and ACs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the principle, and there is clear intent to achieve full compliance with the principle within a prescribed period of time. A principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of formal rules and procedures, and there is evidence that supervision has clearly not been effective, the practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is assessed "noncompliant" if it is not substantially implemented, several essential criteria are not complied with, or supervision is manifestly ineffective. Finally, a category of "non-applicable" is reserved (though not used) for those cases that the criteria would not relate to the Danish authorities.

C. Overview of Institutional Setting and Market Structure

16. The banking system was hit hard by the global financial crisis, which required significant stabilization measures by the government. From summer 2008—when the first bank (Roskilde Bank) collapsed—to mid-2010, banks have experienced substantial losses from impairment charges and write-downs, as well as severe liquidity shortages. The government's intervention, codified in the "Bank Packages," included substantial guarantees on bank's liabilities and capital injections in the banks deemed viable. Distressed banks were either resolved though private solutions (mergers) or wound up under the government sponsored asset management company (Financial Stability Company (FSC). The Danmarks Nationalbank (DN) also provided extraordinary liquidity support.

17. The authorities pursued an active resolution policy. A total of 62 banks ceased operating during the period 2008 to August 2013, and the size of the banking sector assets dropped by 10 percent. The main source of intervention has been in the non-systemic bank segment of the market (i.e., Group 2 and 3 banks which account for approximately 12 percent of total banking assets). In contrast, the number of MCIs has remained unchanged at seven and lending volumes has outpaced that of the banking sector.

18. The repair of banking system is still ongoing: system-wide profitability remains low, deleveraging continues, and vulnerabilities in the non-systemic banks persist. In the initial phase of the crisis (2008–2011), banks recorded write downs of DKK 147 billion (prevalently in the building and construction, property companies, and agriculture sectors) and several small commercial banks became insolvent. Starting in 2012, all the large commercial banks returned to profitability, although their returns on equity (RoE) remained modest at 3.6 percent. About half of the non-systemic banks continue to record losses, a handful of which requiring resolution actions. Overall, prospects for earnings continue to be under pressure from falling lending volumes and a low interest rate environment. In comparison, mortgage banks faced lower impairment charges and maintained a better RoE (around 4 percent), boosted by increased lending volumes and rising administrative margins.

19. A protracted fall in house prices has led to increased credit risk in the household sector. The level of household debt is high, with the ratio of household debt-to-disposable income (over 300 percent of disposable income) twice the average of six of its Organisation for Economic Cooperation and Development (OECD) peers. A large share of household assets in the Denmark is illiquid (housing and pension savings), subject to price risk, or both. After four successive years of contraction, the real house prices show signs of stabilization. The traditional conservative mortgage lending model (based on the balance principle) has been altered over the past decades though significant product innovation. Adjustable interest rate loans (introduced in 1996) and interest-only loans (offered since 2003) have increased credit risk in the system.

20. Covered bonds represent both an important source of wholesale financing and of liquidity for banks. The stock of covered bonds is equivalent to almost twice GDP, more than four times as large as in any other country. MCIs and banks are subject to the same covered bond regulations, however they fulfill the requirement differently owing to the different nature of their businesses and their funding sources. The long-lasting stability of the mortgage market led to a large and liquid market for covered bonds, which became a favored source of liquidity for banks. The maturities of covered bonds were shortened significantly before the crisis (with many issuances of one year), raising important refinancing risks. Recently passed legislation (March 2014) is seeking to address refinancing risk by extending the maturity of the bonds in certain stress scenarios.

21. Capitalization has been improving since the early phases of the crisis, but risk-weights are among the lowest among European banks. System-wide, the capital adequacy ratio (CAR) has increased to 23 percent compared to 12 percent before the crisis. Tier 1 ratio has also improved from 9 percent in 2007 to about 20 percent in 2013. Several banks (Danske Bank, Jyske Bank, Spar Nord Bank and Vestjysk Bank) were able to raise capital through share issuance. Risk-weights in Danish banks are among some of the lowest in the EU. However, the DFSA has taken some corrective action to address this—notably via a large increase in Danske Bank's corporate risk weights—and continues to monitor the area closely. Basel III/CRD IV implementation will also demand an adjustment in the quality of capital (increased deductions and phase out of hybrids). Stress tests performed by the central bank in 2013 shows that the systemic banks are able to withstand substantial shocks, however, several of the non-systemic banks will need to strengthen their capitalization or seek consolidation.

22. Reliance on wholesale short-term funding has been reduced since the crisis. The pre-crisis expansion of the banks was financed to a large extent by short term wholesale funding, which led to the built up of a considerable customer funding gap. When funding markets seized up, the government provided extensive guarantees to the banks. Almost all government-guaranteed bonds issued in 2009–10 have been redeemed. The customer funding gap, most significant in the systemic banks, has recently narrowed and the loan-to-deposit ratio has decreased to 104 percent (from 135 percent before the crisis). Of wholesale funding, majority is long-term. Short term debt now accounts for approximately 11 percent of banks' overall debt issuance (less than 2 percent of total assets), which is significantly less than in 2007 when short term issuance was almost half of total debt issuance.

23. Danish Domestic Systemically Important Banks (D-SIBs) have large operations across the Nordic region. The largest banks have material cross-border activities. The four Nordic countries have close economic and financial ties and face some common challenges, such as large banking sectors and high household debt. In particular, Danske Bank has geographically dispersed credit exposure and depositor base across the region, operating in Finland, Sweden, Norway, but also in other Baltic (Lithuania, Estonia, Latvia) and Northern European Countries (Ireland). As a result, Denmark is home supervisor to several D-SIBs and a host supervisor to one G-SIB (Nordea).

D. Preconditions for Effective Banking Supervision

Sound and sustainable macroeconomic policies

24. Macroeconomic policies are sound and sustainable, reflected in stable government finances and a favorable external balance. The longstanding and tight peg to the euro has anchored inflation and minimized exchange rate volatility vis-a-vis trading partners. Fiscal policy supported the economy during the downturn associated with the global financial crisis and when the recovery faltered in 2011–12. Following fiscal consolidation in 2013, the fiscal stance is expected to return to roughly neutral in 2014. Looking forward, the government's fiscal plans set out a prudent and strong fiscal path for the medium term. Gross government debt is about 50 percent of

GDP, helping to underpin the sovereign's triple-A credit rating. Denmark's external position is expected to remain strong, with the current account surplus at about 5 percent of GDP in 2013 and 2014.

Framework for financial stability and macroprudential supervision

25. Financial sector stability is a shared responsibility of the DN and the DFSA. The DFSA is responsible for overseeing the various financial institutions (commercial banks, mortgage banks, insurance companies, and pension funds) and the regulation of securities markets, while the responsibility for payment systems is shared with the DN. The latter's authority is derived from the DN law of April 7, 1936 (Section 1) which requires the DN to "maintain a safe and secure currency system in this country, and to facilitate and regulate the traffic in money and the extension of credit."

26. The cooperation between the DFSA and the DN is strong and the exchange of information has improved following the crisis. A formal agreement between the DFSA and the DN on access to confidential data on a regular basis was made in January 2010. On an on-going basis the DFSA assesses whether the exchange of information is compliant with the regulation on confidentiality. In practice, the two authorities cooperate on regular bank stress testing and on the monitoring of liquidity and funding, actively exchange data for other financial sector analyses and surveillance, and exchange opinions on legislative initiatives. More recently, the DFSA and the DN - under the auspices of the secretariat of the Systemic Risk Council (SRC) - started working on the development of an analytical framework for assessing the use of macroprudential tools, in particular the countercyclical capital buffer.

27. An institutional framework for macroprudential policy has been established. The SRC composed of 10 members (three members are from the economic ministries—Ministry of Business and Growth, Ministry of Economic Affairs and the Interior and the Ministry of Finance; two members are from the DN; two members are from the DFSA; and three independent experts) has been in place since 2013 and has a quarterly calendar of meetings. The SRC's task is to monitor and identify systemic financial risks and to issue observations, warnings and recommendations regarding the buildup of systemic risks. The SRC can recommend the use of macroprudential tools, but the choice of instruments and implementation lie with the MoBG. The government decision making role carries a risk of inaction bias in cases where financial stability policies need to "lean against the wind" to mitigate systemic risks.

28. Enhanced regulatory requirements have been put in place for D-SIBs. A political agreement from October 2013 outlines the requirements to be imposed on the D-SIBs. The relevant legislation has been put below Parliament and is expected to come into force by the end of March 2014. The six largest commercial banks (Danske Bank, Nykredit, Nordea Bank Denmark, Jyske Bank, BRF-Kredit and Sydbank) have been designated D-SIBs and will be subject to enhanced capital requirements ranging from 1 to 3 percent of risk weighted assets depending on their systemic importance.

29. Denmark is part of several European and regional fora for cooperation on financial stability and supervisory issues. 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 (Nordic-Baltic memorandum of understanding -MoU). Both DN and DFSA are part of the European Systemic Risk Board (ESRB) and participate in pan-European discussions on financial stability.

Public and legislative infrastructure

30. Denmark has a well-established legal system, which provides a high level of legal certainty. The courts system and other legal infrastructure are highly developed and the independence of the judiciary is respected. There is a comprehensive body of business laws, covering insolvency as well as contractual and property rights. The general public infrastructure provides for a broad and coherent framework of systems, ensuring a high level of legal certainty and access to dispute resolution in all the relevant areas. These rules are diligently enforced by the relevant competent authorities and there is general access to fair dispute resolution mechanisms.

31. A key feature of the Danish system is well-defined property rights. The title and land registration systems ensure that ownership and encumbrances on individual properties are easily identified and that the information is available to the public. Furthermore, if a borrower defaults on a payment, the bank can take over the house and the compulsory sale procedure would ensure that the house can be sold in the real estate market or through a forced sale. The period from default to a forced sale being completed may be as short as six months. Hence, the systems add investor protection, while at the same ensuring borrower's discipline.

32. The financial sector has a well-developed regulatory architecture. Banking laws, regulations and prudential standards are regularly updated as necessary (e.g., in context of the EU legislative framework—and "Single Rule Book" standards) to ensure that they remain effective and relevant. The same goes for payment, clearing and settlement systems.

33. Disclosure of information regarding economic, financial, and social statistics is high. Extensive economic, financial, and social statistics are published by the Government Statistical Office, the DN, the DFSA, other public bodies. A number of private credit bureaus exist, which operate under the supervision from the Danish Data Protection Agency with regards to protection of personal data. The financial disclosure requirements according to the EO on Financial Reports for Credit Institutions and Investment Firms etc., are to a large extent based on the disclosure requirements in International Financial Reporting Standards (IFRS) (IFRS 7). Some of the provisions apply only to listed banks as there are wider disclosure requirements to listed banks than to unlisted.

34. There is a high degree of alignment between the Danish accounting standards and the IFRS. The accounting standards in the banking sector are issued by the DFSA in accordance with the European Directives for accounting. Danish accounting rules for financial enterprises are highly aligned to the IFRS in relation to the principles regarding recognition and measurement of assets and liabilities. The standard ensures that impairments are made-up in a timely and adequate manner. IFRS were adopted for all listed companies and by all financial enterprises, effective January 2005. Joint stock companies and limited liability companies are required to submit audited financial statements to the company registrar also using IFRS.

35. As a direct response to the financial crisis, training requirements for auditors of financial undertakings has become stricter. Auditors are required by the Act on Approved Auditors and Audit Firms to use International Standards on Auditing (ISAs), which are "generally accepted auditing practices" for the purposes of the Act. To prepare the auditors for the special circumstances in the world of finance, and a certification scheme has been implemented for the undersigning auditor(s) in financial institutions, MCIs and insurance companies. This scheme allows the DFSA to respond swifter and more efficiently vis-à-vis the auditors of financial institutions if errors and omissions are found relating to their audit.

The resolution framework

36. The Danish resolution framework has evolved following the crisis. As the financial crisis escalated, the government has enhanced the resolution framework to enable a controlled resolution of bank activities in cases where private solutions cannot be reached. Denmark became the first country in Europe to implement a bail-in regime through which losses of a failing banks were imposed on senior creditors. The DFSA is responsible for determining the trigger for resolution and, following the crisis, established a practice of consultation with the MoBG on the specific course of resolution. Controlled resolution of bank activities are handled by the state-owned FSC.

37. Further improvements related to the resolution regime are sought pending the adoption of a new EU Directive on Bank Recovery and Resolution. The EU Directive is expected to complement the CRR/CRD IV regulation (applicable from 2014) on resolution and recovery plans. The concrete supervisory handling of recovery plans in general for all banks in Denmark is expected to be implemented in the regulation and supervisory approach in the first half of 2014, whereas the supervisory process for general resolution of banks has not been decided upon yet as this decision awaits the finalization of the EU Directive on Crisis Management and further work internally.

Systemic protection

38. *The Danish Guarantee* Fund (DGF) for depositors and investors covers deposits of up to 100,000 euro per depositor. Certain special categories of deposit are, however, covered in full. Membership is compulsory for all credit institutions. The DGF is managed by a board appointed by the MoBG and is supervised by the DFSA. Foreign bank branches can, if their national coverage is not at level with the Danish system, buy add-up insurance in the DGF. In 2012, the DGF has migrated to an ex-ante financing scheme, based on annual contributions from banks.

Effective market discipline

39. An EO on Management and Control of Banks establishes the rules and principles for the management of banks, including corporate governance policies. The BoD and Board of Management (BoM) have a variety of obligations which are all aimed at ensuring a robust governance system of the bank. All financial companies are required to regularly assess whether their BoD has the adequate skills and knowledge to ensure an appropriate operation of the financial company. The assessment is based on the bank's business model and the associated risks. In July 2012, the DFSA published its requirements for the knowledge and experience of boards of directors of financial undertakings. The more advanced the bank's business model is, the more advanced the required qualifications necessary to properly manage the bank will be. DFSA's Guidelines include examples of qualifications required to be present collectively in the BoD depending on the bank's business model; the DFSA has also ensured follow-up processes.

40. A political agreement has been reached on sound remuneration policies in the financial sector. The agreement included in Bank Package VI establishes additional and more restrictive requirements concerning remuneration in Denmark than required by the CRD. The agreement widens the scope of the remuneration regulation to all financial undertakings and all financial holding companies.

41. The mechanisms for consumer protection are comprehensive. DFSA's consumer oriented activities are linked to Article 43 on good business practice in the Financial Business Act and the executive orders issued by the minister in this area. The DFSA supervises financial undertakings' general behavior and ensures compliance with the rules of public law, including making a general assessment of the undertaking's financial contracts and business terms. In addition, the Consumer Ombudsman, an independent authority supervising compliance of all sectors of the economy with marketing law, has jurisdiction over the banking sector. The Ombudsman may investigate specific complaints against a bank and issues of public importance relating to marketing activities and may bring civil or criminal actions on behalf of complainants.

E. Main Findings

CP 1–3

42. The DFSA overall has an appropriate set of legal authorities to carry out supervision of the Danish banking system.

43. Structures, both currently in place and expected to be implemented later this year, have the potential to interfere with the DFSA's operational independence. 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 (two years) appointees on the Board will be authorized to decide. Not only will the Board act on numerous policy and individual institution matters, but will add authorities for setting the strategic direction of the DFSA's operations.

44. Current staffing is not sufficient to allow the DFSA to expand readily onsite supervision for individual banks or to expand to meet additional overall demands, and there is not flexibility in expanding resources between annual budget approvals. There is a well-designed structure for supervisory coordination within Denmark which is simplified by the reality that essentially all domestic financial supervision is housed within the DFSA. MoUs with the appropriate set of foreign supervisors are also in place.

CP 4–7

45. 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. Recently DFSA has published guidance to industry and the public on crowd funding and peer-to-peer funding models to clarify licensing restrictions and to educate public decision making and behavior. 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 five new license applications and has applied a sound approach in applying license criteria. The DFSA performs multiple onsite examinations to test the preparedness of the applicant in terms of systems and processes to be satisfied and all aspects of the proposed business model is critically evaluated including structure of the organization, governance arrangements, risk management such as policies and processes and other quantitative aspects.

46. The definition of qualifying interest in the Financial Business Act (FBA) is sufficiently broad for DFSA to capture a range of scenarios where a bank or other party proposes to acquire an ownership stake or interest in a bank which could have the potential to exercise influence over the running of the bank. Supervisors use the rules consistently and with good effect and assessment processes are robust. The legislation provides formal triggers for DFSA approval for movements in the share registry at 10, 33 and 50 percent which allows the DFSA to review changes in ownership of existing owners. In addition to the quantitative thresholds, the legislation contains reference to a number of scenarios where significant ownership could be interpreted below the thresholds where a party exercises effective control, although there have not been examples where DFSA has been asked to interpret ownership activities.

47. There are, however, some weaknesses in the rules where 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 contained within the FBA, restrict the flexibility of DFSA to respond to a change in control if the shareholder acquires a shareholding without approval. No power to impose prudential conditions (conditionality) in the rules when assessing qualifying interest. In the event of 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. Although the power to impose conditions is it not explicitly stated in the legislation, in practice, the DFSA will reject the acquisition unless it is satisfied that all criteria are fulfilled, and use the powers within the law to say what shall be improved in order to reach DFSA acceptance to the change of control.

48. The DFSA uses prescribed criteria to assess major acquisitions clearly set out in legislation. The assessment against criteria will take into account the likely influence of the intended acquirer on the undertaking, the suitability of the intended acquirer, and the financial soundness of the intended acquisition. The assessment process undertaken by the DFSA thoroughly assesses the impact of the acquisition on the acquirer taking into account a variety of scenarios. For major acquisitions of domestic banks, the power to approve or reject is embodied in the FBA and provides the DFSA with sufficient powers to assess the risks of a major acquisition based on a sufficiently broad set of criteria. If the acquisition exhibits excessive risk to the acquirer or system, the DFSA has the power to reject the application. 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.

49. The qualifying interest rules make a distinction, however, in regard to cross-border operations which only require prior notification as opposed to an approval. Section 63 (1)–(4) in the FBA that the DFSA shall be notified prior to any direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest. The implication is that in the circumstance where a bank supervised by the DFSA seeks to make an investment in a foreign asset, an approval by DFSA is not required under the FBA. This limits the DFSA's ability to reject as opposed to discourage a potential foreign acquisition.

CP 8–11

50. 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. 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, but also relevant for larger banks as additional examinations work beyond the annual focused inspection is not performed very often—but have happened when deemed needed.

51. Individual recovery and resolution plans have not generally been required or prepared to date. All banks are expected to prepare for resolution. For small and medium sized banks, the DFSA expects these banks to have plans which allow resolution over a weekend period which has shown to be a well functioning regime. For the systemic banks, preparation of comprehensive recovery and resolution plans that align with international standards remains a work in progress and various actions have been taken—e.g., contingency plans have been required and banks have been given guidance on information availability for resolution purposes.

52. **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).**

53. **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.** This will permit to incorporate additional reviews when, for example, a change in the risk profile or a stress test result, indicates a likelihood that another onsite examination would be needed. Onsite follow-up of problems that were detected is typically deferred to the next scheduled examination.

54. **The assessors offer some cautions on several tools now being used.** One relates to making examination findings public. Making the reports public has the advantage of transparency by informing the marketplace of issues seen by the DFSA but brings with it the danger of accelerating adverse effects on a bank when problems start to arise (the DFSA does have some capacity to hold back reports, and used that authority in at least one instance). In any event, we would encourage policy makers to review the appropriateness of the approach to transparency, given the real potential for these negative effects ultimately to more than offset the value of transparency. A second tool on which we would offer a caution is the DFSA's request of external auditors to review and assess whether orders and risk in formations have been addressed. Given the challenge of outside auditors fully understanding the supervisory perspective and the limited way it appears that this responsibility is being carried out, putting substantial reliance on this work (rather than for example shortening the inspection schedule) would in our view be misplaced. The assessors understand that the DFSA is sensitive to this issue, and views the word of the external auditors as only an input into the supervisory process.

55. **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 (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. Data submitted by banks is subject to various statistical validations for accuracy and quality and then analyzed by supervisors using cohort comparisons to detect outliers and discriminate risk profile. While the reporting instructions are generally comprehensive, the instructions omit reporting operational risk loss and related party lending.

56. **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 and has included recommendations to revoke banks licenses. The DFSA has a wide range of options to intervene at an early stage to require the bank to take actions. The DFSA has demonstrated a capacity to act even though the bank fulfills the regulatory capital requirements. 19 banks in Denmark have been closed as part of a problem bank resolution during the recent financial crisis.

CP 12

57. The approach to consolidated supervision of the groups that have the bank as the ultimate parent (the predominant form within Denmark) appears sound. Such groups are subject to regulations regarding capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure (and related reporting to the DFSA). However, only certain of these are applicable to Financial Holding Companies (FHCs) with other than a bank as ultimate parent (solvency, reporting of large exposures and exposures to related parties) and these are not applicable on a consolidated basis to groups where a non-financial company is the ultimate parent. Some adjustments are being made to make explicit requirements to FHCs. Moreover, no authority exists to do fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies.

CP 13

58. The DFSA works very closely with other national supervisors in well-designed and implemented colleges. As discussed in BCP 9, the DFSA has established a general resolution planning regime applicable to small and medium sized banks. This resolution scheme has resolved many banks during the crisis.

CP 14 & 15

59. The DFSA has a good overall approach to governance. A horizontal review of the appropriateness of the composition of BoDs and then following through to make sure necessary changes were made is a clear example of strong supervisory oversight.

60. There are a few gaps in governance requirements, most notably not yet requiring the establishment of risk committees (to be required April 1, 2014). Other elements that could be made more explicit include codes of conduct and ensuring independence in the validation of models.

61. The DFSA has a generally well designed program for risk management, with detailed requirements spelled out in the regulation and good review and inspection processes. In practice, the DFSA program appears strongest in terms of credit risk (consistent with the risk profile of most Danish banks) with requirements for operational risk in the process of being strengthened.

62. There are some other improvement opportunities, several of which are in train. These include updating the Executive Order—Management and Control to require that the dismissal of the Chief Risk Officer (CRO) will need to have the concurrence of the BoD (this has been implemented as of March 31, 2014), adding further requirements for SIFIs, and applying requirements more generally to financial holding companies (this has been implemented as of March 31, 2014).

CP 16

63. **The supervisor sets prudent and appropriate capital adequacy requirements on an individual basis and incorporates considerations of the broader economic conditions.** The DFSA applies the capital rules consistently across all banks and there is an emphasis on quality of capital to absorb losses. Pillar II arrangements are well developed and applied by supervisors through the annual Individual Capital Adequacy Assessment Process (ICAAP) which includes forward looking elements such as stress testing. A delay in the Parliamentary process to transpose the Capital Requirements Directive (CRD) into legislation has meant that at the time of the mission the application of the Basel III capital requirements have not strictly met the implementation schedule as prescribed by the Basel Committee on Banking and Supervision (BCBS).

CP 17–21

64. **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 at credit inspections has a strong focus on a large number of specific credit risk exposures.

65. **The DFSA has taken a strong and conservative approach to impairment and provisioning, and the assessors commend them on that policy.** However, the database of larger exposures that is used to check consistency of ratings could be broadened.

66. **The DFSA set 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 LE limit and the Supervisory Diamond encourages prudent management of aggregate credit concentration risk.

67. **Regulations for related party transactions includes only BoD, BoM and intra-group transactions.** The definition of related party does not however extend to minor shareholders and key risk takers (due to the potential restrictive definition of BoM). The deficiencies in the way the definition of related party in the legislation limits the application of the DFSA's powers. No routine supervisory reporting (i.e., quarterly, semi-annually) to track and monitor related party exposures.

68. **Offsite surveillance for the major banks where country and transfer risk is most evident is performed quarterly and supervisory reporting requirements are adjusted to enhance the level of detail for supervisors to assess the risk.** During the Euro Area sovereign crisis, banks were asked to report their exposures and analyses undertaken by the DFSA to assess the risk in detail. Sovereign exposures has been reported by the largest banks as part of European Banking Authority (EBA) exercise, most recently in the 2013 'EBA Transparency exercise' covering end-2012 and mid-2013 data. The DFSA does not have a bespoke set of regulations for country and transfer risk and outside of these exercises, 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. 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). Domestic banks have limited exposure to foreign currency sovereign bonds. The DFSA receives quarterly data regarding cross-border exposures on a legal entity basis. The data allows the supervisor to assess the size of exposure as a percentage of total assets.

CP 22, 23 & 24

69. 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, foreign exchange (FX) derivatives, and commodities. Banks are required to implement Board approved policies and processes which are regularly reviewed and adjusted according to macroeconomic conditions. Regulations require segregation of duties between front, middle, and back office, especially for the valuation of traded positions which is independently verified by risk personnel. Bank supervisors routinely perform onsite reviews of risk management to verify compliance and assess risk profile. Instruments in the trading book are valued using fair market values subject to IFRS. Supervisory reporting of traded market risk could be expanded to capture a broader suite of risk information and results of stress testing. Currently offsite reporting of market risk information consists of data for specific categories: currency, interest rate, commodity and equity products. While the reporting requirements will capture the majority of traded market instruments, more exotic instruments will not be captured by the reporting requirements. The DFSA can not directly see an increased exposure to a specific product, but the offsite reporting will show an increase in the overall market risk. If the banks increase their market risk exposure this will be seen in the reporting. The direct cause of the increase will however not be visible. A build-up in market risk can therefore occur undetected. As a result, a build-up in some market risks, for example, option risks or some concentration risks could occur in the absence of onsite examinations.

70. Through quarterly offsite surveillance and routine onsite inspections, the supervisor assesses the implementation of bank risk management taking into account bank's risk appetite and market conditions. A protracted low interest rate environment has increased the dimension of Interest Rate Risk (IRR) as well as the changes in interest rate optionality offered to customers. For the larger banks, onsite market risk inspections are conducted once every four years. In small banks onsite market risk inspections are a part of the ordinary full inspections on a risk based approach. D-SIBs will be subject to market risk inspections annually beginning in 2014. While a risk-based approach is applied to onsite examinations, the supervision cycle for sound and well-capitalized 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.

71. Banks are subject to comprehensive reporting requirements which provide the supervisor sufficient information to monitor changes in risk profile and market conditions. 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). The Supervisory Diamond includes an additional two metrics which also act as early warning indicators to identify banks with higher risk business models. The liquidity ratios are designed to restrict an over-reliance on unstable funding sources and to ensure that a sufficient liquidity buffer is in place at all times. Banks regularly submit results of liquidity stress testing and liquidity and funding positions. The systemic banks are also subject to reporting liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) on a monthly/quarterly basis.

72. A short term liquidity buffer requirement of a similar magnitude to the LCR is in place, however the definition of eligible assets to be included in the liquid asset (high-quality liquid asset (HQLA) portfolios is broadly defined and approval by the DFSA is not required. While the liquidity rules set a liquid asset buffer requirement of a magnitude similar to that of the LCR, the definitions in the liquidity rules are not sufficiently prescriptive (i.e., section 152 includes unlisted liquid securities). No haircuts applied to the value of these assets which is not reflective of stress circumstances. Currently no limit on own-issued mortgage covered bonds to count in the pool of HQLA to meet two quantitative liquidity requirements. Banks are currently transferring out of own-issued mortgage covered bonds to meet the Basel III LCR rules, which is a positive development.

CP 25

73. 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 Basel 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 Q1 2014 in accordance with the new COREP reporting requirements. The deadline for reporting the Q1 data is May 30 for the company level and June 30 for the group level. The following banks use the standardized method: Danske, Nordea, Jyske, Sydbank and FIH.

CP 26–28

74. 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, mainly in relation to lack of requirements that fair value estimates are subject to independent verification and validation and the DFSA does not have access to work papers of external auditors. 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 review of audit books and discussions with bankers the assessors saw evidence that some such reviews are done (at least for the largest banks) but it is important that the EO be appropriately updated. Other elements that should be incorporated into a revision would be provisions related to dual control (of other use of four eyes principle) and provisions on the protection of assets.

75. **While the Pillar III 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 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.

CP 29

76. **The DFSA has developed a risk-based onsite examination program to conduct assessments of banks' compliance with the obligations under Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT) Act.** DFSA has carried out comprehensive onsite inspections (including follow-ups) of 16 large and medium-size banks based on a risk-based selection between 2010–2013. The 16 banks submitted to onsite inspections represent an accumulated share of more than 80 percent of the total working capital amongst Danish banks. However, the DFSA does not have adequate resources to supervise the effective implementation of banks' internal AML/CFT controls. The DFSA's current self-assessment scheme includes 20 medium-size and small banks (risk-based selection) and that he DFSA has issued comprehensive guidance to the financial institutions. The DFSA meets regularly with the Danish Bank Association (private sector outreach) and the Danish Local Banks Association to discuss AML/CTF issues. The DFSA does not monitor that banks have adequate policies and procedures through routine offsite surveillance and onsite reviews to assess the adequacy and effectiveness of banks' policies and procedures.

SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES—DETAILED ASSESSMENTS

Core Principle	Grade	Comment
1. Responsibilities, objectives and powers	C	The DFSA overall has an appropriate set of legal authorities to carry out supervision of the Danish banking system.
2. Independence, accountability, resourcing and legal protection for supervisors	MNC	Structures, both currently in place and expected to be implemented later this year, have the potential to interfere with the DFSA's operational independence. 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 will add authorities for setting the direction of the DFSA's operations. The budget process is not flexible enough to allow the DFSA to expand readily onsite supervision for individual banks or to expand to meet additional overall demands.

Core Principle	Grade	Comment
3. Cooperation and collaboration	C	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. MoUs with the appropriate set of foreign supervisors are also in place.
4. Permissible activities	C	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.
5. Licensing criteria	C	The Danish FSA has appropriate set of powers to set licensing criteria and reject licensing applications.
6. Transfer of significant ownership	LC	In the event of a transfer of significant ownership, the supervisor has the power to review and reject a proposed transfer of significant ownership or controlling interest (held directly or indirectly) in existing banks to other parties, but does not have a formal power to impose prudential conditions. The DFSA has nevertheless been able to address this deficiency in certain circumstances to good effect. There is no definition of ultimate beneficial owners in the FBA. There is no 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. A change of control cannot be reversed.

Core Principle	Grade	Comment
7. Major acquisitions	LC	There is no legal requirement to have the DFSA's approval for foreign acquisitions. This limits the DFSA's ability to intervene prior to the investment in the circumstance where the investment is large and potentially changes the risk profile of the acquiring bank.
8. Supervisory approach	LC	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. However, the very extended examination schedule limits the immediacy with which issues can be discerned from onsite work—an extremely clear problem for smaller banks, but also relevant for larger banks as additional examinations work beyond the annual focused inspection is not done very often. Recovery and resolutions plans have not been required or prepared on and individual basis to date. However, the DFSA require all banks to assess their resolution ability and have systems and procedures ready to be resolved during a weekend. Furthermore, the DSFA has a well established framework for resolution of small and medium sized banks. In addition, the DFSA can ask for a recovery plan on an individual basis when the bank fulfills only the general capital requirement of 8 percent, but not the higher requirement applied to the specific institution.

Core Principle	Grade	Comment
9. Supervisory techniques and tools	LC	The DFSA has done a commendable job in putting in place a set of tools to enhance supervision coming out of the financial crisis. Moreover, the assessors were impressed by the knowledge and commitment of the supervisors of the DFSA. However, the assessors identified several areas where improvements could be made. As noted in BCP 8, the onsite examination schedule is too limited. For the onsite 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	C	The DFSA collects a comprehensive set of prudential reports and conducts routine analysis.
11. Corrective and sanctioning powers of supervisors	C	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.

Core Principle	Grade	Comment
12. Consolidated supervision	LC	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 certain of the prudential rules are applicable to financial holding companies. Moreover, no authority exists to do fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies.
13. Home-host relationships	C	The DFSA works very closely with other national supervisors in well-designed and implemented colleges. As discussed in BCP 8, the DFSA has not established individual resolution plans for large banks. But the DFSA has 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	LC	The DFSA has a good overall approach to governance. Its carrying out of a horizontal review of the appropriateness of the composition of BoD and then following through to make sure necessary changes were made is a clear example of strong supervisory oversight. 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	LC	The DFSA has a generally well

Core Principle	Grade	Comment
		designed program for risk management, strongest in terms of credit risk (consistent with the risk profile of most Danish banks) and is least well developed in terms of operational risk. There are some improvement opportunities, several of which are in train: updating the relevant Executive Order, 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 financial holding companies. The latter has been implemented as of March 31, 2014. Other improvement opportunities include: ensuring that liquidity and other risks are factored into internal pricing of financial products, and performance measurements; as well as clarifying the rules/guidance on independence of the units doing validation of models.
16. Capital adequacy	C	DFSA has implemented the BII 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. The Basel III implementation is pending.

Core Principle	Grade	Comment
17. Credit risk	C	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 during credit inspections has a strong focus on a large number of specific credit risk exposures.
18. Problem assets, provisions, and reserves	C	The DFSA has taken a strong and conservative approach to impairment and provisioning, and the assessors commend them on that policy. However the database of larger exposures that is used to check consistency of ratings could be broadened.
19. Concentration risk and large exposure limits	LC	Notification requirement for large exposures needs to be tightened. Currently, the DFSA will be notified at the end of 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.
20. Transactions with related parties	MNC	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 (i.e. all shareholders, credit officers etc). The deficiencies in the definition of related party in the legislation limits 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.

Core Principle	Grade	Comment
21. Country and transfer risks	LC	Country risk is assessed on an ad hoc basis as there are no specific guidelines or regulations for country or transfer risk outside of the general risk management. As a result, minimum requirements for risk policies, processes and limits is uncertain.
22. Market risk	LC	Supervisory reporting of traded market risk could be expanded to capture a broader suite of specific risk information and results of stress testing.
23. Interest rate risk in the banking book	C	Laws and regulations stipulate minimum obligations of banks to manage and mitigate Interest Rate Risk (IRR). Through quarterly offsite surveillance and routine onsite inspections, the supervisor assesses the implementation of bank risk management taking into account bank's risk appetite and market conditions. There was evidence to suggest this process was effective.
24. Liquidity risk	LC	Eligible assets to be included in the HQLA are broadly defined and approval by the DFSA is not required. DFSA has not implemented formal encumbrance limits.
25. Operational risk	MNC	Supervisory reporting is not sufficiently frequent and detailed to identify and monitor changes in operational risk profile. There are material shortcomings in the notification regime and onsite examinations are not systematically performed across banks to gain a comprehensive view of operational risk bank-wide.

Core Principle	Grade	Comment
26. Internal control and audit	LC	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 such reviews are done (at least for the largest banks), but it is important that the executive order be appropriately updated. Other elements that should be incorporated into a revision would be provisions related to dual control (of other use of four eyes principle) and on the protection of assets.
27. Financial reporting and external audit	LC	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	MNC	While the disclosure requirements look adequate on paper, 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 at all, and what reviews are done are for information purposes of the supervisors, not to assess completeness or accuracy of the filings. Accordingly, while there are provisions that could require

Core Principle	Grade	Comment
		republication or even the imposition of a fine, they have never come into play.
29. Abuse of financial services	LC	The DFSA does not have adequate powers regarding AML/CFT to impose sanctions. While the onsite review program is risk-based, the DFSA has not conducted onsite examinations systematically across the banking sector to accurately assess banks' internal AML/CFT controls.

RECOMMENDED ACTION

77. **This section lists the suggested steps for improving compliance and overall effectiveness of the supervisory framework.** The table indicates only those Principles for which specific recommendations are being made.

Table 1. Recommended Action Plan to Improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
Principle 2	Seek to secure increased operational independence through revisiting the threshold of significance for Risk 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.
Principle 6	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 FBA. Amend 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.
Principle 8	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.
Principle 9	With additional budgetary resources, use the tool of the onsite exam 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.
Principle 12	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.
Principle 14	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.
Principle 15	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.
Principle 18	Broaden the data base of larger exposures that is used to check consistency of ratings.
Principle 20	Revise regulations to incorporate a broader definition of related parties. Enhance routine disclosures to include related party exposures which includes detailed information for offsite analysis.
Principle 22	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).
Principle 23	Formalize procedures for netting.
Principle 25	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 mechanisms should be agreed to allow supervisors to remain apprised of developments at a bank.
Principle 26	Modify regulations to direct internal auditors of banks to review risk management, compliance and control functions.

	Include provisions related to dual control (of other use of the four eyes principle) and to the protection of assets
Principle 27	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.
Principle 28	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.
Principle 29	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.

AUTHORITIES RESPONSE TO THE ASSESSMENT

78. **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.

79. **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.

80. **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.

81. **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.

DETAILED ASSESSMENT

82. The assessment of compliance of each principle is made based on the following four-grade scale—(i) compliant; (ii) largely compliant; (iii) materially noncompliant; and (iv) noncompliant:

- **Compliant:** A country will be considered compliant with a Principle when all essential criteria[2] applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for the aspect of banking supervision addressed by the Principle to be considered effective.

- **Largely compliant:** A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed that do not raise any concerns about the authority's ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment "largely compliant" can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.

- **Materially non-compliant:** A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. It is acknowledged that the "gap" between

[2] For the purpose of grading, references to the term "essential criteria" in this paragraph would include additional criteria in the case of a country that has volunteered to be assessed and graded against the additional criteria.

"largely compliant" and "materially non-compliant" is wide, and that the choice may be difficult. On the other hand, the intention has been to force the assessors to make a clear statement.

- Non-compliant: A country will be considered non-compliant with a Principle whenever there has been no substantive implementation of the Principle, several essential criteria are not complied with, or supervision is manifestly ineffective.

83. Denmark voluntarily chose to be assessed and graded against the additional criteria, in addition to the essential criteria.

DETAILED ASSESSMENT OF COMPLIANCE WITH BASEL CORE PRINCIPLES

A. Supervisory Powers, Responsibilities and Functions	
Principle 1	**Responsibilities, objectives and powers.** An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.[3] A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.[4]
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision[5] are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	The responsibilities and objectives of each of the authorities involved in banking supervision are clearly defined in legislation. In accordance with section 344 (1) of the FBA, the DFSA is authorized to supervise compliance with the FBA and regulations laid down pursuant to this Act (except for two sections not relevant to this analysis). Under this authority, the DFSA supervises banks (and financial holding companies), MCIs, insurance companies, and pension funds through

[3] In this document, "banking group" includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example nonbank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

[4] The activities of authorizing banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

[5] Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

	various of its divisions. The DFSA also oversees the payments work, a responsibility that is shared with the DN. The DN has a responsibility to monitor financial stability, produces financial statistics and manages the Government's debt. The DN also works with the DFSA in developing and implementing stress testing. Some peripheral matters are subject to the jurisdiction of others bodies, e.g., the Danish Commerce and Companies Agency.
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	The primary task of the DFSA is supervision of a wide range of financial undertakings—including banks and mortgage-credit institutions (EC 1). The principal focus is monitoring that undertakings have adequate own funds to cover their risks (that is, the supervision of solvency). From discussions the assessors had with senior officials of the DFSA, they are sensitive to the interplay of financial stability with micro-supervision of the overall sector; the risk-based supervision process gives particular weight to those institutions whose financial condition is most important for the preservation of financial stability. The DFSA has several other roles, but they do not conflict with its primary objective. For example, it also supervises the securities markets in Denmark. Supervision of the stock market area also includes ensuring that prospectuses are published when securities are offered to the public and that prospectus material meets all statutory requirements. Finally, the DFSA monitors the markets with a view to intervening in market abuse situations (insider dealing and price manipulation). These activities are carried out in divisions that are separate from the banking divisions. In addition to, and generally in support of, ongoing supervisory activities, the DFSA assists in drawing up financial legislation and prepares EOs for the financial sector area. Finally, the DFSA collects and communicates statistics and key figures on the financial sector. These various functions are highly complementary to the core function of ensuring safety and soundness.
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile[6] and systemic importance.[7]
Description and findings re EC3	The DFSA has a good supporting legal framework for supervision. As noted above (EC2), ensuring solvency has the highest priority. In accordance with

[6] In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

[7] In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	section 124 (1) and (2) of the FBA, the BoD and BoM of banks and MCIs must ensure that the institution has appropriate internal procedures for risk measurement and risk management for regular assessments and maintenance of a capital base of a size and composition appropriate to cover the risks of the institution. The capital base of banks and mortgage-credit institutions must constitute no less than: 1) 8 percent of the risk-weighted items (the solvency requirement); and 2) EUR 5 million (minimum capital requirement). In accordance with subsection (3) of section 124 of the FBA, the DFSA may lay down a higher individual solvency requirement than the one stipulated in subsection (2), and in a number of cases, shared with the assessors, it has done so. Under section 225 (2), the DFSA may now take a flexible approach allowing a bank to continue to operate if it meets the 8 percent requirement but not the Pillar II requirement; under the 2013 law change (that created the current 8 plus regime), the DFSA can ask the bank to take various kinds of recovery actions, such as capital injections, reductions in risk weighted assets, sale of businesses, or merger to bring itself back to the Pillar II level. In any event, currently and after the entry into force of the EU regulation, the solvency need will at least be the 8 percent specified under section 124 (2) above. The DFSA, under the FBA, imposes a number of other prudential requirements including ones related to liquidity, large exposures, and transactions with related parties among others.
EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	Banking laws, regulations and prudential standards are regularly updated as necessary to ensure that they remain effective and relevant. Changes are also being made to meet EU requirements (i.e., European Directives). Banking laws, regulations and prudential standards are subject to public consultation before final adoption.
EC5	The supervisor has the power to: (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	The DFSA has the necessary powers regarding each of these subsections: a) In accordance with section 347 (4) of the FBA, the DFSA has the authority to request and receive any information, including financial statements, accounting records,

	printouts of books, other business records, and electronically stored data deemed necessary for the activities of the DFSA or for deciding whether a natural or legal person is covered by the provisions of this Act. b) In accordance with section 347 (1) of the FBA, the financial undertakings and financial holding companies, suppliers and sub-suppliers have to provide the DFSA with such information as is necessary for the performance of the duties of the DFSA. In accordance with section 346b of the FBA, the DFSA may request the competent authorities in a Member State within the (EU) or in a country with which the EU has entered into an agreement for the financial area to help supervise compliance with this Act, through supervision activities, on-the-spot checks or inspections in the territory of another Member State. c) In accordance with the provisions laid down in Directives, the scope of section 347 (1) of the FBA shall apply correspondingly to foreign credit institutions, management companies and investment companies that carry out activities in Denmark through establishing branches or through offering financial services. Currently, the DFSA reviews the operations of foreign banks' branches only for liquidity issues (and some broad consumer issues) since all these are established under the single passport principles (i.e., branches of EU incorporated banks). Forthcoming EU directives are likely to shift the responsibility for liquidity review of EU branches to the home supervisor. As with the branches of foreign banks, the DFSA reviews domestic banks and mortgage credit institutions for adherence to broad principles of good business practice in their relationships with consumers (see FBA section 43); much of the work involves following up on complaints, either directly or by forwarding the complaint to the Danish Consumer Ombudsman.
EC6	When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to: (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	The DFSA has the mandate/power to carry out all the above action steps. For example, according to section 350 (1) and (2) of the FBA, the DFSA may order that a financial undertaking take the measures necessary within a time limit specified by the DFSA, if the financial position of the undertaking has deteriorated to such a degree that the interests of the depositors or other specified parties are at risk. As described in other BCPs, the DFSA has extensive supervisory and monitoring mechanisms to detect and limit the potential for such deteriorations.

	Where the measures ordered have not been taken within the time limit specified, the DFSA may withdraw the undertaking's license. In accordance with section 351 (1) of the FBA, the DFSA may order that a financial undertaking remove a member of the BoM within a time limit specified by the DFSA, if the person no longer satisfies the fit and proper conditions of section 64 (2); pursuant to those same conditions, the DFSA may order a member of the BoD to resign his or her position. The DFSA cooperates with the FSC to achieve an orderly resolution of banks. Before initiating into the resolution actions, the DFSA also consults with the MoBG (which oversees both the DFSA and the FSC) regarding the possible course of action, and requests a mandate from the MoBG to pursue alternatives.
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	Pursuant to section 1 (2) of the FBA, financial holding companies are subject to various of the provisions applicable to banks, such as section 43(1); Part 7; section 64(4); section 71(1), no. 9 and (2); sections 77a-77d; section 117; section 124(2), no. 1; section 125(2), no. 1; Part 13; sections 344-348; section 357; section 361(1), no. 5 and (2); section 368(2), (3), (4), no. 1, and (5), and sections 369 and 370. A financial holding company is defined as: a) a parent undertaking, which is not a financial undertaking, of a group where no less than one of the subsidiary undertakings of said group is a financial undertaking, and where no less than 40 percent of the balance sheet total of the group and the parent undertaking's associated undertakings pertains to the financial sector, however subsection (7), or b) a parent undertaking whose activity exclusively or mainly consists of ownership of equity investments in subsidiary undertakings which are financial undertakings or finance institutions, and where at least one subsidiary undertaking is a financial undertaking. As discussed in BCP 12, some provisions of EOs do not apply to financial holding companies; some updates will soon be adopted. As also discussed in that BCP, the reach of the DFSA into the several small non-financial holding companies is very limited.
Assessment of Principle 1	Compliant.
Comments	The DFSA overall has an appropriate set of authorities to carry out supervision of the Danish banking system. As discussed in BCP 12, some provisions of EOs do not apply to financial holding companies (although some updates will soon be adopted) and the reach of the DFSA into the several small non-financial holding companies is very limited.

Principle 2	**Independence, accountability, resourcing and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.**
Essential criteria	
EC1	The operational independence, accountability, and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	There are various structural issues that have led the assessors to conclude that appropriate independence of the supervisor is not assured. While the budgetary and decision-making constraints the DFSA faces as an agency of the MoBG have parallels in other systems, the additional decision-making processes that come into play in oversight forums (currently, the Financial Council, and prospectively, a Board of Directors) is more extraordinary. The three sets of intertwined issues are described below, with the assessors' analysis of the import of these issues discussed in the comment section at the end of the BCP 2 analysis. <u>MoBG issues</u>: The DFSA budget must be approved by the MoBG and ultimately by the Ministry of Finance (MoF), since it becomes part of the general government budget; after approval, the DFSA budget is funded through assessments on supervised institutions under a formula based in significant part on the size of the institution. The DFSA has received approval in recent years to expand significantly its size; the appropriation for the DFSA has more than doubled in the past decade, with most of that expansion coming since 2009. The DFSA believes it could receive support for approval from the MoBG (and ultimate approval from the MoF) for additional resources between budget periods; however, from discussions with both the DFSA and the industry, the assessors understand that such interim budget approvals would likely be forthcoming only if there were a distinct external development (such as the implementation of a new EU directive) driving the need for resources. The MoBG appoints the Director General and has the authority to dismiss an incumbent; there is nothing in the FBA that describes the appropriate basis for a dismissal or requires that reasons for a dismissal need to be made public. The Director General has the authority to name people for the other senior positions of the DFSA, but their contracts are with the MoBG. Carrying out DFSA initiatives jointly with MoBG is also included as an element (counting 10 percent) in a performance contract with the MoBG for the overall DFSA. A performance contract is also concluded each year between MoBG and Director General. To make sure the performance contract is fulfilled the DFSA concludes internal performance contracts with staff, containing the same goals as the overall contract with the Ministry. The MoBG is responsible ultimately for the presentation of statutory amendments and for approving EOs. It also must be consulted in resolution cases, and provide the DFSA with a

	mandate, prior to the DFSA's being able to undertake action. The MoBG ultimately appoints all the members of the Financial Council (based on nominations it receives) to up to four-year terms, which as discussed below, currently has most of the decision-making authority of the DFSA on consequential matters. <u>Financial Council issues</u>: The Financial Council has 14 representatives including four who are nominated by industry groups within the financial area; these individuals are typically current senior officials of financial firms. Of the other ten members, five are nominated solely based on academic criteria and five are nominated by independent organizations (such as the Chamber of Commerce). There are no formal vetting processes. The Financial Council makes decisions on all individual matters which involve policy implications or have the potential for significant effects on even individual firms; decisions are made on the basis of a majority vote following presentations by the non-voting DFSA officials. Other decisions, including some on the strategic direction of the DFSA and the organization of supervision in practice are the responsibility of the Director General. From discussions with DFSA representatives, the assessors have concluded that in practice, the threshold for determining that a matter could have a significant effect on firms overall, or on a single firm, is relatively low, so that consequential matters go as a rule to the Financial Council for decision. The industry participants participate generally in discussions and vote on matters with implications for their industry, but will recuse themselves on specific matters involving a representative's own firm (but not on matters involving a competitor).If there is any doubt whether a representative should recuse themselves, the council determines without the participation of the member whether he or she shall be recused in accordance with the EO 355/2013 on rules of procedures for the Financial Council <u>Board of Directors issues</u>: As part of an agreement last fall between the government and the opposition, beginning July 1, 2014, the DFSA is expected to be changed organizationally through the establishment of a Board of Directors (Board). The members of the (seven person) Board will be appointed by the MoBG each for two-year terms (in contrast to the members of the Financial Council, who can be appointed for up to four-year terms), but none can be current industry representatives. The MoBG will be an observer. Of the seven members, three are to be chosen for their academic qualifications, two for their previous experience in the financial industry, one on the basis of a general business background, and one from the DNB. The assessors understand that no formal vetting process will be required. The Board will, like the Financial Council, make significant decisions on policy matters for

	the industry and on matters that could be significant for individual institutions. The change in powers expected though is that the Board will also make strategic decisions regarding the strategic direction, organization, and operations of the DFSA, including approval of the annual supervision plan. The exact division of responsibility is to be worked out by the Board and the Director General of the DFSA. The capacity of the Board to challenge DFSA management will be enhanced by the creation of an advisory group to which the Board will have access. The Board will not have the power a Board would normally have to appoint and dismiss the CEO (i.e., the Director General of the DFSA), as this authority will remain within the MoBG.
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	The permanent secretary of the MoBG appoints the head(s) of the supervisory authority for five year terms. There are no provisions in the FBA delineating the process for dismissing the Director General; there is nothing to define the possible basis for a dismissal or to ensure that the reasons for a dismissal would be publicly disclosed.
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.[8]
Description and findings re EC3	The organization currently defines and publishes a strategic plan every three years. Presently it includes 18 initiatives which all have separate plans for being implemented within the three year period. The strategic plan is both being operationalized through annual business planning and through key performance indicators (KPIs) for departments and individual staff. As noted above, some initiatives are also included in a performance contract with the MoBG, as well as performance contracts with individual staff, including the Director General. A conclusion on the performance contract of the DSFA is published in the annual report of the DFSA.
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	Most significant issues are escalated to the Financial Council for decision, including the issuance of EOs, deciding on policy or individual institution matters, making decisions to deny applications for a person to become a director or member of BoM of an institution, decisions to remove a director or member of the BoM, or to determine to seek a mandate from the MoBG for initiating a resolution process.

[8] Please refer to Principle 1, Essential Criterion 1.

	There is a special supervision committee to oversee the supervision of high priority financial institutions; it includes the Director General and the heads of the supervisory divisions.
EC5	The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.
Description and findings re EC5	From comments made by industry representatives and from direct observation by the assessors, the staff is recognized as knowledgeable and committed. The personnel policy of the DFSA contains internal guidelines regarding the duty of confidentiality, prohibition on the acquisition of shares, and required reporting of all personal loans excepting those from mortgage companies to the Finance Information and Personnel Division. Noncompliance with such internal guidelines can be penalized by dismissal or could subject the person to the possibility of a prison sentence.
EC6	The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes: (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate onsite work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings re EC6	As discussed in EC 1, the budget of the DFSA is subject to the approval of the MoBG and the MoF, and the DFSA cannot carry over funds from one year to the next, without approval from MoBG. a) The supervisor's budgetary resources do not allow for the ready expansion of onsite supervision for individual banks or to meet additional overall demands, unless external developments are so clear as to support approval from the MoBG. The MoBG appears to have been responsive in approving substantial increases in the annual budget of the DFSA (although the willingness to approve further increases during the budget year has not yet been tested). There have been substantial annual increases in the total appropriation to be levied of the financial undertakings following the financial crisis, and reflecting new European financial regulation being implemented. In particular resources have been expanded significantly to increase

	supervision of SIFI's. b) Salary scales allows the DFSA to attract and retain quality staff reasonably well in the current soft financial sector labor market; however it is well recognized the financial sector can pay substantially larger salaries than the DFSA as a government agency. There are concerns that when the financial sector is fully recovered after the crisis, the DFSA will once again experience heavy turn-over (as high as 28 percent in some years, although currently about half of that) because of large migration towards the private financial sector. In 2012, it was decided not to merge the DN and the DFSA. At that point the MoBG sent out a press release stating that the minister would "future-proof" the DFSA within the present organizational set up. The implications of that have not been clarified. c) The FBA in section 347b.-(1) states that the DFSA may order a financial undertaking or a financial holding company to pay the costs of holding an impartial investigation of one or more aspects of the financial undertaking or the financial holding company, if the DFSA deems that this is significant for supervision of the undertaking and that the DFSA does not have the necessary (specialized) resources. d), e), f)The assessors saw no evidence of (internal) budgets for the regular training of staff; technology and travel that were other than sufficient.
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	The heads of divisions continuously evaluate their division's need of resources (in different form, skills, manpower, etc.), in the long and short term, and reports this to the Finance Information and Personnel Division, who then handle hiring of replacement staff and if necessary seek to raise (or lower) the total appropriation in accordance with evaluations.
EC8	In determining supervisory programmes and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	Each of these elements is spelled out in the FBA section 44 (3): the DFSA shall organize its routine supervision activities with a view to promoting financial stability and confidence in financial undertakings and markets. In its supervision activities the DFSA shall examine in particular the viability of the business model of the individual financial undertaking. Organization of supervision activities shall take materiality into consideration so that the supervision effort is proportionate to the potential risks or damage. Each year, the DFSA reviews through its ICAAP process the solvency need of banks and mortgage-credit institutions which have a working capital of more than DKK 250 million. The executive management of the DFSA is responsible for the organization of supervision activities.
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.

Description and findings re EC9	Officials and agents in both the DFSA and the DN are subject to general liability and employer's vicarious liability for Danish law 3-19-2. It follows that the state, local and other public authorities must bear the same vicarious liability, as private employers bear for their employees' tort (with respect to their Lawful Duties); the assessors understand that application of sanctions would not generally be stayed during the pendency of litigation against the DFSA. Apart from Criminal sanctions against the employee for actions beyond the usual and proper exercise of their professional responsibilities; employees of the DFSA are therefore not personally liable overall for the actions made during the usual and proper exercise of their professional duties.
Assessment of Principle 2	MNC
Comments	Structures, both currently in place and expected to be implemented later this year, have the potential to create problems for the DFSA operating with appropriate independence from the political process. The decision-making process on significant matters (with a relatively low threshold of significance) faced by the DFSA currently requires the approval of a 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 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 members will have even shorter, two-year terms, turnover which is likely to be detrimental to the consistency and efficiency in policy making. Furthermore, there are no fit and proper requirements for the members of the Financial Council or for the Board. The Board will continue the current responsibilities of the Financial Council to act on numerous policy matters and individual institution matters, but will add authorities for setting the direction of the DFSA's operations. The exact delineation of the authorities of the new Board has not yet been established but the expectation, as described to the assessors, is that it will be deciding issues on the organization, operation, and strategic direction of the DFSA; among the issues we understand is likely to fall within the ambit of the Board is approval of the yearly schedule of inspections. We also understand that a key issue motivating the decision to create a Board is concern with the perceived conservative approach of the DFSA to judgments on impairments and provisioning—decisions that are much more clearly within the province of experienced supervisors than of a Board made up of appointees on two-year terms. Preservation of the operational independence and integrity of the decision-making process, particularly on core supervisory matters such as provisioning, should be a high priority. The budget process also raises questions on independence. The supervisor does not have the flexibility to readily expand onsite supervision for individual banks or to meet additional overall demands, unless external developments (such as the need to implement specific European Directives) are so clear as to support approval. Budgetary approvals are

	structured as firm appropriations, constraining the ability of the DFSA to respond to other supervisory pressures. There are other elements of necessary interaction with the MoBG that raise further issues of independence. Not only is the MoBG responsible for the presentation of statutory amendments (as is common in many countries), but also for approving all EOs. It also must be consulted in resolution cases, and provide the DFSA with a mandate before it can initiate action outside of normal supervision—the decision of whether the license should be repealed and the banks send into resolution is the sole responsibility of the DFSA without any interference of the MoBG. Carrying out joint initiatives with the MoBG is also included in a performance contract with the MoBG for the overall DFSA, as well as in a performance contract with the Director General.
Principle 3	**Cooperation and collaboration.** Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information.[9]
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	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. Furthermore the DFSA exchanges views broadly, and at a senior level, with the DN in regular, quarterly meetings involving their respective management boards. The processes and procedures regarding the cooperation in different areas between the DFSA and the DN are documented in a MoU. The DN and DFSA are currently in the process of updating the MoU although no substantial changes are intended. The DFSA has the authority to share confidential information with the DN (as well as with the European Central Bank) under FBA, section 354 (6) (18):(6) provided that the information is necessary to meet their statutory obligations, including performance of monetary policy, monitoring of payment and securities management systems and safeguarding the stability of the financial system. 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 described in a MoU.

[9] Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships (13) and "Abuse of financial services" (29).

EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	There is a cooperation agreement 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 (the Nordic-Baltic countries). The Nordic-Baltic agreement is in accordance with the responsibilities specified in the EU-wide MoU of June 2008. Another major part of the coordination process is the work of the various colleges of supervisors in which the DFSA participates (see BCP 13).
EC 3	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	According to the FBA section 354 (1), and by virtue of sections 152 to 152e of the Criminal Code, employees of the DFSA are obliged to keep secret any confidential information they receive in the course of their supervisory duties. The same provisions apply to persons performing services as part of the operations of the DFSA and experts who act on behalf of the DFSA. These provisions continue to apply after the termination of the employment contract or any other service contract. Subsection (6) of FBA 354 allows confidential information to be divulged to another domestic authority or foreign supervisor, provided that certain conditions are met: • All those receiving confidential information from the DFSA shall fall under the same duty of confidentiality; • Information can only be divulged to a foreign supervisor on the basis of an international co-operation agreement; and • The foreign supervisory recipients of the information are, at a minimum, subject to a statutory duty of confidentiality corresponding to the duty of confidentiality pursuant to subsection (1), and the recipients require the information to perform their duties. In accordance with section 354 (12) confidential information from countries within the EU or countries with which the Union has entered into an agreement for the financial area shall only be divulged pursuant to subsection (6), no. 24 and no. 30 where the authorities submitting said information have granted express permission to do so, and said information shall only be used for the purposes specified by said permission.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information

	in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	Confidential information received by the DFSA shall only be used in the course of its supervisory duties, to impose sanctions, or in legal proceedings where appeals are made against the decision of the DFSA to a higher administrative authority or where such a decision is brought before the courts of law (see section 354 (9) of the FBA); the assessors are aware of one such appeal. According to the FBA section 354 (1) and by virtue of sections 152 to 152e of the Criminal Code, employees of the DFSA are obliged to keep secret any confidential information they receive in the course of their supervisory duties. The same shall apply to persons performing services as part of the operations of the DFSA and experts who act on behalf of the DFSA (including members of the Financial Council). This shall also apply after the termination of the employment contract or any other services contract. As discussed in EC 3, information may be shared with other domestic authorities and foreign supervisors provided certain conditions are met.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	The process in relation to the handling of an ailing bank requires authorization from the MoBG. As described in Section 5.1 of the Crisis Manual and reflected in two letters from the MoBG to the DFSA in 1998, the DFSA must obtain a mandate from the ministry before the DFSA can participate in crisis management of a bank such as initiating discussions with interested parties and stakeholders with a view to resolving the situation. Furthermore it is established in section 354.6 (10) of the FBA that the DFSA can share information with interested parties, including authorities, involved in attempts to save a financial undertaking in critical difficulty provided that the DFSA has been authorized by the MoBG and provided that the recipients of the information have a need for it. In accordance with this provision the DFSA will inform and cooperate with the Financial Stability Company which will receive relevant information so that the company can make a valuation of the bank and prepare for the resolution of the bank.
Assessment of Principle 3	Compliant
Comments	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). MoUs with the appropriate set of foreign supervisors are also in place.

Principle 4	**Permissible activities**. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled**.**
Essential criteria	
EC1	The term "bank" is clearly defined in laws or regulations.
Description and findings re EC1	The term "bank" is defined in section 7(1) of the FBA. According to section 7(1), undertakings shall be licensed as "banks" if they carry out activities which are comprised of receiving from the public deposits or other funds to be repaid as well as activities which are comprised of granting loans at the undertaking's own expense, except on the basis of issuing mortgage-credit bonds. There are 90 licensed banks in Denmark. Pursuant to section 7(5) and (6), banks have the exclusive right (as well as an obligation) to use the words "bank," "sparekasse" or "andelskasse" in their name. In addition to banks (organized as public limited companies), three other types of institutions are permitted to accept deposits from the public: • savings banks (in Danish sparekasser); • cooperative savings banks (in Danish andelskasser); and • savings undertakings (in Danish sparevirksomheder). Savings Banks and cooperative savings banks are subject to the same regulation and supervision as banks but is not organized as public limited companies. Savings banks are independent institutions and cooperative savings banks are cooperatives. In addition to being licensed by the DFSA, banks, savings bank and cooperative banks will also need to be registered by the Danish Business Authority. New banks must be organized as public limited companies. The Danish Business Authority is the registrar for public limited companies and will advise the FSA in the event a company has a purpose in its articles of associations which will require a license as a bank. MCIs are licensed under the Mortgage Credit and Covered Bond Act and are not allowed to use the term 'bank.' There are 8 licensed MCIs.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	The activities of a bank are limited to business and services which it is customary for banks to conduct. According to section 7(1) of the FBA, banks may only carry out the activities of banking services which are detailed in Annex 1 and according to sections 24–26. Banking activities detailed in Annex 1 include 14 separate activities which are accepted as traditional banking activities, e.g. "acceptance of deposits and other repayable funds, lending, payment services etc. The activities include a reference to electronic money transactions. The full list is below:

	Annex 1 defines "bank activities" as: 1) acceptance of deposits and other repayable funds; 2) lending, including: - consumer credit; - mortgage credit; - factoring and discounting; - commercial credits (including forfeiting); and - financial leasing. 3) payment services (money transmission services); 4) issue and administration of means of payment (e.g. credit cards, travelers' cheques, and bankers' drafts); 5) guarantees and provision of collateral; 6) participation in issuing securities and provision of related services; 7) advice to undertakings on capital structure, industrial strategy and related questions and advice, and services relating to mergers and the acquisition of undertakings; 8) money broking; 9) credit reference service; 10) safe custody services; 11) business for own account relating to any of the instruments mentioned in annex 5; 12) safekeeping and administration in relation to one or more of the instruments mentioned in annex 5, and mortgages; 13) other activities in relation to trade in money and credit instruments; and 14) electronic money institutions. According to s.24 of the FBA, banks may carry out activities ancillary to the activities licensed through subsidiaries, other financial activities. The purpose of s24 is to narrow the permissible activities of banks to financial activities associated with banking. The DFSA has published guidance to the public on the interpretations of s.24 although an official list of ancillary activities has not been published. Section 25 states that banks may, temporarily, carry out other activities to secure or phase out exposures already entered into, or with regard to restructuring enterprises. DFSA must, however, be informed regarding the latter. The purpose of s.25 is to allow banks to work-out defaulted loans (in a potential debt for equity swap) to facilitate an orderly sale of impaired assets. Notification to DFSA under s.25 will trigger supervisory actions to monitor and track the disposal of the asset in a prudent timeframe. Pursuant to section 26, banks may carry out other activities in cooperation subject to the following restrictions:

	1) the bank does not have direct or indirect controlling influence on the undertaking; 2) the bank does not carry out the activities in cooperation with other financial undertakings which are part of a group with said financial undertaking, or with regard to insurance companies, in management cooperation with said insurance company, and 3) the activities are carried on in another company than the bank. Mortgage-credit institutions may only carry out activities as mentioned in Annex 3 and activities under sections 24–26. In addition, mortgage-credit institutions may be licensed as "securities dealers" to carry out defined activities as such. Annex 3 defines "mortgage-credit activities" as: 1) Granting of loans against a registered mortgage on real property on the basis of the issue of mortgage-credit bonds or other securities; 2) Granting of loans without a mortgage on real property to public authorities or with a guarantee for surety from a public authority; 3) Business for own account relating to any of the instruments mentioned in Annex 5; 4) Safekeeping and administration of own mortgage-credit bonds and own other securities. Annex 5 describes "instruments" as: 1) Negotiable securities (except for payment instruments) that can be traded on the capital market, including a) shares in companies and other securities equivalent to shares in companies, partnerships and other businesses, and share certificates, b) bonds and other debt instruments, including certificates for such securities, and c) any other securities of which securities as mentioned in a) or b) can be acquired or sold, or give rise to a cash settlement, the amount of which is fixed with securities, currencies, interest rates or returns, commodities indexes and other indexes and targets as reference, 2) money market instruments, including treasury bills, certificates of deposits and commercial papers, with the exception of payment instruments, 3) units in collective investment schemes covered by the Investment Associations, etc. Act and units in other collective investment undertakings, 4) options, futures, swaps, Forward Interest-Rate Agreements (FRAs), and any other derivative agreement concerning securities, currencies, interest rates or returns, or other derivatives, financial indexes or financial targets which can be subject to physical or cash settlements, 5) options, futures, swaps, Forward Interest-Rate Agreements (FRAs), and any other derivative agreement concerning commodities for cash settlement, or which can be settled in cash if one of the parties so wishes (for other reasons than breach or other

	causes of termination), 6) options, futures, swaps, and any other derivative agreement concerning commodities for physical settlement, if traded on a regulated market or a multilateral trading facility, 7) options, futures, swaps, forward contracts or any other derivative agreement concerning commodities not covered by no. 6 and which can be physically settled, and have no commercial purpose, and which have characteristics similar to other derivative financial instruments, taking into consideration whether they are cleared and settled through acknowledged clearing institutions or are covered by regular determination of a margin, 8) credit derivatives, 9) financial contracts for difference (FCDs), 10) options, futures, swaps, Forward Interest-Rate Agreements (FRAs) and any other derivative agreement regarding climatic variables, freight rates, emissions permits or inflation rates, or other official financial statistics for cash settlement, or which can be settled in cash if one of the parties so wish (for other reasons than breach or other causes of termination) and any other derivative agreement concerning assets, rights, obligations, indexes and targets not covered by the other numbers, and which have characteristics similar to other derivative financial instruments, taking into consideration whether they are traded on a regulated market or through a multilateral trading facility, cleared and settled through acknowledged clearing institutions or are covered by regular determination of a margin, and 11) foreign-exchange spot transactions for investment purposes in order to secure a profit in connection with changes in the exchange rate. As stated above, what applies to banks pursuant to sections 24–26, applies similarly to mortgage-credit institutions.
EC3	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	Pursuant to section 7(5) of the FBA, banks have the exclusive right to use the words "bank", "sparekasse" or "andelskasse" in their name and banks are obliged to use the word "bank", "sparekasse" or "andelskasse" in their name, (reference s. 7(6) and see EC1). Other undertakings, except for banks established by law, may not use names or expressions for their activities that create the impression that they are a bank. The Danish Business Authority does, inter alia, register new companies or changes in company names and the Agency will contact DFSA before registering a company that uses the word "bank" etc. in its name. While there is not a formal protocol in place between DFSA and the Danish Business Authority, the two authorities co-operate closely on this matter. If DFSA discovers that an undertaking uses the word "bank" etc. in its name contradictory to section 7(5), DFSA will, in accordance with section 344(1), make a decision stating that the use of the word "bank" etc. violates section 7(5) and that the undertaking

	must cease using the word "bank" etc. in its name. There have been isolated examples where DFSA had identified examples of the use of "bank" or proposed use of the term and taken action to prohibit its use where a license application had not been submitted. These cases did not involve the taking of deposits. If this decision is not complied with, DFSA then reports the violation to the police who, according to section 373(1), will prosecute the said undertaking, the sentence being either a fine or imprisonment.
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.[10]
Description and findings re EC4	Only institutions listed in section 7(3) of the FBA are permitted to take deposits from the public and a license from the DFSA is required which will be subject to supervision by the DFSA. For a full list of the types of institutions permitted to take deposits see EC2. MCIs are not authorized to take deposits from the public. MCI's operate an alternative funding structure mainly through the issuance of covered bonds (according to section 7(3)).
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	On its homepage, www.Finanstilsynet.dk there is a list of all companies under supervision of DFSA. It is easy to access and it is possible to download a complete list of companies under supervision, or to make a search after specific types of companies.
Assessment of Principle 4	Compliant
Comments	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined is the regulations. The use of the word "bank" in names is clearly defined in the regulations (FBA), and there was sufficient evidence to suggest that there is close supervision by the DFSA of the use of the term "bank". 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. Most recently DFSA has published guidance to industry and the public on crowd funding and peer-to-peer funding models to clarify licensing restrictions and to educate public decision making and behavior.
Principle 5	**Licensing criteria.** The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management)[11] of the bank and its

[10] The Committee recognizes the presence in some countries of nonbanking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

[11] This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms

(continued)

	wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	DFSA has the licensing as well as the supervisory authority for granting and withdrawing banking licenses in Denmark. According to s.7 and s.14 of the FBA, DFSA is responsible for granting a bank license and sections 223 to 225 state that DFSA is responsible for withdrawing a bank license. The Danish Business Authority (DBA) is responsible for registering institutions. The minimum capital requirement for banks is 8 million Euros, and only companies organized as public limited companies can apply the DFSA for a bank license. The DBA's role in the licensing process of a bank is initially to register the company applying for a license as a public limited company. If the assessment by the DFSA of the application leads to the DFSA issuing a license, then the DBA's role is to register the company as a bank. There was evidence that this process worked well in practice between the two organizations. The DFSA has the power to impose prudential restrictions or limitations on newly established banks. For example the DFSA can impose an addition to the solvency requirement of a newly established bank in the authorization letter. The addition can then be removed, when the bank shows that the banks customer portfolio meets the budgets etc. sent to the DFSA in the licensing process. Deficiencies in license applications are generally addressed at the time of licensing where applicant banks are required to meet all the criteria. There was sufficient evidence to suggest that during the licensing process that banks met license conditions and addressed issues associated with the license application to the satisfaction of the DFSA.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	Before DFSA grants a banking license, applicants will be assessed against a defined set of criteria including: capital adequacy; thresholds and standards for fit & proper of board and senior management; and business model analysis. When assessing a license application,

"board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

the DFSA undertakes a thorough assessment of all aspects of the proposed business. The power to request information to assess a license application is prescribed in the FBA (s.14(1) of the FBA), and examples include: articles of association of the undertaking; the size of the share capital (minimum EUR 8 million), and documentation for the payment of the share capital; an opening balance and budgets for the first 3 years, description of the basis for business activities; data systems and connection to a data processing center; the standing orders for the BoD; and information for the assessment of the fitness & propriety of the members of the BoD and BoM.

According to section 14(1) and (2) of the FBA, the following criteria apply to license applications:

1) the undertaking uses the term "bank," "sparekasse" or "andelskasse" in its name (section 7(5)), has a share capital of no less than EUR 8 million (section 7(8)), is organized as a limited company (section 12), and intangible assets are not used to pay for shares in the bank (section 13);

2) members of the board of directors and board of management of the applicant are fit & proper;

3) owners of qualifying interests will not oppose appropriate and reasonable management of the bank;

4) there are no close links between the applicant and other undertakings or persons that could complicate performance of the tasks of DFSA;

5) legislation in another country outside the EU with which the Community has not entered into an agreement for the financial area, regarding an undertaking or person with whom the applicant has close links will not complicate performance of the tasks of DFSA;

6) the procedures and administrative conditions of the applicant are appropriate;

7) the applicant has headquarters and registered office in Denmark; and

8) the application contains all information necessary for the assessment by DFSA of whether the requirements in no. 1-7 have been fulfilled, including information on the size of the qualifying interests and the organization of the undertaking. The application shall also contain information about the nature of the business intended.

The powers in relation to licensing banks are equally applicable to mortgage credit banks. That is, section 14(1) apply to mortgage-credit institutions with the modification that mortgage-credit institutions shall have exclusive right to use words such as ”realkreditinstitut,””realkreditaktieselskab,” ”kreditforening,” or ”realkreditfond” in their name (section 8(5)).

During the application process DFSA examine among other things whether the business plan is sustainable, whether the rules of procedure for the management divide the work between the board of management and the BoD in a sound manner and whether the capital plan is viable. DFSA will perform an assessment of risk management to determine

	whether the control environment is appropriate for the business that is being proposed. Applicants will provide three year projections for key financial data such as profitability and capital adequacy. DFSA will stress budget forecasts and capital plans based on a downturn scenario to determine the sustainability of the business model in the likelihood projections are not achieved. The risk management framework is assessed as part of the licensing process to determine that it is appropriate; however an assessment of the application of risk management policies is not undertaken until the business has been operating. A newly licensed bank will be subject to more intensive supervision in the first two years of business. The competency for assessing license applications is contained within Banking Division 3 which is responsible for supervising small to medium sized banks and the information associated with the application is retained for transfer to the supervisor to be used in routine surveillance. There was sufficient evidence to suggest this was a well controlled process with a clear application of licensing conditions. The average period of assessment from the time of application to the time a license is granted is approximately one year. The power to revoke a license may rest with the Director General of DFSA in accordance with s. 224(1) of the Act on the following grounds: 1) the bank or mortgage-credit institution willfully or repeatedly violates this Act or the Mortgage Credit Loans and Mortgage Credit Bonds, etc. Act, or regulations issued in pursuance of said Acts; 2) the financial undertaking does not meet the requirements of Part 3, cf. However, section 124(2), no. 2 and (3), and section 125(2), nos. 2-4; 3) the bank or mortgage-credit institution fails to commence operation as a financial undertaking no later than 12 months after having been granted a license by the Danish FSA; or 4) the bank or mortgage-credit institution does not carry out financial activities for a period of more than six months. The FBA does not specifically permit the DFSA to revoke a license if the license application is based on false information. However, section 224(1) the DBA does give the DFSA the power to withdraw a license if the criteria in Part 3 is not met. Equally, if the criteria in Part 3 is not fulfilled the DFSA is entitled to reject an application. Finally, according to s. 224(3) of the Act, if a bank or mortgage-credit institution is licensed as a securities dealer under section 9(1), its license may be withdrawn if the conditions of section 224(1) are not adhered to.
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	There was sufficient evidence to suggest that the criteria for issuing licenses are consistent with those applied in ongoing supervision. Section 14(1) and 3 of the FBA gives the DFSA the right to reject applications if the criteria are not fulfilled or if the information provided is inadequate.

	The FBA gives the DFSA the power to reject a license application if the proposed legal and managerial structures of the bank could hinder effective supervision. Section 14(1) of the FBA requires the DFSA to determine, e.g., the suitability of major shareholders, transparency of ownership structure, and source of initial capital. Pursuant to section 14(1) no. 3, of the FBA, the DFSA shall only grant a license when the owners of qualifying interests will not oppose appropriate and reasonable management of the bank or mortgage-credit institution. When assessing a license application, the DFSA will evaluate the quality of policies and procedures and written procedures etc as required by the EO-MC (see paragraphs 2–9 for a full description). The assessment of documentation is performed offsite and then in further detail when onsite if the license is issued. As described above in the answer to EC2, according to the EO-MC, a bank is required to have instructions from the BoD to the BoM, written procedures for significant areas of business, a viable business plan etc. Criteria for issuing licenses are consistent with those applied in ongoing supervision. The licensing criteria are clearly articulated in DFSA licensing procedures maintained by DFSA within a specialist division. The criteria are explained to potential applicants during the initial engagement with prospective applicants. DFSA will actively engage with applicants at the initial stages to clarify minimum expectations of the applicant and provide guidance regarding the application procedure and information necessary to assess the application. Regarding capital there is one exception. According to section 124.-(2) in the Danish FBA, the capital base of banks and mortgage-credit institutions shall constitute no less than 8 percent of the risk-weighted items (the solvency requirement), and EUR 5 million (minimum capital requirement). Undertakings seeking a license as a bank shall have a share capital of an amount corresponding to no less than EUR 8 million according to section 7(8). Pursuant to section 224(1), no. 2, of the FBA, DFSA can withdraw a license if a bank or mortgage-credit institution does not adhere to the criteria applied when issuing the license. DFSA may discover or ascertain such deficiencies during its ongoing supervision which, according to section 346(1), is based on reviews of regular reports and inspections of individual undertakings.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. [2] The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	The DFSA has the power to determine whether the ownership structure of the bank can hinder effective supervision or hinder effective implementation of corrective measures in the future. Section 14(1) of the FBA provides sound legal basis for the supervisor to exercise judgment of whether proposed structures will inhibit effective supervision. The ownership structure for banks in Denmark generally falls into three models: (i) a licensed bank as the holding company at the top of the structure; (ii) a bank is owned by a

	financial holding company (where the holding company only holds shares in financial institutions; and (iii) a non-financial holding company holding shares in a bank. The most common model of ownership is (i) a bank being at the top of the ownership structure and there is only one example of a non-financial holding company owning a bank. During the licensing process, a bank is obliged to provide information on the business plan, the management as well as information on the ownership and legal structure. Based on this information DFSA can estimate whether there is reason to believe that any of this will hinder effective supervision or hinder effective implementation of corrective measures in the future. Pursuant to section 14(1), nos. 3–5, of the FBA, DFSA shall only grant a license under the following conditions: 1) owners of qualifying interests will not oppose appropriate and reasonable management of the bank or mortgage-credit institution; 2) there are no close links between the applicant and other undertakings or persons that could complicate performance of the tasks of DFSA; and 3) legislation in another country outside the EU with which the Community has not entered into an agreement for the financial area, regarding an undertaking or person with whom the applicant has close links will not complicate performance of the tasks of DFSA.
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	In the licensing process the DFSA will perform the same assessment of the natural or legal persons planning directly or indirectly to acquire a qualifying interest of the undertaking applying for a license as in any other case regarding acquisitions of qualifying interest. In these assessments the DFSA will require to see annual reports from any company planning directly or indirectly to acquire a qualifying interest. Furthermore the company is obliged to send in a description of, or a chart of, the entire ownership chain and any group or conglomerate before and after the acquisition and information about the management of the company. Accordingly, DFSA will be able to supervise the suitability of the banks major shareholders and the ownership structure of the bank, and to determine the suitability thereof. When a legal person wants to acquire a qualifying interest, then the company has to fill in an application form for authorization for acquisition of, or increase in, a qualifying interest (legal persons), which can be found at the DFSA's website. Furthermore the application form called, "Assessment of members of the board of directors and management in the acquirer" needs to be completed which contains the necessary information for the DFSA to commence their assessment. Section 61(1) of the FBA provides that any natural or legal person planning directly or indirectly to acquire a qualifying interest of 10 percent or more

	in a bank or mortgage-credit institution shall notify DFSA in advance, and DFSA shall assess the planned acquisition. The same applies to an increase in the qualifying interest which, after the acquisition, results in the interest equaling or exceeding a limit of 20 percent, 33 percent or 50 percent respectively of the share capital or voting rights, or results in the bank or mortgage-credit institution becoming a subsidiary undertaking. According to section 63, DFSA has to be notified prior to any direct or indirect acquisition by a bank or mortgage-credit institution of a qualifying interest in a foreign financial undertaking as well as of such increases in the qualifying interest which mean that said interest comprises or exceeds a limit of 20 percent, 33 percent, or 50 percent, respectively of the voting rights or share capital of the company, or that the foreign financial undertaking becomes a subsidiary undertaking. In its assessment of an application received pursuant to section 61(1), the DFSA makes an assessment of the legal and organizational structure of the undertaking in which the acquisition is intended. The assessment also takes into account the likely influence of the intended acquirer on the undertaking, the suitability of the intended acquirer, and the financial soundness of the intended acquisition. The DFSA performs this assessment against the criteria stipulated in the FBA (s.61a(1), including: 1) The reputation of the intended acquirer. 2) The reputation and experience of the person(s) who will manage the financial undertaking or the financial holding company after the acquisition. 3) The financial situation of the intended acquirer, particularly with respect to the nature of the business to be operated or intended to be operated in the financial undertaking, or the financial holding company in which the acquisition is intended. 4) Whether the undertaking can continue to comply with the supervision requirements in the legislation, in particular whether the group of which the undertaking may become a part has a structure which makes it possible to perform effective supervision and effective exchange of information between the competent authorities as well as to determine how responsibilities are to be divided between the competent authorities. 5) Whether, in connection with the intended acquisition, there are grounds to suspect that money laundering or terrorist financing, (sections 4 and 5 of the Act on Measures to Prevent Money Laundering and Terrorist Financing), will occur. In considering a license application, the DFSA will make all efforts to identify the ultimate beneficial owners (UBOs) involved in the transaction and assess their suitability. There is no prescribed minimum ownership of UBOs in the transaction, and DFSA staff will investigate all corporate structures to ascertain interested parties as part of the licensing process. As part of the analysis of the ownership structure, an assessment will be made regarding the transparency of the structure that is in terms of the organizational structure and lines of business, number of non-operating holding companies and beneficial interests in related

	companies within a group. Trust structures are given particular attention. The DFSA will also look into potential related shareholders in the structures, existence of executive management on related party boards and any side letters or agreements related to exercise of voting rights. When assessing sufficiency of capital support, the FSA perform in-depth analysis of the capital strength of owners and ultimate beneficial owners. Initial capital cannot be borrowed, the funds need to be unencumbered as required in Article 124 of the FBA where banks need to have adequate capital base of a size, type and distribution to cover the risks of the bank. Internal require the FSA to assess that the bank has sufficient capital over the business cycle based on analysis of the business model. The assessors viewed evidence that the focus on assessing shareholder capacity to support the bank either in the case of a change of ownership or change in qualifying interest was conducted.
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	According to sections 7(8) and 8(7) of the FBA, all banks and mortgage-credit institutions must have an initial share capital of at least EUR 8 million paid up. In addition to the minimum capital requirements, when considering a license application the DFSA will place emphasis on assessing adequacy of resources for the newly licensed bank. In performing the assessment of the business model which will determine whether the level of capitalization is sufficient. Adequate resources including capital to absorb unexpected losses is a key criterion for the licensing committee. There was sufficient evidence to suggest that in assessing a license application, the DFSA places considerable emphasis on ensuring adequate financial strength at the time of licensing to absorb losses. The verification of paid up capital included independent confirmation of documentation. For banks whose capital base was less than EUR 5 million on December 18, 1989, the minimum capital requirement constitutes the capital base on December 18, 1989. The total capital base of a bank arising in connection with a merger of two or more banks covered by the 1st clause shall be no less than the total capital base of the merged banks at the time of the merger, if the merged bank does not fulfill the minimum capital requirement under subsection (2), no. 2. Subsection (2), no. 2 states the minimum capital requirement of EUR 5 million. However, a lesser initial share capital is sufficient for savings institutions which pursuant to section 334(2) must have an initial share capital of an amount corresponding to no less than EUR 1 million.
EC7	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank. [3] The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	According to section 14(1), no. 2, of the FBA, members of the BoD and BoM of the applicant must fulfill the requirements in section 64 in order for DFSA to issue a license. This implies a fit and proper evaluation, conducted by DFSA. According to DFSAs

	"Guidelines on requirements in financial legislation for fitness and propriety of members of boards of management and boards of directors," this evaluation is carried out simultaneously with the processing of the application for a license. The Guidelines are enforceable by the FSA. According to section 64 in the Danish Financial Business Act, the fit & proper procedure applies to members of the board of directors and board of management. The DFSA cannot extend the F&P procedures procedures to apply to a broader group of staff (roles such as CFO, CRO, CIO etc). Coming regulation will establish more stringent requirements on SIFI's regarding corporate governance. The fit and proper assessment will hereafter include key managerial positions such as CRO and CIO, etc. Section 64(1) provides that a member of the board of directors and the board of management of a bank or mortgage-credit institution shall have adequate experience in carrying out the duties and responsibilities of such a position. Pursuant to subsection 2, a member of the board of directors and the board of management may not occupy the position as member of the board of directors or member of the board of management in a bank or mortgage-credit institution, if: 1. the person in question is held criminally liable for violation of the Criminal Code or financial legislation, and this violation entails a risk that the duties are not carried out adequately; 2. the person in question has filed for suspension of payments, is administered in bankruptcy, has filed for debt restructuring, or negotiations have been initiated with regard to compulsory composition for said person; 3. the financial situation of the person in question or companies owned by the person in question or companies where the person in question participates in their operation have caused losses or risks of losses for the bank or mortgage-credit institution; or 4. the person in question has behaved such that there is reason to assume that said person cannot perform the duties and responsibilities of such position adequately. According to the guidelines, members of the board of directors and board of management of banks and mortgage-credit institutions must submit information on former and current memberships of boards of directors and boards of management within the last 10 years, both within and outside the financial sector, and other duties within the financial sector. For members of boards of directors, the information period is five years. This information will be used as a basis for the assessment by DFSA as to the relevant experience of the members in question. Information on whether undertakings where the member of the board of directors or the board of management is participating or has participated in the management are or have been in suspension of payments or bankruptcy proceedings and whether such undertakings currently or previously instituted negotiations for a compulsory composition.

	This information will be used as a basis for assessment of whether the relevant person, in behavior or duties, has previously behaved in such a way that there is reason to assume that the person cannot perform the du-ties and responsibilities of such position adequately Information on whether there are close links between the member of the board of directors or the board of management and the undertaking for which an information form has been submitted, or between the member of the board of directors or the board of management and other undertakings or persons with close links to the undertaking. In assessing the fit and proper of the board, the DFSA will determine whether the BOD collectively has adequate knowledge and experience regarding the risks associated with running a bank to ensure a sound management of the company. In practice, when assessing license applications, the DFSA will assess whether the collective board has adequate skills commensurate with the business model and risk profile of the bank. For example, if the bank has a large commercial real estate portfolio, then the board will need to demonstrate this type of expertise (see EO on Management and Control paragraph 3).
EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.[4]
Description and findings re EC8	When applying for a license, one of the conditions for assessment is for the applicant to demonstrate written procedures for significant areas of business etc. The EO on Management and Control require banks to have written procedures for all material key (paragraph 9(1)–9(7)). The EO also requires policies and procedures for corporate governance, risk management and internal control. In light of this, the DFSA assess corporate governance, internal control and risk management of the undertaking applying for a license in the licensing process. The same applies to mortgage-credit institutions. According to Guidelines on banks under intensified supervision, DFSA is obligated to perform at least one extra and relevant supervision activity within the first two years in newly licensed banks. The newly licensed bank cannot be removed from intensified supervision until after this activity. The newly licensed bank shall at least be under intensified supervision in one year. An application for a license to operate as a bank or mortgage-credit institution shall, pursuant to section 14(2), contain all information necessary for the assessment by DFSA of whether the requirements in section 14(1) have been fulfilled, including information on the size of the qualifying interests and the organization of the undertaking. The application shall also contain information about the nature of the business intended e.g. lines of business, customer profile, funding structures etc.

[4] Please refer to Principle 29.

	According to the Commentary in section 14 of the FBA and the DFSAs rules of procedures for issuing licenses, DFSA will demand and examine information on, inter alia, the applicant's articles of association, a description of the basis for business activities, the standing orders for the board of directors, the instruction from the board of directors to the board of management, the written procedures for significant areas of business and the size of the share capital as well as documentation of the payment hereof. DFSA will, consequently, consider whether the bank has an appropriate system of corporate governance. Based on the review of the obtained information DFSA will ensure that the bank or mortgage-credit institution is a viable business, based on sound strategic and operating plans.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	DFSA require that the budget for a three-year period is presented by the applicant (section 14 FBA). DFSA examine the budget in order to ensure that the bank can demonstrate adequate financial resources over this period and critically evaluates whether the budgets are realistic by testing assumptions of customer acquisition and net interest revenue in the context of a competitive environment. Macroeconomic conditions are taken into account (currently banks experience low RoE and NIM compression due to competition for deposits and low interest rates). The DFSA will also require stressed versions of the budget, and these versions are also a part of the DFSA's examination regarding whether the budgets are sustainable under various adverse scenarios. Requirements in the FBA oblige supervisors to place emphasis on the sustainability of a banks' business model and there was evidence to suggest that the license process gave adequate attention to this criteria. According to section 14(1), no. 3 of the Act, DFSA will only issue a license if owners of qualifying interests will not oppose appropriate and reasonable management of the bank or mortgage-credit institution, cf. section 61. This requirement implies, for example, that DFSA will refuse the application if the owners during ownership or as members of boards of directors or boards of management of other financial undertakings have proved to be incapable of running a financial undertaking in an economically reasonable fashion, see Commentary to section 14 of the FBA. According to the rules of procedures for issuing licenses, before issuing a license the DFSA will obtain and review documentation for the size and payment of the share capital as well as the opening balance and a three year budget for the applicant. Also in the control carried out according to section 61a (1) DFSA will assess the adequacy of the financial strength of the principal shareholders of the bank in order to ensure the financial stability of the bank.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.

Description and findings re EC10	Pursuant to section 30(1) of the FBA, a foreign undertaking which has been granted a license to carry out the activities mentioned in sections 7 (banks) and 8 (mortgage-credit institutions) in another country within the EU or in a country with which the Community has entered into an agreement for the financial area, may begin carrying out activities in Denmark through a branch two months after DFSA has received notification from the supervisory authorities of the home country. It is not necessary for a foreign bank to obtain a license before carrying out activities in Denmark, if they already have a license in their home country. Accordingly, DFSA does not issue such a license, and does not obtain a statement of no objection from the home supervisor. But there is an extended communication between DFSA and the home country with regard to the intended activities of the foreign bank, the business plan, the capital requirements, the management etc. Regarding credit institutions outside the EU where no agreement has been entered into, section 1(1) of "EO on the authorization procedure for foreign credit institutions which have been authorized in a country outside the EU with which the Community has not entered into an agreement for the financial area and which intend to carry out investment service in Denmark" (no. 1183 of December 6, 2004) provides that foreign credit institutions which have been authorized in a country outside the European Union with which the Community has not entered into an agreement for the financial area and which is under supervision from the supervisory authorities of the home country can, with the license of DFSA, carry out activities as a credit institution through a branch in Denmark. In this situation, the normal rules regarding issuing a license applies.
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	According to procedures on institutions under intensified supervision ("skærpet tilsyn") all new entrants shall be under extra supervision. Accordingly, DFSA will carry out at least one extra relevant supervisory activity during the first two years. Also the new entrant cannot be removed from extra supervision before this activity has been carried out and all new entrants must be under extra supervision for at least one year. The DFSA demonstrated this process was adhered to.
Assessment of Principle 5	**Compliant**
Comments	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. Furthermore there have been numerous inquiries regarding the matter. 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. All aspects of the proposed business model is critically evaluated including structure of the organization, governance arrangements, risk management such as policies and processes and other quantitative aspects. The DFSA performs multiple offsite examinations to test the preparedness of the applicant in terms of systems and processes to be satisfied that the bank is ready to become licensed and that the application meets criteria.

Principle 6	**Transfer of significant ownership.** The supervisor[12] has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest".
Description and findings re EC1	According to the FBA, the term "qualifying interest" is used to refer to "significant ownership" and "controlling interest". Section 5(3) of the FBA defines "qualifying interest" as direct or indirect ownership of 10 percent or more of the capital or voting rights or ownership of an interest which provides the opportunity for exercising significant influence on the management of the financial undertaking or the financial holding company. Significant influence is defined in section 5b (1) in the FBA as the authority to control the financial and operating decisions of a subsidiary undertaking. According to section 5b(2) controlling influence in relation to a subsidiary undertaking exists when the parent undertaking, directly or indirectly through a subsidiary undertaking, owns more than one-half of the voting rights in an undertaking, unless, in exceptional circumstances, it can be clearly demonstrated that such a ownership does not constitute controlling influence. Section 5b(3) states that where a parent undertaking holds no more than one-half of the voting rights in an undertaking, controlling influence exists if the parent undertaking has: • the power to exercise more than one-half of the voting rights by virtue of an agreement with other investors, • the power to control the financial and operating policies of an undertaking pursuant to the articles of association or an agreement, • the power to appoint or remove the majority of the members of the supreme management body, and this body has controlling influence on the undertaking, or • the power to exercise the actual majority of votes at the general meeting or an equivalent body and thus hold actual controlling influence of the undertaking. Furthermore section 5b(4) states that the existence and effect of potential voting rights, including rights to subscribe for and purchase equity investments that are currently exercisable or convertible, shall be taken into account when assessing whether an undertaking has controlling influence, and accordingly to section 5b(5) in the FBA, any voting rights attaching to equity investments owned by the subsidiary undertaking itself or by its subsidiary undertakings shall be disregarded in the determination of the voting rights in a subsidiary undertaking. Shares will be aggregated if a natural or legal person is acting in understanding with each other.

[12] While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	The regulations define significant ownership and controlling interest in a way that includes a quantitative threshold of 10 percent as well as several scenarios which could be perceived as a bank or party exercising effective control and ownership. The definition of qualifying interest in the FBA is therefore sufficiently broad for DFSA to capture a range of scenarios where a bank or other party proposes to acquire an ownership stake or interest in a bank which could have the potential to exercise influence over the running of the bank. There have not been examples where DFSA has been asked to interpret ownership activities under 5b (3).
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	In the event of a change in ownership of a domestic bank, approval of DFSA is required; whereas in the case of a change in ownership of a foreign undertaking, only prior notification is required (direct or indirect acquisition by a bank or mortgage-credit institution of a qualifying interest in a foreign financial undertaking approval is not required). The FBA defines qualifying interest as the threshold trigger for prior notification and approval under both scenarios. The thresholds for approval and notification are the quantitative limits of 10 percent, 20 percent, 33 percent and 50 percent and the more subjective characteristics of qualifying interest specified under Section 5b(3) of the FBA. There is no definition of ultimate beneficiary owners in the FBA. The FBA does not contain the power to apply formal conditions when approving a change in qualifying interest. In practice, DFSA will negotiate changes to various aspects contained in the application if it is not comfortable with a certain feature. Ultimately, if DFSA will not approve an application for a change in qualifying interest unless it is satisfied with the features and structure of the application. Section 61(1) in the FBA states that any natural or legal person or natural or legal persons acting in understanding with each other, planning directly or indirectly to acquire a qualifying interest in a financial undertaking or a financial holding company shall apply to the DFSA in advance for approval of the acquisition planned. The same shall apply to an increase in the qualifying interest which, after the acquisition, results in the interest equaling or exceeding a limit of 20 percent, 33 percent or 50 percent respectively of the share capital or voting rights, or results in the financial undertaking or the financial holding company becoming a subsidiary undertaking. Pursuant to section 61(2), acquisition or increase of the interest mentioned in subsection 1 shall only be approved when approval is not contrary to ensuring appropriate operation of the bank or mortgage-credit institution. Owners of capital holding an interest of at least 10 percent, and who intend to reduce said interest so that it falls below one of the limits stipulated in subsection 1, shall notify DFSA and state the size of the intended future interest (subsection 6). Finally, section 61(7) states that where a bank or mortgage-credit institution learns of acquisitions or sales as specified in subsections 1 and 6, said undertaking shall

	immediately notify DFSA. Similarly, subsection (2) provides that banks or mortgage-credit institutions holding an interest of no less than 10 percent in a foreign financial undertaking, and which intend to reduce said interest so that it falls below one of the limits mentioned in subsection (1) shall notify DFSA and state the size of the intended future interest. According to the Guidelines on requirements for approval of owners of qualifying interests, the DFSA will in the approval process focus on the whether the planned acquisition is contrary to ensuring appropriate operation of the bank or mortgage-credit institution. This is also stated in section 61(2) of the FBA. During the approval process the applicant must deliver the documents mentioned in the publicly available template regarding approval of acquisition or increasing of qualifying interests. The amount of documentation needed to support the application can vary with the size of the qualifying interest as well as the size, scale and complexity of the bank involved. In practice, DFSA will be in contact with interested parties seeking to transfer or acquire a significant interest in a regulated entity. In this way, DFSA ensures that the application process is approached in a thorough a rigorous way. A dedicated team with the supervisory unit (Banking Division 3) will assess all applications for a change in qualifying interest (as well as License applications, merger and acquisitions and change of control. The delegated authority to approve a change in qualifying interest rests with DFSA as per the FBA. After the relevant team in Banking Supervision assesses the application, a recommendation can be submitted to the Director General for approval.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	Section 61(3) of the FBA provides DFSA with the power to approve or refuse a projected acquisition: "The DFSA may refuse an application for approval of an intended acquisition, if, on the basis of the criteria mentioned in s.61a (i)–(v) there are reasonable grounds to believe that the intended acquirer will hinder sensible and proper management of the undertaking. There are five criteria in Section 61.a including: (i) the reputation of the intended acquirer, (ii) reputation of the management planning the change in qualifying interest, (iii) the financial soundness of the bank; (iv) continued compliance with the FBA; and (v) connection with AML/CFT. Indirect ownership situations are addressed when a company applies for approval of an acquisition to buy a qualifying interest. The DSFA will receive information about the company applying. This will be received in form of prints from the Danish Business Authority stating the members of the board directors and board of management of the company. Furthermore when a company applies for approval of an acquisition to buy a qualifying interest an application form must be filled out. The application form can be found on the

	DSFA's website, and is named "Application form for authorization for acquisition of, or increase in, a qualifying interest (legal persons)." One of the requirements in the application form is, that a description of, or a chart of, the entire ownership chain and any group or conglomerate before and after the acquisition is attached to the application. There is a form for natural persons. DFSA has approved ten transfers of significant ownership in the past five years (over 50 pct.). In the past five years there have not been any denials for requests for transfer of significant ownership. There have, however, been two cases where the applicant has withdrawn the application. In this case, the applicant withdrew the application after DSFA had sent the DSFA's draft of decision that was to be submitted to the Financial Council who makes decisions in matters of a principle nature or of far-reaching significance. The DSFA's recommendation to the Financial Council in this case was to deny the application. Where owners of capital holding one of the interests mentioned in section 61(1) in a bank or mortgage-credit institution act contrary to appropriate operation of said undertaking or holding company, DFSA may, pursuant to section 62(1) of the Act, order said undertaking to follow specific guidelines made by DFSA and withdraw the voting rights associated with the holdings of the relevant owners. According to section 62(2), DFSA may also withdraw the voting rights associated with holdings owned by natural or legal persons who do not comply with the duty to submit to DFSA prior notification of a change in qualifying interest mentioned in section 61(1). Section 61(1) in the Danish Financial Business Act also states that any natural or legal person, or natural or legal persons acting in understanding with each other, planning directly or indirectly to acquire a qualifying interest, cf. section 5(3), in a financial undertaking or a financial holding company shall apply to the DFSA in advance for approval of the acquisition planned. The same shall apply to an increase in the qualifying interest which, after the acquisition, results in the interest equaling or exceeding a limit of 20 percent, 33 percent or 50 percent respectively of the share capital or voting rights, or results in the financial undertaking or the financial holding company becoming a subsidiary undertaking. Such specific guidelines, in what form they may be, will have the purpose of re-establishing a sound and reasonable development for the undertaking in question. As an example, if the said owner during ownership or as a member of the BoD or BoM of another undertaking has proved to be incapable of carrying out a business in a financially reasonable manner, e.g. if the owner has been convicted of an economic crime, DFSA may withdraw his voting right.
EC4	The supervisor obtains from banks, through periodic reporting or onsite examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.

Description and findings re EC4	According to section 61c(2) of the FBA, banks or mortgage-credit institutions shall, no later than February each year, submit information to DFSA of the names of the owners of capital who own qualifying interests in the bank or mortgage-credit institution as well as information on the sizes of said interests. The supervisor will compare the list of shareholders to the previous year to identify potential changes in qualifying interests. If there are new names on the list of significant shareholders, the supervisor will make necessary investigations with the bank and through other sources. It is unusual in Denmark for custodians, trusts or nominees to have ownership of Danish banks. The other source of analysis of a bank's share register is during onsite examinations where the supervisor will perform a similar analysis. There is an ongoing obligation for the bank to inform DFSA of changes in its share registry of significant shareholders under section 61(c).
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	In the first instance, DFSA has the power to refuse a change of control. In the event a change of control takes place without the approval of DFSA, it can withdraw the voting rights of the shareholder through section 62(1). While the DFSA can withdraw the voting rights, it cannot however, reverse the change in significant ownership. According to section 61(3) of the FBA, DFSA can approve or refuse a projected acquisition. Where owners of capital holding one of the interests mentioned in section 61(1) in a bank or mortgage-credit institution act contrary to appropriate operation of a bank, MCI or holding company, DFSA may make orders to follow specific guidelines made by DFSA and withdraw the voting rights associated with the holdings of the relevant owners. According to section 62(2), DFSA may also withdraw the voting rights associated with holdings owned by natural or legal persons who do not comply with the duty to submit to DFSA prior notification mentioned in section 61(1). The powers of the DFSA do not permit it to reverse a change of control. The DFSA can withdraw voting rights which mitigates potential influence, but a change of control cannot be reversed.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	Banks are required to inform DFSA about changes in the ownership structure of the bank as soon as the bank has the knowledge, section 61c (1). But there is no 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.
Assessment of principle 6	Largely compliant
Comments	The definition of qualifying interest in the FBA is sufficiently broad for DFSA to capture a range of scenarios where a bank or other party proposes to acquire an ownership stake or interest in a bank which could have the potential to exercise influence over the running of the bank. Supervisors use the rules consistently and with good effect and assessment processes are robust.

	Significant ownership is clearly defined in legislation. The regulations define significant ownership and controlling interest in a way that includes a quantitative threshold of 10 percent as well as several scenarios which could be perceived as a bank or party exercising effective control and ownership (although there have not been examples where DFSA has been asked to interpret ownership activities under 5b(3)). The legislation provides formal triggers for DFSA approval for movements in the share registry at 10, 33 and 50 percent which allows the DFSA to review changes in ownership of existing owners. There are, however, some weaknesses in the rules: • 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 contained within the FBA, restrict the flexibility of DFSA to respond to a change in control if the shareholder acquires a shareholding without approval. • There is no definition of ultimate beneficial owners in the FBA. Implication for exercise of powers if there is no definition with the FBA whether DFSA could enforce its powers to a change in a UBO. • While banks are required to inform DFSA about changes in the ownership structure of the bank as soon as the bank has the knowledge, there is no 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. • The ability to successfully apply the DFSA's powers of a change of control in a FHC (under Section 63 of the FBA because the DFSA only receives notifications) is uncertain and remains untested.
Principle 7	**Major acquisitions**. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	Prior notification and prior approval is required by the DFSA for major acquisitions according to the powers in the FBA sections 61 and 63, if there is a change in a qualifying interest (i.e. 10 percent) up to 20, 33 and 50 percent. The financial undertaking or financial holding company shall submit prior notification to the DFSA before making any changes in conditions of which notification has been submitted pursuant to subsection (3), nos. 1-4. In

	the event that the financial undertaking or the financial holding company has no prior knowledge of such changes, notification shall be submitted to the DFSA immediately after said financial undertaking or financial holding company has received notification of such change. The qualifying interest rules make a distinction however, in regard to cross-border operations which only require prior notification as opposed to an approval. Section 63 (1)–(4) in the FBA that The DFSA shall be notified prior to any direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest (qualifying interest is defined as 10 percent ownership or voting rights as per the FBA) in a foreign financial undertaking as well as of such increases in the qualifying interest which mean that said interest comprises or exceeds a limit of respectively 20 percent, 33 percent and 50 percent, respectively of the voting rights or share capital of the company, or that the foreign financial undertaking becomes a subsidiary undertaking. Such notification shall include information on the country in which such an undertaking is established. The implication is that in the circumstance where a bank supervised by the DFSA seeks to make an investment in a foreign asset, an approval by DFSA is not required under the FBA. This limits the DFSA's ability to intervene prior to the investment in the circumstance where the investment is large and potentially changes the risk profile of the acquiring bank. The DFSA can take action to discourage the acquisition, but it cannot reject. The remedies the DFSA can rely upon in a circumstance where it becomes concerned regarding a foreign acquisition include: • apply Section 350 of the FBA which allows the DFSA to instruct the bank to restructure; • adjust capital requirements; and • dismiss the BoD. Financial undertakings and financial holding companies holding an interest of no less than 10 percent in a foreign financial undertaking, and which intend to reduce said interest so that it falls below one of the limits mentioned in subsection (1) shall give the DFSA notification hereof and state the size of the intended future interest. Where the foreign financial undertaking becomes a subsidiary undertaking, the notification to the Danish FSA shall include the following information on the subsidiary undertaking: 1) the country in which the subsidiary undertaking is to be established, 2) a description of the business to be carried on by the subsidiary undertaking, including information on its organization and planned activities, 3) the address of the subsidiary undertaking, and 4) the names of the management of the subsidiary undertaking.
EC2	Laws or regulations provide criteria by which to judge individual proposals

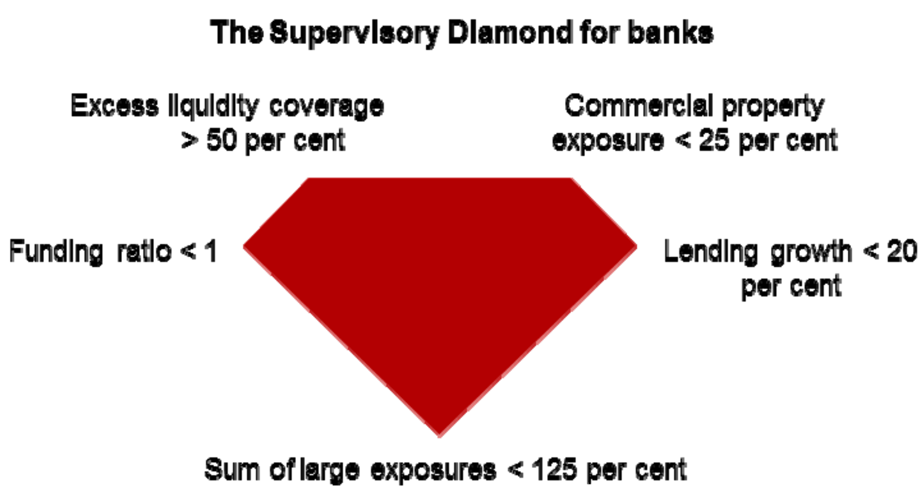
Description and findings re EC2	According to 61(1) of the FBA, any natural or legal person planning directly or indirectly to acquire a qualifying interest of 10 percent or more in a bank or mortgage-credit institution shall notify The Danish FSA in advance, and the Danish FSA shall approve the acquisition in accordance with the requirements of Section 61a (1) cf. EC 1 above. According to section 61a (1) In its assessment of an application received pursuant to section 61(1), the Danish FSA shall ensure that account is taken of sensible and proper management of the undertaking in which the acquisition is intended. The assessment shall also take into account the likely influence of the intended acquirer on the undertaking, the suitability of the intended acquirer, and the financial soundness of the intended acquisition in relation to the following criteria: 1) The reputation of the intended acquirer. 2) The reputation and experience of the person(s) who will manage the financial undertaking or the financial holding company after the acquisition. 3) The financial situation of the intended acquirer, particularly with respect to the nature of the business to be operated or intended to be operated in the financial undertaking, or the financial holding company in which the acquisition is intended. 4) Whether the undertaking can continue to comply with the supervision requirements in the legislation, in particular whether the group of which the undertaking may become a part has a structure which makes it possible to perform effective supervision and effective exchange of information between the competent authorities as well as to determine how responsibilities are to be divided between the competent authorities. 5) Whether, in connection with the intended acquisition, there are grounds to suspect that money laundering or terrorist financing, cf. sections 4 and 5 of the Act on Measures to Prevent Money Laundering and Terrorist Financing, will occur. The criteria provided for in the FBA are sufficiently broad to permit the DFSA to consider a cross section of potential risks associated with a major acquisition. Due to the fact that any direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest in a foreign financial undertaking according to section 63 (1) is subject only to prior notification, no approval procedure takes place according to section 63. Although no direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest in a foreign financial undertaking according to section 63 (1), is subject to prior approval by the Danish FSA, the Danish FSA may order financial institutions to undertake measures to comply with the Financial Business Act in its entirety. For example, The Danish FSA may, in accordance with section 350 (1) order that a financial undertaking to take the measures necessary within a time limit specified by the Danish FSA, if: 1) the financial position of the undertaking has deteriorated to such a degree that the interests of the depositors, the insured parties, the bond owners, the investment associations, the special-purpose associations, the approved restricted associations,

	the hedge associations, other collective investment schemes or other investors are at risk; or 2) there is a not insignificant risk that, because of internal or external conditions, the financial position of the undertaking will develop so that the undertaking loses its license. In accordance with section 350 (2), if the measures ordered have not been taken within the time limit specified, the Danish FSA may withdraw the undertaking's license.
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.[13] The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision.
Description and findings re EC3	No direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest in a foreign financial undertaking according to section 63 (1), is subject to prior approval by the Danish FSA, the Danish FSA may order financial institutions to undertake measures to comply with the Financial Business Act in its entirety. For more information please see EC 2. As to any natural or legal person planning directly or indirectly to acquire a qualifying interest of 10 percent or more in a bank or mortgage-credit institution According to 61(1), (please also see EC 2). Two separate powers are needed: the power prior to a proposal for a change in significant ownership and a power after if information was false. In relation to the first power to reject an application, section 61(3) of the FBA provides the DFSA the power to refuse an acquisition. The DFSA performs a comprehensive assessment on a detailed set of information. A detailed assessment of the Host country is performed. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis. In the event a bank supervised by the DFSA makes a foreign acquisition, approval by the DFSA is not required under the FBA. In this instance, the lack of a need for formal approval has the potential to limit the DFSA's ability to exercise its power if it arrives at an assessment that the host supervisor does not perform consolidated supervision as required by this criterion. Deficiency in the powers is problematic to fully satisfy this criterion.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and	In its assessment of the application, the DFSA will determine if the bank has adequate

[13] In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

findings re EC4	financial, managerial and organizational resources to handle the acquisition as required under section 61a (1) of the FBA (also see EC2). In assessing a major acquisition, the DFSA emphasizes the sustainability of the business model to ensure the acquisition has adequate financial resources so as not to pose risks to the individual banks or the system. To make this assessment the DFSA collects a wide range of financial information such as projections and budgets which it then critically evaluates the assumptions supporting the projections and applies various stress scenarios to determine whether the business model could absorb worse conditions than built into the financial projections. In addition to analysis of the adequacy of resources, the supervisor will assess whether there is sufficient management expertise and skill to effectively manage the risks of the acquirer. This assessment includes not only the sufficiency of resources, but the experience and expertise of management and organizational structure. Upon receipt of the application of a major acquisition, the DFSA will establish a team comprised of a cross section of staff to assess the application. DFSA representatives will have specialist knowledge of banking issues as well as legal, risk and financial skills. The team will be led by a Director General and will be submitted to the Committee. Established internal procedures for assessing a major acquisition. To make an assessment of the managerial and organizational resources, the DFSA will firstly assess the combined size, scale, complexity and risk of the acquisition. In doing so, the DFSA will meet with management and risk personnel. Nature of the operations to be acquired is a key focus for the assessment team to understand management stretch, oversight responsibilities and governance. The application will include detailed projections of resources and asset growth which will form the base for the assessment team to critically review. The team applies base case and stretch case to the resource projections. The risk assessment of management by the relationship manager is used as an input into the assessment and is updated where necessary.
EC5	The supervisor is aware of the risks that nonbanking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in nonbanking activities.
Description and findings re EC5	The responsibility for supervising insurance, pension and markets activities rest with dedicated teams within the DFSA. The responsible banking supervisor will liaise regularly with responsible supervisors within the DFSA in regards to group risks in both formally structured processes and on an ad hoc basis. Where a bank has material cross-border operations and supervisory colleges are held, it was evident that nonbank risks are discussed. In terms of non-financial activities within the group, it is the obligation of the bank to advise the DFSA if activities ancillary to banking. The supervisor will make an assessment of the activities and act accordingly. Nonbank activities undertaken by banks have typically been involved in real estate brokerage firms. The FBA has a maximum threshold of direct property of 20 percent. According to section 147 (1) of the FBA, banks, mortgage-credit institutions, investment firms and investment management companies may not own real property or hold equity investments in property companies amounting to more than 20 percent of the capital base. The real property of

	banks and mortgage-credit institutions shall include loans and guarantees to subsidiary companies that are property companies. Properties acquired by a bank, mortgage-credit institution, investment firm, or investment management company in order to carry out main or ancillary activities shall, however, not be included in these provisions. DFSA does not approve the establishment of subsidiaries of a bank, unless the subsidiary is applying for a banking license or other license issued by it.
Assessment of Principle 7	**Largely Compliant**
Comments	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. For major acquisitions of domestic banks, the power to approve or reject is embodied in the FBA and provides the DFSA with sufficient powers to assess the risks of a major acquisition based on a sufficiently broad set of criteria. If the acquisition exhibits excessive risk to the acquirer or system the DFSA has the power to reject the application. The power to impose prudential conditions on an acquisition is not contained in the legislation, which is a gap in regards to this Core Principle. In practice, when assessing a major acquisition, the DFSA will not approve an application unless it is satisfied that all criteria are fulfilled. The DFSA uses prescribed criteria to assess major acquisitions clearly set out in legislation. The assessment against criteria will take into account the likely influence of the intended acquirer on the undertaking, the suitability of the intended acquirer, and the financial soundness of the intended acquisition. The assessment process undertaken by the DFSA thoroughly assesses the impact of the acquisition on the acquirer taking into account a variety of scenarios. The qualifying interest rules make a distinction however, in regard to cross-border operations which only require prior notification as opposed to an approval. Section 63 (1)–(4) in the FBA that the DFSA shall be <u>notified</u> prior to any direct or indirect acquisition by a financial undertaking or a financial holding company of a qualifying interest (qualifying interest. The implication is that in the circumstance where a bank supervised by the DFSA seeks to make an investment in a foreign asset, an approval by DFSA is not required under the FBA. This limits the DFSA's ability to reject as opposed to discourage a potential foreign acquisition.

Principle 8	**Supervisory approach**. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.
Description and findings re EC1	The DFSA assesses on an ongoing basis the risks that banks are exposed to and the soundness of the banking system. An overarching element of the framework is the use of a so-called Supervisory Diamond to constrain firms to operating within prudential limits in dimensions that can be associated with undue risk-taking. The Supervisory Diamond builds in prudential parameters for the sum of large exposures, lending growth, commercial property exposure, a funding ratio, and excess liquidity coverage. 

	The Supervisory Diamond has been designed to limit the range of acceptable business models that firms can use. Changes have been made in the Diamond as a result of external developments such as the adoption of the Liquidity Coverage Ratio, and the DFSA shows some openness to reviewing the parameters as necessary over time. The industry representatives with whom the assessors met were generally supportive of the Diamond, including its current parameters, although questioning whether in a recovering economic time the parameter on loan growth could be problematic. The intensified focus on the viability of business models is a key lesson learned from the crisis. Supervision of individual institutions is organized as follows: Bank Division I—concerning the largest five banking organizations; Bank Division II—regarding medium sized banks; Bank Division III—regarding the small banks; Operational Risk Division—including some market risk specialists in charge of overseeing three specialized banks, most importantly, Saxo Bank; Mortgage Credit Division—overseeing the mortgage credit institutions; Banking Analysis Division—collecting regulatory reports and preparing regulatory analyses for the use of the other divisions. Furthermore an internal SIFI-analysis unit has been established as a result of the regulation of SIFIs in Denmark. The unit is tasked with performing horizontal analysis of Danish SIFIer, including benchmarking their performance and perceived risks with their relevant peers. The purpose of the work of the unit is to supplement the ordinary supervisory approach applied for the SIFIs, including highlighting areas to be further examined. The establishment of the SIFI-analysis unit is part of the general enhancement of the supervision of the Danish SIFIs. There is a well-developed process for assessing risks of individual banking institutions that takes place annually, largely during the spring of each year, prior to the approval of the annual schedule of inspections, that run from July 1 to the following June 30. Much of the risk assessment work is done by the responsible banking division, aided by the analytical work of the Bank Analysis Division. The assessors were advised that while the assessments were not generally formally updated during the year, they are reviewed as conditions warrant. The responsible banking division reviews relevant information from inspection reports, regulatory and Annual reports, the heavily relied-upon ICAAP process, the Audit books of each of the Internal and External auditors, and the Joint Risk Assessment Decisions (JRAD) if applicable, and material prepared for the annual meeting (if applicable) among other sources as key inputs into the Supervisory Review and Evaluation Process (SREP). The SREP process in turn feeds into the ultimate risk assessment process. The Risk Assessment begins with a mechanical slotting by the Banking Analysis Division into one of five categories and then involves the relevant banking division modifying the risk assessment up or down based on its knowledge of the specific institution. The Risk Assessment is then used as an input in developing the inspection schedule, which commences on July 1 of each year. The assessors were advised that the risk assessment is an important element in the scheduling of inspections of medium and small banks but is much less likely to be the driver of the scheduling of inspections of the largest banks (which are better known by their supervisors).

EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	The DFSA focuses strongly on analysis that can help the supervisors to understand the risk profile of banks and banking groups. There are ongoing processes to assess risks in absolute terms and relative to other Danish banks; this includes a specific effort to highlight banks that have profiles that deviate from relevant peers due to a specialized business model, or simply because condition and performance makes them stand out from relevant peers on specific parameters (weak performance with respect to core earnings, asset quality, or larger impairments than peers among other considerations). The risk assessment model (alluded to in EC 1) is intended to be forward-looking in its conceptual composition. The model scores and ranks undertakings on stressed key risk parameters and on excess solvency coverage under more adverse economic conditions. That first cut, done by the Banking Analysis Division, is then, as noted in EC 1 by relevant supervisors within a banking division and can be changed on the basis of their more direct understanding of the specific firm. Not only does this risk assessment form the basis for planning various inspections, it is also used as a basis for decisions regarding other supervision activities, including reporting requirements or calls to initiate supervisory dialogue. A key element within the risk assessment is the stress tests carried out within the Banking Analysis Division. The stress tests are designed to identify which banks might come into trouble in different stress scenarios. The DFSA usually assesses three scenarios in its stress tests covering the expected base-line macroeconomic development, a mild stress scenario of slightly worsened macroeconomic conditions and a hard stress scenario with considerably more negative macroeconomic assumptions. The planning of supervisory activities take the stress test results into account, e.g. the DFSA might consider initiating a dialogue or changing prioritization of onsite inspections for banks where the stress tests results come out negative.
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	The DFSA reviews required financial filings to ensure that each bank meets its relevant regulatory requirements. The banks are held responsible for complying with all rules, but The supervisors particularly focus on those parts of the regulation particularly relevant for the main risks of a specific bank (which typically includes strong focus on capital requirements).
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in nonbank financial institutions, through frequent contact with their regulators.

Description and findings re EC4	As discussed in EC2 above, the DFSA conducts stress tests which take the actual and the possible macroeconomic developments into account. Moreover, the economic growth and other relevant macroeconomic variables are followed, analyzed when deemed relevant, and communicated to the banking supervisors at internal DFSA meetings. Moreover, relevant DFSA staffs working in different supervisory areas (banking, insurance, pension funds, etc.) cooperate closely and exchange information when relevant. This is especially the case for banking groups which have different activities such as banking, mortgage credit activities and pension funds as part of their business model.
EC5	The supervisor, in conjunction with other relevant authorities, identifies monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	A Systemic Risk Council was set up in Denmark in June 2012. The Council is charged with monitoring and identifying systemic financial risks in Denmark and with issuing observations, warnings and recommendations regarding macro prudential concerns and the buildup of systemic risks. There is also a well established and regular dialogue with DB on financial stability matters. In addition, the DFSA conducts analysis and monitoring of risks, trends and concentrations in the banking sector taking a broad perspective where a number of relevant risks are considered (solvency, structure of capital and funding, liquidity, concentration risks etc.). Serious threats as well as expected challenges ahead (for instance due to new regulations) are communicated both to individual banks and to the public on an ongoing basis. In various instances, the risks and challenges identified are incorporated in supervisory activities onsite or offsite depending on the depth and seriousness of the challenges identified. Supervisory actions could include onsite inspections, dialogue with banks that are identified as banks challenged by a concrete threat, and offsite monitoring of reports or thematic reviews. However, the framework of approach to onsite examinations reduces the timeliness with which issues can be discerned from onsite work even for larger banks, although the issue is starker with the smaller banks. There is more flexibility with the largest banks, such as Danske Bank; they are subject to at least a targeted examination annually, and a number of specific follow-ups that are carried out from time to time. Medium-sized and smaller banks are subject to a much more extended cycle—our years for the most well-capitalized medium-sized banks and up to six (or occasionally more) years for the smallest and most well-capitalized banks. The assessors' review of the Division 3 plan for 2013 showed one or

	more banks with each of 2005 and 2006 as the most recent previous inspection. In addition to the communication to the banks and the public, the DFSA discusses risks and challenges in the financial sector (especially in the banking sector as the banks have been challenged by the financial crisis to a larger extent than insurance companies, pension funds and other types of financial firms under supervision) with other relevant Danish authorities. The authorities are in the process of implementing the CRD IV/CRR regulation with respect to macroprudential tools and systemic risks in cooperation with other relevant authorities (for instance the Systemic Risk Council) This work supports the current supervisory approach in Denmark as the basic thinking behind the CRD IV/CRR is an integrated part of the supervisory practice already.
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	While the DFSA has extensive experience in dealing with the resolution of failing banks (and has handled them successfully) and has instructed banks on information availability at time of resolution, it has not yet implemented individual resolution plans for large banks. In accordance with section 245 a of the FBA, the DFSA has issued an EO on resolution that provides that: 1) all banks shall ensure that they have effective case procedures and systems which ensure that the individual bank is prepared and within 24 hours can produce the necessary statements and information about the deposit and loan accounts, pension custody accounts, etc. of the bank, in the event that the DFSA has stipulated a time limit in context of withdrawal of licenses. 2) the DFSA shall lay down more detailed regulations on the measures and systems necessary to ensure that the bank can take the required initiatives in the event that the DFSA has stipulated a time limit in context of withdrawal of licenses. At the entry into force of the regulation the DFSA looked at the banks implementation during the DFSA's onsite inspections. Now the external auditor must every year review and make a statement about the bank's fulfillment of the requirements of this regulation. Having access to all the data about the bank is of course critical to the carrying out of resolutions and Danish data centers are now aware of all these requirements so they are expected to deliver them within a short timeframe. These requirements facilitate the resolution of banks in accordance with the Danish

	resolution scheme. For small and medium sized banks this is the resolution plan. For larger banks an individual resolution plan will be established with the implementation of the BRRD.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	The handling of troubled banks is expected to be an integrated part of the supervisory process with the expectation that the supervisors will be well aware of the bank's challenges, in advance of distress being evident. However, this was not true in the case of Tonder Bank, which failed after having not been examined for more than four years. Moreover, the DFSA has an internal handbook for the handling of distressed banks, which is followed in all relevant cases. The handbook contains a description of concrete supervisory actions that may be relevant to take including guidance for the dialogue with the resolution authority (the state-owned FSC), etc. Individual resolutions plans have not been required or prepared to date. For small and medium sized banks Denmark has a well functioned resolution regime in place. In relation to recovery plans various kinds of contingency plans have been required; In addition the DFSA has on an individual basis asked certain banks to prepare a recovery plan when the bank's fulfills the capital requirement of 8 pct. but not its own solvency need. A recovery plan requirement for larger banks is coming into force April 1, 2014.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	The DFSA takes action when it becomes aware of bank-like activities being performed fully or partially outside the regulatory framework. The DFSA warns the public against such firms via the DFSA website and DFSA news alerts by email to citizens, which have signed up for the DFSA news email service. Little or no shadow banking activity has to date been seen.
Assessment of Principle 8	Largely Compliant
Comments	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; use of that approach will require thoughtful modifications over time as conditions change. Another positive development would be the related adaptation of the Supervisory Diamond to the mortgage credit institutions (where work is underway). 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 seven more years for smaller and most well-capitalized banks). The approach to onsite examinations—even of the largest banks—limits the immediacy with which issues

	can be discerned from onsite work. Moreover, risk assessments could more formally be updated during the year. Individual resolutions plans have not been required or prepared to date. However for small and medium sized banks Denmark has a well functioned resolution regime in place and this is the resolution plan for these banks. In relation to recovery plans various kinds of contingency plans have been required; In addition the DFSA has on an individual basis asked certain banks to prepare a recovery plan when the bank fulfills the capital requirement of 8 pct. but not its own individual solvency need. A recovery plan requirement for larger banks is coming into force April 1, 2014.
Principle 9	**Supervisory techniques and tools**. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of onsite[14] and offsite[15] supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between onsite and offsite supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its onsite and offsite functions, and amends its approach, as needed.
Description and findings re EC1	The DFSA uses a variety of tools to implement the supervisory approach for banks; the tools take the risk profile and systemic importance of banks into account. As discussed in BCP 8, EC 1, the Supervisory Diamond is a key tool that is utilized to constrain the business models of banks to be operating within perceived prudential limits. There have been periodic breaches of the Diamond that lead to immediate calls to the banks for explanations. In very rare cases, the DFSA could be satisfied by the explanation and allow the breach to continue, but it is much more likely that the DFSA will advise the bank of the need to begin addressing the problem right away. If the breach is not promptly addressed, the DFSA would then order the bank to comply. As discussed in BCP 8, the DFSA has not established a general resolution planning regime to address options in more complex situations, but has extensive (and successful) experience in dealing with failing banks.

[14] Onsite work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

[15] Offsite work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further offsite and onsite work, etc.

	The Banking Analysis Division receives quarterly, semi-annual, and annual reports from banks. As described to the assessors, after taking steps to ensure the accuracy of the data, they assemble the data into tables designed to show which banks are outliers, to assess compliance with the Supervisory Diamond, and to prepare on an annual basis a "mechanical" and preliminary assessment of the risk of the bank using a rating construct with five levels. The information is shared with the three Banking Divisions and the Mortgage Credit Division. In the spring of each year, those Divisions take the "mechanical" risk assessment as a starting point and adjust the ratings based on their finer knowledge of the specific firm. The results are shared within the DFSA, and can be discussed at the fortnightly Supervision Committee meeting of the Director General and other senior officials. The exam schedule is then developed for the twelve-month period beginning each year on July 1. In addition to the Supervision Committee a SIFI-risk committee was established within the DFSA in 2013. The SIFI-risk committee, which is supported by a small internal analysis unit, consists of the Director General, the Deputy Director General for Banking issues and other relevant senior officials. The purpose of the committee is to discuss horizontal issues of importance for the Danish SIFIs as a supplement to the ordinary supervisory approach applied by the DFSA. As discussed in BCP 8, the largest banks and mortgage credit institutions are subject to an annual review of one (or more) designated risk areas (with the requirement that all significant risk areas are reviewed at least once every four years). The schedule is more drawn out for smaller banks, with the very smallest (10-15 currently out of 90 total banks) banks on a six-year (or occasionally longer) cycle if no problems seem evident. Through the Supervision Committee and other forums, the DFSA discusses issues and approaches and seems open to making frequent adjustments in law, regulation, guidance, and processes.
EC2	The supervisor has a coherent process for planning and executing onsite and offsite activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the onsite and offsite functions.
Description and findings re EC2	The supervisory activities of the DFSA are a combination of 1) offsite data surveillance and analysis of regulatory reports from the banks, 2) offsite analysis from additional material received from the banks (e.g., benchmark reviews or thematic studies) and 3) onsite inspections. The various Divisions of the DFSA have well defined roles and elements of structured interaction. For example, as noted above there is coordination and information sharing between various parties of the DFSA during the SREP process. Fortnightly meetings between senior management and head of bank divisions through the Supervision

	Committee aid in the coordination process. The onsite examination schedule is however limited—typically only one multi-week review of each of the major institutions per year (targeted to one or more major risk area with the requirement that all major risk areas are reviewed at least every four years) supplemented by various fact finding efforts tied to for example thematic reviews, and by regular processes such what is done under the ICAAP process. It is not clear how much flexibility the DFSA has from a resource standpoint to incorporate additional reviews when a risk assessment indicates some likelihood they would be needed. There clearly would be follow-up through phone conversations and meetings when a new concern surfaces with one of the largest banks, but additional onsite inspection work may not be undertaken. The assessors understand that the extended schedule (up to six years or even longer) of small banks can be adjusted to move up the examination of a bank that appears to be an outlier; the issue on which the bank is an outlier would more commonly be addressed through requesting and receiving more information offsite. When a small bank is moved up in the scheduling process, there will likely be an exam of another small bank that gets pushed back (witness that several small banks on the 2013 schedule have not been examined since 2005 or 2006). When banks are judged to need intensive supervision they also become subject to much more frequent examinations (typically at least annual). The banks under intensive supervision account for about 15 percent of the total number of banks, but less than 3 percent of total assets. When a bank is placed under intensive supervision, its supervision is not moved away from the individual/Division currently responsible for it, as the set of banks under intensive supervision are not reviewed as a portfolio except by the most senior of DFSA officials; for example, prior to Financial Council meetings, the relevant DFSA senior official will typically ask for an update on all such banks so he can make a report to the Council.
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable[16] and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	The DFSA uses a variety of information to regularly review and assess the safety and soundness of banks, including the required regulatory filings, annual reports, and to some extent information from external sources (e.g., rating agencies). The offsite analysis is an important starting point for the risk assessment of the banks and

[16] Please refer to Principle 10.

	for the finalization of the examination schedule. The offsite analysis would be aided if the DFSA received institution-specific risk management reports and audit reports on a flow basis from at least the major banks throughout the year.
EC4	The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as: (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC4	The DFSA uses a variety of tools to regularly review and assess the safety and soundness of banks such as: analyses of both standard and ad hoc reporting, business model assessment (e.g. in the context of the SREP process or the Supervisory Diamond surveillance), thematic or horizontal reviews, the ICAAP process, offsite analysis and stress testing. Much of the work on items (a)–(d) is carried out offsite, although some business model reviews (now heavily emphasized by the DFSA as a result of the lessons learned from the crisis) and horizontal assessments have important onsite examination components. Horizontal review topics are chosen each year on the basis of a blend of the top down perspective of senior DFSA officials and bottoms-up sense of the supervisors within the relevant divisions. Assessment of corporate governance, risk management, and internal controls is heavily the responsibility of the onsite examiners. Similarly, detection of problems and conveying of findings generally derive from the work onsite. Follow-up is carried out by DFSA personnel, including by relatively small teams covering specific major institutions (e.g., 5–7 people on somewhat less than a full-time basis); onsite follow-up often extends to the next scheduled (annual) examination.
EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and	Stress testing of individual banks is an integrated part of the supervisory process. Top-

findings re EC5	down stress tests are conducted twice a year for all banks and mortgage credit institutions. Bottom-up stress tests are further generated/requested for the IRB banks annually. These results are evaluated and communicated to the management board of the DFSA, discussed at regular meetings between high-ranking staff members in different divisions, communicated to onsite inspectors and evaluated and challenged in dialogue with the individual banks when relevant. However, it was not clear to the assessors how often stress test results drove specific follow-up examination work.
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	The DFSA evaluates the work of both internal and external auditors both during onsite inspections and via annual readings of the internal and external auditors' protocols. The internal and external auditors must state the results for individual banks with respect to a number of issues such as the large exposures of a bank and the impairments and solvency needs of a bank. While the large banks usually have both internal and external auditors, the smaller banks may only have external auditors to carry out both sets of functions. During onsite inspections, the supervisors have a meeting with internal and external auditors where the auditors' work and findings are discussed. The supervisors then compare the auditors' findings with the supervisors' findings during the onsite inspection and follow up if the supervisory findings are not consistent with the findings by internal and/or external auditors.
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	The DFSA has considerable contact with large and midsize banks during the annual SREP; process; considerably more frequent contact with the largest banks for other purposes (ICAAP, IRB matters (if relevant), follow-up work on orders, etc.) occurs as well. The issues of strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls are focused on in onsite inspections and offsite surveillance by the DFSA—particularly during the annual SREP, where the banks' capital adequacy is considered both individually and compared across relevant peer groups of banks. Further the DFSA holds annual meetings with the largest banks, where the Director General of the DFSA participates.

	New strategies or changes of the business models in banks are expected to be challenged by the supervisors. The DFSA advises that based on experience, the supervisor focuses on changes in sets of customers, which changes can require additional risk management and better internal controls. The assessors have reviewed files that demonstrate that the DFSA has challenged business models on this basis.
EC8	The supervisor communicates to the bank the findings of its on- and offsite supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	The DFSA communicates to the bank the findings of its on- and offsite supervisory analyses in a timely manner by means of written reports or through discussions with the bank's management. At the start of the inspection, meetings between DFSA staff and the BoM, other senior management and the external/internal auditors are held. By the end of the inspection the management and executive boards as well as internal and external auditors meet with officials and the relevant staff of the DFSA. For all firms these meetings take place in connection with onsite inspections (other meetings and contact take place separate from the inspection process). For the largest banks, annual meetings at top-level are held in addition to the regular meetings during onsite inspections. The idea is to have a strong dialogue between the management boards of the systemic and large banks and the management board of the DFSA. Further, the results and recommendations of the inspection are communicated to the BoD and the management of the bank by the end of the inspection. Power point presentations are often made, first to the senior management and then to the BoD. Significant conclusions then are submitted within 35 days in the form of a written report to the undertaking's BoD, BoM, the external auditor, and the chief internal auditor following an inspection visit. Responses are received from the bank and reviewed by the DFSA. Follow-up is expected to be done by the External Auditors (see comments in EC 9 below) and by the DFSA at the next scheduled examination. It is striking that the full DFSA reports are typically made public, although the risk ratings are not shared publicly or even with the bank. Making the reports public has the advantage of transparency by informing the marketplace of issues seen by the DFSA but brings with it the danger of accelerating adverse effects on a bank. The DFSA does have some capacity to hold back reports for a time, and used that authority in at least one instance.
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and	External Auditors and the DFSA follow up on how a bank has addressed supervisory orders

findings re EC9	or risk information (i.e. recommendations made on risk matters). The DFSA has been given tools and regulatory authority to intervene if needed (for example, early intervention if a business model is deemed to be unsustainable cf. §64, §71, §344 and §350 of the FBA). However, the onsite follow-up is typically deferred to the next scheduled examination. The DFSA has advised that it views this work as only an input into their information base. Placing more reliance on the external auditors to assess progress in compliance would, in the assessors' views, be misplaced. The assessors reviewed a sample of Audit books and found the descriptions of what the external auditors did to confirm progress was generally very limited; in some instances the work seemed limited to confirming that "if" management had done what it asserted, then the order could be considered addressed, with no apparent review of whether such work by management was in fact done.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	In its ongoing supervision, the DFSA is typically informed about any substantive changes, although there is no specific requirement for banks to do so.
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	In exceptional cases the DFSA has the possibility to utilize external assistance, under section 344(6) of the FBA. Following a 2010 amendment to the FBA, it became possible for the DFSA to request independent third parties to carry out investigations for the DFSA provided that there is a clear and detailed mandate for the work and provided that the DFSA does not have the necessary competencies itself. The investigations performed by third parties is at the expense of the entity under supervision, e.g. if a third party is requested to investigate a specific issue within Danske Bank, then Danske Bank pays for the work carried out by the external party. The DFSA has not outsourced any supervisory work on auditing, accounting, level of impairments or solvency needs to any third party. The DFSA has used external third parties only in two specific cases as described below. In 2010 the DFSA issued an order in accordance with section 347b of the FBA, requiring Saxo Bank A/S to conduct an independent investigation regarding whether manually executed orders placed in the bank's electronic trading system, Saxo Trader, were systematically executed in accordance with the bank's General Business Terms and Best Execution Policy. It was the DFSA's assessment that the investigation was significant for the supervision of Saxo Bank and that it was not a routine investigation for the DFSA as the investigation required IT-systems and competencies that the DFSA did not have.

	In 2012 the DFSA issued an order in accordance with section 347b of the FBA, requiring Danske Bank A/S to conduct an independent investigation of its market risk area. The reason was that over a few years, the bank had had very large earnings on market risk activities, also in comparison with peer earnings in the area. The investigation was to determine whether Danske Bank had assumed market risks in excess of those permitted by its market risk policy and the guidelines issued by the BoD to the executive board. Moreover, the investigation was to test whether Danske Bank's market risk calculations reflected its actual market risks. The investigation was also to show whether, in the market risk area, the bank incurred operational risk not commensurate with the earnings contributed by the area. It was the DFSA's assessment that the investigation was significant for the supervision of Danske Bank A/S and that due to the size and complexity of the bank and granularity of investigation it was not a routine investigation for the DFSA.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	The DFSA has an adequate information system of reporting, supervisory tools and regular meetings between high-ranking staff members in different divisions on the banking area in the DFSA. The assessors viewed relevant tracking forms to confirm this. The DFSA tracks whether examinations in practice meet the schedule that was developed. Changes can be made in the schedule only with the approval of the Director General.
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.
Description and findings re AC1	The DFSA does not have a periodic and independent review such as an internal audit function or third party assessor. In 2013 an independent review was generated by Oliver Wyman. The review was conducted as a benchmark study with 17 participating supervisory regulators.
Assessment of Principle 9	Largely Compliant
Comments	The DFSA has done a commendable job in putting in place a set of tools to enhance supervision coming out of the financial crisis. Moreover, the assessors were impressed by the knowledge and commitment of the supervisors and inspectors with whom we met. However, the assessors identified several areas where improvements could be made. As noted in BCP 8, the onsite examination schedule is too limited. 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 likelihood that another onsite examination would be needed. In addition onsite follow-up of problems that were detected is typically deferred to the next scheduled examination. As discussed in BCP 2, additional resources will be needed in order to make these kinds of adjustments.

	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 later this year), and potentially by an explicit requirement that banks advise the DFSA of material adverse developments. We would also offer some cautions on several tools now being used. One relates to making examination findings public. Making the reports public has the advantage of transparency by informing the marketplace of issues seen by the DFSA but brings with it the danger of accelerating adverse effects on a bank when problems start to arise (the DFSA does have some capacity to hold back reports for a time, and used that authority in at least one instance). In any event, we would caution policy makers on the appropriateness of the approach to transparency, given the real potential for these negative effects ultimately to more than offset the value of transparency. A second tool on which we would offer a caution is the DFSA's request of external auditors to review and assess whether orders and risk information have been addressed. Given the challenge of outside auditors fully understanding the supervisory perspective and the limited way it appears that this responsibility is being carried out, putting substantial reliance on this work (rather than for example shortening the inspection schedule) would in our view be misplaced. The assessors understand that the DFSA is sensitive to this issue, and views the word of the external auditors as only an input into the supervisory process.
Principle 10	**Supervisory reporting**. The supervisor collects, reviews and analyses prudential reports and statistical returns[17] from banks on both a solo and a consolidated basis, and independently verifies these reports through either onsite examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power[18] to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	The DFSA has the power to require banks to submit supervisory data under section 198 of the FBA. The FBA states that "Financial undertakings and financial holding companies shall regularly submit financial statements to the DFSA in accordance with formats and guidelines in this respect prepared by DFSA."

[17] In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

[18] Please refer to Principle 2.

	Further, the DFSA has the legal authority to request ad-hoc reports from all financial firms under its supervision. The DFSA typically request firms to deliver supplementary information (data, descriptions etc.) both in relation to thematic surveys and in case a firm is identified as an outlier with a different business profile than other firms of a similar size and scale. Examples of supplementary information requests include: credit quality of private customers in 2012 and a survey on core earnings (2013) both as inputs in thematic reviews. The banks file financial reports each quarter and the report at year-end contains a greater depth of information. From the beginning of 2012, banks have in context of the ongoing reporting to the Danish FSA semi-annually reported exposures as a separate reporting to the FSA. There are mandatory data templates for reporting to the Danish FSA. The reports include all data needed for offsite surveillance. The categories of data that are collected by the DFSA on a quarterly frequency as routine regulatory reporting include: • Capital adequacy; • Liquidity; • Pillar 1 risks—credit, market and operational risk; • Balance sheet and P&L, full performance figures broken down into key categories of the P&L such as net interest income, expenses etc; • Large exposures; • Intra-group exposures • Derivatives • Off-balance sheet exposures and contingent liabilities The data points are reported on both a solo and consolidated basis. Consolidated data could be (if deemed relevant and necessary for the supervisors) provided at the banking group level and at holding level. Unregulated parts of the group are, if significant (i.e. regulated by Accounting standard), part of the group reporting. The reports include all data necessary for offsite surveillance to perform a comprehensive analysis of performance of the business model and risk profile. The DFSA maintains a heightened focus on credit exposures of a material size which is reflected in reporting requirements. Banks in Groups 1 and 2 are required to report exposures above 2 percent of the capital base after deductions. Group 3 shall only report the exposures over 5 percent of the capital base after deductions. Group 4 shall only report the exposures exceeding 10 percent of the capital base after deductions. The data templates for reporting are reviewed annually in order to keep the templates up-

	dated and reflective of supervisory concerns to ensure supervisory reporting aligns with emerging risks. For example, since 2005 the banks have been required to report specific information on credit quality. Furthermore, the credit institutions report additional information such as in the case of banks accredited to use the advanced approaches to credit risk (IRB) e.g. selected variables in their IRB-models as well as stress test results. In the case of distressed banks, the DFSA will require these banks provide additional details on expected management interventions etc. as part of their workings on finding solutions of the distressed situation. The requirements for supervisory reporting are consistent across all banks and mortgage credit institutions. However, the smallest banks in Group 4 are exempted from reporting certain data templates in the first and third quarters. Moreover, there are differences between the reporting of banks and mortgage credit institution, which reflect the different business models of deposit-taking and non-deposit taking credit institutions. There was evidence to suggest that supervisory reporting was sufficiently broad in key areas such as credit risk to identify and monitor changes in risk profile. However, for other certain areas, such as operational risk and market risk, the reporting instructions and regulatory returns were not sufficiently broad to include supervisory data that would indicate changes in risk profile or a build-up in excessive risk.
`EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	The DFSA makes available to the public a comprehensive set of reporting instructions for all regulatory returns. The reporting instructions clearly describe the type of data to be submitted and the accounting treatment. The instructions are available on the DFSA's website. To support the reporting process, the DFSA has a dedicated team responsible for collection of statistical data—the Financial Reporting Division. The DFSA has on its website various manuals for the different reporting standards both for banks, mortgage credit institutions and for other types of supervised financial firms (manuals are only available in Danish): http://www.finanstilsynet.dk/da/Indberetning/Vejledninger-og-informationer.aspx. The accounting standards that are used for regulatory reporting are issued by the DFSA. The national accounting standards are to a large extent aligned with the IFRS standard and the standard ensures that impairments are made-up in a timely and adequate manner.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the

	supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	According to the DBA, s.71 and The EO on Management and Control of Banks, a financial undertaking shall have effective forms of corporate management including good administrative and accounting practices. The EO includes requirements for banks to implement a prudent approach to valuing assets and liabilities. Expectations of the DFSA in terms of governance structures and control processes for processes that produce valuations are confirmed through offsite analysis in accordance with the EO on Management and Control. Offsite analysis confirms the bank's policies for prudent valuations and through the onsite review process verify that policies are being adhered to. There are however, no specific requirements for independent collateral valuations in the case of determining appropriate levels of loan loss provisioning (see CP18). In addition the DFSA evaluates the banks' ICAAP reports during the annual SREP process. If any deficiencies are noted, DFSA can lay down further requirements concerning the obligations of the bank (s.70).
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	The normal frequency for supervisory reporting is on a quarterly basis where banks submit a comprehensive suite of returns containing information across its entire business regarding financial performance, balance sheet and risk information. In addition, banks will routinely submit returns on a more frequent basis to reflect the risk type such as liquidity returns which are submitted on a monthly basis. On an annual basis, banks will submit their full balance sheet information. For less systemic banks, the frequency of reporting is less onerous. Banks designated as D-SIBs under the new framework to be implemented May 2014, will be required to report on an ad hoc basis for a number of purposes such as to support thematic reviews and/or specific situation based events. For example, in the crisis banks were asked to regularly report solvency, liquidity and loss rates. Where banks have significant cross border exposures, these banks will report country specific reports that will provide supervisors with an overview of size, scale and risk profile of exposures. In a circumstance where banks have been identified as being an outlier through breaching the Supervisory Diamond as an example, more regular and granular reporting requirements is applied which was confirmed by the assessors. There are no general manual for offsite analysis. The main reason for this is that the themes and risks which are analyzed change over time and the offsite analysis process remains agile to adapt to potential changes in the supervisory focus. However there are business procedures on risk assessment and on audit protocol.

	In context of the ICAAP, the DFSA uses a guideline for the assessment. The guideline is also communicated to the banks as a benchmark for conceptual and metrological approach towards the solvency need estimation.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	For the purposes of analyzing regulatory returns, individual banks are compared against their peer group (i.e., Group 1, 2, 3 etc). The Banking Analysis Division develops cohort data sets for compassion and benchmarking and the data package has the capacity to allow supervisors to customize data sets for per group analysis. The comparison between banks and banking groups allows supervisors to make meaningful comparisons against banks of a similar size, scale and business model. The frequency and data collected is standardized for all banks and mortgage credit institutions ensuring that the data on which the analysis is performed is comparable by date and measuring the same period. The analytical reports produced by Monitor allow for quarter on quarter comparisons and against moving year averages. When supervisory reporting is submitted, the data will undergo a check for data quality through a number of automated validations. Once the data has been checked for accuracy, the data is transferred into a spreadsheet where financial ratios are calculated and allow for comparisons between a standardized set of peers as well as functionality to allow more bespoke comparisons. The data is presented quarter on quarter and year-on-year trends identified. The data is available in a format that also allows supervisors to manipulate the data to generate their own tables and graphs. The DFSA collects reporting on consolidated and unconsolidated (solo entity) basis. Consolidated data could be (if deemed relevant and necessary for the supervisors) provided at the banking group level and at holding level. Unregulated parts of the group are, if significant (i.e. regulated by Accounting standard), part of the group reporting).
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	The power to request and receive relevant information from banks and from entities in the wider group is contained in section 347 of the FBA. The FBA states "the financial undertakings and financial holding companies, shared data centers, suppliers and sub-suppliers shall provide the DFSA with such information as is necessary for the performance of the duties of the DFSA. Paragraph (4) expands the power to request information more broadly.

EC7	The supervisor has the power to access[19] all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	As per the response in EC5, CP1, the DFSA can ask in accordance with section 347 (4) of the FBA for any information, including financial statements, accounting records, printouts of books, other business records, and electronically stored data deemed necessary for the activities of the DFSA or for deciding whether a natural or legal person is covered by the provisions of this Act. Furthermore the DFSA has access to the bank's board, management and staff and regularly uses that access at the appropriate level.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines-the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	There is no explicit requirement for senior management to sign-off of regulatory reporting, it is industry practice however, that senior personnel are responsible for submitting regulatory reports. In addition, banks have validation procedures in place to test the accuracy of data prior to submission. In the case of incomplete reporting or a bank has not reported within the specified date, the DFSA will issue a reminder. After having issued two reminders, the DFSA will address a supervisory request for immediate reporting. In case the bank still has not reported as required, the DFSA can issue a fine to the firm or enforce other supervisory actions such as onsite inspections etc. The DFSA has not issued any fines in relation to reporting of accounting data etc., but has the legal possibility to issue such. Senior management is held responsible for inaccuracies. In larger institutions it is typically the risk management or the internal auditing of control that is in charge of the reporting, while in slightly smaller institutions it will be the senior management. Note however that fines have been issued in about 20 cases where firms did not report stock exchange information to the FSA as requested in accordance with the MIFID regulation. Quarterly regulatory returns are required to be submitted no later than 20 business days after the quarter. Annual reporting of data needs to be submitted 45 business days after the end of financial year (mid March). The DFSA does not have a zero tolerance regime in terms of late submission of data. Persistent late lodgment will be referred to the supervisor for remediation as a reflection of deficiencies in risk management.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.[20]

[19] Please refer to Principle 1, Essential Criterion 5.

[20] May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

(continued)

Description and findings re EC9	There is a general obligation under the FBA for banks to have the necessary risk management and control procedures to ensure accurate reporting (s.71 of the FBA). The firms are requested to report non-audited data to the DFSA and the firms are responsible for and take the initiative to revise reported supervisory data in case the internal or external auditors' work give rise to major revision of the data reported to the FSA. The reporting to the DFSA is analyzed both during offsite surveillance and data analysis and via onsite inspections. The first validation process is undertaken by a statistics division within the DFSA responsible for the collection of regulatory reports. Once the data is validated for accuracy it is then passed to the Banking Analysis Division for financial and risk analysis. Offsite analysis can typically identify banks with business profiles that deviate from the business profiles of a relevant peer group of banks as well as identify banks where the developments during the last quarter deviates considerably from the historical development in the individual bank. A very useful by-product from onsite analysis is a check of the data quality as supervisor's knowledge from offsite surveillance is compared to actual findings in concrete customer filings, etc. in the banks. The DFSA's experience shows that during onsite inspections, problems with the data quality with respect to correct distribution of exposures into economic sectors and correct consolidation of large exposures are often identified. In these cases, banks are often requested to revise and resubmit data for a specified time period (for instance data for the last 2-4 quarters) to the DFSA. Thus, onsite and offsite inspections are complementary.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts,[21] including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	According to section 347b of the FBA, the DFSA has the regulatory power to require external experts to conduct an independent investigation of one or more elements in a bank. The DFSA has used external third parties in two specific cases (see EC11 in Principle 9).
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	As mentioned in the answer to EC11 CP 8, the DFSA only uses external parties for tasks, which require very specialized skills. The mandates of external parties are formulated by the DFSA such that the external parties provide information both about material shortcomings and about its findings several times during the work phase.
EC12	The supervisor has a process in place to periodically review the information collected to

[21] May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	determine that it satisfies a supervisory need.
Description and findings re EC12	The Banking Analysis Division reviews annually the information collected to determine if the data is satisfactory in terms of supervisory needs and in order to keep the templates up-dated. Moreover, the need for data changes over time due to changes in the supervisory focus and the underlying risks.
Assessment re Principle 10	Largely Compliant
Comments	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. 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. Two factors have led to a downgrade: firstly, the reporting instructions do not include instructions for reporting operational risk loss and related party lending (EC1). Reporting for these risks is important given some banks are subject to less frequent onsite examinations cycles. Secondly, greater attention to requirements for prudent valuations in reporting instructions and processes for collateral valuation to be independently verified when submitted in supervisory reporting.
Principle 11	**Corrective and sanctioning powers of supervisors**. The supervisor acts 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 at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	Implementation of the Supervisory Diamond—which is based on the concept of prudent buffers for five key risk criteria—provides the DFSA with an early warning mechanism to raise supervisory concerns with management if there is a risk the criteria are going to be breached or are in fact breached. The Supervisory Diamond is a key tool in the DFSA's offsite surveillance and, if triggered, there was evidence that remedial action is actively pursued. Furthermore, it was demonstrated that non-compliance against the Diamond is published on the DFSA's website, which is visible to the public. In the event one of the five

criteria is triggered, the DFSA have escalated the issue to the banks' BoM/BoD.

The Supervisory Diamond is a structured set of risk criteria, which have been developed based on observed vulnerabilities built into the system prior the crisis. When communicating results of its onsite and offsite supervision, the DFSA can employ a range of tools depending upon severity of the concern: the DFSA can issue an Order, an Immediate Order, or Risk Information. Each of these three tools can be issued based on observations form offsite analysis, but usually will be the result of an onsite examination. Of greater significance is a Report issued by the DFSA. A Report will be communicated to the bank as a written report and can contain a list of Immediate Orders, Risk Information and Orders. Importantly, the Report will contain a Risk Assessment. If the Risk Assessment is not adhered to, a Risk Warning can be issued which is addressed to the BoD. The most important tool in the supervisory process is the Public Report which is publicly available and will contain results of onsite examinations and a general risk assessment. Within this process for issuing written communication to the bank, there is a clear hierarchy among the tools which reflect the severity of the issue.

An important focus of offsite surveillance and onsite examinations is to assess changes in the business model through increased risk taking and accuracy of provisions. Issues identified through onsite and offsite activities are pursued with the bank through a formalized approach. Raising issues with senior management and the BOD is a tool employed by the DFSA when issues are of a material concern during annual meetings with BOM.

In order to insure that financial undertakings and financial holding companies act in accordance with the financial regulations the DFSA may:

1) Provide guidance;
2) Take action against violations;
3) Order that errors be corrected and that violations are remedied; and
4) Issue fines.

In the past several years, the DFSA has strengthened its supervisory powers, including: a requirement for the DFSA to assess the sustainability of a bank's business model over a two to three year outlook; enhanced fit and proper powers to employ skilled persons. A review of supervisory files evidenced an emphasis on assessing the sustainability of a bank's business model. In addition to strengthened powers, the DFSA has focused its supervisory attention on a more intensive approach to supervision. The Danish Supervisory Ladder of action is as follows:

- Intensified surveillance and disclosure of risk information
- Inspection, management statement FBA s.349 statement
- Order corrective actions under FBA s.350 e.g. closing branches.

	Concurrent with the above are actions regarding (i) disclosure of supervisory actions via the DFSA website and (ii) capital requirements (Pillar II). While the DFSA has the ability to act at an early stage (section 350) it will normally increase its intensity through a modulated approach in order to give the bank an opportunity to take necessary measures within a certain time limit to rectify the situation. The powers under s.350 give the DFSA far reaching powers to take remedial action if: 1) the financial position of the bank has deteriorated to such a degree that the interests of the depositors are at risk; or 2) there is a not insignificant risk that because of internal or external conditions the financial position of the bank will develop so that the bank loses its license. The DFSA has used section 350(1) several occasions recently to intervene early to mitigate a build-up in risks. For example, DFSA ordered a bank to stop granting new loans from a certain category of customers. This case ended with the bank merging with another bank. In this case the DFSA also used the fit and proper rules and demanded the bank to change the whole management of the bank both the BOD and the BOM.
EC2	The supervisor has available[22] an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings re EC2	The DFSA has a wide range of supervisory tools available at its disposal to perform oversight of individual banks and the system (see also EC 1). The Supervisory Diamond is a key tool that gives the DFSA an ability to engage at an early stage if the bank is exhibiting excessive risk taking as measured against the five criteria. Qualitative and quantitative inputs into the supervisory process enable the supervisor to exercise judgment in applying tools such as a Risk Warning or an Order in the event the supervisor forms a view that the bank is engaging in unsafe and unsound practices. Onsite and offsite activities will allow the DFSA an opportunity to assess emerging risks. In the event excessive risk taking is identified, the DFSA has pursued remedial action with the bank to achieve a lower risk profile (examples cited involved orders to restrict lending to certain types of borrowers). Often recommendations rely on supervisory judgment such as in the case of recommendations to increase provisions. In this example, supervisors have required banks to increase provisioning based on results of onsite credit risk examinations (see also CP17). An integral component of the DFSA's supervisory toolkit is the Public Report where it makes public results of supervisory activities reflecting a Risk Assessment, results of an onsite examination. There was evidence which demonstrated that this process

[22] Please refer to Principle 1.

	had benefits of introducing market discipline if a bank engaged in unsound practices that increased its risk profile of risk to the system. The Supervisory Diamond is the first line of quantitative tools used to identify emerging risks. The supervisory tools available to the DFSA were used extensively during the last five years when individual banks and the financial system as a whole came under significant stress. The DFSA has used these tools effectively to impose sanctions on banks to improve their risk management and solvency position. When institutions did not improve their situation, the DFSA actively encouraged banks to merge and in extreme circumstances withdrew licenses As mentioned in EC 1, in order to insure that financial undertakings and financial holding companies act in accordance with the financial regulations the DFSA may: provide guidance, take action against violations, order errors to be corrected and violations to be remedied and issue fines (s.350 FBA). In accordance with section 373 in the FBA, any person violating the sections mentioned in section 373 (1) will be liable to fines or imprisonment of up to four months unless more severe punishment is incurred under other legislation. In accordance with section 374 (1) the BOD, BOM, external auditor, chief internal auditor, responsible actuary, liquidator, general agent, branch manager or shareholder committee when failing to comply within the proper time with the duties and obligations imposed on them under this Act or under regulations laid down pursuant to this Act towards the DFSA or the Danish Commerce and Companies Agency, the DFSA or the Danish Commerce and Companies Agency may as a coercive measure impose daily or weekly fines. In accordance with section 373 (2) any person violating section 70(1)-(4) and section 71(1) will be liable to a fine. The DFSA can therefore take enforcement action based on their supervisory judgment that risk governance, systems and controls are not effective and adequate. In accordance with section 351 (1) The DFSA may order that a financial undertaking remove a member of the board of management within a time limit specified by the DFSA, if, pursuant to section 64(2), said person may not occupy the position. The DFSA withdraws the license of the undertaking (see section 224(1), no. 2) if the financial undertaking does not remove the member of the board of management before expiry of the time limit (see also section 351 (7)). In accordance with Section 225 (1) if the bank, mortgage-credit institution, investment firm or investment management company does not meet the capital requirements mentioned in section 124(2), (3), (5), (7) and (8), section 125(2)-(5) and (8), and section 125a, and if the bank, mortgage-credit institution, investment firm or investment management company has not raised the capital required prior to the time limit set by the DFSA, the DFSA withdraws the license.
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The

	supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	The DFSA has a wide range of options to intervene at an early stage to require the bank to take actions allowing it to act even though a bank may fulfill minimum regulatory requirements. The DFSA has exercised its powers after forming the view that depositors' interests are at risk or there is significant risk that the bank may breach regulatory minimum requirements (see s.350 FBA). Furthermore, the DFSA can require a recovery plan when the bank fulfills the capital requirement of 8 percent. Since the onset of the financial crisis, the DFSA has intervened early to require the bank to remediate the situation. If the bank does not fulfill the capital requirement of 8 percent, then the DFSA shall withdraw the license (as per section 351 of the FBA). And after a mandate from the MoBG is received, the DFSA can help prepare the bank for resolution. Every violation of the FBA is subject to individual evaluation on a case to case basis. Therefore no mandatory sanctions or fines are issued for certain violation. The calibration of the Supervisory Diamond is such that it includes conservative settings over and above regulatory minimums contained in the FBA which promotes early intervention.
EC4	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.
Description and findings re EC4	The DFSA can react at an early stage if the financial position of the bank has deteriorated to such a degree that the interests of the depositors are at risk or there is a not insignificant risk that because of internal or external conditions the financial positions of the bank will develop so that the bank will lose its license. This power enables the DFSA to require a bank to take remedial actions in a timely manner or face sanctions depending on the causes of the bank's problem. For example, the DFSA can require a bank to change its risk profile, risk settings and or liquidity and capital position. The DFSA has demonstrated the willingness and ability to exercise its power to intervene early when it detects a build-up of risks. Examples of Orders include: restrict the activities of the bank such as cease lending, increase provisions and increase individual capital adequacy requirements. The DFSA can also restrict or suspend payments to shareholders or share repurchases and has done so on occasion. The DFSA can also demand a bank to change management or to declare that the board is no longer fit and proper. The fit and proper rules have been used in several cases to change the management and the board. The DFSA also plays a vital role in the

	resolution of a bank. There is no provision whose infraction leads to the automatic imposition of civil and penal sanctions. Every case is judged individually. Penal sanctions are described in FBA section 373 and 374. The measures which can be taken in order to address problem banks depend on the seriousness of the problems. If the bank has financial problems, section 225 of the FBA regulates the actions the DFSA must take. The reaction in accordance with this section depends on the seriousness of the financial problem. If the bank does not fulfill the regulatory capital requirement in accordance with section 124 (2) in the FBA, then the bank will receive a short time limit to fulfill the regulatory capital requirement again. If this is not possible the license must be withdrawn in accordance with section 225 (1) and the bank will go into resolution (or bankruptcy). Section 124 (2) requires the bank to fulfill a capital requirement of 8 pct. of the risk weighted items. Section 124 (2) will be replaced by article 92 and 93 in the forthcoming EU regulation 575/2013 on prudential requirements for credit institutions and investment firms (CRR). Besides the regulatory capital requirement the BOD and BOM of the bank must in accordance with section 124 (1) ensure that the bank has an adequate capital base. This will still be a requirement in the FBA after the entry into force of the EU regulation. In addition to this requirement the bank must in accordance with section 124 (4) on the basis of the assessment of the adequate capital base after section 124 (1) calculate the individual solvency need of the bank. The solvency need shall be expressed as the adequate capital base as a percentage of the risk-weighted items. The solvency need cannot be less than the solvency requirement after section 124 (2). This will still be a requirement in the FBA after the entry into force of the EU regulation. However, if the bank fulfils the capital requirement of 8 percent but not the individual solvency need then section 225 (2) of the FBA, the situation leaves room for a more flexible approach. Under section 225 (2) the DFSA can ask the bank to take different kind of recovery actions. The bank will in most cases be asked to draw up a recovery plan and the bank will be asked to at least describe how it plans to recovery the capital so that the capital again comes above the bank's actual individual solvency need. The bank will be asked to consider several recovery actions including different kind of capital injections, reduction of risk weighted items, sale of business, merger etc. The DFSA has used section 350(1) number 2, in one case and ordered a bank to stop granting new loans from a certain category of customers. This case ended with the bank merging with another bank. Denmark established a resolution regime for distressed banks taking effect in October 2010 ("Bank Package 3"). The Danish resolution regime offers an alternative to ordinary liquidation according to standard bankruptcy procedures allowing the distressed bank to decide on a voluntary basis to be wound up under the special resolution regime.

	Bank Package 3 introduced the legal set up of an orderly winding up, including the possibility to bail in creditors and large depositors, while maintaining the bank as a going concern. Finansiel Stabilitet A/S (FSC), a state owned winding up company, was established in 2008. Resolution under Bank Package 3 involves the following steps: 1. If a bank fails to meet the capital requirements the DFSA sets a deadline for the bank to meet the requirements (often by a Friday evening). The bank must then (within 6 hours) declare to FSC whether, by the deadline, it wishes to transfer its activities to FSC or enter into liquidation according to standard bankruptcy procedures, if the bank fails to meet the requirements. 2. If the bank has chosen to transfer its activities to FSC, a subsidiary bank ("New Bank") is created at FSC at the deadline, which takes over the assets of the distressed bank ("Old Bank"). New Bank purchases all assets in Old Bank at realization value. As payment for the assets, a proportional share of the unsubordinated liabilities (all deposits and other unsecured, unsubordinated debt etc.) is transferred pro rata from Old Bank to New Bank. The proportional share is set provisionally (based on a conservative estimate) so that it reflects asset value at realization price relative to the size of unsubordinated liabilities in total (a haircut is applied). The valuation and the transfer of assets and liabilities are done over the weekend of the takeover, so that New Bank can open up on the following Monday morning. 3. Shareholders, subordinated debt holders and unsecured deposits exceeding the proportionate share are left with claims on Old Bank. Other creditors are transferred to New Bank, with the provisional haircut applied to the unsecured debt. Secured debt is transferred at par. 4. For a large depositor (with deposits above the limit of EUR 100.000 of the deposit guarantee scheme) a proportionate share of deposits in excess of the deposits guarantee limit will be transferred pro rata to New Bank. Unsecured deposits exceeding the proportionate share will in accordance with the resolution scheme be left as claims on Old Bank. The Danish Deposit Guarantee Scheme (DGS) thereafter becomes a creditor against Old Bank on equal terms with other claims in accordance with the normal insolvency order. 5. In the months following a takeover by FSC a due diligence procedure is carried out by two independent auditors. In the event that they come to determine a higher pro rata value percentage for the assets of the distressed bank, more liabilities are then transferred pro rata to accounts in New Bank. Liabilities are not withdrawn from New Bank, should due diligence determine a lower value of the assets transferred to New Bank. In this case Danish banks have to jointly cover the shortfall through a loss guarantee issued by the Winding-up Fund from the Danish Guarantee Fund for Depositors and Investors.

	6. In addition, excess liabilities remain as claims against Old Bank and will according to normal insolvency order be granted an earn-out, if the subsequent winding up of New Bank should lead to a surplus. The timeline for the valuation of assets is as follows: 1) First valuation of all assets and provisional hair cut (in the weekend of the takeover by FSC of the distressed bank) 2) Valuation report by auditors and a second estimate of haircut (in practice up to six months after the takeover) 3) Final result when all assets have been wound up (probably after several years) In terms of the applications of the Danish resolution regime, the Bank Package III resolution tool has been used twice. In February 2011, the scheme was applied to Amagerbanken A/S and in June 2011 it was applied to Fjordbank Mors. The size of Amagerbankens' balance sheet was approximately DKK 33.3 bn. amounting to 0.66 percent of the Danish banking sector as a whole. The provisional haircut to large depositors and other unsecured creditors was set at 41 percent. Due diligence brought the haircut to large depositors down to now 16 percent. The size of Fjordbank Mors' balance sheet was approximately DKK 12.7 bn. amounting to 0.31 percent of the Danish banking sector as a whole. In the case of Fjordbank Mors the provisional haircut was set at 26 percent, and due diligence brought the haircut down to now 14 percent. The Bank Package IV solution (model II) was applied with the takeover of Max Bank by Finansiel Stabilitet A/S in October 2011 and the subsequent sale of sound assets to Sparekassen Sjælland. The size of Max Banks' balance sheet was approximately DKK 9.4 bn. amounting to 0.24 percent of the Danish banking sector as a whole. In April 2012, the Bank Package IV was applied twice firstly in relation to Spar Salling where the FSC managed to sell the whole bank to Den Jyske Sparekasse. The size of Spar Sallings' balance sheet was approximately DKK 1.6 bn, amounting to 0.04 percent of Danish banking sector as a whole. Secondly the Bank Package IV was applied to Sparekassen Østjylland which was taken over by FSC and subsequently the sound assets were sold to Sparekassen Kronjylland. The size of Sparekassen Østjylland's balance sheet was approximately DKK 6.3 bn. amounting to 14 percent of the Danish banking sector as a whole. Finally, as mentioned in addition to the question whether the supervisory authority may impose or facilitate a merger or a purchase and assumption transaction upon an undercapitalized bank. There is a special rule on forced redemption in the FBA. The Conditions for this possibility is that the bank does not fulfill the capital requirements and that the DFSA has set a time limit for the fulfillment of the capital requirement. In addition

	to this the general legislation regulating the business of limited companies has also some provisions about forced redemption. Furthermore, in accordance with section 246 when the DFSA has set a time limit to fulfill the capital requirements (section 225) the bank's board of directors can inform the general assembly that it will sell the bank. The general assembly can decide to recapitalize the bank and then the conditions for a forced sell are no longer present. In accordance with section 247 the BOD can sell the bank if the bank is insolvent or likely to become insolvent. In this situation the general assembly has no power to prevent the sell and it is only informed about the decision to sell. In addition to this the general legislation regulating the business of limited companies has also some provisions about forced redemption. Denmark has delayed the implementation of a framework geared for resolving systemically important firms, pending adoption of new EU legislation on bank recovery and resolution. According to the political agreement reached in October 2013, SIFIs must draw up resolution plans no later than January 2016.
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	The DFSA has applied sanctions not only to the bank, but also to management and/or the Board when necessary. In accordance with section 373 (6), a member of the board of directors or board of management of a financial undertaking or a financial holding company who omits to take the steps necessary in the event of losses or imminent danger of material losses shall be liable to a fine or imprisonment for up to four months unless a more severe penalty is incurred under other legislation. This shall apply correspondingly for members of the board of directors or the board of management in a savings undertaking or electronic money institution or administrators of an estate under administration established pursuant to section 247(a) of the FBA. The DFSA has however, used section 350 to require a bank to stop granting loans to new customers. The DFSA has also exercised powers under section 349 to order the management of a bank to prepare an account of the financial circumstances and future prospects of the bank. There was sufficient evidence to demonstrate the supervisor has the powers to sanction a bank and individual members of the bank (including board) and that these powers had been exercised on occasion when warranted. The DFSA has several powers in relation to the board members or senior manager. The fit and proper rules have been uses as a preventive measure in several cases. The DFSA can in accordance with section 351 in the FBA compel a bank within a certain time limit set by the DFSA to remove the senior manager if the senior manager is no longer fit and proper in accordance with section 64 (2). The DFSA can also ask a member of the board to quit if the BOD no longer fulfills section 64 (2). In the EO on Management and Control of banks (section 10) it is established that the bank must be organized and structured in a way that ensures that the employees have clear powers and that the area of responsibility for the employees are clear. Each department

	must furthermore be manned with employees with relevant competences and with a relevant number of employees so that the department can fulfill its obligations successfully. The DFSA can compel the bank to change the organizational structure; however this power has not been used to date. Section 179 of the FBA gives the DFSA powers to order a parent undertaking (which owns equity investments in financial undertakings) to separate such financial undertakings and finance institutions in a subgroup under a financial holding company, under the following conditions: 1) the group is structured in a manner which entails that the parent undertaking need not meet the solvency requirement in section 170, 2) a member of the board of directors or the board of management of the parent undertaking falls within the scope of section 64(2), nos. 1, 2 and 4, or 3) the structure renders performance of the tasks of the DFSA difficult in other ways. Furthermore, section 180 of the FBA gives the DFSA power to order a financial holding company to dispose of equity investments in a financial undertaking. It should be noted that Section 179 and 180 have not been used to date.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	The DFSA does not have the power to ring-fence a bank within a group of companies. It does however have a range of other powers which can bring about the isolation of the bank when risk escalates to protect the bank from contagion. For example, the DFSA can order a FHC to dispose of an equity investment in a financial undertaking (e.g. bank) according to Section 180(1). Equally, section 179 permits the DFSA power to order a parent undertaking to separate subsidiaries in a subgroup. The DFSA also has the power to withdraw the license if the bank does not fulfill the capital requirement. If the bank has not taken any kind of legal action for example a decision to be resolved under the Financial Stability Act—then the license can be withdrawn and the DFSA will file a bankruptcy procedure in accordance with section 234 in the FBA. Although certain provisions in the FBA and the Act on Financial Stability adds to the legal framework of bankruptcy of banks, the general Bankruptcy Law applies to the bankruptcy of banks.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	The DFSA cooperates and collaborates with the FSC when it has been established that a bank is failing or likely to fail. This determination is with the DFSA solely. But once this has been established then the DFSA cooperates and collaborates with the FSC about the resolution of the problem bank.
Additional	

criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	There is no specific provision within the FBA to guard against the supervisor unduly delaying appropriate actions.
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of nonbank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	As an integrated regulator, the DFSA has responsibility for supervising banks, insurance undertakings, pension and securities which encompass most domestic financial firms. As a matter of protocol, the DFSA will advise other domestic agencies where necessary such as the Danish Business Authority, MoBG and FSC etc. Also, in accordance with Section 354b (1) The DFSA shall inform the public about cases it has dealt with, the prosecution service or the courts, and which are of public interest or of significance for interpretation. In accordance with Section 354a (1) Decisions made pursuant to section 345(1), 3rd clause and section 345(2), no. 1 shall be made public. Lastly, the DFSA must publish this information on its website.
Assessment re principle 11	Compliant.
Comments	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 and has included recommendations to revoke a banking license. The DFSA has a wide range of options to intervene at an early stage to require the bank to take actions. The DFSA has demonstrated a capacity to act even though the bank fulfills the regulatory capital requirements. The number of banks closed as part of a problem bank resolution is in the recent financial crisis in Denmark is 19. However, a framework geared for resolving SIFIs, including the preparation of recovery and resolution plans, is still an important missing element. The pending adoption of the EU Bank Recovery and Resolution Directive should expedite the process of reinforcing the Danish resolution framework, in line with international developments. While the DFSA does not have explicit powers to ringfence a bank, it has used various complementary powers to achieve the same outcome.
Principle 12	**Consolidated supervision**. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.[23]
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including nonbanking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking

[23] Please refer to footnote 19 under Principle 1.

	group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	There are a variety of different structures in Denmark for banking organizations: 1) Bank at the top of the chain with the possibility of subsidiary financial companies under it; this is far and away the most common model. 2) FHCs: a handful of banks are held by a company whose only function is the holding of shares of a bank and potentially of sister (to the bank) financial companies; 3) There are two instances where a bank is directly held by a mortgage credit institution; in each instance, the mortgage credit institution is itself held by a financial holding company; in this instance the MCI would on a consolidated basis be subject to the FBA (on a solo basis the MCI would be subject to the Mortgage Banking Act as well as the FBA) 4) In a handful of cases, a controlling interest in a bank is held by a non-financial company—these include a recent case where a grocery store company was allowed to establish a bank, as well as several situations where a formerly mutual savings institution was demutualized with the shares then held by a foundation—for ease of reference these are referred to below as non-financial holding companies. 5) In several cases a pension company owns the shares of a bank, and is subject to insurance regulation on a consolidated basis. In the analysis below, the assessors evaluate three structures for the application of the CP 12 criteria: One (bank-led groups), two (FHCs) and four (non-financial holding companies). Section 78, section 80 and sections 170-182 of the FBA apply various prudential requirements to the consolidated organization of bank-led groups, and the provisions of the EO-MC generally apply. This is not the case for non-financial holding companies, nor is it currently the case across the board for FHCs (solvency and fit and proper tests apply but the set of risk management and control requirements do not currently apply). After the commencement of CRR implementation the regulation of groups will be moved to the regulation where applicable, that is, article 11, subsection 1 and 2 in the CRR. Some adjustments are being made to apply explicit requirements to FHCs beginning Marts 31, 2014. Contagion and reputation risks are addressed in the FBA sections 179 and 182, particularly as they relate to exposures to related parties.
EC 2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.
Description and findings re EC2	The prudential regulations addressing consolidated supervision are particularly sections 170–182 of the FBA. After the commencement of CRR the regulation of groups will be

	moved to the regulation where applicable, cf. article 11, subsection 1 and 2 in the CRR. There will be some additional requirements in the FBA, e.g., solvency requirement for financial holding company on solo basis and section 179–182 in FBA will still apply. According to these regulations groups are subject to regulations regarding capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure including reporting on this to the DFSA. Only certain of these are applicable to FHCs (solvency, reporting of large exposures and exposures to related parties) and these are not applicable on a consolidated basis to groups where a non-financial company (e.g., grocery chain) is the ultimate parent. Financial reports are made on the basis of both bank consolidated and solo-bank basis and FHCs also have to file reports (non-financial holding companies are not required to file).
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings re EC3	It is primarily the largest banks in Denmark that have foreign operations, almost all of which are located in the EEA. Only three banks have foreign operations located outside the EEA: one with small operations in Switzerland; one with small operations in Russia, while Saxo has specialized trading platforms in a number of countries. The DFSA assesses as part of the supervision of foreign operations how management of the parent bank manages the foreign operations e.g. how the parent bank ensures that the foreign operations comply with Danish regulatory requirements (e.g., the EO-MC) and the bank's policies and guidelines. If a foreign operation is experiencing financial difficulties the DFSA assesses how management of the parent bank handles this situation. The kind of reporting the parent bank receives is assessed, primarily in association with an onsite examination. For foreign operations located in the EEA, there is no hindrance for the parent bank to get access to all material information from the foreign operations. If a bank wishes to establish foreign operations in a country outside the EEA the DFSA will, before the bank is given permission to start operations, ensure that the bank and the DFSA can get access to all material information. The DFSA will also ensure that the host supervisor conducts an effective and adequate supervision of the foreign operation. As mentioned above the activities in Russia are very limited and the customers are from the Nordic countries. The bank and the DFSA can get access to all material information. The DFSA expects banks to assess the competence of its management located outside of

	Denmark. Moreover, assessment of local management is part of the onsite examinations. At onsite examinations the DFSA has a meeting with the local management. At this meeting the DFSA assesses if local management has the necessary expertise to manage the operation. So far these assessments have not resulted in an order for the dismissal of a local manager. Supervision of the parent bank and its foreign operations in the EEA is discussed in the supervisory colleges.
EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct onsite examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	The assessment of whether an onsite examination of a bank's foreign operations needs to be conducted is part of the general assessment of the need to conduct onsite examinations. As described above, the DFSA conducts risk based supervision which also applies to foreign operations. The host supervisors are given the opportunity to attend the examination and are informed about the findings. The DFSA prepares a statement about the findings of the examination in a foreign branch or subsidiary. The parent bank has to publish the statement on its website. When determining the annual examination plan the necessary resources required for the examinations are allocated to the different examinations.
EC5	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.
Description and findings re EC5	The division responsible for solo supervision of a parent financial undertaking is also responsible for the consolidated supervision of the group which includes coordination of inspections, high level summit meetings, assessing the risk profile of the whole group, etc. DFSA can require access to and information from a financial undertaking, an FHC and a non-financial company, pursuant to FBA section 347. If a group does not fulfill its capital requirements including the individual solvency need, which may be laid down by DFSA (section 124(5)), on a consolidated level, DFSA may, in accordance with section 225(4) in the FBA, withdraw the license of a financial undertaking within a group. There are limited nonbank subsidiaries within groups—beyond those otherwise supervised by the DFSA such as mortgage credit institutions. The DFSA has utilized broad interpretations of its general authorities to review such operations.
EC6	The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:

	(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered
Description and findings re EC6	As noted above, the division responsible for solo supervision of a parent financial undertaking is also responsible for the consolidated supervision of the group, which includes coordination of inspections, organizing high level summit meetings, assessing the risk profile of the whole group, etc. Key knowledge gained on the solo level from onsite inspections in other divisions must be reported to the consolidated supervisor. The consolidated supervisor will on the other hand inform all divisions with interests in entities within the group about matters of general relevance, and advise the division directly involved of matters involving its specific entity. Financial undertakings may only carry out activities in accordance with section 7, 8, 9, 10 or 11 in the FBA and ancillary activities under sections 24–26 and section 29. In general financial undertakings may not directly or indirectly engage in activities in areas that are not associated with or a natural extension of the activity to which the undertaking have been granted permission (e.g., FBA section 7 regarding banking). As noted above, it is possible for a company engaged in other than financial activities to acquire a bank. According to Section 179, DFSA can order a restructuring of the group if, for example, the structure of the group makes it difficult to supervise the group; the restructuring referenced in that statutory provision would have all the financial companies in the group placed in a common holding company structure. If it is determined that the safety or soundness of a bank is compromised e.g. because the foreign operations expose the bank to excessive risk and/or are not properly managed the DFSA can according to section 350(1) of the FBA order the bank to take necessary measures within a time limit specified by the DFSA. The necessary measures could be the closing of foreign operations or limitations of operations abroad. According to section 350(2) of the FBA, the DFSA may withdraw the bank´s license where measures ordered have not been taken within the time limit specified. The DFSA has not ordered any banks to close or limit operations abroad.

EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.[24]
Description and findings re EC7	Solo supervision is the core element within the overall supervision process. Requirements are to be observed both at solo level and at group level. Acquiring a significant holding in a financial institution requires an approval from DFSA. Intragroup exposures also require approval from the DFSA. The division responsible for solo supervision of a parent financial undertaking is also responsible for the consolidated supervision of the group which includes coordination of inspections, high level summit meetings, assessing the risk profile of the whole group, etc. Knowledge gained on the solo level, e.g., from onsite inspections must if relevant continuously be reported to the consolidating supervisor within DFSA. The consolidating supervisor will on the other hand inform all divisions with interests in entities within the group about matters of general relevance, and advise the division directly involved of matters involving its specific entity.
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	There are provisions of the FBA that give the DFSA substantial capacity to review owners and senior management of companies, seeking to acquire a bank or FHC. However, no authority exists to do fit and proper reviews on an ongoing basis of owners and senior management of non-financial holding companies. Some information is provided at the time of acquisition by even a non-financial company. Section 61, 61 a-c, 62 and 63 in the FBA regulates personal and corporate ownership of financial undertakings and FHCs. In DFSA's assessment of an application for a company to acquire a qualifying interest in a financial undertaking or FHC, DFSA must under section 61 of the FBA ensure that account is taken of sensible and proper management of the undertaking in which the acquisition is intended. The assessment shall also take into account the likely influence of the intended acquirer on the undertaking, the suitability of the intended acquirer, and the financial soundness of the intended acquisition in relation to the following criteria, including: 1) The reputation of the intended acquirer. 2) The reputation and experience of the person(s) who will manage the financial undertaking or the FHC after the acquisition. 3) The financial situation of the intended acquirer, particularly with respect to the

	nature of the business to be operated or intended to be operated in the financial undertaking, or the FHC in which the acquisition is intended. 4) Whether the undertaking can continue to comply with the supervision requirements in the legislation, in particular whether the group of which the undertaking may become a part has a structure which makes it possible to perform effective supervision and effective exchange of information between the competent authorities as well as to determine how responsibilities are to be divided between the competent authorities. 5) Whether, in connection with the intended acquisition, there are grounds to suspect that money laundering or terrorist financing, cf. sections 4 and 5 of the Act on Measures to Prevent Money Laundering and Terrorist Financing, will occur.
Assessment of Principle 12	Largely Compliant
Comments	The approach to consolidated supervision of the groups that have the bank as the ultimate parent (the predominant form within Denmark) appears sound. Such groups are subject to regulations regarding capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure (and related reporting to the DFSA). However, only certain of these are applicable to FHCs with other than a bank as ultimate parent (solvency, reporting of large exposures and exposures to related parties) and these 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. Some adjustments are being made to make explicit requirements to FHCs, as currently a number of prudential requirements do not clearly apply. Moreover, no authority exists to do fit and proper reviews on an ongoing basis of owners and senior management of non-financial parent companies.
Principle 13	**Home-host relationships**. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	As the consolidated supervisor for the Danske Bank Group, the DFSA has established a supervisory college in accordance with the revised CRD 2009/111/EC art. 42, 42a and 131a and CEBS' guidelines for "the operational functioning of supervisory colleges" (GL 34). The supervisory authorities of subsidiaries and significant branches are all members of the college. There are eight countries represented in the core college and 12 in the general

	college. Mapping work to ensure appropriate representation is updated every year. The DFSA participates in all the colleges where a foreign banking group has established relevant subsidiaries or significant branches in Denmark (4 colleges), as required by FBA 344. The four banks are Nordea, Svenska Handelsbanken, SEB, and DnB—the first three subject to home country supervision by the Swedish authorities, and the last by the Norwegian authorities. The CEBS guidelines (GL 34) will be replaced by CRD IV and the supplementary binding technical standards for colleges of supervisors.
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group[25] and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	The DFSA is very open in the sharing of information with other supervisors, consistent with the high transparency it exhibits in making most of its supervisory decisions public. The DFSA shares appropriate information on a timely basis both as home and host supervisor in accordance with the revised CRD 2009/111/EC art. 44-52 and art. 131a, art. 132 and CEBS GL 34, chapter 2. The CEBS guidelines will be replaced by CRD IV and the supplementary binding technical standards for information exchange. Types of information which is customarily shared between supervisors include: • Material from the bank, e.g., capital plans, risk reports; • Proposed supervisory measures regarding the bank, provided they have been fully vetted internally; • Results from inspections; • National reports and analysis relevant to the supervisors e.g. political agreement on SIFIs, report on the financial crisis in Denmark; • News from the Danish financial sector with potential relevance to the Group, e.g., acquisitions. Once a year the DFSA produces a Joint Risk Assessment report (representing the Joint Risk Assessment Decision or JRAD) for Danske Bank in cooperation with the supervisors of subsidiaries and significant branches. In the Joint Risk Assessment report all relevant risks

[25] See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	of the Group are described and analyzed. On the basis of the JRAD the supervisors of the subsidiaries and the DFSA agree on the Joint Decision on the adequate level of capital in the Group and in the subsidiaries. In all the colleges the DFSA participates in, memoranda of understanding have been established between the supervisors, most importantly the Nordic-Baltic MoU.
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	The DFSA monitors all supervisory activities through the Joint activities plan in accordance with CEBS GL 34, chapter 7. The Joint activities plan is regularly updated and discussed at the college meetings twice a year. The activities are both national and joint activities. Examples of recent joint inspections in relation to Danske Bank are the joint liquidity inspection and the joint IRB follow-up meeting in 2013.
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	The agreed MoUs form the basis of the communication between the supervisors. In practice, the colleges are well functioning and the supervisors can have a common understanding of the communication with the banks. The process following all joint activities includes a consultation procedure with the authorities involved, where views are discussed and outcomes agreed upon.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	The DFSA has developed a framework for the planning and coordination of supervisory activities in preparation for and during emergency situations in accordance with art. 131a of CRD and CEBS GL 34, chapter 8. The document addresses information sharing in the Danske Bank college in a crisis situation and provides the overall structure of the set-op. The overall aim is to gain insight into the crisis situation at hand and to interact at as early a stage as possible in order to enable timely actions and preventive measures. Parts of the information to be exchanged between the supervisors in the college are based on a predefined set of information. The document includes preparation before a crisis situation (including contact information, means of communication and crisis scenarios); check list for communication during a crisis situation; predefined set of information to be exchanged and other preparatory arrangements.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home

	supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	As discussed in BCP 9, the DFSA has not established a general resolution planning regime but has extensive experience in dealing with failing banks. Denmark introduced a national resolution regime—Bank Package 3 in 2010 (Act no. 721 of June 25, 2010 and Executive Order no. 1135 of September 29, 2010). The regulation allows for a controlled winding-up of a distressed bank through the company established by the Danish Ministry of Economic and Business Affairs (Financial Stability Company). If the DFSA sets a deadline by which a bank must meet the Danish capital adequacy requirements, the bank will be required to inform the DFSA as to whether it will use the controlled winding-up procedures (normally a faster process) or will go through the traditional bankruptcy procedures as established under Danish law. Bank Package 3 will transition into the harmonized EU regulations (e.g. the upcoming Bank Recovery and Resolution Directive) once these come into force. In the political agreement concerning the regulation of SIFIs (October 2013) it was decided that the regulations for the crisis management of SIFIs and other banks and mortgage-credit institutions will not be established until forthcoming common EU crisis-management regulations have been agreed upon. The resolution plans must be drawn up for all Danish SIFIs by no later than January 1, 2016, by the national resolution authority in close dialogue with the SIFIs and with the involvement of the DFSA and the DN. If an agreement on common EU crisis-management regulations is not reached in the years ahead, the political parties will discuss the need to revise the resolution scheme currently in effect in Denmark.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	National treatment is clearly in place, as the Danish subsidiaries of foreign banks must follow the same rules as other Danish banks, and since all FBOs branches in Denmark are those of EEA banks, their activities follow EU regulation (CRD articles 23–28).
EC8	The home supervisor is given onsite access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Section 345a of the FBA allows supervisory authorities of foreign branches to perform inspections in Denmark after having notified the DFSA. The DFSA has likewise often performed onsite inspections in foreign jurisdictions of both subsidiaries and branches. In both instances, the standard practice is for the host supervisor to share findings with the home country supervisor at the completion of the review.

EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	The DFSA does not permit shell banks or booking offices.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	The DFSA follows this general practice. Its representatives discussed with the assessors some examples including sharing with the home country supervisor information on discovered deficiencies in the IT-security framework prior to the home supervisor's taking of action.
Assessment of Principle 13	Compliant
Comments	The DFSA works very closely with other national supervisors in well-designed and implemented colleges. As discussed in BCP 9 the DFSA has not established a general resolution planning regime for the largest banks but has extensive experience in dealing with failing banks.
B. Prudential Regulations and Requirements	
Principle 14	**Corporate governance**. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management,[26] and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	The EO on Management and Control of Banks ("EO-MC") regulates the responsibilities of the BoD and BoM (see EC 4 for a discussion of how this term is used) and the division of responsibility between them. As set out in Section 6 of the EO-MC., the BoD must establish written guidelines for BoM with clear descriptions of their range of authorities. The guidelines are established on the basis of the risk assessment carried out by the BoD as required by Section 4(1) of the EO-MC and of the risk management and other policies adopted pursuant to Section 5 of the EO-MC. Section 2 establishes an ongoing responsibility of the BoD to assess whether the guidelines

[26] Please refer to footnote 27 under Principle 5.

	for senior management are appropriate in relation to the business activities, organization and resources of the undertaking etc. and to monitor that the senior management performs its duties appropriately and in accordance with the risk profile, policies and guidelines laid down. Furthermore, the BoD must ensure that reporting and information from the BoM to the BoD is sufficient for the work of the BoD, and monitor that the undertaking has effective forms of corporate governance. The EO-MC regulates the responsibilities of the BoD and BoM, as well as providing guidance more generally on how to manage a financial company properly from a corporate governance perspective. A main focus of DFSA's inspections is to ensure that EO-MC is complied with and that a bank has the necessary guidelines and effective control systems in place. As discussed in the following EC, a key element in its approach is interaction with the Chairman of the BoD and review of relevant BoD documents.
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	As discussed in EC 1 the BoD and BoM have a variety of obligations which are aimed at ensuring a robust governance system for the bank. As part of the DFSA onsite inspections the DFSA reviews, either prior to the inspection or during the inspection, the rules of procedure of the BoD, the minutes of the meetings of the BoD and the BoD's self-assessment. The DFSA interviews the Chairman of the BoD regarding this material, and more broadly to determine whether the bank has a robust governance system. During the inspection, the DFSA reviews the policies of the banks and their implementation, and the banks' compliance with the EO-MC. The DFSA requires banks to correct any deficiencies in a timely manner, by issuing orders or risk information to correct the deficiencies within a short timeframe and to report back to the DFSA when the corrections have been made.
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members
Description and findings re EC3	The DFSA has established requirements for banks to ensure the appropriate set of skills on their BoDs, and has demonstrated to the assessors that examiners regularly review such assessments (in regulars inspections that build on the work of a special horizontal review done in 2012). The DFSA has not as yet provided guidance on the nomination process, nor has it established requirements for risk committees (although it has for audit and

	remuneration committees at least for larger banks); these shortcomings will be significantly addressed with the adoption of CRD-IV. Under Section 3 of the EO-MC, all financial companies are required to at least once a year assess whether their BoD has the adequate skills and knowledge to ensure an appropriate operation of the financial company given its business model and associated risks. As set out in the DFSA Guidelines on Self-Assessment of the Required Skills and Knowledge of the Boards of Directors of Credit Institutions, a BoD of a large or medium-sized bank (banks belonging to groups 1 and 2) must also have at least one board member with management-level experience from a relevant financial company. Denmark is in the process of implementing the CRD IV (Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC), including the provisions on nomination committees. Until then, Danish legislation does not include regulation specifically dealing with the process for nominating and appointing Board members of banks, other than the general requirement for ensuring that Boards have the adequate skills and knowledge, as described above. In general, the review of board qualifications is a main element in all DFSA onsite inspections, beginning with an interview with the chair of the BoD. Also on the inspection the DFSA will read the minutes of the board meetings since the last inspection. As a part of the review of the minutes the DFSA will go through the BoD's self-assessment in order to evaluate whether the BoD as a whole has the necessary skills and knowledge. The BoD's consideration and deliberations in regards to its self-assessment must be written into the board meeting minutes as required by the DFSA Guidelines on Self-Assessment, and the DFSA will use these as well as interviews with the BoD to evaluate the BoD's process for self-assessment and to ensure that the BoD as a whole adequate skills and knowledge. In 2012 the DFSA conducted a horizontal review regarding the BoD's self-assessments by all banks under the DFSA Guidelines on Self-Assessment of the Required Skills and Knowledge of the Boards of Directors (see EC 8 for a full description of the results). In regards to committees, Denmark has implemented the Capital Requirements Directive 3 (Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitizations, and the supervisory review of remuneration policies), including the requirements to set up an audit committee and a remuneration committee. As such, Section 77c of the FBA requires financial undertakings and financial holding

	companies that are listed or have on average 1,000 or more full-time employees in two consecutive financial years to set up a remuneration committee consisting entirely of independent board members. The composition and tasks of the committee are further regulated in Section 77c. The members of the committee should have the necessary skills to be able to give advice to the rest of the BoD on questions regarding remuneration issues. Section 2 of the Executive Order on Audit Committees in Companies and Groups under Supervision of the DFSA requires listed companies and companies that have a balance sheet total of DKK 500 million or more in two consecutive financial years to set up an audit committee. The audit committee is also made up entirely of board members and must contain at least one member who is independent and who has qualifications in regards to accounting, the level of which depends on the size and complexity of the company. The BoD of all remaining financial companies are required to at least once a year evaluate the need to establish an audit committee while taking into account the complexity of the company. The audit committee is subject to a series of regulatory requirements set forth in Section 2. Danish legislation does not at present include requirements to set up a risk committee, but such requirements will be introduced when Denmark implements the CRD IV which includes provisions on risk committees on companies that are listed or have an average 1,000 or more full-time employees in two consecutive financial years. The assessors have reviewed Annual Reports of two of the largest banks, which both have already established risk committees.
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty."[27]
Description and findings re EC 4	In accordance with Section 64(1) of the FBA, a member of the BoD or BoM of a financial company must be approved by the DFSA as fit and proper in accordance with Section 64. Members of the BoD or BoM must submit information to the DFSA in order for the DFSA to be able to make an assessment of the person's fitness and property. In response to questions posed to the DFSA, the assessors were given a writing by the DFSA on the definition of BoM, advising that the term BoM (or management board) has the meaning it has in the Danish Companies Act: that is, managers hired by the BoD to be responsible for the day to day management of the company. For smaller banks it could be

[27] The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

	just the CEO (or co-CEOs). For the largest banks, it could include the heads of the key business areas as well as such people as the Chief Financial Officer. There is considerable judgment that can be exercised by the bank in determining who is a member of the BoM. Members of the BoM are required to be registered with the Danish Business Authority and are able to sign on behalf of the company. As noted, BoD members and the members of the BoM are subject to the fit and proper review of the DFSA. In a required submission, the institution must inform the DFSA of whether or not the person previously has been assessed as fit and proper by the DFSA or in another EU/EEA country as well as submit information in regards to previous employment (10 years back) and current and previous board memberships (10 years back). Further, information in regards to any suspensions of payments or bankruptcies must be submitted, as well as a copy of the individual's judicial record (the individual must get a from the police, attesting to his/her not having been convicted of a crime in the past five years. The prospective BoD or BoM member is obligated to inform the DFSA of any additional information which may be of importance to the DFSA when determining fitness and propriety. Following fit and proper approval, members of BoD and the BoM are under an obligation to inform the DFSA of any changes in the information given in regards to their fit and proper assessment and of any change that may materially adverse the assessment of their fitness and propriety. Section 64 requires, among other things, that the board member must not have behaved or behave in such a manner that there is reason to assume that the person in question will not perform the duties and responsibilities as board member adequately. As such, fit and proper approval requires board members to exercise duties of care and loyalty upon and following approval, and the DFSA has the means to order board members to resign their position if this is not the case as discussed in EC 9. Approval of applications can be made by the Director General of the DFSA. Denials can generally be made by the Financial Council; when proposed directors clearly do not meet even baseline fitness criteria, the Financial Council has delegated authority to deny to the Director General.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite[28] and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and	The DFSA requires that many of the objectives of EC 5 are met, although it does not

[28] "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

findings re EC5	specifically require issuance of codes of conduct, or overall conflicts of interest polices. It has issued guidance on the core elements of a risk appetite statement, focusing primarily on the approach to credit risk taking and the setting of appropriate limits. According to Section 2 of EO-MC, the BoD has to decide on the business model of the undertaking and must monitor that the BoM performs its duties appropriately and in accordance with the risk profile, policies and guidelines laid down for the senior management as well as to monitor that the undertaking has effective forms of corporate governance. There are no explicit requirements regarding establishing a code of conduct or conflicts of interest policies in the FBA. In the EO on organizational requirements for investment firms (including banks with IF license) section 16, there are requirements for identifying and mitigating conflicts of interest. Section 26 of the EO-MC does require that companies have a strong overall control environment which ensures that the undertaking has control systems for all tasks and duties which may cause a risk for the undertaking. This includes control of compliance with any delegated authorities, compliance with limits for risk taking, etc. Before an onsite inspection, the bank must submit documentation to the DFSA including a description of the bank's organization, the bank's risk policy, the bank's guidelines and the bank's written procedures as well as the bank's management reporting including reporting from the chief risk officer and the chief compliance officer. The received documentation is reviewed by the DFSA before the onsite inspection and is used to help plan the details of the onsite inspection. When conducting onsite inspections the DFSA verifies that the BoD has approved the bank's risk profile and implemented this in the bank's risk policy. The DFSA also verifies that the BoD has issued written guidelines for the bank's risk taking and that the guidelines are in line with the bank's risk profile. The DFSA's inspection of a bank includes a review of the guidelines from the BoD to the BoM and from the BoM to other divisions of the undertaking. During the onsite inspection the DFSA reviews how duties are carried out and discusses any discovered weaknesses in the system within the undertaking in order to ensure that the control functions actually work. The DFSA's inspection includes a review of reporting to the BoD in order to evaluate whether the BoD has sufficiently overseen implementation of the bank's risk policy, guidelines and other structures across the firm.
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.

Description and findings re EC6	The DFSA does not require the banks to have specific standards for the BoD selection of senior management. Section 10 (2) of the EO-MC requires that each organizational entity be staffed by employees with relevant competences on a sufficient level. It is a part of the DFSA inspections to evaluate whether employees on different management levels have the relevant competences and are able to execute their duties. When conducting onsite inspections the DFSA interviews among others the bank's heads of business lines and the chief risk officer in order to determine whether this requirement is met. As discussed in EC 4, the BoM is subject to a fit and proper review by the DFSA; other members of senior management are not subject to such review.
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	Section 77(a) of the FBA establishes a number of compensation principles for BoD, BoM and material risk takers that are designed to ensure an appropriate compensation policy is established for the bank's long run safety and soundness. These include maximum levels of variable compensations to base salary (50 percent), minimum proportions of stock to overall variable compensation (50 percent) and the use of deferred payments (40 percent—60 percent over three year periods, depending on the size of the grant. Adherence to these requirements is reviewed by DFSA examiners. The DFSA has a team consisting of five to six employees which specializes in corporate governance and remuneration. The corporate governance team carries out a risk based inspection of remuneration of members of the BoD and BoM and material risk takers in all financial companies. The DFSA's corporate governance team collects comprehensive remuneration data from all financial institutions and the financial holding companies on an annual basis. The DFSA's corporate governance team reviews all the data and discloses a national remuneration benchmark report by the end of each year. If the DFSA discovers inconsistencies between the submitted remuneration data and the Danish remuneration regulation the DFSA asks the institutions to verify the data and/or explain the inconsistencies. The DFSA also carries out offsite and onsite remuneration inspections at selected institutions and oversees the design and operation of the bank's and banking group's compensation system including the incentives program and performance standards. Prior to conducting an onsite inspection regarding a bank's remuneration system, the bank is asked to submit: the bank's remuneration policy for the BoD, BoM and material risk takers; the remuneration policy for the bank's subsidiaries, if any; documentation for the

	BoD's yearly review of the bank's remuneration policy; the Chairman of the Board's report on remuneration included in his annual statement for the previous years; and a list of persons identified as material risk takers in the bank and in the bank's subsidiaries, if any, with an explanation of why the individuals have been identified as material risk takers. The bank is further asked to describe the types of instruments granted as variable remuneration in regards to Section 77 (1)(3) of the FBA as well as submit any audit or compliance report on remuneration from the previous years. The DFSA oversees the rectification of any discovered deficiencies.
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g. special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	As discussed in EC 3 and EC 4 the DFSA conducts a thorough evaluation of whether the members of the BoD and BoM are suitable for their position, both in regards to the skills and knowledge of the BoD as a whole and in regards to each individual member's fitness and propriety The DFSA issued some guidance in 2010 on the composition of Boards and more detailed guidance in 2012 (Guidelines on Self-Assessment of the Required Skills and Knowledge of the BoD of Credit Institutions) as a prelude to a horizontal review. For example, the largest banks (group 1 and group 2) were expected to have a director with senior management experience at another financial institution, and all banks were expected to have directors with knowledge in the risk areas of the bank's business models. The DFSA then carried out a horizontal review of the board qualifications in all banks in the fall of 2012. The DFSA first sent out the new guidance to all banks on July 4, 2012 and asked that the BoD carry out a self-assessment exercise in accordance with the guidelines and reported the results hereof back to the DFSA by November 1, 2012. All Danish banks carried out such a self-assessment exercise and reported back to the DFSA. The DFSA evaluated the self-assessment results received from the banks and reported its findings back to the banks. The assessors reviewed with DFSA examiners the results of the review: nearly half (7 of 15) of the largest and medium sized banks did not have on their board a person with necessary senior experience, and over one-quarter of the overall set of banks (25 of the then 94) lacked directors with necessary background in the specific or general risks faced by the bank (e.g., market risk, real estate, applicable legislation, etc.). The DFSA then ensured that all the gaps were promptly addressed. The assessors commend the DFSA for undertaking the systematic review and continuing to ensure the proper mix of skills on Banks' boards. As discussed in EC 7, the DFSA also supervises whether managers at other levels have the necessary competences to perform their job.

EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	The DFSA is able to require changes in the composition of a bank's BoD and BoM in situations where individuals are not fulfilling their duties and also in situations where the BoD and BoM as a whole does not meet the requirements in regards to collectively having the necessary qualifications. If the DFSA finds that a member of BoD or BoM no longer fulfills the requirements of Section 64 of the FBA and is thus no longer deemed to be fit and proper and able to occupy the position as board member, the DFSA may, in accordance with Section 351(2) of the FBA, order a director to resign his position within a time limit specified by the DFSA. With regard to members of the BoM the DFSA may, in accordance with Section 351 (1) of the FBA, order a financial undertaking to dismiss a member of the BoD within a time limit specified by the DFSA. In cases where the DFSA intends to order a BoD or BoM member to resign his position as member of the BoD or BoM, the DFSA consults the parties involved, in such cases the individual BoD or BoM member and the financial undertaking, from which the DFSA intends to order the BoD or BoM member to resign, by submitting a draft decision for their examination and comments. It is a requirement in the Danish Public Administration Act that parties involved in a decision must be informed of the factual grounds of the decision and given an opportunity to comment on these facts, before an authority can make a final decision in the case. This is, however, only a requirement in regards to facts which are disadvantageous for the individual and which are essential to the case. After the consultation period has passes, the draft decision is submitted to the Financial Council. Among other things, the Financial Council decides on matters of principle, which includes all cases regarding fitness and propriety, where the DFSA intends to order a member of a BoD to resign his or her position. The parties involved may speak before the Financial Council, before the Financial Council considers the case. The Financial Council makes a decision in the matter, and based on the Financial Council decision the DFSA implements the final decision. The DFSA is also able to issue other supervisory reactions if the BoD or BoM does not meet the collective qualification requirements of that specific company. In such cases, the DFSA may provide a risk statement or order the company to remedy such violation.
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and	The FBA requires board members and the BoM to notify the DFSA in such situations.

findings re AC1	According to Section 64(3) of the FBA, members of the BoD or BoM of a financial undertaking is required to submit information to the DFSA on the circumstances mentioned in Section 64 (2) when applying for fit and proper approval in connection with their appointment to the management of the undertaking, and following the fit and proper approval if the circumstances subsequently change. While there are these personal responsibilities on individuals, there is no specific legal requirement on banks to report material changes in information concerning the fitness and propriety of a Board member of member of senior management.
Assessment of Principle 14	Largely Compliant
Comments	The DFSA has a good overall approach to governance. Its carrying out of a horizontal review of the appropriateness of the composition of BoDs and then following through to make sure necessary changes were made is a clear example of strong supervisory oversight. There are a few gaps in governance requirements, most notably not yet requiring the establishment of risk committees even for firms whose risk profile and systemic importance would indicate they should be in place (to be required April 1, 2014). Other elements that could be made more explicit include: codes of conduct, and overall conflicts of interest polices to ensure independence in the validation of models; and making banks be subject to a requirement to report material changes in information concerning the fitness and propriety of a Board member of member of the BoM to the DFSA (to supplement the current personal obligation).
Principle 15	**Risk management process**. The supervisor determines that banks[29] have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate[30] all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.[31]
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that

[29] For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

[30] To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

[31] It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	Through the FBA and provisions in the EO-MC, the DFSA provides detailed requirements to banks on the key elements of the risk management framework they need to put in place. The requirements are appropriately extensive and well spelled out, although there are areas for refinement such as on the application of the framework to financial holding companies (in train). Section 70.1 of the FBA sets forth the overall requirements on the BoD of a bank to identify and quantify significant risks of the bank and determine the risk profile of the bank, including which types of large risks the bank may accept and to what extent. It further makes explicit that the Board shall lay down policies for how the bank is to manage all significant activities of the bank and associated risks. Pursuant to EO-MC section 2, the DFSA has established rules that make clear that a key responsibility of the BoD is aassessing whether the risk profile and policies of the bank and guidelines for the BoD, are appropriate in relation to the business activities, organization and resources of the bank. The DFSA is currently amending the EO-MC to apply explicitly these requirements to financial holding companies, in line with a proposed amendment to sections 70 and 71 of the FBA and the CRD IV in general; the amendments will go into force on March 31, 2014. According to EO-MC section 4 the BoD shall carry out an assessment of the risks of the bank. On the basis of the risk assessment the Board shall, according to section 5, adopt the relevant policies on credit, market risk, operational risk, liquidity risk, etc. On the basis of the risk assessment and the policies adopted, the Board shall provide the senior management with guidelines pursuant to EO-MC section 6, which under section 7 include controllable limits for the size of the risks the senior management is authorized to take on behalf of the bank. The Board shall decide which information and reports the Board shall have in order to have a full picture of the risks in the bank. The DFSA will scrutinize and evaluate the material requested from the bank ahead of the

	onsite inspection. During the onsite inspection the supervisor will interview relevant staff members in the bank. The quality of the material and the results from the interviews will allow the DFSA to assess if a sound risk management culture is established throughout the bank. By examining the policies and relevant processes concerning for example the bank's credit activities, market risk activities etc., before the onsite inspection takes place, DFSA will be able to use that review in order to assess onsite whether the risk profile and policies are consistent with the management strategy and established risk appetite. The DFSA will also be able to assess if the bank's risk profile and its risk appetite seem to be different from other comparable banks' risk profiles and risk appetite. During the onsite inspection interviews with relevant staff members can confirm if DFSA's preliminary assessment of the risks of the bank is correct or not. DFSA will also assess whether guidelines for the BoM are appropriate for the bank's risk appetite, its risk profile and the strength of its capital. The ICAAP process and stress testing reviews will be used to assess how well banks are prepared for potential vulnerabilities and external developments. Based on the material and the interviews the DFSA will conclude whether the conditions listed in EC1 (a)–(e) are met. As discussed in BCP 11, if the bank does not comply with the provisions of the EO-MC or other EOs, the DFSA may order the bank to comply or issue supervisory information. This is true generally for the specific issues covered within the various ECs enumerated below.
EC2	The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate: (a) to provide a comprehensive "bank-wide" view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and findings re EC2	The DFSA ensures that the banks comply with the rules by examining the banks' financial reporting to the DFSA and, particularly, by conducting inspections in the banks onsite. Assessment of risk management is a substantial part of the onsite inspections According to the EO-MC, the CRO and the risk management function are held responsible for ensuring that the risk management in the bank is carried out appropriately, and that an overview is established of the risks of the bank and the overall risk profile (inclusive of its subsidiaries). Furthermore, the annexes of the EO-MC contain very detailed regulations of the different types of risks and how these need to be managed by the banks.

	Banks, designated as systemically important, must in future legislation meet the enhanced requirements for risk management in CRD IV. A key element in the revised EO-MC which enters into force on March 31, 2014, will be the establishment of a commission to consider what should be substantively changed; the work the commission is expected to be done by June 30, 2014. (There are 10 Danish domestic SIFIs—five largest banks, two largest mortgage credit institutions, two banks in the Faroe Islands, and one in Greenland.) Before the start of an onsite inspection DFSA will request relevant material regarding the bank's risk management policies and its processes. DFSA will scrutinize the material to assess if it provides a comprehensive "bank-wide" view of risks across all material risk types. DFSA will also assess if the material is relevant for the chosen risk profile and if it is sufficient according to the systemic importance of the bank, and if the processes are adequate to assess risks arising from the macroeconomic environment. During the onsite inspection DFSA will determine by interviewing the staff in the relevant entities if the processes are adequate to provide a comprehensive view of the different kinds of risks. The DFSA will also determine if the processes are adequate for the risk profile and the systemic importance. Finally DFSA will assess if the processes are adequate for the risks arising from the markets in which the bank operates.
EC3	The supervisor determines that risk management strategies, policies, processes and limits are: (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.
Description and findings re EC3	Pursuant to EO-MC sections 15, 17 and 18 the bank shall have properly documented and updated policies, limits, procedures etc. that reflect the bank's risk profile. The bank shall be organized such that risk management strategies, policies etc. are clearly communicated within the bank. According to EO-MC section 4, the BoD has to carry out an assessment of the risks in the bank as an ongoing process. Regarding exceptions to the established policies and limits, reports to all relevant management levels are required to be made (EO-MC section 26). A couple of weeks before the onsite inspection takes place, DFSA will receive and scrutinize the requested material, covering risk management strategies, policies, processes and risk limits from the bank. The DFSA reviews that the risk management strategies, policies,

	processes and limits are properly documented, regularly reviewed (they should be dated), appropriately adjusted and accessible and communicated to the relevant parts of the bank's organization. During the onsite inspection the DFSA will assess by checking the Board Minutes if the requested material has been submitted to the Board according to EO-MC annex 6 regarding the business procedures of the BoD.
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	The DFSA has regulations detailing requirements that the BoD has the capacity to understand the risks to ensure proper operation of the bank, that in conjunction with senior management it ensures that the risks are appropriately addressed, and the BoD and BoM receive necessary reports. These elements are reviewed in the onsite process. Pursuant to EO-MC section 3, the BoD has to regularly assess whether its members collectively possess the necessary knowledge and experience regarding the risks of the bank to ensure appropriate operation of the bank. This applies in particular to the bank's use of models for risk calculation, to the introduction of new products, and to the undertaking of other initiatives which could involve an increased risk for the bank or which could significantly influence the way in which risks are calculated and reported in the bank. According to EO section 9.5, the senior management has day-to-day management responsibility for ensuring that the undertaking only accepts risks to the extent necessary (for its business model). Pursuant to EO section 26 regular written reports shall be issued at all relevant management levels on compliance and utilization of all limits for risk assumptions contained in the guidelines pursuant to EO section 6 or in the authority transferred, cf. section 5.2. During onsite inspections DFSA's supervisors review the BoD's work by reading BoD minutes and reviewing the reporting to the Board. DFSA also hold a meeting with the Chairman of the Board. The purpose of this is to establish how the BoD works, how it is informed and whether the CEO is challenged by the BoD. Usually DFSA may request the reporting to the BoD before the onsite inspection takes place. The DFSA also examines the Board's compliance with the requirement to evaluate the competence and experience of the Board.
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.

Description and findings re EC5	Based on the business model the BoD has set for the bank, pursuant to EO-MC section 2, section 4.1 and section 5, the Board determines the individual solvency need of the bank (ICAAP), reflected in section 6.3. The DFSA assesses annually the bank's ICAAP, or more often if needed. The bank must report its ICAAP to DFSA under the EO on Capital Adequacy Guidelines (EO-CAG), issued 2013. Also at most onsite inspections DFSA assesses the bank's solvency requirement, as a central focus point. The DFSA examines the ICAAP process, the ICAAP methods and whether the actual capital set aside is sufficient to cover losses. This includes the evaluation of credit exposures and examination of losses due to other factors, including market risk and operational risk.
EC6	Where banks use models to measure components of risk, the supervisor determines that: (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.
Description and findings re EC6	If the bank uses its own models on credit risk, market risks etc., the bank must obtain the approval of DFSA before the model is used for capital adequacy purposes. The bank must maintain continuously validation and stress tests of its models and report the results to the DFSA under the EO-CAG. The DFSA also monitors banks' compliance with the validation requirements in for example annual IRB status meetings, actual IRB inspections, and in connection with applications for model changes. The DFSA assesses whether the output of each internal model appears reasonable as a reflection of the risks assumed by the bank. If the outputs do not seem to be reasonable, the supervisor will ask the bank to provide further information and data regarding the results of the model. With respect to internal models for credit risk, the reasonableness of model outputs is also assessed as an integral part of credit inspections. As described to the assessors by DFSA supervisors, the DFSA's credit experts go through a high number of specific customers and assess whether assigned ratings and allocated capital are in line with expert judgment. The DFSA has also used benchmarking across IRB institutions as a tool for assessing the reasonableness of model output and such benchmarking will grow in importance in the coming years, cf. Article 78 in CRD. In relation to VaR-models the banks must undertake a model validation every year, which the DFSA reviews. The extent to which validation is done by independent units within the

	bank varies as the DFSA does not have clear guidance on that. The DFSA has advised the assessors that even in a large institution that some (market risk) validation is performed by the same group or by persons who are responsible for model development, a matter that is under DFSA review. In conjunction with model validation, the DFSA assesses the back-tests of the VaR-models quarterly in order to test the VaR-model. Banks also provide the DFSA with information and background on back-test exceptions when they occur. The main focus of the quarterly review is the number of exceptions and a general analysis of the P/L vs. the upper and lower limits. More generally the material on back-tests that the DFSA receives is reviewed, to assess the accuracy and completeness of the data.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	During onsite inspections DFSA evaluates if the bank's information systems are adequate for measuring, assessing and reporting on all the bank's risks. The DFSA also evaluates if the risk measurement and risk reports reflect the bank's actual risk profiles, including liquidity risk and capital requirements. The DFSA has the powers to impose additional requirements to the bank's risk management, liquidity and capital requirements if DFSA does not believe that the risk is adequately addressed.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products,[32] material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	Pursuant to EO-MC section 9.3 and 9.8 the senior management must ensure that the policies and guidelines adopted by the BoD are implemented in the day to day operations of the bank. The CEO has to approve the guidelines of the bank for development and approval of new products (which may impose material risks on the bank), new counterparties or customers, and changes to existing products by which the risk profile of the product is changed significantly, cf. section 28. It follows from the DFSA practice that all functions in the bank shall sign off that they are able to manage the new product before it is launched. In Section 28, it is required that the internal guidelines shall state which general conditions are to be analyzed an documented, including the nature, size and

[32] New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	calculation of risks for the undertaking, effects on the costs and revenues of the undertaking, the possibilities of the undertaking to operate in new markets, the effects on the solvency of the undertaking, accounting treatment. Furthermore there shall be provisions on guidelines which establish that new products and services, which may involve significant new risks for the undertaking or customers, shall be submitted to the board of directors for their decision on whether utilization of the new product implies changes to the policies adopted pursuant to section 5 or the guidelines issued pursuant to sections 6 and 7, including establishment of special principles for calculation of the risks associated with the product. During onsite inspections the DFSA assesses the bank's compliance with the provisions of the EO-MC, including ensuring that the bank's management is aware of the risks assumed by the bank and that major activities or decisions of unusual nature are taken at the right level of management. It is a substantial part of the onsite inspection to interview the Chairman of the Board, read all the Board Minutes after a former onsite inspection and to assess the Board's self-evaluation and handling of situations in general.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	According to EO-MC section 12–14 the bank should have a segregation of duties that ensures that entities which dispose do not report to a manager who is responsible for entities which carry out settlement, return and risk calculations, internal control or reporting. Segregation of duties has been clarified in annex 1, # 9, annex 2, # 6, annex 4, # 20 and annex 5, # 6 b) in the EO. Pursuant to EO-MC section 10.2., each organisational entity shall be staffed by employees with relevant competences at a suitable level. The number of employees, together with their competences, shall ensure that the entity can carry out its tasks adequately. Risk exposures should be reported directly to the BoD and the senior management according to section 7.6 and 7.7. cf. section 26 and annex 1–5. According to section 199.11 in the FBA, DFSA shall lay down provisions on audit processes in the banks. The DFSA may lay down provisions on internal audit. DFSA has issued Executive Order on Auditing Financial Undertakings etc. no.1024 of 21 August 2013. The relevant regulation regarding internal audit can be found in EO-AFU section 45.2. During onsite inspections DFSA assesses on a risk based approach the bank's compliance with the provisions of the EOs, including segregation of duties, if the bank has appropriate staff resources, appropriate procedures, adequate reporting etc. DFSA reviews the relevant

	entities and assesses the human resources and IT systems related to the particular entity and the activities, cf. EO section 10.2. and annex 5. Beforehand and during the onsite inspection the reporting from risk management will be scrutinized and challenged in meetings with the CRO. The assessment of staffing is judgmental and outcome focused, as examiners described to the assessors that the question they seek to answer is "does the staff carry out its responsibilities effectively", not the more conceptual question "do they have the right number of staff". The specific functions and organizational entities of the bank are also examined in order to establish whether they are sufficiently staffed. This is done by interviewing the management of the specific entities.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	The DFSA uses a proportionality approach in practice with increased expectations for the largest banks, although most rules apply equally to all banks. Sections 19, 20 and 21 in the EO-MC define the requirements of the CRO and the risk management function for all banks. A clarification, that the removal of the CRO requires the Board's approval is included among the changes in the new draft of the EO. During onsite inspection the DFSA will examine the organization and the function of the dedicated risk management entity. The DFSA will evaluate if the CRO/ risk management department complies with the requirements set out in the EO-MC. For a smaller bank, the CRO role may be a part-time role for a person who carries out other responsibilities as well (even that of the CEO).
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	The DFSA has issued detailed annexes to the EO-MC regarding credit risk (annex 1), market risks (annex 2), liquidity risk (annex 4) and operational risk (annex 3).). This EO-MC is currently being up dated. The order has been approved by the Financial Council on February 19 2014 and it will enter into force as soon as the CRD IV amendment to the FCA has been adopted by the Danish Parliament in Spring 2014. The above mentioned annex 3 regarding market risks is supplemented by the DFSA-guidance of October 11, 2013 on interest rate risk. As discussed in detail in BCP 25, the DFSA's program for Operational Risk is much less developed than for other categories of risk, although operational risk is a core focus on market risk and it inspections
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an

	integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	On the basis of the risk assessment carried out pursuant to EO-MC section 4.1., the BoD has to adopt the relevant policies and contingency plans, including provisions in the EO-CAG relevant to adequate capital and solvency requirements (paragraphs 18 and 99). The DFSA will during an onsite inspection evaluate if the bank, in light of its risk profile and its systemic importance, has appropriate contingency arrangements, recovery plans and the feasibility of their implementation during periods of stress. This is done by reviewing the contingency plans with the relevant senior executives. As discussed in BCP 8, the DFSA has not yet required the general submission of recovery and resolution plans.
EC13	The supervisor requires banks to have forward-looking stress testing programmes, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing programme and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing programme: (a) promotes risk identification and control, on a bank-wide basis (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing programme or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process
Description and findings re EC13	The DFSA supervisory assessment of Danish banks' stress testing programmes is conducted at two levels: through the annual ICAAP review and through the technical assessment. For more details on the technical assessment, see EC5 in CP9. During the annual ICAAP review, the focus lies: • on the outcome of the macroeconomic stress-tests given the assessment criteria

	such as scope, relevance and severity of the scenarios and assumptions, • on the results given the levels of capital and liquidity in the different scenarios, and • on eventual contingency plans in the different scenarios (incl. reverse stress test). The ex-ante requirement to banks' stress testing programmes is that they cover all risks relevant to the specific business model and risk profile of the institution, that is, also risks not necessarily specified in the Pillar 2 guidance. The requirement of sophisticated forward-looking stress testing programmes is more relevant for large and complex banks. In general, large commercial banks have comprehensive stress testing programmes where resilience is tested to different adverse economic scenarios (which they also design). In such banks, stress testing is a key part of the institutions' capital and liquidity planning. Legally, the EO-CAG requires the integration of stress testing programmes into the management framework. By conducting a dialogue with the institution, the DFSA challenges the involvement of the BoD and BoM in those programmes. Moreover, the institution's stress test results are explicitly discussed with the management body during the annual meetings with the DFSA. As the stress test is part of the ICAAP, the material related to internal discussions of stress testing at the BoD (e.g. minutes) are in general reviewed during onsite supervisions. Apart from the documentation requirements in the ICAAP, the annual supervisory stress test exercise requires the submission of internal handbooks and guidelines on stress testing as part of the documentation. Ad hoc submissions of specific documents have also been requested at times. Deficiencies identified by the supervisory assessment are reported to the institution either at the technical level or/and to the Board. The DFSA will require corrective actions depending on the severity of the deficiency. The supervisor will at least once a year, and also in connection with an onsite inspection review the bank's stress testing programs and its "solvency need assessment" to examine if it is satisfactory and reasonable.
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	The DFSA does not explicitly require banks to take into account liquidity impacts in their reviews of internal pricing, performance measurement, or new product approvals. The DFSA has issued more general guidance regarding each of those areas.

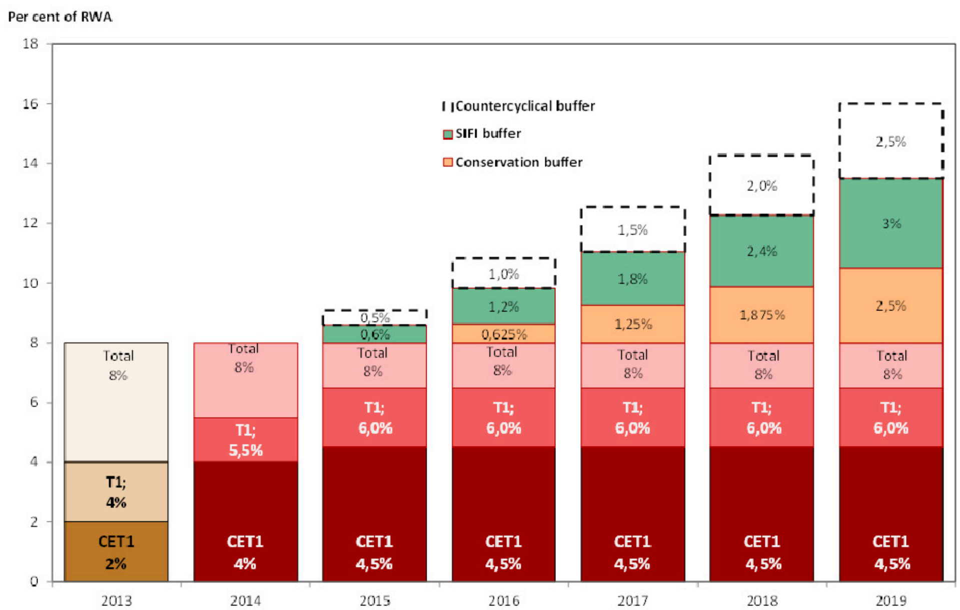
	According to EO-MC section 28 and 29 new products, new services etc. have to be approved by the relevant management (the BoD or BoM) before they may be used by the bank. Approval of new products etc. according to section 28 and 29 has been clarified in annex 1, # 7, and annex 4, # 11 in the EO. During onsite inspections, DFSA evaluates on a risk based approach the internal pricing, performance measurement and approval of new products in the bank. If the bank obtains calculations of risks and gains/losses as well as values of financial instruments and other items with market risks from external parties, DFSA will evaluate if the bank ensures, that the external parties perform the task appropriately. DFSA will also assess, if the bank also regularly evaluates whether the prices, parameters etc. received from, and applied by, the external parties are correct and thereby ensure a fair presentation of the risks of the undertaking as well as correctly calculating items presented in the financial statements. DFSA will make the assessment of the bank, in part, on an interview based approach with relevant staff in the bank's entities. According to the updating of the EO-MC, cf. EC1, the bank may benchmark itself to comparable banks. The benchmarking should be reported to the BoD at least once a year. The BoD should on this basis evaluate if the bank is a "well run bank" compared with other comparable banks.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	The DFSA requires the banks to have appropriate policies and processes for assessing other material risks, such as reputational and strategic risks pursuant to Executive Order on Capital Adequacy no. 1399 of 16 December 2011, Annex 1 of adequate capital and solvency requirements paragraphs 72, 73 and 83. During onsite inspections, DFSA evaluates based on the requested material from the bank and on interviews with the relevant staff in the different entities, if the bank has appropriate policies and processes for assessing other material risks, such as reputational and strategic risks. As a part of the requested material from the bank, DFSA will ask the bank to evaluate itself regarding the strategic and reputational risk, in the template. Based upon the bank's self-evaluation, DFSA will make an assessment if the bank does comply with the regulation.
Assessment of Principle 15	Largely compliant
Comments	The DFSA has a generally well designed program for risk management, with detailed requirements spelled out in the regulation and good review done during inspections

	(which, however, as discussed earlier, are not always done with the optimal frequency). In practice, the DFSA program appears strongest in terms of credit risk (consistent with the risk profile of most Danish banks) and is least well developed in terms of operational risk. With respect to the overall frameworks there are some improvement opportunities, several of which are in train: updating the EO-MC, 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 financial holding companies. Other improvement opportunities include: ensuring that liquidity and other risks are factored in internal pricing of financial products, and performance measurements; and clarifying the rules/guidance on independence of the units doing validation models.
Principle 16 Capital adequacy.[33]	The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	Denmark is subject to the legislative framework implementing Basel III in the EU, which was adopted in June 2013. The package contains the Capital Requirements Regulation (CRR), which is directly applicable to member countries, as well as the Capital Requirements Directive—CRD IV, which has to be transposed into the national legislation. Denmark has not yet aligned its supervisory framework with the implementation of EU-Basel III implementation package. The bill which is intended to implement the CRD IV in Denmark (the "Bill"), was put before the Danish Parliament by the MoBG in 7 February 2014 with a proposed date of entry into force of March 31, 2014. Following the short timeframe to perform all the steps necessary to adjust the relevant Danish legislation, the implementation could not be completed while adhering to the deadline for transposition—1 January 2014. The delay is particularly due to the scope and the content of the adjustments necessary to implement CRD IV, as well as the comprehensive work in relation to consultation on the bill and political negotiations, including on the regulation regarding SIFIs, which in nature is closely intertwined with the CRD IV. It should be noted that according to the Danish

	Constitutional Act, a bill must be read three times in the Parliament before it can be adopted. Furthermore, as a general rule, in order to ensure a thorough work on the legislative files, a minimum period of 30 days applies to the reading of the Parliament. The first reading of the bill took place on Tuesday the February 25, 2014. As a result, the DFSA continues to supervise banks based on the Basel II capital requirements until the Bill is passed by Parliament, although preparations for implementation have been made. The delay in implementation does not meet the strict requirement of this EC which requires that for at least internationally active banks the Basel standards are applied. In terms of the existing regulations, there are requirements for banks in terms of capital and risk management and more specific elements to the prevailing rules on the methods of calculation, thresholds and qualifying constituent components of capital (see EO on Calculation of Capital Base paragraph 4). Banks are obliged to have robust governance arrangements, which include effective processes to identify, manage, monitor and report the risks they are or might be exposed and to manage these risks (FBA, section 71(1), no. 4 and EO on Management and Control of Banks, etc.) Furthermore, banks are required to have in place sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed. Those strategies and processes need to be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the institution concerned (FBA, section 124(1)). Requirements on calculation of capital are set out in Article 93 section of the CRR, where general own funds shall be met at all times: (a) CET1 4.5 percent; (b) Tier 1 capital ratio of 6.0 percent; and (c) A total capital ratio of 8 percent. The capital thresholds place greater emphasis on higher quality capital in CET1. The CRR requirements to be implemented as of 1 April, 2014 place a greater proportion of the overall capital base to absorb loss on a going concern basis. Article 93 of CRR sets the initial capital requirement on going concern. On top of the own funds requirements, the credit institution shall compute based on its risk exposure an ICAAP. The resulting capital charge, expressed as a percentage of the total risk exposures (risk-weighted assets), may not be less than the general own funds requirements in CRR, art. 92(1) and the initial capital requirement in CRR, art. 93. In addition DFSA are mandated to define the qualifying components of capital, to cover the imposed capital charge (FBA, section 124(3)). Requirements on eligible capital elements are set in CRR Part Two. Article 26 defines the Common Equity Tier 1 items. The items are only recognized as Common

	Equity Tier 1 if they are available to the credit institution for unrestricted and immediate use to cover risks or losses as soon as these occur. Additional Tier 1 items are defined in article 51. The items shall meet specific requirements laid down in article 52. Tier 2 items are defined in article 62. Capital instruments that were issued before end of 2011 and disqualify as capital instruments according to CRR can under certain conditions be grandfathered according to CRR. The approach of DFSA will apply the full grandfathering available under the CRR to 2022. Average subordinated debt as a percentage of total capital for banks in Groups 1-4 is approximately 23.7 percent. Section 124(3) provides DFSA the ability to impose a specific Pillar 2 capital charge. DFSA will generally require the capital charge to be covered with CET1 capital or capital with a corresponding absorption capacity, when necessary. In practice, Pillar II add-ons can be applied at each of the CET1, T1 and TC. The Pillar 2 process occurs at least annually (approximately in the period between March to May) and uses a number of inputs, including: results from supervisory activities throughout the year; ICAAP; annual accounts; report from the external auditor ("audit book"); results of the DFSA's stress testing; and analysis of supervisory reporting. The SREP will evaluate all of the inputs and will place a degree of reliance upon the ICAAP and the bank's calculation of required capital. In case of non-compliance with the own funds requirements, DFSA sets a time limit for the bank to meet the requirements, otherwise the authorization can be withdrawn (section 225(1) FBA). DFSA can grant an extension to the period to remedy the capital deficiency (section 225(5)) and it is DFSA's general practice that the stated time limit is very short – a matter of days depending on the circumstances and the lower the capital ratio the shorter the time limit will be. In case of non-compliance with the imposed capital charge the credit institution shall take the necessary measures in order to comply with the requirement within a time limit. Sanctions may as well be imposed, e.g. restrictions on distributions, restrictions on (new) lending, reporting requirements, etc., cf. FBA, section 225(2). CRD IV operates with a set of capital requirements, which are intended to act as a buffers to protect the own funds requirements: • Capital conservation buffer, section 125a(3) • Countercyclical capital buffer, section 125a(4) • G-SIFI-buffer, section 125a(5) • Systemic risk buffer, section 125h

	The capital conservation buffer is the same for all credit institutions in EU and must constitute 2.5 percent of risk-weighted exposures out of Common Equity Tier 1 capital. The capital conservation buffer will be phased in gradually from 2016 to 2019. The countercyclical capital buffer can be set by national authorities during periods of above-normal loan growth in the economy. The institutions can be ordered to have up to 2.5 percent extra Common Equity Tier 1 capital in countercyclical buffer in addition to basic capital requirement. In extraordinary situations the countercyclical capital buffer can be higher than 2.5 percent. In Denmark, the MoBG will be able to trigger and set the level of the buffer, based on total lending trends as a percentage of GDP and other relevant factors. The MoBG's triggering and setting of the buffer can be based on a recommendation from the Systemic Risk Council. The framework for the countercyclical capital buffer will be phased in gradually from 2015 to 2019. Buffer rates set in other countries in which Danish institutions have exposures will be recognized up to 2.5 percent from 2015. None of the Danish financial groups are identified as global SIFI and therefore the G-SIFI-buffer is not relevant in Denmark. Nordea Bank Danmark is an affiliate of Swedish Nordea Group, which is identified as a global SIFI. However, Denmark has implemented a framework for domestic SIFIs. In addition to the capital requirements generally imposed for on credit institutions, differentiated SIFI buffers comprising Common Equity Tier 1 capital are imposed on Danish SIFIs. The requirement is determined on basis of the SIFIs systemic importance and a quantitative scale (SIFI scale). The requirement constitutes 1 to 3 percent of risk weighted exposures and will be phased in gradually from 2015 to 2019. To be defined as an SIFI, the institution must exceed one of the following three limits for two consecutive years: • The size of the balance sheet is equivalent to more than 6.5 percent of Denmark's GDP. • Loans comprise more than 5 percent of total sector loans. • Deposits comprise more than 5 percent of total sector deposits. SIFIs will be identified by DFSA once a year in June on the basis of the most recent financial statements. The first identification will take place in June 2014. New SIFIs must meet the SIFI requirements at the end of the following year, i.e. at least 18 months after having been identified. At present seven credit institutions (five banks and 2 MCIs) meet the criteria for Danish SIFIs. From 2019, a combined capital requirement of at least 11.5–13.5 percent of risk-weighted exposures will be required of Danish SIFIs, depending on the individual institution's systemic importance. The capital requirement will comprise both the pillar I requirement (minimum capital requirement) of 8 percent, which will be the same for all institutions, and a combined buffer requirement. The combined buffer requirement will consist of a capital conservation buffer of 2.5 percent, which will apply to all institutions after the transposition

	of CRD4 into Danish law, and the unique SIFI capital requirement of 1–3 percent, depending on the individual institution's systemic importance. The intention is for the capital requirements imposed on Danish SIFIs to be on a par with the requirements set in other comparable European countries. The final level of the Danish SIFI capital requirement will be assessed no later than 2017. If it turns out that the final level of the Danish SIFI capital requirement is not on a par with the final level in comparable European countries (Sweden, Norway, the United Kingdom, Germany, France, the Netherlands, Austria and Switzerland), the final level of the SIFI capital requirement will be adjusted accordingly. In case of non-compliance with the buffer requirements sanctions will be imposed, e.g. restrictions on distributions and submission of capital conservation plan, section 125b. The table below shows the implementation timetable for the new capital rules under the CRR and the minimum capital requirements.  Note: The specific pillar 2 capital charge is not included in the figure
EC2	At least for internationally active banks,[34] the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and	A delay in the Parliamentary process to transpose the CRR into legislation has meant that

[34] The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

findings re EC2	at the time of the mission the application of the Basel III capital requirements have not strictly met the implementation schedule as prescribed by Basel, i.e. January 1, 2014 CET1 4 percent; T1 5.5 percent and 8 percent TC (see also EC1). Notwithstanding, the CRR/CRD rules are based on Basel standards, however CRR/CRD rules apply to all banks and do not distinguish between internationally active banks and non-internationally active banks. Definitions of capital, risk coverage, method of calculation and thresholds for the prescribed requirements are all defined in the CRR/CRD framework.
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g. securitization transactions)[35] entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	DFSA imposes has the power to impose a Pillar 2 capital charge that is higher than the general own funds requirements as per FBA, section 124(3). The Pillar 2 process is well established in the DFSA's supervisory framework. Typically the SREP is performed annually where a comprehensive assessment of the risks and adequacy of capital. A key input into the process is the ICAAP. The Pillar 2 process is described in the 'Guidelines on adequate capital base and solvency need' (hereafter referred to as "Guidelines"). According to FBA section 124(1), the credit institution has to perform an internal capital adequacy assessment process (ICAAP), in order to ensure that the bank has adequate capital and has internal procedures to measure and manage the risks and on an ongoing basis assess and keep sufficient own funds to cover the risks. Furthermore, the BOD and BOM have the obligation to assess and calculate the internal capital adequacy charge, although ultimately the BoD has responsibility for capital adequacy (see also EC1). DFSA evaluates the ICAAPs of all credit institutions annually, except for the smallest banks which is performed less frequently, commensurate with their size and risk profile. ICAAP reviews are prioritized according to DFSA's rating of the credit institutions (high/medium/low). The rating consist of a quantitative rating based on offsite reporting and a qualitative rating based on a professional judgment. In addition to the annual assessment, the ICAAP will be discussed during onsite inspections. During the risk assessment process each main risk area is under consideration and the result of the credit institution's ICAAP is an integrated part of these risk assessments. This includes a consideration of the assumptions, components, methodology, coverage and outcome of the credit institution's ICAAP. The review covers the credit institution's material risk areas, risk management processes and systems of internal control. Stress-testing is part of the review process and is related to the credit institution's assessment of adequate capital. The

[35] Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	Guidelines set out the process bank's need to follow to calculate required capital. The Guidelines establish various benchmarks for banks to follow in assessing its required capital according to six risk areas: earnings; growth in loans; credit risks; market risks; liquidity risks; and operational risks. Within credit risk, there are sub-categories designed to specifically capture an assessment of credit concentration risk. (The ICAAP is further described in Annex 1 of Executive Order on Capital Adequacy). DFSA has also set up a number of benchmarks for banks to indicate banking activities which initially should be regarded as having a higher risk profile (The Supervisory Diamond for banks). The limit values have been set so that, on the one hand they counteract excessive risk-taking, and on the other hand they make it possible for resilient banks to carry out profitable banking activities and offer the credit required to undertakings and households. The supervisory diamond was first introduced in June 2010. DFSA will conduct an individual and specific assessment of the extent to which public risk information must be given in the situations in which the bank exceeds the limit values in the Supervisory Diamond (see also CP8). (Note: DFSA are working on a Supervisory Diamond for Mortgage credit institutions.) In making the assessment of the ICAAP, if DFSA makes an assessment that the capital of a bank does not adequately reflect its overall risk profile, the following four actions can be applied depending upon the circumstances: 1. Impose a capital charge that is higher than the general own funds requirements, (FBA, section 124(3)); 2. Requiring the credit institution to apply a specific provisioning policy or treatment of assets in terms of own funds requirements, (FBA, section 124(5)); 3. Requiring the credit institution to improve its internal control and risk management frameworks, FBA, section 71 (1); 4. DFSA may in accordance with FBA, section 350(1) order that the credit institution take the measures necessary within a time limit specified by DFSA, if (1) the financial position of the undertaking has deteriorated to such a degree that the interests of the depositors, the bond owners or other investors are at risk; or (2) there is a significant risk that the financial position of the undertaking will develop so that the undertaking will lose its license due to internal or external circumstances. The capital charge can be imposed on a single credit institution or on a group of institutions with a similar risk profile, in order to cover a specific category of risks, FBA, section 124(4). The ICAAP, and the resulting capital charge, includes all material risks, on-balance or off-balance, and all relevant transactions, including securitization transactions. The process is an integrated component of the annual SREP and demonstrated challenge to the banks of assumptions and required capital. For the Group 1 banks, the results of the ICAAP analysis is a key input into the annual meeting with BOM (often called a Summit Meeting) where the DFSA discusses the bank's business model, strategy, risk profile and

	financial adequacy in detail.
EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks[36] in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	The ICAAP is main tool employed by the DFSA to ensure a bank makes an assessment of capital adequacy which takes into consideration macroeconomic circumstances. The ICAAP also requires stress testing for forward looking analysis. Explicit SIFI requirements will be implemented in the near term which will adopt a bespoke approach to assigning capital for this cohort. Currently, all of the largest banks are supervised as a portfolio in Banking Division 1. For the regulation of systemically important institutions and requirements on the back of macroeconomic developments, please see EC1. The DFSA will apply the Leverage ratio as per the BIII timeline with introduction of a pillar 2 requirement as of April 2014 and possibly a pillar 1 requirement in 2017, if the CRR introduces such a requirement. The leverage ratio will be an explicit non risk-based measure of leverage.
EC5	The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use: (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the DFSA prior to implementation. If the supervisor approves such

[36] In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	use, banks will observe the following conditions: DFSA rules governing internal model users is based on the current CRD and when the CRR is implemented domestically, those rules will replace the DFSA rules: • In respect of IRB model accreditation the DFSA have a dedicated team of 6 full-time employees, most with extensive IRB experience that are involved in the accreditation, monitoring and validation of IRB models. There are seven banks accredited to use the IRB approach. • In respect of VaR models, the DFSA has a team of 2 full-time employees with experience and expertise with VaR models involved in the accreditation, monitoring and validation of VaR models. There are three banks approved to use internal market risk models. The validation requirements for IRB banks are set out in the EO on Capital Adequacy, Annex 8, paragraphs 223–227 (the validation requirements are based on the requirements in Article 185 in the CRR). There is a structured process associated with IRB model approval (outlined in the EO Capital Adequacy, Annex 21). All material changes to an existing IRB rating system or the range of application of an existing IRB rating system also have to be approved by the DFSA prior to implementation (this will also be a requirement when the CRR enters into force, article 143 (3) in the CRR). When assessing major changes to models, the DFSA is attentive that RWAs does not decrease significantly unless such decreases can be justified by actual reductions in risk. Significant reductions of RWA should not occur due to purely technical changes. In terms of ongoing monitoring after the model has been accredited, the DFSA will monitor the performance of IRB models in several ways. As part of ongoing monitoring, the IRB team undertakes benchmarking across IRB institutions as a tool for assessing the reasonableness of model output. The DFSA has used Pillar 2 add-ons to address uncertainty related to model risk as a result of our credit inspections and model reviews. The IRB team meets with the bank at least annually where results of the bank's model validation are discussed. In the event validation results reveal weaknesses the DFSA has issued orders regarding safety margins and other corrective actions. In addition to yearly IRB status meetings, the DFSA conduct IRB inspections. Generally the conclusions from inspections are presented in a report to the BoD and the management of the institution. The DFSA also prepare a short statement of the results of the inspection which the institution has to disclose on the institution's website. The conclusions from an IRB inspection are presented in the same way as other inspections. Reasonableness of model outputs is also assessed as an integral part of routine credit inspections. During the onsite examination, credit experts go through a sample of exposures to assess whether assigned ratings and allocated capital align with expert judgment.

	The frequency of IRB inspections is not prescribed but determined on a case by case basis.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).[37] The supervisor has the power to require banks: (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) To have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	Banks are required to perform stress testing as part of the ICAAP assessment to determine their capital needs under various scenarios (EO on Capital, Annex 1, paragraph 20). The requirements for the ICAAP are further described in Annex 1 of EO on Capital Adequacy and the guideline on the ICAAP framework and internal capital charge calculation. Annex 1 set requirement on the process, methodology, relevant risks included, reassessment, monitoring, reporting and documentation of the ICAAP. The assessment must be on-going and forward looking. In their assessment of the ICAAP, supervisors challenge the assumptions and key inputs into the stress tests and while there is a degree of freedom in the choice of calculation of the adequate capital base, the guidance to banks is that the approach should be fair and prudent. Furthermore, banks are subject to semi-annual stress testing exercises conducted by the Banking Analysis Division. This process will stress the banks financial results and assess capital adequacy under three scenarios: base case, downturn and worst case. The results are shared with supervisors as an input into discussion with BOM. There was evidence to suggest that this process worked well in practice where supervisors considered stress testing as an input into the annual risk assessment process where the bank was slotted into one of five ratings. For those banks accredited to use the Internal Ratings-Bases (IRB) approach to calculating capital for credit risk, enhanced stress testing requirements are applied. IRB banks are required to perform annual stress tests. The scenarios include a base case as well as more severe recession scenarios. The scenarios are required for a two to three year time horizon. The BOD and BOM are required to consider both the inputs into the scenario as well as the outcomes to assess adequacy of capital.

[37] "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

	IRB banks must also perform a reverse stress test (Guidelines 9.3). The bank must identify all material risks that may trigger a stressed loss under relevant events or changes in future economic conditions. The objective of the reverse stress test is for the bank to focus on the most important risks and severe enough to cause severe stress in the capital adequacy. Changes in strategy, business plans, macroeconomic issues and other issues that may affect the assumptions and methods used should lead to a reassessment. It also implies that the credit institution in the calculation of capital charge should attach more importance to future expectations and less on historical experience, cf. Annex 1, no. 16. The assessment must include relevant stress tests of the assumptions made. The stress tests must include unlikely, but not unthinkable events. The credit institution must have a plan for raising capital and a timeframe for doing so. The plan shall include (Annex 1, no. 13): • General principles for capital planning; • Who is responsible for the process; • How the company expects to comply with capital requirements in the future; • An overall contingency plan, including specific plans for raising new capital, limitations of activities or mitigation of risks. The credit institution must at least annually report the ICAAP and the capital plan to DFSA. There are bespoke stress testing requirements for MCIs which reflect their individual risk profile based on the unique business model. MCIs must specifically consider the increased risk connected to the part of the loan portfolio in which borrowers are exposed to an interest-rate risk which could impose an increased credit risk (see Guidelines part 10).
AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	The DFSA will apply the capital rules consistently across all banks and this will apply for the CRR/CRD rules from April 1, 2014.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.[38]
Description and findings re AC2	Unregulated members within a banking group are also captured by the capital rules (CRR-Articles 11–24). The rules place minimum capital adequacy requirements on the parent company within the group and also require that the parent institution and its subsidiaries ensure that their subsidiaries not subject to the CRR-regulation (unregulated members of the group/non-financial activity) implement arrangements, processes and mechanisms to ensure a proper consolidation. Groups are regulated in Danish law, (section 170–176 of the

[38] Please refer to Principle 12, Essential Criterion 7.

	FBA). According to sections 171–174, of the FBA, the individual solvency need must be calculated on consolidated basis and the DFSA may lay down a higher individual solvency requirement than the one calculated by the group. Capital of a financial group is measured on a consolidated level. However insurance companies are not included in the consolidation. As an alternative, the bank may be granted permission by the DFSA in accordance with article 49, in the CRR-regulation, to deduct the following from the capital: • A proportion of the capital requirement of a subsidiary insurance company or an associated insurance company, which corresponds to the directly or indirectly owned proportion of the share capital and guarantee capital of said insurance company. If the insurance company does not have its registered office in Denmark, the capital requirement under the regulations of the home country shall be used. However, the capital requirement shall be no less than it would have been if the insurance company had had its registered office in Denmark. The deduction under the 1st clause shall be reduced by an amount corresponding to the difference between a) an amount corresponding to the proportion of the base capital of a subsidiary insurance company or an associated insurance company, which corresponds to the proportion of the share capital owned; and b) the value in the balance sheet of the ownership interest in question with an addition of the value of the subordinate loan capital, including subordinate loan capital from other group undertakings, to the subsidiary insurance company or the associated insurance company, when subordinate loan capital is included in the base capital of the subsidiary insurance company or the associated insurance company under section 135(1), no. 1. of the FBA.
Assessment of Principle 16:	Compliant
Comments	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. The DFSA applies the capital rules consistently across all banks.
Principle 17 Credit risk.[39]	The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk[40] (including counterparty credit risk)[41] on

	a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	According to Annex 1 to the EO-MC banks are required to have appropriate procedures for monitoring credit risks and procedures for risk management in the credit area. Supervision of a bank´s compliance with Annex 1 to the EO is primarily performed during onsite credit inspections. The core of onsite credit risk inspections is a review of extensive samples of the bank's credit files. In connection with supervisors' review of samples of exposures, the supervisors also consider whether the bank is compliant with the requirements in Annex 1. The coverage of the loan portfolios of smaller banks is sometimes above 50%; the coverage percentage is of course lower for the largest banks and more well-diversified banks, but the samples are extensive and focused on potential problem areas for a particular bank. At onsite credit inspections the supervisors receive the bank's credit policy, selected credit procedures, such as procedures for individual and collective impairment, procedures for valuation of collateral values, procedures for handling of weak exposes, procedures for risk classification etc. In connection with the review of the samples of credit files the supervisors examine the bank's compliance with the bank's credit policy and the procedures regarding credit risk. At onsite inspections supervisors have meetings with the board of management, the management of the credit department, and in major banks, employees working on IRB matters. At these meetings supervisors discuss with the management the bank's risk appetite, credit procedures, changes in the credit organization etc. For smaller and medium-sized banks, the supervisors use compliance check forms in connection with onsite inspections. The compliance check forms cover different areas including credit risk. Examinations of the loan portfolios of the MCIs is also performed regularly (the largest firms are subject to an annual examinations process). The focus of the review is to ensure the quality of the assets supporting the covered bonds it used to finance operations is sound. Heavy emphasis is placed on ensuring that appropriate loan-to-value ratios are maintained, with appropriate valuations used. Due to the high level of interest only mortgages and adjustable-rate mortgages the DFSA

	has in connection with the credit risk inspections in the banks increased its focus on the need for impairments related to this.
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,[42] identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	According to section 5 (1) and no. 1–3 in Annex 1 to the EO-MC a bank´s BoD is required to adopt a credit policy. According to section 4(1) of the EO the BoD needs to carry out an assessment of the risks of the bank when the situation of the bank, the market situation, or other relevant factors so dictate, and in any event no less than once a year. According to Section 4(2) such an assessment shall be carried out on the basis of a report on the risks of the bank prepared by the board of management. According to Annex 1, no. 6, the report which the BoM needs to prepare pursuant to section 4(2) must contain an account of how the credit policy is reflected in the credit risks accepted by the bank. In the report, the BoM also has to make a reasoned assessment of whether the credit risks of the bank have been calculated fully and prudently, including whether the methods applied for classification are capable of ranking customers correctly. The report has to include a review of the internal controls carried out as well as the results from such review In addition the report must include the results of the annual review of exposures which are not covered by the review by the BoD pursuant to Section 6(3), no. 3. The EO-MC is under review. According to the draft revised Annex 1 the BoD is to receive at least quarterly reporting on the credit area. The reporting is to clarify compliance with the elements of the credit policy. Furthermore, the reporting is to give the BoD a complete overview of the total credit risk and the developments in credit risk over time. According to Annex 1, no. 19, the chief risk officer shall ensure that appropriate management of credit risk takes place in the bank. Supervision of compliance with the EO-MC is primarily performed during onsite credit inspections. The supervisors read the protocol of the board of directors and the annexes to the protocol of the period from the last inspection. The review of the protocol give the supervisors good insight into the reporting the board receives, including how well the organization complies with the limits laid down by the board of directors. In connection with the review of samples of the credit files the supervisors also get insight into how well the organization complies with the credit policies. At onsite inspections the supervisors hold a meeting with the chairman of the board of directors and the chairman of the audit

42 "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	committee. In the major banks, where the inspections are carried out more often, the supervisors do not meet with the chairman of the board at every inspection. As for the supervision of senior management´s implementation of the approved credit strategy and development of policies and processes, compliance is supervised in connection with onsite credit inspections by supervisors reviewing the procedures for the bank´s credit area.
EC3	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: (a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) Effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings re EC3	With the exception of item (f) on exception tracking, the enumerated areas are effectively covered within Annex 1 of the EO-MC, as described below: (a) Covered in Annex 1 to EO-MC no. 10-18. (b) Covered in Annex 1 to EO-MC, no. 10 on procedures for approving exposures (new and existing exposures), no 12(b) annual renewal of the banks' larger exposures, no. 5(a) on guidelines from the board of directors to the board of management and no. 21 on delegation of lending authorities.

	(c) Covered in Annex 1 to EO-MC, no. 10 on procedures for approving exposures, no. 12 on procedures for monitoring exposures and credit risks and no. 16 on procedures for risk classification of customers, no. 17 on procedures for mortgages and no. 18 on procedures for securitization . (d) Covered in Annex 1, no. 19-20 on the chief risk officer and risk management function, and no. 25 on aggregation. (e)Covered in Annex 1, no. 2 on the credit policy. (f) Exception tracking is not explicitly covered. (g) Covered in Annex 1, no. 16 on procedures for risk classification of customers, no. 19(e) on the chief risk officer and risk management function and no. 22–24 on procedures for internal controlling. A review of these areas is part of the normal credit inspection program as confirmed by a sample review by the assessors.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	According to Annex 1 to EO-MC no. 10(a) a bank’s procedures for approving exposures must make clear the basis for approval, including the assessment of the borrower´s creditworthiness. According to Annex 1 to the Executive Order no. 12(c) a bank´s procedures for regular monitoring of exposures shall among other things contain principles for follow-up of individual exposures, including review of accounting material, annual tax returns and budgets etc. from the borrowers. The ability to determine total borrowings of a customer is largely dependent on the contents of the lending file. Review of such risk factors as unhedged FX risk is a matter of examiner judgment as there are no specific requirements to include this in the assessment.
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm’s length basis.
Description and findings re EC5	Section 78 of the FBA provides that banks may not establish a business exposure with or accept collateralization from 1) members of the BoD and members of the BoM of the bank, or 2) undertakings where the persons specified in no. 1 are members of the BoM or members of the BoD, without the approval of the BoD, which shall be entered in the minute book of the BoD. These exposures shall be granted in accordance with the usual business terms of the bank and on terms based on market conditions. The external auditor of the bank shall make a statement in the annual audit protocol on whether these requirements have been met.

	According to section 78 (3) the BoM and the BoD must in particular monitor the appropriateness and status of the business exposures mentioned above. According to Annex 1 to the EO-MC. no. 3(k) the banks must comply with the rule of impartiality regarding its employees. In connection with onsite credit inspections the supervisors review all Section 78 exposures of the inspected bank. More generally, Annex 1 of the EO-MC in Section 3 requires the establishment of credit policies with principles addressing a series of considerations including the decision basis and risk analyses that need to be carried out before a credit facility is approved and the impartiality of the employees involved in the credit process.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	EO-MC section 6(3) provides that the BoD may not delegate to the BoM authority which belongs to the overall management duties of the BoD or which is otherwise of an unusual nature or of material significance for the bank. Furthermore, it is required in Annex 1 to the EO-MC that guidelines from the BoD to the BoM for the credit area shall contain provisions on the size of the exposures the BoM can approve without participation by the BoD. The EO-MC is under revision. In Annex 1 to the draft revised EO it is required that as a starting point exposures exceeding 2 percent of the bank´s core capital is to be approved by the BoD unless the BoD has prescribed a lower limit. Certain exceptions apply depending of the size of the bank and the complexity of the exposures.
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	The supervisors have full access to all credit material. At onsite inspections the supervisors review the samples of credit files together with the relevant credit officers.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programmes for risk management purposes.
Description and findings re EC8	The DFSA has an ongoing offsite surveillance and analysis based on reporting from the bank, with regular stress tests performed. . Trends and risk identification across the banking sector as well as the macro economic outlook are taken into account.
Assessment of Principle 17	**Compliant**
Comment	The DFSA gives very strong focus to credit risk, with much of its examination activity centered on it, as well as extensive regulatory reporting covering it. Particularly heavy focus is given to the review (by the Board, by examiners, and by the external auditors) of the largest credit exposures of the bank. The DFSA is very hands-on in its credit quality assessments.

Principle 18	**Problem assets, provisions and reserves.**[43] The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.[44]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	The DFSA has set out rules in Annex 1 to the EO-MC that require banks to formulate policies and processes for identifying and managing problem assets. Furthermore, under section 51-53 of the Executive Order on Financial Reports for Credit Institutions and Investment Firm ("EO-FR"), banks must regularly review problem assets, at an individual level, or portfolio level for assets with homogenous characteristics, to assess whether the loan or the group of loans is subject to objective evidence of impairment. If the loan(s) is (are) subject to objective evidence of impairment, the bank shall assess the size of a provision on the individual loan or the portfolio of loans with homogenous characteristics. Pursuant to Section 53 of the EO-FR, the DFSA has issued guidance on writing down of individual assets and groups of loans that have similar characteristics. The DFSA has issued explanatory guidelines concerning individual impairment losses and provisions cf. Annex 10 to the EO-FR and the DFSA is currently in the process of issuing additional guidelines on provisioning/increased charges for impairment. The current approach involves expeditious recognition of impairment, and the assessors would caution the DFSA on the dangers of responding to political and industry criticism if the DFSA were to move away from such a sound approach The DFSA has described to the assessors the approach it follows to gain some degree of assurance that all loans with the same client have the same level of classification. The DFSA has developed a matrix of 7,000 borrowers, based on the reports of largest exposures of the individual 90 banks. To the extent that a borrower is among the largest exposures of more than one bank, cells are filled in on the matrix that are checked to ensure consistency of classification. The approach is carried out in a systematic way but could be broadened to

[43] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

44 Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	include more observations.
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes
Description and findings re EC2	The DFSA regularly conducts onsite inspections in credit institutions to ensure that credit institutions are compliant with regulation on loan classification for credit management and provisioning on loans. After the inspection the DFSA publicly discloses a report with the major conclusions from the inspection. The DFSA confirmed that there are no specific standards for provisions by classification but shared with the assessors regulatory requirements on the banks under both capital and accounting policy to regularly review poorer rated, large credits to see if additional provisions were necessary.
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures.[45]
Description and findings re EC3	As discussed in CP 10, extensive information is regularly provided to the DFSA on classification and provisioning. The DFSA reviews during onsite inspections that banks take into account off-balance sheet exposures, when the banks review classification and provisioning.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	The DFSA has issued explanatory guidelines concerning individual impairment losses and provisions, in Annex 10 to the EO-FR. The DFSA regularly conducts onsite inspections to determine if banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions. The DFSA describes its loan sampling process to the assessors, indicating that for small banks, coverage of approximately 50 percent of the portfolio would be expected; for larger banks, a smaller percentage would be covered but sampling would still be extensive. The latter was confirmed in discussions with officials of larger banks. After the inspection the DFSA publicly discloses a report with the major conclusions from the inspection.
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing

45 It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g. 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g. rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	Requirements for the monitoring and management of credit risks are well spelled out in Annex 1 to the EO-MC. Under section 12 and 19 in Annex 1 to the EO-MC, banks are required to have appropriate policies and processes to ensure the early identification of deteriorating assets, ongoing oversight of problem assets, and for collecting past due obligations. Furthermore, banks have to assess regularly whether they have sufficient resources and expertise to ensure an adequate ongoing oversight and management of the banks' credit risk. While not specified in the EO, banks are expected to array credits in buckets according to days in arrears by 30, 60, and 90 days and do so. Specialized mortgage credit institutions, which only lend against collateral in real estate, submit information to the supervisor each quarter regarding mortgage loans in arrears by more than 15, 105, 195 and 380 days. On basis of the information submitted concerning mortgage loans in arrears, the supervisor benchmarks the specialized mortgage banks and takes appropriate follow-up action. The specialized mortgage bank must have policies and processes to monitor and control mortgage loans in arrears; the supervisor reviews these policies and processes on onsite inspections. The DFSA regularly conducts onsite inspections to test banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards. The external auditors are also expected to review for this possibility. After the inspection the DFSA publicly discloses a report with the major conclusions from the inspection.
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	As discussed in CP 10, extensive information on credit quality is regularly submitted to the DFSA. Section 12 in Annex 1 to the EO-MC requires that banks shall have policies that ensure an ongoing oversight of credit risk, including policies on relevant economic information on clients, and clients' assets posted as collateral for loans etc. Section 2 and 29 in Annex 10 to the EO-FR requires that banks have adequate documentation to support levels of provisioning. These are reviewed during credit inspections.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are

	deemed to be inadequate for prudential purposes (e.g. if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	It is normal practice that the supervisor assesses the provisions/impairment losses under onsite inspections and requires them to be adjusted if they are deemed to be inadequate under the authority of Section 344 of the FBA.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	The value of collateral is taken into account in the calculation of the necessary impairment losses at conservative estimates of fair value less expenses to take over and realize the collateral, under section 52(5) of the EO-FR. Specialized mortgage credit institutions, which only lend against collateral in real estate, submit information to the supervisor each half and full year on the loan-to-value (LTV) on its mortgage loan portfolio. LTV will to a certain extent reflect the credit risk and expected loss. LTV is also used to calculate how much additional collateral the specialized mortgage bank must put forth in regard to its outstanding covered bonds. The specialized mortgage banks also submit information to the DFSA quarterly on the amount of additional collateral the bank has put forth and its capacity to supply additional collateral should it be needed. On basis of the information submitted concerning LTV and additional collateral, the DFSA benchmarks the specialized mortgage banks in its ongoing supervisory processes. The specialized mortgage bank must have policies and processes to monitor and control LTV and additional collateral. The supervisor reviews these policies and processes during onsite inspections.
EC9	Laws, regulations or the supervisor establish criteria for assets to be: (a) identified as a problem asset (e.g. a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g. a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	The criteria for objective evidence of impairment which triggers the requirement to calculate an impairment loss are taken from IAS 39 and prescribed in section 52(2) of EO-FR. Under section 54(1) any impairment loss shall be reversed when new circumstances or information show that it is no longer necessary, although no specific criteria for the reclassification are provided in the EO.

EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	Under section 4 of the EO-MC, the bank's BoD shall make an assessment of the bank's risk when the bank's circumstances, market conditions or other conditions so dictate, but in any event at least once a year. The assessment shall be carried out on the basis of a report made by the BoM. In the Board of Directors' assessment, the BoD has to make a reasoned assessment of whether the credit risks of the bank have been calculated fully and prudently, including whether the methods applied for classification are capable of ranking customers correctly, pursuant to Annex 1 to the EO-MC. Pursuant to Section 6 of Appendix I, an annual review of exposures is also required to be provided by the BoM to the BoD, complementing the review of classification methodologies. If a bank utilizes internal models (IRB) to calculate risks, the BoD must on a regular basis receive an analysis of the bank's internal model (section 119 in Annex 8 to the Executive Order on Capital Adequacy). Furthermore, the BoD needs to have an overall understanding of the bank's internal models and a detailed understanding of the reporting on the internal models. The requirements to reporting to the BoD are similar to the requirements set out in Article 189 of the CRR. The DFSA regularly conducts onsite inspections and reviews the minutes of the bank's BoD's' meetings to ensure, that the Board receives information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and major problem assets. The DFSA is currently in the process of revising the EO-MC and in accordance with the draft; the BoD shall in the future make an assessment of the bank, based on a report made by the bank's chief risk officer. Furthermore, according to section 29 in Annex 1 to the revised EO-MC the bank's BoD must on a quarterly basis receive a report on the credit area. The report has to review how the bank complies with its credit policies and to give the BoD an adequate overview of bank's total credit risk, including an overview of the development in credit risk over time. The report must be substantiated by a descriptive analysis and assessment of the bank's credit risks, especially if there are indications of substantial increase in those risks.
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	The Banks are required at every balance sheet date to assess whether there is objective evidence of impairments on its loans. The assessment shall be made individually as a

	minimum for all loans of significant size. "Significant size" is determined taking into account the size of the individual bank, as described in section 51 and 52(1) of the EO-FR.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	The DFSA conducts ongoing offsite surveillance and analysis based on reporting from the banks. Trends and risk identification across the banking sector as well as the macro economic outlook are taken into account. The supervisory activity address and access the adequacy of provisions and capital reservation e.g. in particular by going through the credit files (the banking books) onsite.
Assessment of Principle 18	Compliant
Comments	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. However the data base 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.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.[46]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk.[47] Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and	In accordance with the EO on Management and Control of Banks, etc. and the EO on

[46] Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

[47] This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

findings re EC1	Capital Coverage, banks must have policies and processes for all major risks including concentration risk which includes: credit concentration risk, market concentration risk and concentrations within liquidity and funding sources (in particular and exposures should take into account on-balance and off-balance sheet items). Specifically in relation to credit concentration risk, the definition is stated in Annex 1 to the EO on Large Exposures and requires banks to develop and implement bespoke policies to identify and manage large exposures. The EO requires banks to take into account sector and geographical concentration risks. Furthermore, Danish regulation has transposed CEBS's guidelines on the implementation of the revised large exposures regime, 11 December 2009 aimed to ensure harmonized implementation of the revised large exposures regime across the EU Member States. Future regulation will be based on the similar definition in the CRR art. 4 (39). The EO includes an interpretation of economic interconnection in cases with possible economic dependence between clients without a formal control position (Annex 1—Mutually Connected Clients paragraphs 1–17).
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure[48] to single counterparties or groups of connected counterparties.
Description and findings re EC2	Through onsite inspections and offsite surveillance, the DFSA test and confirm that banks' are able to properly manage large exposures and concentration risks. Large exposure reporting is a key focus of offsite surveillance where banks are required to report all exposures in accordance with the FBA (s.145) and in accordance with EO on Large Exposures. Supervisors closely monitor trends and movements in large exposures which will be a key input into the frequency, scope and depth of credit risk reviews and other types of periodic engagements with the bank. Furthermore, banks are required to report data to the DFSA both on large exposures and on measures of concentration risks from single-name concentration and concentration on economic sectors and geographical segments. Exposures in the banking book and trading book to the same are aggregated into a single exposure and are required to be reported as concentration risks. Quarterly reporting captures detailed information on concentration risks reported by geography and industrial sector for commercial exposures. One of the five criteria contained in the Supervisory Diamond refers to large exposures (also see CPs 8 & 9) which is an upper limit of 125 percent the capital base. Compliance against the Supervisory Diamond is reported on a quarterly basis. In the event the 125 percent limit is breached, supervisors will take action for banks to take corrective action in a timely fashion (breaches are also made public on the DFSA's website).

[48] The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e. it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see "*Measuring and controlling large credit exposures*, January 1991).

	Onsite examinations will emphasize the importance of effective risk management systems for identifying and managing large exposures, especially the identification process of connected counterparties to aggregate exposures. Supervisors will evaluate risk management in relation to large exposures through review of board papers and minutes. When selecting files for examination as part of a credit risk review, supervisors will typically include a sample of large exposures (both in terms of exposures greater than 10 percent of capital and the largest loans). The EO on Large Exposures includes detailed guidelines for identifying connected counterparties in the measurement and calculation of large exposures (annex 1). The EO describes definition and characteristics to determine direct and indirect control; a description and procedures to identify of financial interconnectedness; and, procedures and checks for identification of mutually connected clients. In reviewing large exposures, supervisors will assess a banks policies and processes in compliance with the EO and the measurement of the exposure to assess that it reflects the maximum possible loss from their failure (i.e., it encompasses actual claims and potential claims as well as contingent liabilities) as required by the EC.
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	Risk management and control procedures for concentration risk are required to be integrated into a bank's management and aligned with capital adequacy (EO Management and Control). A primary tool that integrates the bank's limit structure to credit concentration risk and capital strength is the ICAAP and SREP. In this regard, banks are required to assess their capital needs with regard to concentration risk and adjust capital adequacy as necessary to mitigate those risks. Current Danish regulation on large exposure limits is based on Directives stated in section 145 in the Danish Financial Business Act. Future CRR regulation, cf. art. 395 (1), is much in line with the current. Cf. CRR art. 395 (1) an institution shall not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, to a client or group of connected clients the value of which exceeds 25 percent of its eligible capital. Where that client is an institution or where a group of connected clients includes one or more institutions, that value shall not exceed 25 percent of the institution's eligible capital or EUR 150 million, whichever the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, to all connected clients that are not institutions does not exceed 25 percent of the institution's eligible capital. The current DFSA requirement to report covers institutions' exposures to a client or group of connected clients where its value is equal to or exceeds 10 percent of the institution's eligible capital. The DFSA definition of an exposure is "the sum of all positions with a client or a group of mutually connected clients which involve a credit risk for the undertaking, and equity investments issued by the clients or by one of the group of connected clients." The exposure is calculated by adding up the parts as stated in section 3 and 4 in the

	Executive Order on Large Exposures. A benchmark (back-stop) for the sum of large exposures is included in the Supervisory Diamond, where the sum of large exposure is defined as mentioned above (sum of large exposures after deductions that exceed 10 percent of the capital base). Furthermore, note that the Supervisory Diamond contains a benchmark on the sum of large exposures of 125 percent of the capital base. Since the introduction of the Supervisory Diamond in the summer of 2010, the banks have worked on decreasing their sum of large exposures. Thus, although the benchmark on the sum of large exposures in the Supervisory Diamond is not a regulatory binding rule, it has improved the incentives of the banks seen from the DFSAs perspective. Exceptions to the calculation of large exposures is allowed detailed under in the FBA (s.145) and EO on Large Exposures, including: • settlement exposure is a key exemption. • certain secure parts of exposures are deducted, cf. section 5. Section 5 is much in line with the CRR article 400. (section 145 (11)), DFSA may permit exposures or parts of exposures to be exempted, provided the amount is deducted from core capital. • banks are allowed larger exposures to clients, which are banks, mortgage credit institutions or investment funds – the limits of these large exposures is DKK 1 billion or maximum 100 percent of the capital base. This regulation entered into force from July 2010 when the regulation of large exposures in the FBA was adjusted both with respect to the size of large exposures allowed and with respect to the deductions when making large exposures up. Earlier on, there has been regulation on the sum of large exposures earlier on in the FBA. However, the limit on the sum of large exposures of 800 percent of the capital base has not been binding for the banks and this rule was therefore eliminated with effect from 1. July 2010 (although this rule was phased out in a 6 months period, e.g. the 800 percent limit was finally repealed with effect from January 1, 2011).
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Banks are required to report single-name concentration and concentration on economic sectors on a quarterly basis. In addition, banks are required to take all relevant concentration risks into account in their ICAAP and the Danish FSA assesses that all relevant concentration risks have been taken into account in the annual SREP evaluation. The current DFSA requirement to report covers institutions' exposures to a client or group of connected clients where its value is equal to or exceeds 10 percent of the institution's eligible capital (s.145(4)). The SA does not address a number of dimensions of this EC: a. the frequency of supervisory reporting of concentration risks. b. sectoral, geographic, currency etc concentration risks.

EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	Current DFSA regulation on limits is based on EU Directives. The limits are stated in section 145 in the FBA. Future CRR regulation, cf. art. 395 (1), is much in line with the current practices. The definition refers to a client or group of connected clients the value of which exceeds 25 percent of its eligible capital. Where that client is an institution or where a group of connected clients includes one or more institutions, that value shall not exceed 25 percent of the institution's eligible capital or EUR 150 million, whichever the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403, to all connected clients that are not institutions does not exceed 25 percent of the institution's eligible capital. The current definition in DFSA regulation is based on the CEBS's (EBA from 2011 and onwards) guidelines on the implementation of the revised large exposures regime, 11 December 2009. The definition is stated in Annex 1 to the EO on Large Exposures. Future regulation will be based on the similar definition in the CRR art. 4 (39) with only few changes in practice. A connected customer is defined as any of the following: (a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; (b) two or more natural or legal persons between whom there is no relationship of control as described in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties. The CEBS' Guidelines include the interpretation of economic interconnection in cases with possible economic dependence between clients. As the CEBS guideline says, it is not possible to give a comprehensive list of possible cases of economic interconnection. Since the large exposure regulation is essential from a credit risk point of view the Danish FSA has a long tradition for a relatively strict decision making. It is Danish practice that the methodology is an issue not just for the large exposures but broadly for the credit institutions' total loan portfolios. The DFSA believes it will be possible to maintain this practice within the new CRR regime. The DFSA provided examples where it had exercised its powers in relation to enforcing LE rules as a result of onsite inspections.

EC6	Laws, regulations or the supervisor set prudent and appropriate[49] requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	Banks are required to monitor different types of concentration risk both with respect to credit risk and other types of risk. Credit concentration risk should be monitored both with respect to single-name concentration risk, sector concentration risk and with respect to credit concentration risk within geographical areas, concentration of lending within businesses or households and the (volatile) value of collateral behind credit exposures and large exposures. At a minimum, the banks are requested to conduct simple sensitivity analysis of their concentration risk in the banks' ICAAP according to the DFSAs guidelines on capital adequacy and solvency need for credit institutions (EO on Capital Adequacy). In addition, the Supervisory Diamond sets benchmarks for the large exposures and the exposure with real estate property, which also limits the credit concentration risk. Supervisory actions are enforced after an individual and specific assessment of the extent to which public risk information must be given in case of breaches of the benchmarks in the Supervisory Diamond. In addition, the DFSA's EO Capital Adequacy establishes benchmarks for the size of single-name credit concentration risk and sector concentration risk. If these benchmarks are breached, the individual bank is expected to set aside capital (under Pillar II) for credit concentration risk. The EO on Capital Adequacy and the EO on Management and Control require Boards to establish limits for risks and to regularly review compliance against these limits. To ensure that Boards are actively reviewing compliance to limits and assessing the overall concentration risk of the bank, the DFSA performs a mix of onsite and offsite analysis. Offsite surveillance is based on bank's periodic reporting of large exposures. In addition, a Long Form Audit Report must also include the auditors' assessment of the institution's 10 largest exposures and all exposures larger than 10 pct. of the capital base and this is reported to the DFSA on an annual basis. A benchmark for the sum of large exposures is included in the Supervisory Diamond and large exposures are an integrated part of the FSA ICAAP-guidelines and the SREP process of the FSA. To complement offsite supervision, onsite activities include periodic inspections to assess banks' risk management of quality and credit management.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programmes for risk management purposes.
Description and	All banks are required to consider the effect of risk concentrations on the banks' conduct of

[49] Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

findings re EC7	business. Smaller banks are requested to conduct rather simple impact studies of the effect of risk concentrations, whereas large banks and most mortgage credit institutions are requested to conduct regular stress tests, which takes concentration risks on all relevant risk areas into account. The DFSA performs stress tests twice per year at six monthly intervals and banks are required to perform a bottom up stress test annually. Results of the exercise are analyzed by supervisors and followed up accordingly with the bank where risks and not being managed sufficiently.
Additional criteria	
AC1	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) ten percent or more of a bank's capital is defined as a large exposure; and (b) twenty-five percent of a bank's capital is the limit for an individual large exposure to a private sector nonbank counterparty or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.
Description and findings re AC1	The FBA does not define a large exposure per se. According to the FBA, banks are required to report exposures above 10 percent the capital base (s.145 (4) FBA) and a 25 percent threshold is applied as the upper limit of a single or group of connected counterparties (s.145). The FBA provides for limited exemptions to the large exposure rules which are time-based and require an exit strategy. Where deviations from the large exposure limits are permitted, the supervisor monitors the exposure closely. Few examples are available for permission to exceed the 25 percent limit, mainly in relation to a merger of two banks where a large exposure is created. There were minor examples where a large exposure had been identified due to an institution's error in the calculation of the base capital. The bank is usually required by the FSA to work on decreasing its large exposures with frequent reporting to the FSA on each step taken during this process.
Assessment of Principle 19	Largely Compliant
Comments	Notification requirement for large exposures needs to be tightened. Currently, the DFSA will be notified at the end of 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. There is generally a strong focus on credit risk by the supervisor which includes credit concentration risk. The DFSA set 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.

Principle 20	**Transactions with related parties**. In order to prevent abuses arising in transactions with related parties[50] and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties[51] on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	Related parties: The FBA provides detailed descriptions of prescribed treatment of related party exposures to the Board of Directors (BOD), Board of Management (BOM) and intragroup exposures e.g. subsidiaries and affiliates. However, the FBA does not provide an exhaustive definition of related parties. Therefore treatment of exposures to related parties that do not conform to the three groups listed in the FBA (Board, management and intragroup) is uncertain —the main exception being the bank's main shareholders. As a result, the FBA does not contain explicit provisions for the treatment of exposures to minor shareholders as related parties. Board and Board-related parties. The relevant sections of the FBA 78(1) and (4) refer to limitations of exposures with Board members and with persons related to the BOD. Specifically, section 78(1) restricts transactions by the bank with board members, and s.78-(4) states that the provisions also apply to business exposures with persons related to members of the board of management by marriage, cohabitation for no less than two years or kinship in the direct line of ascent or descent or as siblings, and to business exposures with undertakings in which such persons are members of the BOM. The FBA section 78(1) states that without the approval of the BOD, which shall be entered into the minute book of the BOD, financial undertakings may not establish a business exposure with or accept collateralization from members of the BOD and BOM of the bank, or undertakings where the persons specified in no. 1 are members of the board of management or members of the board of directors. Financial information must be available about the group of persons mentioned in section 78(1) and (4) of the Financial Business

[50] Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

[51] Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	Act, since the board of directors is required to monitor these exposures in particular, cf. section 78(3) of the Financial Business Act. This does not apply, however, to fully secured exposures or exposures of entirely insignificant size. <u>Management</u>. Sections 78 (2) addresses the necessity for transactions between the financial undertaking (bank) and the BOD and BOM to be based on commercial terms/market conditions. Further, section 80(3) stipulates that "the board of directors shall decide which employees have a significant risk of conflicts between the interests of the employee and those of the financial undertaking". This requirement by the FBA obliges a bank to identify employees with potential conflicts of interest so that appropriate policies and processes can be implemented to mitigate potential risks. <u>Intragroup transactions</u>. Sections 179 to 181 provide detailed limitations for intra-group transactions which deal directly with risks involved in related party exposures: "a financial undertaking may not have an exposure with undertakings or persons who exercise direct or indirect controlling influence in the financial undertaking or who are controlled by undertakings or persons with such influence. Lending, specifically add additional requirements to the 25 percent limit. Permission for intra-group exposures is based on the updated assessment by the FSA of the risk profile of the financial undertaking and group in question and granted on basis of offsite reports typically for one year's duration. It is further stated in section 182(2) that a bank may not have an exposure with undertakings or persons who exercise direct or indirect controlling influence in the bank, or who are controlled by undertakings or persons with such an influence. DFSA may allow exemptions from this subsection in limited cases but where transactions are at an arm's length.
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g. in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties.[52]
Description and findings re EC2	Section 78(1) of the FBA states that without the approval of the board of directors, which shall be entered into the minute book of the board of directors, financial undertakings may not establish a business exposure with or accept collateralisation from members of the board of directors and members of the board of management of the bank, or undertakings where the persons specified are members of the board of management or members of the board of directors. The FBA strictly requires transactions between Board members and BOM on an arms-length basis/market conditions (FBA s.78 (2)). The EO on Intra-Group Transactions regulates the terms of intra-group transactions

[52] An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g. staff receiving credit at favorable rates).

	(section 3 and 4) that state that intra-group transactions shall be entered into on the basis of written agreements and on market-based terms and conditions. Where there is no actual market, reasonable estimates shall be applied.
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	There are no specific requirements in relation to the write-off of related party transactions. However, the FBA does restrict exposures and transactions between the BOM and the financial undertaking. The EO on Management and Control emphasizes the role of the board in relation to oversight of the write off process and boards are expected to have formal procedures.
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	The scope of the FBA provisions associate to related party transactions do not strictly require banks have policies and processes to prevent persons benefiting from a transactions with related persons to be excluded from approving or managing a transaction i.e. a credit officer granting a loan. Section 78 and 80 in the FBA directly apply to restrict malfeasance. Section 78(1) of the FBA, states that without the approval of the board of directors, which shall be entered into the minute book of the BOD, financial undertakings may not establish a business exposure with or accept collateralization from related parties. Financial information must be available about the group of persons mentioned in section 78(1) and (4) of the FBA, since the board of directors is required to monitor these exposures in particular, cf. section 78(3) of the FBA. This does not apply, however, to fully secured exposures or exposures of entirely insignificant size. Thus, it is not sufficient to make only an assessment at the time of establishment of the exposure. The DFSA include related party exposures in their onsite supervision activities to assess whether appropriate risk management has been applied to these exposures. When reviewing board papers the supervisor will also test to determine whether the board has approved the exposures. In sampling related party exposures, supervisors will assess the terms, interest rate and approval process to assess that the terms and conditions of the exposure align with commercial conditions.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	There are no such powers in the FBA in relation to deduction from capital of related party transactions. There are however prohibitions within the FBA and EO on intra-group

	transactions which mitigate the need for adjustments to capital. The FBA section 182(1) states that a financial undertaking may not, without prior approval from FBA, have exposures within the same group except for exposures with subsidiaries. According to the EO on Intragroup Exposures, in normal circumstances if the total intra-group weighted exposures are below the capital base minus 75 percent of the capital requirement and if the total intra-group exposures un-weighted are below the capital base. In some cases no approval will be given and in other rare cases amounts exceeding these limits have been granted. Hence undertakings with an approved permission in accordance with section 182 (1) may have higher exposures than 25 percent of eligible capital, cf. CRR article 395. Permission to intra-group exposures is based on the updated assessment by the DFSA of the risk profile of the financial undertaking and group in question and granted on basis of offsite reports typically for one year's duration. In relation to exposures with related parties outside of intragroup exposures, the provisions within the FBA do not permit a capital adjustment.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	The Danish regulations place clear lines of responsibility for BOD oversight of related party exposures as defined by exposures to Management, intragroup and BOD FBA section 78(1) states that without the approval of the board of directors, which shall be entered into the minute book of the board of directors, financial undertakings may not establish a business exposure with or accept collateralization from related parties. As such, banks are obliged to record related party exposures. During onsite inspections, DFSA examine whether the bank adheres to the relevant sections in the FBA e.g. by interviewing the board of management and by examination of the largest intra-group transactions and the intra-group lending portfolio. The external auditor of the financial undertaking will also have to report on this matter annually attesting to the adequacy of policies and whether the policies have been applied. Supervisors perform an annual assessment of the audit book and will meet with the external auditor in preparation for onsite reviews where related party exposures will be discussed. Financial information must be available about the group of persons mentioned in section 78(1) and (4) of the FBA, since the board of directors is required to monitor these exposures in particular, cf. section 78(3) of the FBA. This does not apply, however, to fully secured exposures or exposures of entirely insignificant size. Thus, it is not sufficient to make only an assessment at the time of establishment of the exposure.

	According to The FBA section 181 DFSA shall lay down more detailed regulations on transactions carried out between a financial undertaking and group affiliates. EO on Intra-Group Transactions regulates the terms of intra-group transactions, which include section 3 and 4 that state that intra-group transactions shall be entered into on the basis of written agreements and on market-based terms and conditions. Where there is no actual market, reasoned estimates shall be applied. The FBA section 182(1) state that a financial undertaking may not, without prior approval from DFSA have exposures within the same group except for exposures with subsidiaries. According to DFSA guidelines on this area approval can be expected in normal circumstances if the total intra-group weighted exposures are below the capital base minus 75 percent of the capital requirement and if the total intra-group exposures un-weighted are below the capital base.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	The FBA Act section 182(1) states that a financial undertaking may not, without prior approval from DFSA, have exposures within the same group except for exposures with subsidiaries. According to DFSA guidelines on this area approval can be expected in normal circumstances if the total intra-group weighted exposures are below the capital base minus 75 percent of the capital requirement and if the total intra-group exposures un-weighted are below the capital base. In some cases no approval will be given and in other rare cases amounts exceeding these limits have been granted. Permission to intra-group exposures is based on the updated assessment by the FSA of the risk profile of the financial undertaking and group in question and granted on basis of offsite reports typically for one year's duration.
Assessment of Principle 20	Materially Non-Compliant
Comments	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 in the legislation limits 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. Offsite reporting for related party exposures is not reported on a quarterly basis to allow supervisors to identify and monitor trends or exceptions to policy. The absence of meaningful offsite data inhibits the ability of the supervisor to identify, monitor and track related party exposures in a timely manner and act at an early stage if required. The deficiency in offsite data for related party exposures is exacerbated by the lengthy supervision cycle. There are no specific requirements in relation to the write-off of related party transactions. However, the FBA does prohibit exposures and transactions between the BOD and the financial undertaking. The EO on Management and Control emphasizes the role of the BOD

	in relation to oversight of the write off process and boards are expected to have formal procedures.
Principle 21	**Country and transfer risks**. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk[53] and transfer risk[54] in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	The requirement for banks to have policies to manage and mitigate country and transfer risk is contained in the EO on Management and Control. According to the EO, "A bank shall have procedures or descriptions of processes etc. for all significant areas of activity which includes country and transfer risk" (section 17(1)). It is a general requirement that if a bank is exposed to this type of risk it is obliged to establish and implement policies for the identification, measurement, evaluation and monitoring of country and transfer risk. The EO on Management and Control of Banks (annex 1, paragraph 15 (point a-c) requires banks to have procedures which: a) contain a description of the bank's internal control system for the credit area; b) how internal controls are to be carried out, including the scope and frequency of the internal controls; and c) What reporting is to be carried out for individual exposures and at portfolio level, including the scope and frequency of reporting for all levels of the bank? Based on these requirements, banks will be obliged to ensure that all material risks are

[53] Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

[54] Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)

	controlled and reported, including country and transfer risk if the bank assesses that the risk is material. In this way, the FBA does not require a specific policy for country and transfer risk, but that policies have due regard to these risks. Banks are aware of their obligation to have policies and processes to identify, monitor and manage country and transfer risk which was evidenced doing the mission. In terms of governance expectations, s. 5(1) of the EO on Management and Control of Banks etc. require BOD's to develop and approve a credit policy. The credit policy shall contain the decision on what credit risk profile the board of directors wants the bank to have. The above mentioned procedures shall, according to section 18(2) of the same executive order, to a relevant extent, reflect the policies adopted by the board of directors. This ensures that the processes are consistent with the bank's risk profile. In a revision of the EO on Management and Control of Banks etc. the rules on "procedures for continuous monitoring of exposures and credit risk in general" have been further clarified. The procedures must ensure that the bank on a customer and portfolio level has an updated overview of developments in the bank's credit risk. The bank will then have an adequate basis for making decisions in order to reduce credit risk which also applies to country and transfer risk. In practice, this was observed by the assessors to ensure that the banks monitored and evaluated the developments in country and transfer risk and applied appropriate countermeasures. If country and transfer risk is assessed to impose a risk to a bank, the DFSA determines - in accordance with the rules described above - if the bank has the relevant procedures, and whether the procedures are in compliance with the credit policy. The DFSA will also assess if exposures with country and transfer risk are identified, monitored and managed sufficiently. When macroeconomic conditions indicate that country risk can pose a risk to individual banks and system-wide, the DFSA conducts, depending on the severity of the macroeconomic conditions, an offsite assessment, where banks are asked to report on their exposures towards countries that are assessed to impose a country risk. In practice, the banks are asked to explain how their exposures are monitored, controlled and reported for country and transfer risk as observed by the assessors. Depending on the results, the offsite assessment can lead to an onsite examination which has been the case in recent years for several banks. Another example was the euro crisis the DFSA asked the largest banks in Denmark to report on their exposures towards banks in the EU. The reporting showed that the banks' exposures towards banks from Portugal, Italy, Ireland, Greece and Spain (PIIGS) were limited. However, measured on utilization, one of the banks was to a larger extent exposed to PIIGS countries and the bank in question was asked to explain how it assessed the risk in the countries concerned and how it expected the exposures would evolve going forward. Furthermore, the bank was asked to briefly describe how the exposures were monitored and controlled. Subsequently it was assessed that country risk did not impose a large risk to the bank, and that the bank monitored, controlled and reported the risk sufficiently. Further, sovereign exposures has been reported by the largest banks as part of EBA exercise, most recently in the 2013 'EBA Transparency exercise' covering end-2012 and mid 2013 data. 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.

	Routine supervisory reporting for the largest banks involves information regarding income, exposures, and other balance sheet information for each of the Group's subsidiaries and foreign branches. The frequency for this reporting to the supervisor is quarterly and it was evident to the assessors that the analysis was adequate to identify risks. For the largest listed banks, quarterly public disclosures supplemented supervisory reporting and covered additional areas such as impairment charges, and lending and deposits for each subsidiary and foreign branch.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	As part of the overall and strategic management of banks, the Board is required to monitor that management performs its duties appropriately and in accordance with the risk profile, policies and guidelines laid down for the board of management (EO management and Control section 2(4)). Furthermore, the Board monitors that policies and guidelines are implemented effectively and fully integrated into the bank's overall risk management process. The adequacy of banks' risk management policies and its application to effectively address and mitigate country and transfer risk is assessed through onsite examinations. Country and transfer risk is evaluated mainly as a subset of credit risk. Credit risk reviews are performed on an annual basis for the Group 1 banks with significant portfolios and less frequent for other group banks. Country risk was assessed in detail during 2010 to 2013 where the risks were most evident. For the larger banks with extensive cross-border exposures, the nature and extent of country and transfer risk is assessed on an ongoing basis through offsite supervision. Depending on the type and size of the bank, as well as the complexity of the bank's activities subject to credit risk, the credit policy shall contain specific measurement and limits for country and transfer risk. According to annex 1, paragraph 2 (point e) of the EO on Management and Control of Banks etc., the credit policy shall contain principles for the size, type and scope of credit risks, including principles for geographical exposure, including the bank's maximum exposure within selected geographical areas. Thus, the credit policy will state limits and how to manage country and transfer risk, if country and transfer risk is part of the bank's risk profile.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	The FBA and EO (Management and Control) require banks to have established risk management systems to monitor risks and report detailed risk information in a timely manner. The requirement for risk systems to aggregate exposures is contained within the EO on Management and Control of Banks (specifically Annex 1). In practice, banks have demonstrated the capacity to respond to ad hoc information requests and report close-to

	real-time risk positions across banking and traded portfolios for country and transfer risks (i.e. by currency, country etc). According to the EO, a bank shall establish independent internal control of all material activities in the credit area. As a minimum, there shall be regular internal control that the credit policy is complied with by the employees of the bank (cf. annex 1, paragraph 22, point a). The requirement to apply risk limits is also contained within the EO. Adherence to limits is regularly reviewed as part of the onsite review and on a less systematic basis through offsite supervision. The EO on Management and Control requires that the BoD receive at least every quarter reports that illustrate the bank's compliance with the credit policy. Reporting needs to be at a portfolio and sub-portfolio level and, as a minimum, contain information about the bank's exposures with higher or special risks (Annex 1, paragraph 25). Thus, if country and transfer risk is assessed to impose a high risk to the bank, the board of directors will receive quarterly reports on compliance with the exposure limits and an assessment of the risk. If country risk is assessed to impose a risk to a bank, the DFSA will on examinations determine if the internal control is sufficient to manage the risk, and that the board of directors at least quarterly receive relevant reports. As mentioned in EC2, the adequacy of bank information systems and capacity to report real time aggregate risk information is assessed onsite through credit risk examinations.
EC4	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	The practice described under (c) is in place, i.e. the banks assess individual loans on the basis of whether there is an impairment loss in relation to the country and transfer risk involved in accordance with the general rules for calculating impairment losses. The adequacy of the impairment losses is judged by the external auditor and by the DFSA on onsite inspections if relevant.

	No specific provisioning standards on country risk have been issued. Impairment losses stemming from country risks have to be taken into account within the general rules on the calculation of impairment losses. All information that can influence future cash flows, including country risk has to be taken into account when calculating impairment losses. No specific provisioning standards on transfer risk have been issued. Impairment losses stemming from transfer risks have to be taken into account within the general rules on the calculation of impairment losses. All information that can influence future cash flows, including transfer risk has to be taken into account when calculating impairment losses. Supervisors assess the adequacy of provisions for country and transfer risk when performing onsite reviews. In the event of deterioration in external market or macroeconomic conditions that impact country and transfer risks, the supervisor will undertake more periodic analysis.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programmes to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	The DFSA requires banks to include in scenarios the relevant risk for risk management purposes for country risk and transfer risk as for all other relevant risks. The FSA performs reviews on the banks—in particular IRB banks—procedures and documentation. The results of stress tests are reported to the DFSA on a six-monthly frequency. The results are analyzed as part of routine supervision to determine whether there has been any change in risk profile which will trigger a supervisory activity (i.e. request for more information, meeting with bank, adjust onsite supervision cycle). Action is taken when the risks are excessive and pose risk to financial soundness.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g. in crisis situations).
Description and findings re EC6	The supervisor has the power to ask for any information if needed in accordance with section 347 in the FBA (also see EC5). For example, the DFSA exercised this power in the euro crisis as an example where banks were asked to report their exposure to countries which were experiencing significant volatility.
Assessment of Principle 21	Largely Compliant
Comments	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). Domestic banks have limited exposure to foreign currency sovereign bonds. The DFSA receives quarterly data regarding cross-border exposures on a legal entity basis. The data allows the supervisor to assess the size of exposure as a percentage of total assets. On an annual basis supervisors will receive more detailed information regarding the risk profile of cross-border exposures. Through onsite 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.

	There are no specific guidelines or regulations for country or transfer risk outside of the general risk management requirements (i.e. EO Management and Control). Where country and transfer risk is de minimus, banks adopt a proportionate approach and manage this risk as a subset of credit risk. For the largest banks with more significant cross-border exposures, standalone reporting is implemented is used to manage and monitor this risk. Offsite surveillance for the major banks where country and transfer risk is most evident is performed quarterly and supervisory reporting requirements are adjusted to enhance the level of detail for supervisors to assess the risk. During the euro crisis, banks were asked to report their exposures and analysis was undertaken to assess the risk in detail. Sovereign exposures has been reported by the largest banks as part of EBA exercise, most recently in the 2013 'EBA Transparency exercise' covering end-2012 and mid 2013 data. Outside of these exercises, 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. No specific policies are in place to address provisioning for country and transfer risks. Instead, banks are expected to consider this risk as part of their overall provisioning framework. Supervisors perform a thorough review of bank provisioning practices which incorporated country risks.
Principle 22	**Market risk**. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	The market risk standards for the Danish banks are set out in the FBA sections 70–71 and specified in the EO on Management and Control of Banks. Taken together, the FBA and EO oblige banks to have a comprehensive view of market risk. FBA section 71 requires banks to have effective processes to identify, measure, monitor, control and report the market risks the bank is or can be exposed to. These include written procedures, internal controls and reporting systems as well as organizational division of responsibilities, including for risk taking, risk management, control and reporting. The specific requirements for market risk management processes are specified in the EO on Management and Control of Banks and are proportional to the bank's market risk profile, the bank's size, the structure of the bank and the structure of any group the bank may be part. The main instruments used by banks include: interest rate products, equities and equity derivatives, commodity futures and FX derivatives. Banks have limited exposure to structured credit products, CDS, CDO or other types of exotic instruments. The majority of instruments in the trading book are exchange traded and cleared through central clearing

	platforms (e.g. LCH). The trading strategies adopted by banks vary between the banks, though in most part banks fulfill customer flow and fulfill their role as market makers. Proprietary trading is limited to the very few larger banks which take positions in the market for an extended period. Section 70 of the FBA requires the BOD to determine the bank's market risk profile and codify in a market risk policy. On the basis of the market risk policy, the BOD provides the BOM with written guidelines for market risk. When formulating the written guidelines the board of directors ensures that the board of management is sufficiently qualified to use the authority stated in the guidelines in a manner appropriate for the bank (EO Management and Control Annex 2). Together, the market risk policy and the written guidelines on the market risk area shall determine the desired or acceptable level of market risk, what types of market risks the bank want and does not want to accept, limits for the total market risk and for the individual market risks and how exposures and positions subject to limits are calculated. Furthermore, the market risk policy and the written guidelines on the market risk area must state the purposes for which securities, currency and derivative financial instruments may be traded, e.g. risk hedging, active risk taking or trading for customers. As regards derivative financial instruments it must be stated which types of derivative financial instruments may be traded or taken positions in. As regards calculations of risks and gains/losses as well as the values of financial instruments and other items with market risks, the board of management shall according to the EO on Management and Control of Banks ensure that the bank has appropriate methods for this, including that it can be controlled. If the bank obtains calculations of risks and gains/losses as well as values of financial instruments and other items with market risks from external parties, the bank shall ensure that the external parties perform the task appropriately. The bank shall also regularly evaluate whether the prices, parameters etc. received from and applied by the external parties are correct and thereby ensure a fair presentation of the risks of the bank and correct financial statements (Annex 2, EO Management and Control). According to the EO on Management and Control of Banks the calculation and reporting of positions and risks as well as the prices, parameters etc. received from and applied by external parties shall be controlled by a function independent from the relevant risk taking businesses units. On the market risk area independent controls shall also cover control of whether authorities given to the board of management and delegated authorities are observed; whether agreements with customers as regards investment limits and portfolio management are complied with and whether transactions are entered into at correct rates and prices. The reconciliations of holdings of securities, financial instruments and accounts shall also be controlled. Positions need to be valued daily on a marked to market basis according to the EO on Capital Requirements. Where marking to market is not possible, the bank must mark to model their positions before it calculate the capital requirement for trading book positions. Furthermore, models used to value positions need to be developed or approved independently of the relevant risk taking businesses units and shall be independently tested (see EO Annex 2). According to the EO on Capital Requirements the bank must have systems and controls sufficient to provide prudent and reliable valuation estimates. Furthermore, the bank must have procedures for considering valuation adjustments/reserves for positions that cannot be prudently valued, including concentrated, less liquid, and stale positions. There was evidence to suggest that when

	performing onsite inspections, supervisors verified valuation processes through meetings with risk management staff, assessment of documentation and analysis of external rate sourcing. Risk management obligations of banks are prescribed within the EO on Management and Control. According to the EO, the risk management function shall be able to report directly to the BOD and shall at least once a year submit a report on the bank's risk management processes to the board of directors. In addition, the risk management function is obliged to inform and warn the BOD of any reservations that the risk function may have regarding the bank's risk management processes. According to FBA section 124(1) the BOD and the BOM of banks shall ensure that the bank has adequate capital base and has internal procedures for risk measurement and risk management for regular assessments and maintenance of a capital base of a size, type and distribution adequate to cover the risks of the institution. Furthermore, the board of directors and the board of management shall compute the banks individual solvency need, FBA section 124(4). On the market risk area this means that the bank must assess its assets, liabilities and off-balance sheet items for market risks, especially equity risk, interest risk and currency risk (see EO on Capital requirements).
EC2	Through onsite examinations, the supervisor assesses whether banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	FBA section 70 requires the BOD to determine the bank's market risk profile and implement this risk profile in a market risk policy. On the basis of the market risk policy, the board of directors shall provide the board of management with written guidelines on the market risk area. Onsite inspections conducted by the DFSA are the main tool to verify that the board of directors has approved a market risk policy and to test whether the policies and processes have been implemented in line with the policy. Furthermore, the DFSA examine whether the bank has an internal information and reporting system that enable senior management and the board of directors to: • monitor the bank's risk, results and positions; • evaluate the bank's risk profile; and • Make sure that the written guidelines for risk taking are being followed. During onsite inspections, the DFSA examine whether the bank's risks and positions, gains/losses as well as the values of financial instruments and other items with market risks as they are reported to the senior management and the BOD are measured correctly and controlled independently from the relevant risk taking businesses units. A dedicated unit within the DFSA with specialist market risk skills (Operational Risk Divisions) is responsible for conducting onsite inspections for the larger banks (Group 1). There is a four year cycle of onsite inspections for the larger banks. Whereas the supervision of the market risks of other banks is placed at the responsible banking

	divisions, although the Operational Risk Division may assist the responsible banking divisions in their supervision of banks. Onsite inspections on the market risk area in mainly the larger banks can be focused on one or more areas or topics depending on an offsite risk assessment of the individual bank's activities on the market risk area, the bank's market risk profile, the bank's organization on the market risk area, the bank's capital strength etc. A typical onsite inspection for market risk involves an examination of the policy, the guidelines for risk management, an assessment of existing risk positions and exposure, the organization of the market risk area including the segregation of duties, internal controls and valuations. The approach to onsite inspections typically involves meetings with the member of the board of management that are responsible for the market risk area, the internal auditors, front office, back office, middle office, treasury, risk management, chief risk officer and chief compliance officer. The onsite team will sample risk positions and test the accuracy of valuations and the sources of valuations to ensure independence. An onsite inspection will also involve an examination and assessment of the bank's ICAAP as regards market risks. Marked to market valuations is examined and the DFSA verify that the bank has systems and independent controls sufficient to provide prudent and reliable valuation estimates to use in both the reporting to the senior management and the board of directors and the financial reports. Valuation adjustments/reserves for positions that cannot be prudently valued, including concentrated, less liquid, and stale positions, is discussed in connection with the examination of the ICAAP on the market risk area. The bank's allocation of positions to the trading book and to the baking book is also discussed in connection with the examination of the ICAAP on the market risk area. Some banks use models to identify and measure market risk and set limits for market risks. The DFSA examine the bank's use of the model and verify that the bank including the senior management and the board of directors has the necessary understanding of the model and its limitations. Furthermore, the DFSA examine whether the model is controlled independently from the relevant risk taking businesses units and that the controls include relevant back tests of the model. A bank's market risk management processes and their implementation in the organization are examined and assessed during onsite inspections, cf. FBA section 346(1). In the examination of the market risk profile, the limits set for market risks and the management reporting on market risks the DFSA will assess whether the bank has taken due consideration to the risk of a significant deterioration in the market liquidity. As regards banks of systemic importance (SIFIs) a political agreement has been made in the Parliament on 13 October 2013 which requires an intensified supervision of SIFIS. The requirements that transpose the international guidelines issued by the Financial Stability Board guidelines will be implemented in the FBA section 344(3) and is expected to come into force in the first quarter of 2014. The intensified supervision of SIFIs will be characterized by more frequent inspections; benchmarking of banks of systemic importance, also in relation to foreign banks of systemic importance; enhanced focus on corporate governance and risk management; and enhanced focus on model risk and capital allocation. As a result, the normal onsite cycle will be annual and the Operational Risk Division for market risk will increase from five staff members to six.
EC3	The supervisor determines that the bank's policies and processes establish an appropriate

	and properly controlled market risk environment including: (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) Sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	Please see under EC 1 and 2 for a complete discussion. The DFSA will assess the adequacy of a bank's market risk policy through the onsite review and tests effective implementation through sample testing. A review of the banks' Board minutes evaluates reporting and governance around exception reporting and adherence to limits. Equally, the onsite review will verify compliance against revaluation procedures and allocation of exposures to the trading book.
EC4	The supervisor determines that there are systems and controls to ensure those banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	Please see under EC2 The majority of the Danish banks trading are order driven and market making activities are modest. Trading strategies and the instruments being traded normally depends on the size of the bank and the current market situation. Currently, the small and medium banks typically have a low to medium market risk profile with no proprietary trading and with positions mainly in Danish mortgage bonds and Danish government bonds and only some listed Danish or foreign shares. Derivatives are usually only used for hedging purposes. Medium and larger banks typically have a medium market risk profile with some proprietary trading and with positions in more diversified financial instruments such as listed Danish and foreign shares, Danish and foreign corporate, mortgage and government bonds, CDS' etc. Generally, the market risks in the Danish banks consist mainly of interest

	rate risk. Equity risk and currency risk is often moderate and commodity risk is very modest. In the supervision of the banks' market risks the DFSA examines the different risk measures that the banks must report to the DFSA in accordance to the DFSA's guidelines on financial reporting to the DFSA. The DFSA looks at a sample of positions in both the trading book and the banking book. As regards positions risk the DFSA looks at specific and general risk. As regards benchmarking the DFSA mainly benchmark the banks to their peers. Onsite inspections are the most effective tool to verify the bank's policies and processes for valuation adjustments on less liquid positions as well as the bank's policies and processes for marked to market positions are examined and assessed during onsite inspections, cf. FBA section 346(1). The DFSA review the bank's written procedures on the area and discuss them with relevant staff in order to assess whether the policies and the processes ensure prudent and reliable valuation estimates to use in both the reporting to the senior management and the board of directors and the financial reports. The DFSA also takes into account any comments that the internal or external auditors might have given in the audit book. The DFSA will normally not engage with external experts to verify the bank's valuations policies and processes but this is a possibility, cf. FBA section 344(6). Interest rate risk shall be calculated as modified duration in accordance with the DFSA's guidelines on financial reporting to the DFSA (a parallel shift of the yield curve of 1 percentage point). Currency risk shall be calculated as a position (indicator 1) or for some banks as a risk measurement (indicator 2). Indicator 1 shall be calculated as the largest of the greater of the sum of all the short currency positions and the sum of all long foreign currency positions. Indicator 2, which is a simple VaR model, shall be calculated in accordance to the DFSA's guidelines on financial reporting to the DFSA. Equity risk shall also be calculated as a sum of net position.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	On onsite inspection the DFSA examine the ICAAP to assess whether the bank allocates appropriate levels of capital against unexpected market risk losses and makes appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities. The DFSA consider the banks market risk offsite regularly and in connection with a yearly assessment of the banks ICAAPs. Onsite inspections of the market risk area are conducted in accordance with a risk based approach and normally every 4-6 years for the small and smaller banks and more frequently for the larger banks. As regards to SIFIs, in the future the DFSA intends to conduct onsite inspection every year for market risk.
EC6	The supervisor requires banks to include market risk exposure into their stress testing programmes for risk management purposes.
Description and findings re EC6	The DFSA require that the bank's stress testing programs include the bank's market risk exposure such that the bank can ensure that the risk management processes is adequate relative to the risk taking on the market risk area. Stress testing is required to be performed by banks annually which include market risk which is a minimum expectation.

Assessment of Principle 22	Largely Compliant
Comments	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. Banks are required to implement Board approved policies and processes which are regularly reviewed and adjusted according to macroeconomic conditions. Regulations require segregation of duties between front, middle and back office, especially for the valuation of traded positions which is independently verified by risk personnel. Bank supervisors routinely perform onsite reviews of risk management to verify compliance and assess risk profile. Instruments in the trading book are valued using fair market values subject to IFRS. Supervisory reporting of traded market risk could be expanded to capture a broader suite of risk information and results of stress testing. Currently offsite reporting of market risk information consists of data for specific categories: currency, interest rate, commodity and equity products. While the reporting requirements will capture the majority of traded market instruments, more exotic instruments will not be captured by the reporting requirements. As a result, a build-up in market risk could occur in the absence of onsite examinations. There are no minimum expectations for stress testing traded portfolios outside of the annual ICAAP. For positions that are subject to volatile market movements, more frequent reporting of stress testing will identify potential sources of risk. The requirement to strengthen offsite reporting is in the context of the following factors: • Market risk for the larger banks is in some instances is not insignificant, ranging between 9.37 percent of RWAs to as high as 15.81 percent for the larger banks; • A four year onsite review cycle is not adequate for the larger banks given their risk profile and extent of trading; and • The notification regime for market risk is not strong. Banks are not required to seek prior approval to commence trading in new types of instruments, or if they amend trading strategies-new products that raise their risk profile. Banks are therefore able to take on additional risk without notifying the DFSA.
Principle 23	**Interest rate risk in the banking book**. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk[55] in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.

[55] Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	The EO on Management and Control outlines the minimum expectations for management of risks associated with IRR. EO no. 1325 of 1 December 2010 on Management and Control of Banks etc. requires the board of directors to detail instructions for the management of market-risk including limits on IRR. In addition, the DFSA has issued a guideline on capital adequacy requirement EO on Capital Adequacy. The guideline includes IRR for the purpose of calculating capital adequacy and introduces two approaches: a standard approach and a portfolio-based approach. In addition, banks have the possibility to use advanced internal models. In both the standard and portfolio-based approaches banks must be able to separate IRR in the banking book from IRR in the trading book and to measure and control these factors. The major difference between the models is that the portfolio based approach allows for netting of positions between IRR in the trading book and IRR in the banking book, when certain conditions are met. The capital requirement calculated in the models is based on the level of utilization of market risk limits set by the board of management for IRR in the banking book and IRR in the trading book. Netting arrangements are closely monitored by the DFSA and a number of risk management conditions are required to be satisfied for netting to be allowed: • Duration and size of positions are taken into consideration; • The bank is required to actively manage the IRRs including hedging of IRRs in TB and BB; • The decision to use netting in this regards is decided by senior management and procedures are in place for daily risk management; and • The strategy and policies are clearly described in the ICAAP. If a bank is permitted to hedge between the TB and BB, supervisors review the risk management as part of the onsite review and as part of the annual ICAAP assessment. There was evidence to demonstrate that this aspect of IRR was given adequate attention during the onsite examinations and ICAAP. The requirement for limits follows from EO no. 1325 of 1 December 2010 on Management and Control of Banks etc. where the board of directors is obliged to detail instructions to the board of management for the market-risk area including limits on IRR. According to the

	EO, the board of management and other employees shall provide clear and concise risk reports to the board of directors on both the current utilization of the limits lay down and on utilization over time which includes, amongst others, IRR in the banking book. Banks are required to assess their IRR on a quarterly basis and reported to the DFSA through offsite reporting. The supervisor performs an assessment of IRR as part of offsite monitoring. is assessed every quarter with the banks' reporting of IRR to the DFSA and the ICAAP. An assessment of IRR is included in the quarterly analysis performed by supervisors in the Bank Analysis Division and communicated throughout the supervision department. In terms of onsite supervision activities, the DFSA conducts annual risk assessments of all banks that lead to a plan as to which banks are subject to onsite inspection for the following year. The frequency of onsite inspections depends on the individual risk assessment for each bank. As a minimum requirement, the smallest banks are subject to onsite inspections at least every sixth year. For the larger banks, onsite inspections for IRR risk are performed once every 2nd year. When the arrangements for SIFIs are introduced, banks with SIFI-status will be assessed once a year.
EC2	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	The EO on Management and Control require the board to approve and regularly review a bank's strategy, policies and processes for the management of IRR (EO 1325 of 2010). The DFSA uses onsite inspections to assess if the banks' strategy, policies and processes for the management of IRR have been approved, and are regularly reviewed by the board of management and to confirm, that the board of directors ensures that the strategy, policies and processes are developed and implemented effectively. Macroeconomic conditions are taken into account in the banks' stress tests (please also see EC4) and it is expected that the board of management reports on current market conditions and their expectations of market conditions to the board of directors. IRR is managed at the ALCOs of the Group 1 banks where product, pricing and hedging strategies are developed and confirmed.
EC3	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary;

	and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	MCIs are subject to quarterly monitoring of IRR. Interest rate risk is tested in scenarios of both yield curve shifts and yield curve twists. The diversity of scenarios implies that duration matching of a loan and funding portfolio will not be sufficient to pass the test but requires additional risk management. MCIs are subject to the 'Balance Principle' as set out in the Mortgage-Credit Loans and Mortgage-Credit Bonds Act (paragraphs 19-20). Analysis of IRR for MCIs is conducted by the dedicated team of supervisors that supervise the MCIs as a portfolio. The DFSA makes use of bank quarterly reporting to track and monitor IRR. Routine reporting includes an overview of the banks overall IRR and further drilldown is possible by supervisors such as the risk stemming from hedges of IRR. These data are compiled in a graphical overview (Excel) with other risk parameters and distributed every quarter in the DFSA's market risk team. Data can be assessed on bank level or at a "top-10 level" of banks which hold the most risk. Information from ICAAP, risk reports and onsite inspections are also used to produce an assessment of IRRBB at least annually. The DFSA also hold "track-the-market" with the largest Danish Banks which is held annually. The aim of these meetings is primarily to collect information about market trends, how the banks position itself and monitor current market conditions. Group level analysis is conducted by analyzing the individual banks level of IRR (from the bank's quarterly reporting's) with its peer level group. The peer level is based on group 1, 2 and 3 with Group 1 being the 5 largest Danish banks. A key input into the assessment of IRR is the ICAAP which is assessed on annual basis as an input to the overall risk assessment of the bank. IRR is one of the specific risks which is required by the DFSA to be addressed within the ICAAP. In relation to the specific requirements in this EC: a) The formal requirements for banks to use IRR systems have been set out in the EO 1325 on Management and Control of Banks etc. The DFSA expects banks to have such systems in place in order to properly measure and control risks on IRR and calculate adequate regulatory capital. b) The DFSA requires the bank to be organized such that appropriate and independent controls for the market-risk area are established (including IRR), according to Executive Order no. 1325. In case that the banks outsource any tasks related to IRR they should have in place processes for independent validation, depending on the scope and complexity of the undertaking's market-risk-bearing activities, that should include control of whether the prices, parameters etc. received from and applied by external parties are correct and thereby ensure a fair presentation of the risks of the undertaking.

	c) The DFSA ensures that these limits are appropriate, understood and regularly reported to the board of directors. This is done by thoroughly reviewing the banks' market risk policy, the limits set accordingly, the use of limits, the process of breach of limits etc. The Banks must adopt market risk policies and appropriate limits accordingly following the EO Management and Control of Banks. Onsite examinations will also perform sample testing to verify that strategies, limits and controls are working effectively. d) The EO on Management and Control of Banks state that: "Regular written reports shall be issued at all relevant management levels on compliance and utilization of all limits for risk assumption contained in the guidelines pursuant to section 6 or in the authority transferred. Reports shall also be issued in compliance with the limits laid down in legislation for risk in the area, where this is relevant for the undertaking. Reporting shall also cover risks managed on behalf of the undertaking by portfolio managers."Furthermore: "Reporting to the board of directors shall be at the intervals stated in the guidelines (see, Annex 1, point 25). As a minimum, transgressions are required to be reported at each meeting of the board of directors, and reports shall be issued, if the conditions on which the individual limits for risks are based are changed significantly for example as a consequence of market unrest, extraordinary losses, changed capital position etc." and furthermore: "Reporting on delegated authority, including incidents when these are exceeded, shall be to the person who has allocated the authority, at intervals which reflect the surrenderer's involvement in the daily transactions and which are stated in the authority. Incidents of exceeding authority shall normally be reported no later than the day after the incident was ascertained." e) Please see the above answer.
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programmes to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	In the DFSA's guideline on capital requirements banks must stress their positions on IRR by a standard shock of 200 bps (parallel movement) (see Guideline on adequate capital base section 6.3). While banks are encouraged to also consider the effects of bends and twists of the yield curve to their portfolio in the banking book it is not strictly required in the guidelines. When assessing banks ICAAP, other stress scenarios than the standard shock are accepted if banks can demonstrate, to the DFSA on the basis of their portfolios, that other measures are more appropriate than the default stress test of 200 bps. An example of this is related to the currently low interest rate levels. The DFSA does not require banks to stress positions in the banking book to lower rates than zero.
Additional criteria	
AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using

	a standardized interest rate shock on the banking book.
Description and findings re AC1	Banks must report quarterly the krone durations of the positions in the banking book on positions. The default interest rate shock applied is the standard shock of 200 bps, but may vary as defined in EC4 which is reflected in the capital requirements for the bank.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	Assessment of banks' internal capital measurement systems is performed onsite. The assessment covers what instruments are present in the banking book, types of instruments and their respective durations. This is also reviewed in conjunction with the banks' capital requirements, in order to assess the capital adequacy.
Assessment of Principle 23	Compliant
Comments	Laws and regulations stipulate minimum obligations of banks to manage and mitigate IRR. Through quarterly offsite surveillance and routine onsite inspections, the supervisor assesses the implementation of bank risk management taking into account bank's risk appetite and market conditions. A protracted low interest rate environment has increased the dimension of IRR as well as the changes in interest rate optionality offered to customers. 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.
Principle 24	**Liquidity risk**. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	Regulations require banks to maintain liquidity buffers above defined quantitative requirements (s.152 of the FBA). In addition, the Supervisory Diamond (see CP8) requires banks to meet two liquidity metrics: an excess liquidity coverage requirement and a funding ratio requirement. According to this section, banks must have appropriate liquidity and that such liquidity shall amount to no less than: 1) 15 percent of the debt exposures that, irrespective of possible payment conditions,

	are the liability of the bank to pay on demand or at notice of no more than one month, and 2) 10 percent of the total debt and guarantee exposures of the bank, less subordinated debt that may be included in calculations of the base capital. In general, it is the 10 percent total debt ratio that is binding for the majority of banks. In terms of the definition of the portfolio of liquid assets that is required to be held, the definition is also set out in s.152 of the FBA and includes: 1) cash in hand, 2) fully secured and liquid demand deposits with credit institutions and insurance companies, and 3) Holdings of secure, easily realizable, securities and credit funds not used as collateral for a loan. The definition is broad and in practice there is a wide variety of instruments that comprise bank liquid asset portfolios. In practice, the largest single asset category of banks liquid assets is comprised of Danish covered bonds (approximately 45 percent for the system). Sovereign debt represents only a small proportion of bank liquid asset portfolios (approximately 10 percent for the system). As an example, committed credit facilities will also count towards a banks' liquid asset portfolio to meet the two quantitative tests specified in s.152. The liquidity rules do not formally require limits in terms of what assets comprise the liquid asset portfolio. The frequency of the liquidity reporting depends on the size of the bank. Banks with working capital above DKK250mn (which are group 1, 2 & 3 banks) and all banks on the Faroe Islands (Group 6 banks) report monthly. Banks with working capital below the DKK250mn threshold report quarterly (Group 4 banks). The Supervisory Diamond introduces two liquidity requirements for banks. Firstly, they should have an excess coverage of the s.152 requirement of 50 pct. And secondly, it introduces a funding ratio measure, which is the ratio between loans and working capital less bond issuance with a remaining maturity less than one year. This must be below 1. The five largest Danish credit institutions (Group 1 banks) have reported monthly LCR and quarterly NSFR-equivalent data to the DFSA since September 2011. From December 2011, the number of banks reporting the LCR and NSFR to the DFSA was expanded and the DFSA uses the BIII templates for reporting purposes. The largest banks (group 1 & 2) perform their own individual stress tests and report the results to the FSA on a monthly basis. The stress test is a standardized stress scenario defined by the DFSA. The EO on Management and Control Annex 4 prescribes a comprehensive set of parameters to establish the scenario and assumptions i.e. no access to market-based funding, idiosyncratic and market-wide disruption etc. The use of standardized scenarios enhances the comparability of results to identify outliers for follow up by supervisors. The results of stress tests are

	reported internally through the DFSA for analysis and action if required. In addition to the s.152 ratios and LCR that are reported monthly, banks report information regarding their market-based funding arrangements, including: price, tenor, currency, breakdown of senior funding above 12 months, details of short-term Commercial Paper programs etc. Banks are also required to submit results of stress testing on a monthly basis. Banks report a stress based on the s.152 ratios over a 12-month basis which assumes no access to wholesale markets and interbank. In addition to reporting the LCR, MCIs are subject to the Balance Principle as prescribed under the Mortgage-Credit Loans and Mortgage-Credit Bonds Act (paragraph 19 & 20 and EOno.718 of June 21, 2007). The cover of future payments to covered bond investors, tests are performed to limit the liquidity and funding risk of mortgage banks. In passing this test, MCIs will need to demonstrate sufficient liquidity to meet future payments on mortgage bonds. For example, deficits in interest payments may not exceed OC within 12 months to meet the General Principle.
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	The liquidity requirements are described in EC1, namely (i) a 15 percent liquidity requirement for total liabilities and (ii) a 10 percent requirement for debt instruments net of subordinated capital. The Supervisory Diamond also includes a criterion for stable funding. In line with the EU implementation of the CRR/CRDIV, Denmark will also implement the liquidity rules as prescribed by BCBS including the LCR and possibly the NSFR if this is decided by Council and Parliament in 2017. In addition, as part of the political SIFI-agreement, the Ministry of Business and Growth and the DFSA will in cooperation with Danmarks Nationalbank will look at proposals for specific requirements for stable funding for banks which will be discussed by the political Parties behind the agreement with a view of incorporating such requirements into Danish law at a later stage. There was evidence to demonstrate that supervisors paid close attention to the market conditions and adopted a forward looking approach to banks' liquidity risk settings. The Group 1 banks are mainly deposit funded representing an average of 40 percent of liabilities, followed by debt issued to credit institutions and central banks (20 percent) and other liabilities (21percent). Denmark will adopt an implementation timeline equivalent to that suggested in CRR/CRDIV commencing 1 January 2015. For systemic institutions, a faster implementation will be considered, depending on the final definition of the LCR in the EU Commission delegated act. Currently, the two BIII liquidity requirements are reported by all banks on a monthly basis to the DFSA. These are tracked and benchmarked both against the levels required by the Supervisory Diamond, as well as against group peers and the development over time. In addition, institutions submit on a monthly basis liquidity data on the composition of their liquidity buffer, details on all market based funding with original maturity over 1 year including issuance data, maturity data, and type of funding, currency and price. In addition,

	the institutions submit maturity profiles of all short term market based funding such as CP programs, the composition of deposits, and information composition of term deposits, term, amount and price of 10 largest term deposits. Finally, all institutions on a monthly frequency submit a standardized liquidity stress test, designed by DFSA and DN. The liquidity information submitted by banks is available on a bank level for all employees at the FSA via a supervisory tool. Monthly reports are produced that evaluate the trends and key drivers of certain liquidity metrics. This report is produced for individual banks and at an aggregate system level. The report uses six liquidity metrics, including: the two regulatory liquidity requirements, the LCR and NSFR metrics of the Basel Committee, development in deposit deficit, maturity profile of market based funding, dependence on interbank funding and the development of the mandatory liquidity stress tests. The variety of liquidity metrics allows a comprehensive view of liquidity risk. Monthly reporting allows supervisors ability to monitor the changes in funding markets and adapt to changing conditions if necessary which was well demonstrated. Banks are required to consider liquidity risk in their annual ICAAP where the bank is required to assess whether there is adequate liquidity management and control and whether there should be a supplement in the solvency need under the risk area “control risk” as per Annex 1 points 60-69 of the EO on Capital (Guidelines on adequate capital base paragraph 7.1). While the guidance to banks confirms that adequate liquidity is the most appropriate mitigant, the requirement for the bank to consider liquidity risk adds to the need for the bank to assess its liquidity risk profile against the context of current and future economic conditions.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks’ Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks’ risk profile and systemic importance.
Description and findings re EC3	Requirements regarding the liquidity risk management framework of banks are set as part of the requirements related to banks fulfillment of s.71 of the FBA. Further details on the requirements are specified in Annex 4 of EO Management and Control, which aligns closely with the CRD and CEBS guidelines on liquidity risk management. According to the EO on Management and Control (Annex 4), bank BOD’s are responsible for liquidity risk management and must have Board approved policies reviewed on an annual basis. The BOD reviews policies and processes on an annual basis. The BOD will also ensure that the liquidity buffers are adequate based on the outcome of stress testing. Stress scenarios and the liquidity strategy are reviewed and adjusted as necessary if macroeconomic variables or market conditions change. Each of the systemic banks has constituted an Asset Liability Committee (ALCO) which meets at least monthly and considers bank funding requirements on a forward looking basis. The ALCO consider a

	range of liquidity measures as well as funding needs to support asset growth targets on a forward looking basis. A dedicated team within the DFSA with specialist skills is assigned the responsibility to support the supervision of liquidity risk in banks. The team produce monthly reports containing key risk information and assessing the liquidity profile of the banks. In addition to analysis of monthly reporting, the team meet with the larger banks on a quarterly basis to discuss market conditions and their liquidity risks. The liquidity requirements are currently being revised in order to align them further with the requirements of the CRDIV and ESRB recommendations regarding asset encumbrance. Liquidity is a central feature of on and offsite supervision activities. Liquidity reporting submitted monthly to the DFSA is analyzed and circulated throughout various internal users. The Supervisory Diamond includes two liquidity-funding related metrics designed to act as early warning indicators. Onsite reviews will include analysis of liquidity risk management and is included in the business model analysis carried out quarterly. There was evidence which showed that the DFSA had considered liquidity risk supervision on a group-wide basis, including cross-border operations (subsidiaries and branches). For banks with large cross border activities, it was demonstrated that the DFSA discussed liquidity with host country supervisors.
EC4	The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including: (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	All of the above requirements are part of annex 4 of EO management and Control. These elements form part of the running onsite inspection process performed by the supervisory authority (see EC2). Typically the onsite examination would include a review of the: liquidity policy; risk limits and risk appetite as specified by the board; intra-group liquidity funding; liquidity buffers

	across the group; stress testing; contingency funding plan and internal controls and risk management. The scope of the onsite examination will adapt according to the size, scale and complexity of the business model and treasury model.
EC5	The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g. credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include: (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	All of the above requirements are part of annex 4 of Management and Control of banks. These elements form part of the running onsite inspection process performed by the supervisory authority. The assessors reviewed a suite of reports which demonstrated that the onsite inspection adequately covered the requirements in EC 4 & 5.
EC6	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	The requirements for liquidity risk management are contained in Annex 4, EO which also contains a requirement for banks to maintain a contingency funding plan. According to the regulation, banks are required to update a contingency funding plan at least annually reviewed by the Board of Directors and to be reviewed where market conditions change. Within the plan, banks will consider alternative sources of funding in stress circumstances within an overall strategy of diversifying its funding base. These elements form part of the running onsite inspection process performed by the supervisory authority. Danish MCIs have a very concentrated funding profile with 100 percent of their funding coming from issuance of covered bonds potentially leaving them highly exposed to a tail risk if there was a disruption in this market. However regulation is applied to the MCIs, limiting the liquidity risks they are able to take on through the 'balance principle'. In

	addition, new legislation is being put in place, which minimizes the tail risk associated with refinancing of issued short-term covered bonds, by imposing a soft bullet structure on these ensuring an automatic 12 month term extension in case of a refinancing failure. The high dependence on covered bond funding and the fact that covered bonds are a key asset in banks liquid asset holdings represents a concentration risk for the system. The Danish mortgage covered bond market showed relative resilience during the crisis and continued to function providing the banks with a source of balance sheet funding. In the event of a severe disruption to this market, the new law regarding automatic extension of the term of short term covered bonds will help reduce the otherwise high probability of the need for reliance on the lender of last resort for the MCIs.
EC7	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programmes for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	All of the above requirements are part of EO Management and Control annex 4 and form part of the running onsite inspection process performed by the supervisory authority. According to the EO on Management and Control, banks are required to perform stress tests on a monthly frequency and the stress tests should cover a period of at least 12 months. In addition to the internal stress tests conducted by the institutions, banks are required on a monthly basis to submit standardized stress tests, the results of which are submitted to the DFSA for analysis. The parameters of the scenario are defined by the DFSA. The scenarios include both idiosyncratic (bank only funding stress) and market-wide stress scenarios. The stress tests are applied only to banks and not MCIs. Individual liquidity stress tests in all foreign currencies is not required on a monthly basis to be submitted to the DFSA. Danish institutions have limited liquidity exposure in other currencies than DKK and EUR which is partly a result of DN's policy to maintain a peg of the Danish Krone and the EUR. In particular USD funding is limited, and the supervisory authority follows the development in this funding exposure closely. Although no foreign currency stress tests are in place currently, the supervisory authority in general follows the development in the use of foreign currency funding, and stands ready to put such stress tests in place if developments warrant it.
EC8	The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal

	entities.
Description and findings re EC8	As part of the running onsite supervisory process and the monthly liquidity reporting produced by banks to the supervisory authority, the supervisor is able to identify those banks that carry out significant foreign currency liquidity transformation. Where the supervisor finds it necessary, additional reporting and risk management requirements are put in place, e.g. reporting of LCR data on a currency basis or requirements for certain funding sources to be reduced. With the upcoming introduction of CRR based LCR monitoring on significant currencies, this will become a more standardized approach. The introduction of additional monitoring metrics following the upcoming EBA recommendations, will also take account of significant currencies, and hence strengthen the view of banks currency risks further.
Additional criteria	
AC1	The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	Management and reporting of asset encumbrance levels is not part of the regulation currently in place, but the ESRB recommendation regarding risk management of encumbrance levels is currently being incorporated in the EO on Management and Control, which will come into effect April 1, 2014. In the future, credit institutions will be required to follow the reporting and disclosure measures regarding asset encumbrance currently being developed by the EBA, and which will come into effect in 2014. The FSA's periodic reports only contain encumbrance information for the banks and not MCIs. However the DFSA confirmed anecdotally that due to the business model of the MCIs, their levels of asset encumbrance will be close to 100 percent, depending on the exact definition of encumbrance. The most recent figures for asset encumbrance for banks show that as of December 2012. 29 out of 92 banks had asset encumbrance where central bank financing (including three year LTRO) was the main source for group 2 & 3 banks and for group 1 banks repo transactions was the main source of asset encumbrance. Encumbrance levels were mainly present among group 1 institutions and reflect asset encumbrance from four sources: repo transactions (excluding central bank repo; three year LTRO from the central bank; other secured central bank financing; and covered bonds (SDOs). Other sources of encumbrance such as derivative transactions or CCP transactions are not included as this type of data was not collected.
Assessment of Principle 24	Largely Compliant
Comments	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). The Supervisory Diamond includes two metrics which act as early warning indicators to identify banks with higher risk business models. 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. Buffers built into

	the Supervisory Diamond (i.e., 50 percent above s.152 prescribed minimum) act as early warning mechanisms and give the DFSA time to respond. The systemic banks are also subject to reporting LCR and NSFR on a monthly basis. Banks regularly submit results of liquidity stress testing and liquidity and funding positions. The DFSA requires banks to submit results of liquidity stress tests on a monthly frequency. The stress scenarios are standardized which increases comparability between banks to identify outliers. Liquidity reports are assessed by supervisors on a monthly basis and will trigger a response if risks are detected. In addition to the quantitative requirements, banks are required to adhere to qualitative standards of risk management, based on the BCBS *Sound Principles*. Banks are subject to comprehensive reporting requirements which provide the supervisor sufficient information to monitor changes in risk profile and market conditions. Analysis is performed by subject matter experts and circulated across relevant supervisors. Onsite supervisory activities support this process to gain a deeper understanding of risk management. Banks are required to perform monthly stress testing based on an adverse set of assumptions which is shared with the supervisor. Additionally, banks are required to maintain a contingency funding plan which is part of the onsite examination. Qualitative aspects of this CP appear reasonably covered. 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, simply because covered bond investors have a priority claim to all assets in the capital centers in the first instance and to the insolvency estate in the second instance. For practical purposes though the covered bond investors are the only creditors in MCI's. AC1 is not met as the DFSA does not currently systematically assess that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. On this point, the extent of encumbrance is relevant for Danish banks. It is acknowledged that management of encumbrance levels will be incorporated in the EO on Management and Controls which will come into effect April 1, 2014, in line with ESRB recommendations on the topic. The DFSA has a short term liquidity requirement in place, which requires banks to hold a buffer of liquid assets similar in magnitude to that of the coming LCR requirement. However, the definition of eligible assets to be included in the liquid asset (HQLA) portfolios is broadly defined and approval by the DFSA is not required. While institutions mainly hold cash, deposits in other financial institutions and the central bank, government bonds and covered bonds in their liquidity portfolio, the definitions in the liquidity rules are not sufficiently prescriptive (i.e. section 152 includes unlisted liquid securities). No haircuts are applied to the value of these assets which is not reflective of stress circumstances. Also under the section 152 banks are given eight days to remediate the shortfall and do not

	have to notify the DFSA, which is too long a period. However, if the shortfall is deemed to be of vital importance to the continuation of the conduct of the institutions business, the DFSA must be notified immediately. Currently there is no limit on own-issued mortgage covered bonds to count in the pool of HQLA to meet the two quantitative liquidity requirements. The Danish covered bonds are tightly regulated, in order to ensure minimal credit risk and in particular minimal credit risk related directly to the issuer. On this basis, the Danish covered bond market has traditionally ben viewed as a unity market, where the particular issuer of a covered bond did not have an impact on price and liquidity. On this basis, own issued covered bonds were allowed to be included in the liquidity buffer of issuing institutions. No portfolio limits are in place as to how much of one asset can be used to meet those liquidity ratios. Assets in the HQLA must be unencumbered, but there are no restrictions on the inclusion of repo assets or re-used repo collateral. Banks are currently transferring out of own-issued mortgage covered bonds to meet the LCR rules, which is a positive development.
Principle 25	**Operational risk**. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk[56] on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	The FBA sets out the minimum expectations generally of banks in relation to having effective procedures "to identify, manage, monitor and report the risks the bank is exposed to" which includes operational risk but not explicitly (FBA s.71 (iv)). Specific requirements of banks in relation to operational risk are prescribed in three EOs. The EO on Management and Control of banks (Annex 3) provides a definition of operational risk and the requirements associated with each facet of operational risk management and measurement. In addition, two other EOs have been issued relating to specific operational risks: EO on Outsourcing Significant Areas of Activity and EO on IT Security. Taken together, the EOs form a framework for the management and measurement of operational risk and bank's responsibilities to align policies and processes with the risk profile of the bank that take into account external market conditions. However, there was no evidence to suggest that internal and external loss data was reported by banks as an input into offsite monitoring. Of the Group 1 banks only one had access to consortia data.

[56] The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	In accordance with the EO on Management and Control, banks are required to implement a policy on managing operational risks, including a requirement to set the risk appetite on operational risk. The EO contains requirements on gathering of information of operational incidents (actual as well as hypothetical), assessments on probability and impact, record-keeping, mitigation methods, management reporting and principles of managing the identified operational risks and incidents. The DFSA assesses compliance with its requirements through on onsite inspections using a risk-based approach. Individual (as well as sector-wide aspects) are taken into consideration when conducting onsite inspections. Furthermore, assessments of the management of operational risks are made on the basis of the nature, scale and complexity of their business. The larger and more complex a bank is, the higher standards of managing operational risks are expected by the DFSA. The main source of operational risk for the sector is IT related fraud and BCP/DR. The DFSA has a dedicated team of IT risk specialists that supervise the banks by performing targeted onsite reviews of banks' IT operational risk management. The typical approach to onsite operational risk reviews is to be included in credit and market risk inspections. That is, when a credit or market risk review is performed, the team will also evaluate operational risk processes for the area being inspected. Limited opportunities where the operational risk framework would be evaluated onsite to a degree of depth equal to other risk areas which would be prudent. Banks are able to use either the Standardized Approach (SA) or Basic Indicator Approach (BIA) to measure operational risk regulatory capital. During the annual assessment of the ICAAP, the supervisor assesses whether the bank has sufficient capital put aside in Pillar II to address its operational risks (no Danish banks have applied for or have approved AMA-models). The assessment approach will critically assess whether the parameters and assumptions used by the bank are appropriate. For those banks which had been subject to an onsite review where operational risk was included, an assessment of the effectiveness of controls would be taken into consideration. Other elements in the estimation of operational risk profile such as internal loss data, external loss data and scenario analysis was not a strong focus of the assessment. Internal benchmarks for supervisors to make comparisons had not been developed. Most of the banks map their identified operational risks with regard to probability and impact. The higher the probability and impact, the higher the attention of the management. Changes in the identified incidents are mapped on scorecards and reported to management. This provides a useful insight into the vulnerabilities from a supervisory perspective. Supervisors use the scorecards as inputs into their assessment of the risk profile. The identification process differs across the banking sector but most banks establish workshop sessions in which the relevant staff members participate in identifying operational risk events relevant to their unit comprised of representatives both the business and risk and compliance. The DFSA investigates the used methods by interviewing staff who facilitate the workshops. The workshops are held at least annually and the purpose is to: assess potential sources of vulnerability; identify emerging operational risks, assess quality of controls and to consider external market conditions.

EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	The responsibilities of the Board in relation to operational risk are set out in Annex 3 of the EO on Management and Control of Banks (more broadly the EO requires BOD to take responsibility for the articulation of risk limits, and to develop and implement policies to mitigate this risk—see also EC1). According to this section, the BOD are required to carry out an assessment of the operational risks of the bank taking into account the situation of the bank, the market situation, or other relevant factors at least annually. This assessment includes the risk appetite as set out in the banks' policy on operational risk. The management board (senior management i.e., CEO, CRO, CFO) is required to manage the implementation of the policy on operational risk as determined by the board of directors. This includes methods of incident gathering, reporting, calculation, effective procedures to manage and mitigate operational risks, support of IT-systems etc. It is the DFSA's expectation that the BOD should oversee that the implementation is carried out in a sound manner. The requirements in Annex 3 of the EO are used as a minimum standard. However, the more complex or larger the bank, the higher expectations the DFSA will have for its ability to manage operational risk. The DFSA uses peer groups as a benchmark when assessing the appropriateness of operational risk frameworks for individual banks. BOD approved policies are reviewed as part of an onsite examination where the supervisor reviews board minutes and papers for the last year. The effective implementation of the policy will also be assessed when onsite.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	The DFSA supervises banks' management of operational risk mainly via on onsite inspections. Ongoing monitoring of operational risk through quarterly analysis of loss data or qualitative information regarding effectiveness of operational risk controls is not regularly reported to the DFSA for inclusion in risk profiling. In the event an onsite review has been performed, the implementation of operational risk policies is able to be assessed in a general way. Where an onsite review has not been performed over a certain period of time, a systematic process to confirm the implementation of the operational risk management framework is not in place. Whether an operational risk is part of a specific inspection is a risk-based assessment (see EC1). As a minimum requirement, the smallest banks are subject to onsite inspections at least every sixth year, though there is potential for slippage beyond six years. For the larger banks onsite inspections are much more frequent. In practice, the systemic banks have been subject to more frequent reviews mainly as a subset of an onsite examination for credit risk and market risk which occur on a two to three year individual cycle. The supervisors of the largest banks (Group 1) have multiple opportunities to engage with

	banks regarding risk management generally and are able to gauge the effectiveness of operational risk policies, although a comprehensive assessment of operational risk within each institution has not been systemically performed. The current approach has certain shortcomings that will not necessarily allow the supervisor to conduct an independent evaluation of a bank's policies, processes and systems related to operational risk as part of the assessment of the Framework. When planning the next onsite inspection of a particular bank the DFSA assess which areas of the bank should be covered on the inspection, including the area of operational risk. Hence, the frequency depends on this risk assessment. These requirements include integration of managing operational risk into the overall risk management. The dedicated IT specialist team has a capacity to conduct 10 targeted IT Security onsite inspections annually and employs a risk-based approach to inspection planning which complements the other onsite activities. Coverage and depth of onsite examination of operational risk is problematic given the current supervision cycle. Thematic (horizontal) targeted reviews on operational risk have not been used.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	It is a requirement in EO on Management and Control (Annex 5, IT Security) that the BOD shall adopt contingency plans for serious operational problems. Contingency plans must include objectives and plans for re-establishing normal operations in the event of a breakdown, loss of data/systems, etc (paragraph 3(g)). While the obligations for a bank to implement a contingency plan is relatively comprehensive, there is no requirement to regularly test the contingency plans (i.e. carry out a full fail over to the DR site etc). The quality and comprehensiveness of business and contingency plans are assessed during onsite inspections and if assessed if necessary. The same approach is used in assessing due diligence in outsourcing. Hence, the DFSA does not use objective/quantitative measures to address this matter.
EC5	The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	The systemic banks are highly sophisticated and offer a large proportion of their product suite through the internet channel. The DFSA has a dedicated IT-team (see EC2) which assess whether banks have a clear IT strategy aligned with the business strategy, sufficient IT risk analysis, an IT security policy based on that risk assessment and that banks have clear written procedures on all IT critical areas. The team employs the IT GRC terminology in its supervision. Furthermore, they determine whether a Board and the senior management have clear roles and

	responsibilities and use samples testing of the implementation of the IT security policy to assess it is sufficiently implemented in the IT organization. The DFSA has at its disposal 3 skilled IT-experts in the team. These IT-inspectors have been recruited from industry. This team is supporting other inspectors at the DFSA in different ways in relation to onsite inspections, in creating tools and in connection to the licensing process. The team is working closely with the Central Bank also and performs inspections also in central units of the general IT structure in Denmark. During inspections the DFSA will interview relevant staff on the shortcomings of IT systems, the degree of integration between IT systems etc. The adequacy of IT-systems in specific banks is assessed by the DFSA by benchmarking the bank with its peers. In special cases where specific issues have arisen and if the DFSA does not have the resources to assess possible issue with IT-systems, the DFSA has the legal possibility to order the bank to have outside experts scrutinize the identified IT-issue in accordance with section 347 b of the FBA.
EC6	The supervisor determines that banks have appropriate and effective information systems to: (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	(a) During onsite inspections the DFSA assesses the banks' ability, including shortcomings in information systems, to gather information on operational risk. Further, the DFSA's IT-team can assess the IT-security level of critical IT-systems. Hence, advice and assessment of this team would be included if considered necessary by the inspectors. (b) The banks' ability to compile and analyze the gathered data is taken into consideration when the DFSA assess the effectiveness of the information systems through onsite inspections. (c) The quality of reporting mechanisms is also a part of the assessment. The DFSA makes assessments on an ongoing basis when incidents occur and through sample testing onsite of Board minutes and board reports.
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	Banks are required to report quarterly the RWA on operational risk (Pillar I) and the ICAAP annually (Pillar II). In addition, the DFSA expects to be notified of significant developments, e.g., IT security fraud, disruption to business continuity with significant customer impact. In practice, banks will alert the supervisor when material incidents occur and prior notification protocol is typically written into banks' incident management procedures. While there is an understanding of notification obligations for major events, there is no formal requirement in the regulations. Reporting obligations where there are material

	changes in operational risk profile, though no actual event (such as failing to perform DR test, or systems failing without customer impact) is not required to be reported. It is therefore possible that material changes in a bank's operational risk profile occur without the notification of the DFSA. For those banks that use the BIA to calculate capital, the DFSA does not seem to make a prior analysis that would enable it to be satisfied that the preconditions to migrate to a more sophisticated approach in determining capital charges for operational risks are met. Equally it is not clear whether banks using the SA approach provide the supervisor with sufficient data to indicate a change in operational risk profile.
EC8	The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers: (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) Establishing viable contingency planning. Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.
Description and findings re EC8	Provisions on outsourcing are laid out in 'EO on outsourcing significant areas of activity'. Ad (a) The EO requires the management to ensure that the service provider possesses the ability and capacity to carry out the outsourced activities satisfactorily and has the licenses required to do so. Ad (b) Outsourcing shall be decided by the BOD. The minimum requirements of the outsourcing contract includes inter alia the scope of the outsourced activity, provisions on reporting to the bank (content, quality and frequency), provisions on chain outsourcing, provision on the DFSA's access to all information, etc. Ad (c) + (d) The responsibility of the outsourced activity cannot be outsourced. Hence, risks that may be inherent or arise as a consequence of the outsourced activity is the responsibility of the bank. The DFSA supervises that the bank monitors and manages risks associated with the outsourced activities and that there are an effective control environment in this regard during onsite inspections. Ad (e) Banks are required to prepare internal procedures to ensure that outsourcing does not impede implementation of the banks' contingency plans. The Executive Order on outsourcing significant areas of activity contains minimum requirements on the content of outsourcing contracts, including the allocation of responsibilities between the undertakings.
Additional	

criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g. outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	Outsourcing is a key operational risk for the Danish banking sector with many of the larger banks outsourcing material aspects of their IT processing to data centers, etc. Banks have entered into joint ventures and established nine datacenters which are managed by service providers (the two largest banks own their own data centers independently). According to the EO on Outsourcing, the DFSA shall be informed of all outsourcing activities of significant areas of activity. Through the reporting of banks of outsourced activities, the DFSA will become aware of potential concentrations in service providers and will adjust its supervision accordingly. For example, the DFSA performs ongoing analysis on concentration risk in certain service providers, epically in regards to IT services.
Assessment of Principle 25	Materially Non-compliant
Comments	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. While protocols for notification of significant events is agreed informally with banks, there are material shortcomings in the formal notification regime for operational risk where the supervisor does not require that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk (EC7). Nor is the DFSA assessing the capability of banks to migrate to more sophisticated approaches for determining capital charges for operational risk. Formal mechanisms should be agreed to allow supervisors to remain apprised of developments at banks. Onsite operational risk examinations are performed as a subset of credit and market risk reviews. It is a compartmentalized approach where the entire operational risk framework bank-wide is not assessed in a comprehensive way. Instead there is a targeted approach at specific areas within a bank, such as a credit portfolio or a markets division or specific IT security risk review which is making progress at assessing risks across the sector.
Principle 26 Internal control and audit.	The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing

	the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent[57] internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g. clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g. business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.
Description and findings re EC1	As discussed in BCP 14 and 15, the DFSA has established numerous requirements for the organizational structure of a financial undertaking to ensure appropriate delegation of authorities, the segregation of business originations from payments, and the establishment and operation of key risk management and control areas. They do not however explicitly cover some of the specific areas within this Essential Criterion. The EO-MC contains the requirements regarding the organizational structure of banks in general which also specifically address risk management, compliance, audit functions and accounting policies and processes. There are no specific provisions for the "four-eyes" principle or for the protection or safeguarding of physical and automation assets. This follows, however, from the practice of the DFSA has established.
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and

57 In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.
Description and findings re EC2	As with all other areas of the bank, DFSA looks to ensure that staffing of the back office and control levels have people with relevant competencies at a sufficient level. It is a normal procedure—on a risk based approach—on the market risk examinations to establish whether the risk management, back office and control functions in the market risk area are sufficiently staffed, quantitatively and qualitatively.
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function[58] that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function is suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	Under section 22 of the EO-MC, all undertakings must name an employee who is responsible for the compliance function and who reports to the BoD and BoM no less than once a year. Employees who are involved in the compliance function may not participate in providing services or performing activities they control. The undertaking shall have a compliance function which acts independently and which shall check and assess whether the methods and procedures for identifying and reducing the risks and the measures taken to correct any deficiencies are effective. With regard to the competences of the staff within the compliance function, the DFSA ensures as with each area of the bank, that it is staffed with people with relevant competencies at a sufficient level. It is a normal procedure - on a risk based approach - on the market risk examinations to establish whether the RM, BO, control functions and compliance functions in the market risk area are well organized and sufficiently staffed, quantitatively and qualitatively. This should be reflected in the finding although the assessors did review an inspection report that was highly critical of the staffing of the compliance function of a bank.
EC4	The supervisor determines that banks have an independent, permanent and effective internal audit function[59] charged with: (a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and

[58] The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

[59] The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g. conducted by external experts, of key internal controls as an alternative.

	(b) Ensuring that policies and processes are complied with.
Description and findings re EC4	EO-AUD section 17–27, 29 and 45 address some key elements of the Audit department's role and independence. In particular, the head of Internal Audit must be hired by the BoD and can only be dismissed by the BoD. The Audit Committee must have an independent director (a person not in management of the bank, but also without material borrowings, shareholdings, or familial relationships). A self-assessment by the Audit Committee of how it has carried out its responsibilities is part of the pre-inspection package that is requested of the bank. Before an inspection begins, the DFSA acquires from the internal audit function of the bank the audit plan, budget, audit charter and all audit reports issued over the last year. During the inspection, the DFSA always meets with the chief internal auditor (often in a meeting between the DFSA, external auditor and the chief internal auditor). Based on the meeting and the material received, the DFSA evaluates the internal audit function of the bank. The DFSA receives on an annual basis a copy of the audit book comments for review and sign-off by a designated DFSA person on the standard checklist (sample was reviewed by the assessors). The assessors also reviewed several sample audit books, which, while sometimes brief in their analytical comments, provide good insight in gauging the range of work of the audit department. However, the specific areas outlined in paragraph (a) of the EC (risk management, compliance, and control) are not cited in the EO-AUD as mandatory areas to be covered. These areas are referenced regarding investment operations but not specifically for banks. The DFSA asserts that these areas are typically covered by Internal Audit and the assessors were able to confirm some degree of coverage in the audit books (at least for the largest banks). Discussions with industry people and an external audit firm also supported the DFSA assertion of normal coverage.
EC5	The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and

	(g) Has the authority to assess any outsourced functions.
Description and findings re EC5	In its self-assessment, the DFSA had concluded that each of the areas enumerated above was addressed by EO-AUDIT. However the assessors found two areas which were not explicitly covered—that is, there are no explicit provisions requiring the internal audit department to be advised of material changes in operations of the bank and there is nothing on outsourced function being within the remit of the internal audit department. However, according to the EO on Outsourcing Significant Areas of Activity provides in Section 5(7) that the service provider will provide the DFSA, the outsourcing undertaking, and its auditors with all necessary information regarding the outsourced activities. a) Training and staffing: EO-AUD section 8, 18 and 23 addresses audit staffing and training. b) Independence and stature: EO-AUD section 18(1), 26, 27 provides that the head of audit can only be hired or fired by the BoD; while compensation practices are not referenced, the assessors were advised that the head of audit is not eligible for bonuses; the extent of the line to Audit Committee does give the head of internal audit considerable stature. c) Advice of material changes: The DFSA had referenced EO-AU section 21(1) but on explicit provision in this regard was found; the assessors confirmed in discussions with the DFSA that this would only be implicit. d) Access to information and people: EO-AUD section 21(1) provides explicitly access to information and is in the assessors' views clearly implicitly covering access to people as well. e) Methodology covers material risks: EO-AUD section 24 does so. f) Audit plan: EO-AUD section 23-24 covers this requirement. g) Coverage of outsourced functions: EO-AUD section 21(1) was cited by the DFSA but no such specific charge is included: confirmed in discussions with the DFSA although they believe that internal auditors would interpret their charge to include outsourced functions. However, a review of the Executive Order on Outsourcing Significant Areas of Activity provides in Section 5(7) that the service provider will provide the DFSA, the outsourcing undertaking, and its auditors with all necessary information regarding the outsourced activities.
Assessment of Principle 26	Largely Compliant
Comments	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 review of audit books and discussions with bankers the assessors saw evidence that some such reviews are done (at least for the largest banks), but it is important that the EO be appropriately updated. Other

	elements that should be incorporated into a revision would be provisions related to dual control (of other use of four eyes principle) and provisions on the protection of assets
Principle 27	**Financial reporting and external audit**. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor[60] holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	Sections 184 and 185 of the FBA require the management and the board to sign the annual financial report and make them responsible for the content of the report, including that it is in accordance with legislation and gives a true and fair view of the entity. The DFSA is furthermore responsible for the enforcement of requirements relating to financial information from banks and carries out the enforcement for listed banks in accordance with ESMA's standards for enforcement. The DFSA regularly scrutinizes a sample of published financial reports from banks for compliance with applicable rules. Furthermore, all listed banks' financial reports are quick scanned for compliance and further scrutinized if the quick scan indicates non-compliance. In case of material errors or omissions the bank can be required to publish corrective information.
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	The annual report must be audited (see FBA section 193) and has to include the full audit report (section 195(2)). The auditor shall perform the audit in accordance with ISA's generally accepted auditing practices: see Act on Approved Auditors and Audit Firms, section 16(1) and EO-AUD section 4. The FSA receives all annual reports and a copy of the audit book comments and reads the comments. The assessors discussed the concept of audit book comments with the DFSA as a source of good information on the issues addressed by the External Auditors, and reviewed samples that confirmed the point.
EC3	The supervisor determines that banks use valuation practices consistent with accounting

[60] In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

	standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.
Description and findings re EC3	During inspections, the DSFA reviews whether valuation practices are consistent with accounting standards, including reviewing for example a sample of real estate valuations. There are not however requirements that fair value estimates are subject to independent verification and validation. As a starting point the same valuations are used for financial reporting purposes and for regulatory purposes. However, for regulatory purposes different haircuts are used when assessing the need for impairments and for solvency.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.
Description and findings re EC4	Auditors have to perform the audit in accordance with ISA's as described in EC3. In cases where the DFSA finds material errors and/or omissions from generally accepted auditing standards the FSA typically files a complaint to the Disciplinary Board on Auditors. Errors and/or omissions can be discovered during an inspection of a bank or in other ways.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	As described above, auditors shall perform the audit in accordance with ISA's, as well as under EO-AUD section 11 and 33–34. The DFSA receives a copy of the audit book comments. The DFSA has specifically added to the list of matters that must be reviewed by the external auditors, the specific review of each of the ten largest exposures of the bank. It also has mandated that solvency be reviewed under a going concern approach. As laid out in the FSA's internal procedure for reading of the audit book comments, the inspectors read the comments to see if there are comments, inconsistencies or other relevant information which the FSA needs to follow-up in relation to the auditor or the bank.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor, who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and	The DFSA may dismiss an auditor who is deemed clearly unfit to perform his duties and

findings re EC6	instead appoint another auditor (see FBA section 199(4)). Moreover, from January 1, 2014 the signing auditors of banks under DFSA's supervision need to be certified by DFSA before their election as external auditors of banks. The auditors who apply for certification in 2014 have to document they have performed at least 400 hours of audit work from a least 3 different banks. At least half of the hours performed have to be obtained from the role as signing auditor or leader of an audit team. The auditor also has to have participated in at least 20 hours of education concerning financial undertakings within the past 3 years. The auditor cannot have had a case at the Disciplinary Board of Auditors within the past 5 years, which the DFSA believes is relevant to the assessment of the auditor's adequate performance as an auditor for banks. If the auditor no longer meets the criteria to obtain his/her certification, the DFSA can withdraw his or her certification. In cases where the DFSA finds material errors and/or omissions in a performed audit of a bank—during an inspection or enforcement of the financial information—the DFSA typically files a complaint to the Disciplinary Board on Auditors.
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	This is required under Danish law although it is not the DFSA, but the Danish Business Authority, that supervises the rotation principle that is prescribed in section 25 of Act on Approved Auditors and Audit Firms. The act requires partner rotation (replacement for a period of two years not later than seven years after the appointment of the auditor).
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	During ordinary inspections of banks, the supervisor always meets with the external auditor of the bank to discuss risks, management, reporting and the status of the bank. At least annually the executive management of the DFSA meets with the management of the Danish Auditors Association (FSR—Danske Revisorer) to discuss issues of common interest, like new legislation and the relations between DFSA and auditors. When developing new requirements relating to the audit of banks, the supervisor meets with the representatives from the Danish Auditors Association.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	Under section 200 of the FBA, reports must be made by the external auditor to the DFSA on "matters which are of material importance to the continued operation of the undertaking". Under section 5(4) of EO-AUD the DFSA receives a copy of the audit book comments in relation to the annual report. However, the DFSA rarely receives notification according to section 200. The DFSA advised

	that the audit profession has told them the reason section 200 is so rarely used by auditors, is that they offer the management of the company the choice to immediately contact the DFSA directly—and if they do not, then the auditor will contact DFSA immediately, an explanation that resonated with the assessors. As laid out in the DFSA's internal procedure for reading of the audit book comments, the investigators read the comments to see if there are comments, inconsistencies or other relevant information which the DFSA needs to follow-up in relation to the auditor or the bank. The information gained from reading the audit book comments is taken into account when making the risk-evaluation of the bank.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	The Danish Business Authority supervises auditing firms and auditors and has in this capacity the power to access working papers. The DFSA does not have such power. However, as noted above, under section 5(4) of EO-AUD, the DFSA receives a copy of the audit book comments in relation to the annual report.
Assessment of Principle 27	Largely Compliant
Comments	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 not requirements that fair value estimates are subject to independent verification and validation and the DFSA does not have access to work papers of external auditors.
Principle 28	**Disclosure and transparency**. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures[61] of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	According to section 60 and Annex 20 of the EO-CAG, the banks are required to publicly disclose periodic information under Pillar 3 of the Basel II Capital Accord, including disclosure about the size and calculation of the solvency requirement and the capital base. According to section 64 of the EO-CAG the information must be published yearly, with the banks required to periodically assess whether it is necessary to publish the information on

[61] For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	a more regular basis. According to section 60 and Annex 20 of the EO-CAG the information can be disclosed on a consolidated basis, under the condition that every entity shall publish the consolidated information according to the rules laid out in the executive order. Quantitative information on banks on a solo basis is also required, although the organization may supply the information on risk management practices on a consolidated basis. In addition to the above mentioned rules, banks are required to publish information on the results, of as well as the methods for calculating, of their solvency requirement according to Annex 20, points 5-10 of the EO-CAG. That is, banks must also publish their fulfillment of the Pillar II requirements.
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	The DFSA does not comply with this EC. From responses to assessors' questions, the DFSA does not review whether any of these requirements are met. The assessors were advised that only Group 1 banks have such disclosures read at all, and what reviews are done are for information purposes of the supervisors, not to assess completeness or accuracy of the filings. Accordingly, while there are provisions in the EO-FR that could require republication or even the imposition of a fine, these provisions have never come into play. Section 63 of the EO-CAG does put an onus on the banks to have rules regarding the publishing of the information required according to the executive order. Given the absence of policing by the DFSA, it is not clear to the assessors that the banks carry out their mandate to assess whether the information provide markets participant with a correct picture of the risk profile of the institution.
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	The disclosures are generally required in sections 122, 123 and 131 (10 and 11) in the EO-FR.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	As described in EC 2, the assessors were advised that no review is done of these disclosures for compliance for adherence to the applicable standards. No evidence was presented to the assessors that anything is done to enforce compliance with the disclosure standards.
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations

	(balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	The DFSA regularly publishes information on the financial sector. This information is among other statistics (income statement, balance sheet, solvency etc.) key figures and analyses on e.g. impairments and loss absorption capacity (semiannually and annually market development articles). The information includes aggregate data as well as institutional for some figures.
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	The assessors were advised that no such information on average exposures or turn-over during the reporting period is required.
Assessment of Principle 28	Materially Non Compliant.
Comments	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 at all, and what reviews are done are for information purposes of the supervisors, not to assess completeness or accuracy of the filings. Accordingly, while there are provisions in the EO-FR that could require republication or even the imposition of a fine, these provisions have never come into play.
Principle 29	**Abuse of financial services**. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.[62]
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	The DFSA has responsibility for supervising the effective implementation of banks' internal controls for AML/CFT. The obligations of the DFSA are provided for in the Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism (no. 1022 of 13. August 2013), hereafter "The AML/CFT Act" (see s.24), implementing the European Parliament and Council Directive 2005/60/EC of 26 October 2005, on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. The

[62] The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	obligations stated in the AML/CFT Act include the requirements for banks to comply with the AML/CFT Act and for the DFSA to supervise compliance (section 25(1)). The following powers of the DFSA are established in the AML/CFT Act: • 34(5): Provides that banks shall provide the Danish FSA with the information necessary for supervision of compliance with the Act; • 34(6): Provides that the Danish FSA may at all time, on proof of identity and without a court order, gain access to banks; and • 34(7): Provides that the Danish FSA may order banks to take the necessary measures in the event of violations of the provisions of the AML/CFT Act etc. In relation to the supervision of banks´ internal controls, the DFSA has issued a comprehensive set of guidelines which elaborate on section 25(1) specifying what needs to be considered in order to comply. In practice, the DFSA has communicated its expectations of compliance to the AML/CFT Act with the banks through onsite inspections. In relation to the enforcement of relevant laws and power to sanction, enforcement powers rest with the FIU where the DFSA works closely in prosecuting cases. The DFSA cooperates closely with: National Commissioner of Police; Police Districts; Asset Recovery Office; Danish tax authorities and the Gambling Authority. It was evidenced that the level of cooperation is effective.
EC2	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	Responsibility for supervising AML/CFT obligations of banks under the AML/CFT Act has been allocated to a dedicated team of specialists within the DFSA within the Legal Division. The team was established in 2010 and consists of 3.5 full-time equivalents (FTE) with a multi-disciplinary background of banking and law (note that the 3.5 FTE are responsible for supervising compliance with the AML/CFT Act across all institutions supervised by the DFSA e.g. banks, insurance, pension etc). Prior to 2010 the responsibility for supervising AML/CFT obligations of banks rested with the line supervisor as part of their overall responsibilities as distinct from the current arrangement of a dedicated specialist function for AML/CFT supervision in a centralized team. Taken together the FBA and EO provide an overall obligation for the bank to conduct its business with high ethical and professional standards. According to section 43(1) of the FBA, banks shall be operated in accordance with honest business principles and good practice within the field of activity. More detailed regulation is laid down in EO on Good Business Practice for Financial Undertakings (No. 928 of 28. June 2013). The EO describes in detail the responsibilities of banks with regard to sound business practices, prudent policies and procedures (including AML/CFT).

	The DFSA is responsible for monitoring the implementation by banks of the obligations described under the FBA and EO, including through onsite examination. The onsite examination is the main tool used by the DFSA to verify that banks have adequate preventative policies and processes to deter unethical behavior in the first instance, but also to test the effectiveness of detective controls to identify potentially criminal activities. A key component of the onsite examination is an assessment of the adequacy of policies and whether the policies are fit for purpose given the risk profile of the business model, size, scale and complexity of the activities being undertaken. Another important element of the onsite examination will be to make an assessment of the training program adopted by the bank and how this has been rolled out to relevant staff involved in account opening and managing correspondent banking relationships. The onsite will involve sample testing of customer accounts to determine how policies have been applied in practice. The onsite examination is typically a multiday activity conducted by between 2-3 DFSA staff. The review is comprehensive in nature and includes all of the banks internal AML and CFT procedures as well as a number of samples relating to the measures taken by the banks when accepting new customers, including higher risk customers who have not been physically present for identification purposes, cross-frontier correspondent banking relationships and relationships with politically exposed persons. Since 2010, the number of onsite target AML/CFT examinations by the DFSA has increased (see the table below).

	2010	2011	2012	2013
Number of onsite inspections	2	5	5	4

	The onsite presence of the DFSA has increased the awareness of banks of their obligations to detect potential criminal behaviour. The FIU has also made efforts in this regard to promote awareness. The DFSA adopts a risk-based approach to onsite examinations, and has prioritized the larger banking groups for onsite inspections. However, a large proportion of banks will not be subject to an onsite inspection on an annual frequency. In the absence of onsite examinations, the DFSA will not receive confirmation of the implementation or effectiveness of AML/CFT policies and processes to mitigate and manage risk. The DFSA has implemented a self assessment process for the top 20 banks. A review of the self assessment results has not yet been performed. In addition to onsite examinations, the DFSA also conduct offsite surveillance. Offsite surveillance will not typically include reporting by banks (such as quarterly or annually). The DFSA does not request information specific to AML/CFT to be reported as part of routine offsite supervision. However, the external auditor should generally report to the Board in case of material compliance deficiencies but there is no specific provisions regarding AML/CTF controls. We were advised but did not confirm that such controls are usually reviewed by audit at least in the larger banks. According to the EO, if a bank does not act in accordance with good practice, the DFSA can

	issue orders to correct this, cf. to section 35. In addition, fines may be imposed on persons, natural or legal, who fail to comply with such orders, cf. to section 36. The AML/CFT Act contains, inter alia, provisions on the prevention and detection of money laundering activities and financing of terrorism, and reporting of these activities to the Public Prosecutor for Serious Economic Crime. The provisions of the AML/CFT Act are subject to penalty (fines or imprisonment). Section 34(7) of FBA provides that the DFSA may order the undertakings and persons dealt with in subsection (1) to take the necessary measures within a time limit specified by the Authority in the event of violations of the provisions of the AML/CFT Act, the regulations issued pursuant hereto, the Regulation of the European Parliament and of the Council on the information on the payer accompanying transfers of funds, or regulations containing rules on financial sanctions against countries, persons, groups, legal entities, or bodies. Such administrative orders will be subject to a follow up investigation. Part 11 of the AML/CFT Act states which sections are subject to penalties, or in the event of particularly gross or extensive intentional violations imprisonment up to six months.
EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank.[63]
Description and findings re EC3	According to section 6 of the AML/CFT Act, banks are required to pay special attention to customers´ activities which, by their nature, could be regarded as being particularly likely to be associated with money laundering or financing of terrorism. This applies in particular to complex or unusually large transactions and all unusual patterns of transactions in relation to said customer as well as transactions which have connection to countries or territories where, pursuant to declarations from the FATF, there is deemed to be a special risk of money laundering or financing of terrorism. The purpose of the transactions mentioned in subsection 5 shall be investigated and the results of such investigation shall be recorded and kept (cf. section 23). According to the AML/CFT Act (s.25 (2)), banks are required to appoint a person at management level to ensure that the banks comply with the obligations under the Act. Section 23(11) and (2) states that inter alia banks shall store identity and control information for no less than five years after the customer relationship has ceased. Copies of the identification documents obtained pursuant to sections 11, 12, 14, 15 and 19 may be stored. Documents and records concerning transactions shall be stored so that they can be located together for at least five years after the performance of the transactions. This shall also apply to the information recorded pursuant to section 6(2).

[63] Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	With regard to banks' reporting obligations of suspicious transaction reports (STRs), such reports are made to the Public Prosecutor for Serious Economic Crime, the Danish financial intelligence unit (FIU) (section 7(1) of the AML/CFT Act). The FIU is located at the Public Prosecutor for Serious Economic and International Crime and is responsible for the receipt and analysis of STRs and dissemination of reports of possible money laundering or financing terrorism and reports related to certain EU sanctions (WMD). It has a total staff of approximately 21 from 2014 and cooperates both domestically and internationally with authorities that are responsible for AML/CFT. However, Section 75 of the FBA states that the banks are obligated to immediately inform the DFSA of matters which are of material significance to the continued operation of the bank which may capture AML/CFT related issues, and this applies correspondingly to individual members of the board of directors and members of the board of management. Banks are not required to report STRs to the DFSA. The FIU submits quarterly reports to the DFSA containing the number and types of STRs reported by individual banks. The report enables the DFSA to benchmark reporting volumes by banks. The data is used by the DFSA as an input into the risk profiling of individual banks and planning of onsite examination activities. If there is a suspicion that a customer´s transaction or enquiry is, or has been associated with money laundering or financing of terrorism, the bank shall investigate the transaction or enquiry in more detail (see section 11 AML/CFT Act). The AML/CFT Act contains a reporting threshold to only report STRs if the suspicion relates to offences punishable by imprisonment of more than one year and this suspicion cannot be disproved. The assessors were advised by the FIU and the DFSA that the threshold does not limit the number of STRs reported and that in practice banks report all STRs. Since the original MER conducted by FATF in 2006, progress has been made in terms of reporting of suspicious transactions (ST)s (FATF Recommendation 13). Since 2009, reporting of STs to the FIU has increased from 753 to approximately 3,000 in 2012 out of a total of 5,500 STRs reported for Denmark. Nonetheless, the third follow-up report (October 22, 2010), highlighted that the number of STRs filed by banks remains low by comparison with other countries, in particular neighboring countries. In addition, the scope and the quality of STRs have not been considered. The follow-up report concluded that while an increase in the level of reporting of STRs since the MER is a positive development, it is not yet sufficient to address the concerns about the effectiveness of the AML/CFT regime raised in the MER. During the onsite inspection, the process for identifying and handling STRs will be a key aspect of the assessment. Through this evaluation process, the DFSA will become aware of the quality and effectiveness of banks' risk management framework and its application in practice.
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the

	financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	During the onsite and offsite inspections, the DFSA has access to both the banks´ suspicious transaction reports and the files on investigations that did not result in filing a report to the FIU. Based on the findings the DFSA will have discussions with the banks relating to their procedures on handling suspicious transactions. There are however, no examples of the DFSA making the FIU aware of suspicious transactions. There is an ongoing close corporation between the DFSA and the FIU. The DFSA has established the Danish Money Laundering Forum where meetings are held on a quarterly basis. In this context, the DFSA, the FIU, the Ministry of Taxation, the Ministry of Justice, Ministry of Foreign Affairs, the Gambling Association, The Danish Bar and Law Society, the Tax Authorities and the Danish Business Authority participate in meetings where issues of relevance to the prevention of money laundering and financing of terrorism are discussed. Members of the Forum have executed a formal Memorandum of Understanding to facilitate the exchange of information. According to the FBA, section 354(6)(2) confidential information may be divulged by the DFSA to other public authorities, including the prosecution and the police, in connection with the investigations and legal prosecution of for criminal offences covered by the Criminal Code or the supervision legislation. Section 7(1) of the AML/CFT Act states that if there is a suspicion that a customer's transaction or enquiry is or has been associated with money laundering or financing of terrorism, the undertakings and persons covered by this Act shall investigate the transaction or enquiry in more detail. If the suspicion relates to offences punishable by imprisonment of more than one year and this suspicion cannot be disproved, the FIU shall be informed immediately.
EC5	The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements: (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g. escalation to the bank's senior

	management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) Clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.
Description and findings re EC5	Section 25 of the AML/CFT Act prescribes the expectations in relation to banks' processes for account opening and CDD. The DFSA has issued a comprehensive set of guidelines on the AML/CFT Act. While conducting inspections (onsite or off site), the DFSA reviews the banks overall risk assessments which must be approved by bank management. The DFSA will assess whether risk assessments performed by banks are appropriate in taking steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers. Furthermore, the DFSA determines whether the bank has established policies and processes on other relevant areas relating to AML/CFT, including (a) to (f). The relevant sections of the AML/CFT Act include: (b): Sections 25(1), 11, 12, 13, 14 (occasional customers), 15 (transactions for a third party) and 16 (transfer of funds). (c): Section 12(5), Part 3: "Investigation and reporting obligations", sections 6 and 7 and section 25(1). (d): Sections 25(1) and 19. (e): Section 19(4). (f): Section 23. The DFSA assesses bank compliance with the requirements mainly through onsite reviews which involve face to face interviews, review of policies and procedures, and sample testing of transactions. During onsite inspections, the DFSA also reviews the banks' procedures for training and instruction programmes for their employees in order to forestall and prevent money laundering and financing of terrorism. Part of this review is to determine if the training and instructions programmes are tailored to suit the needs of different employees on grounds of the different ways they deal with customers etc. The AML/CFT legislative framework is also composed of the Danish EO No 712 of 1 July 2008, which stipulates that natural and legal persons as well as products can be made exempt from the AML/CFT Act as well as the definition of "politically exposed persons" (see FSA Regulation 712/2008 which provides a legal definition). The EO implements the Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC as regards the definition of "politically exposed person" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis. The enhanced due diligence for PEP will require a senior manager from the bank to approve continuation of customer relationships established before January 1, 2007 (paragraph 19(5) of the AML/CFT Act).

	Furthermore, the EO no. 1347 of 3 December 2010} on countries and territories that are considered to be a high risk for money laundering or financing of terrorism (the FATF list, implies that countries undertakings and persons covered by the AML/CFT Act shall pay special attention to transactions which have connection to countries or territories where, pursuant to declarations from the Financial Action Task Force, there is deemed to be a special risk of money laundering or financing of terrorism. (The Executive Order furthermore lists which countries are currently on the so called "black list"). Regarding the prevailing know-your-customer rules we refer to the following sections of the Danish Act on Measures to Prevent Money Laundering and Financing of Terrorism: **Section 11:** The undertakings and persons covered by this Act shall always require that customers identify themselves, if they suspect that a transaction or consultancy assignment is associated with financing of terrorism or money laundering covered by the reporting obligation under section 7. **Section 12:** This section lists the basic requirements relating to customer due diligence. This implies, for example, that banks shall demand that their customers provide proof of identity when establishing business relationships with them, including the opening of an account or a custody account. If the customer is a natural person, proof of identity shall include name, address, civil registration number (CPR number) or similar documentation if the person in question does not have a CPR number. If the customer is an undertaking, the proof of identity shall include name, address, CVR number (business registration number) or similar documentation if the undertaking does not have a CVR number. The ownership and control structure of the undertaking shall be clarified and the beneficial owners of the undertaking shall provide proof of identity. Information shall be obtained about each customer's objective regarding the business relationship and the intended extent hereof. Section 12 also states that customer relationships shall be monitored on a regular basis. Transactions undertaken throughout the course of a customer relationship shall be monitored to ensure that the transactions being conducted are consistent with the undertaking's or person's knowledge of the customer and the customer's business and risk profile, including, where necessary, the source of the funds. Documents, data or other information about the customer shall be kept up to date. In the event of doubts about the veracity or adequacy of previously obtained customer identification data, new proof of identity shall be required as mentioned in subsections (2) and (3). **Section 13:** This section states that the identification procedure in section 12 shall be completed in connection with the establishment of the customer relationship and no later than before

	carrying out the transaction. Provided that it is necessary in order not to interrupt the normal conduct of business, the identification procedure may, on the basis of a risk assessment, be completed in immediate continuation of the establishment of the customer relationship. In such situations, the identification procedure shall, however, be completed as soon as practicable after the initial contact with the customer. Section 13 also states that if customer identification of the customer cannot be carried out in accordance with section 12(1)-(4), a regular customer relationship or a business relationship may not be established, and transactions may not be carried out for said customer. At the same time, the undertaking shall check whether notification under section 7 is to be carried out. **Section 14(1):** This section covers occasional customers and states that for assistance to occasional customers with isolated transactions, compliance with the requirements of sections 12, 15 and 19 may be omitted, if the transaction does not exceed an amount corresponding to EUR 1,000. Compliance with the requirement in section 12(3), 2nd clause64 may also be omitted on basis of a risk assessment, if the transaction does not exceed an amount corresponding to EUR 15,000. **Section 15:** It covers transactions for a third party, section 16 covers transfer of funds, and **Section 19**: It covers enhanced customer identification, inter alia politically exposed persons and correspondent banking-relationships. **Section 23:** This section requires that information on proof of identity shall be kept on record for a minimum of five years after the termination of the business relationship with the customer, while documents and records concerning transactions shall be stored for at least five years after the performance of the transactions. Based on the evidence, the assessors were satisfied that the DFSA examines, in practice, whether banks are complying with their obligations. Although a greater onsite presence for the population of banks is required.
EC6	The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes

[64] States that the ownership and control structure of the undertaking shall be clarified and the beneficial owners of the undertaking shall provide proof of identity, cf. however section 21(1), no. 2. Section 21(1) provides for exemptions in regards to certain undertakings and domestic public authorities.

	include: (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) Not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	Section 19 of the AML/CFT Act sets out the provisions for enhanced customer due diligence identification. According to section 19 (6) banks may not enter into or continue a correspondent banking relationship with a shell bank and they shall take reasonable measures to avoid a connection with a credit institution, which is known to permit shell banks to use its accounts. Moreover the guidelines issued by the DFSA on the Act contain a part on correspondent banking. During investigations (either onsite or off site), the DFSA reviews the banks´ policies and procedures regarding correspondent banking. During on site investigations this comprises reviewing a number of spot checks focusing on the measures taken by the banks when accepting co-respondent banks as customers, including the obtaining of sufficient information to ensure that the relevant institution has adequate and effective control procedures in order to ensure compliance with regulations on preventing money laundering and financing of terrorism. Since 2011, correspondent banking relationships has been a focus of the onsite review process when the DFSA has inspected the largest banks. The onsite inspections assessed the appropriateness of banks' risk management for correspondent banking relationships. The review focused on policies for existing correspondent relationships as well as arrangements for new relationships. The review resulted in a number of requirements for banks to investigate existing relationships and to enhance policies and processes.
EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	During investigations, the DFSA reviews banks´ procedures to assess if they are sufficient to effectively mitigate the banks´ AML/CFT risks. There was sufficient evidence to suggest that the onsite examination process verified the adequacy and effectiveness of controls. A typical onsite examination involved discussions with management, assessment of documentation and sample testing of customer accounts (approximately 50, split between retail and corporate customers). Section 25(1) of the Act states that banks shall (inter alia) prepare adequate written internal rules about customer identification, the obligation of attentiveness, investigation and recording, reporting, record-keeping and internal control.
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and	We refer to sections 34(1) and 34(7) of the AML/CFT Act. Administrative orders issued by

findings re EC8	the DFSA will be subject to a follow up investigation. In addition, part 11 of the AML/CFT Act states which sections are subject to penalties, or in the event of particularly gross or extensive intentional violations imprisonment up to six months. There have been two cases of AML prosecution in the last five years resulting in banks being fined (Forex Bank A/S (2011) these cases resulted in the bank being fined 3.7 million DKK and Arbejdernes Landsbank A/S was fined 5.5 million DKK (2013).
EC9	The supervisor determines that banks have: (a) Requirements for internal audit and/or external experts[65] to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) Ongoing training programmes for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	(a) Section 24 of Executive Order no. 1224 of 21 August 2013 on Auditing Financial Undertakings etc. as well as Financial Groups, states that in undertakings and groups with an internal audit function, all auditing shall be carried out in accordance with generally accepted auditing practice. This means that the work of the internal auditors must be planned, executed and controlled based on an assessment of materiality and risk. The DFSA has access to the reports cf. section 347 of the FBA. (b) According to Section 22 of EO no. 1325 of 1 December 2010 on Management and Control of Banks etc. all undertakings must name an employee who is responsible for the compliance function and reporting to the board of directors and board of management no less than once a year. When on inspections the DFSA determines that the banks have established policies and processes to meet this statutory demand. (c) No specific requirements are codified regarding the existence of screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship. (d) In the context of onsite inspections, the DFSA reviews the banks procedures for training and instruction programs for their employees. Part of this review is to determine if the

[65] These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	training and instructions programs are tailored to suit the needs of different employees on grounds of the different ways they deal with customers etc. (section 25 (1)).
EC10	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	The onsite review process is the primary tool the DFSA uses to determine whether banks have clear policies and processes for staff to report problems related to the abuse of banks' financial services. In the context of onsite inspections, the DFSA will determine whether the bank has an appropriate training program for staff and that staff have been trained to allow them to identify AML/CFT related issues to management. Reporting systems are also evaluated when onsite to assess the quality and quantity of AML/CFT related issues such as STRs, and PEPs. To augment the onsite examination process, the DFSA has introduced a self assessment questionnaire that banks are required to complete and forward to the DFSA which covers questions associated with training, reporting and MI systems. Board reporting of compliance with AML/CFT requirements is contained within the CRO report and through internal audit reports to the Audit Committee. Board reporting contains evidence of compliance with internal policies and procedures, and statistics on STRs, etc.
EC11	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	Section 26 of the AML/CFT Act requires that notifications and information that undertakings covered by the Act disclose in good faith suspicious transactions and not incur any liability.
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	Section354 of the FBA provides that confidential information can be divulged to several Danish public and judicial authorities and institutions as well as DN, foreign central banks and the European Central Bank. The duty of confidentiality is, according to the FBA section 354(7), projected to these national and foreign authorities and institutions. The DFSA actively participates in domestic and international fora in relation to AML/CFT issues and shares information where necessary. See below for more details in relation to cooperation and confidentiality: <u>Cooperation:</u> The DFSA has established the Danish Money Laundering Forum where meetings are held on a quarterly basis. Besides the DFSA, the FIU, the Ministry of Taxation, the Ministry of Justice, Ministry of Foreign Affairs, the Gambling Association, The Danish Bar and Law Society, the Tax Authorities and the Danish Business Authority participate in the meetings where issues of relevance to the prevention of money laundering and financing of terrorism are discussed. <u>Sharing of information:</u>

	The AML/CFT Act (s.34) provides that confidential information can be divulged to a certain agencies involved in AML/CFT regulation and enforcement: - Other public authorities, including the prosecution and the police. - Supervisory authorities in other Member States of the European Union or in countries with which the Union has entered into an agreement for the financial area which are responsible for ensuring compliance of persons and undertakings with legislation on measures to prevent money laundering and financing of terrorism. - Financial supervisory authorities in countries outside the EU with which the EU has not entered into an agreement for the financial area which are responsible for ensuring compliance of persons and undertakings with legislation on measures to prevent money laundering and financing of terrorism.
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	The DFSA´s Legal Division has specialist expertise on anti-money laundering obligations. In addition to supervision responsibilities of AML/CFT for DFSA regulated institutions; the team participates in the international meetings of the FATF on and the European Commission Expert Group on Money Laundering and Terrorist Financing. The Public Prosecutor for Serious Economic Crime (FIU) also has specialist expertise on money laundering. The dedicated team within the DFSA is responsible for supervising compliance obligations with the AML/CFT Act for approximately 971 organizations. The size, scale, complexity and risk of these organizations vary markedly. At the current headcount, the 3 ½ FTEs would seem stretched to conduct onsite examinations for this number of organizations.
Assessment of Principle 29	**Largely Compliant**
Comments	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. To complement the onsite activities, the DFSA has implemented a self assessment questionnaire for banks to complete on an annual basis. In terms of coordination and cooperation among the authorities, the DFSA actively liaises with the FIU to share data and intelligence and ensure prosecution of cases. As a result of the DFSA's actions, the reporting of STRs has increased and there have been more cases of AML prosecution. There have been two cases of AML prosecution in the last five years resulting in banks being fined (Forex Bank A/S (2011) these cases resulted in the bank being fined DKK 3.7 million and Arbejdernes Landsbank A/S was fined DKK 5.5 million (2013). Despite this progress, work remains to effectively implement AML/CFT supervision. The DFSA has commenced onsite examinations to the largest banks to assess the adequacy and effectiveness of internal processes and controls for AML-CFT which captures the majority of banking system assets. However, the DFSA has not yet had an opportunity to perform an onsite examination of all banks. From a reporting perspective, with regard to STRs, banks

	are not required to report suspicious activities and incidents of fraud to the DFSA. Banks report STRs to the FIU, and the FIU and the DFSA receive statistics from the SØIK, on a quarterly basis, on suspicious transaction reports received by the SØIK from the financial sector, both number of reports and transactions involved. The statistics include sector numbers on aggregates as well as numbers on institutional level. While an increase in the level of reporting of STRs is a positive development, it is not sufficient to establish the effectiveness of the AML/CFT regime. The DFSA does not receive periodic reporting from banks regarding quality and effectiveness of risk management in relation to AML-CFT compliance. The DFSA does not have a range of powers to directly sanction breaches of the AML/CFT Act, as this power, which falls to the responsibility of the FIU. The next evaluation of Denmark's AML/CFT framework will be conducted in late 2015 and the report will be discussed at the October 2016 FATF Plenary. The authorities are encouraged to address the remaining deficiencies and effectively implement the revised FATF standard.